BY STEVEN NUDELMAN

The Fractured World of Conditional Payment Provisions

The world is full of disclaimers. They may be found on the back of a dry cleaning ticket, on a sign in a parking garage, or virtually everywhere you look in an amusement park. Most lay people read these disclaimers and believe them to be true. They believe that a dry cleaner may limit its liability to $20 if it damages your Ugg boots, that a parking garage is not liable for that ding in your fender courtesy of a reckless patron, or that an amusement park is not liable if you get injured falling off of one of its rides. The merchant who writes the disclaimer is counting on the reader believing exactly what he reads. This results in fewer claims or lawsuits, and any resultant "savings" to the merchant get factored into the cost of doing business.

Lawyers, as you can imagine, look at disclaimers with a skeptical eye. They read these disclaimers and doubt that most of them are true or enforceable. Lawyers know that a local ordinance or state statute may restrict limitations on liability by dry cleaners. They know that similar regulations may govern parking garages, and they know of plenty of reported cases about amusement park liability and assumption of risk. Merchants who write disclaimers are counting on the fact that lawyers are expensive and that, unless the loss is significant or catastrophic, the customer will not assert a formal legal claim against the merchant. If a claim is asserted, then the merchant is hoping that such a claim is covered under the merchant's commercial general liability insurance policy.

By now you may be wondering what all of this has to do with plumbing engineers. No, this article is not going to discuss how to word a disclaimer effectively to insulate the plumbing engineer from liability for a leaky pipe. Instead, this article takes a look at popular contract clauses that affect a plumbing contractor's liability. Like a disclaimer, some plumbing contractors will read these clauses and believe that they are self-explanatory and automatically impose liability. Others will have that skeptical eye and question whether the clauses mean exactly what they say.

Yes, sports fans, the clauses that we are going to talk about are conditional payment provisions, also known as "pay-when-paid" and "pay-if-paid" clauses.

PAY-WHEN-PAID CLAUSES

In *MidAmerica Construction Management Co., Inc. v. Mastec North America, Inc.*, the U.S. Court of Appeals for the Tenth Circuit explained the difference between pay-when-paid and pay-if-paid clauses in construction contracts.

> A typical pay-when-paid clause might read: "Contractor shall pay subcontractor within seven days of contractor's receipt of payment from the owner." Under such a provision in a construction subcontract, a contractor's obligation to pay the subcontractor is triggered upon receipt of payment from the owner. Most courts hold that this type of clause at least means that the contractor's obligation to make payment is suspended for a reasonable amount of time for the contractor to receive payment from the owner. The theory is that a pay-when-paid clause creates a timing mechanism only. Such a clause does not create a condition precedent to the obligation to ever make payment, and it does not expressly shift the risk of the owner's nonpayment to the subcontractor.

Commentators examining the enforceability of a pay-when-paid clause in all 50 states found dramatic differences. However, they found no jurisdiction that treated a pure pay-when-paid clause as a condition precedent to payment. They also found no differences in how this clause was enforced based on whether the subject project was public or private or based on the contracting tier at issue (i.e., contractor vs. subcontractor vs. sub-subcontractor).

PAY-IF-PAID CLAUSES

As it relates to pay-if-paid clauses, the *MidAmerica Construction* Court noted the following.

> A typical pay-if-paid clause might read: "Contractor's receipt of payment from the owner is a condition precedent to contractor's obligation to make payment to the subcontractor; the subcontractor expressly assumes the risk of the owner's nonpayment and the subcontract price includes this risk." Under a pay-if-paid provision in a construction contract, receipt of payment by the contractor from the owner is an express condition precedent to the contractor's obligation to pay the subcontractor. A pay-if-paid provision in a construction subcontract is meant to shift the risk of the owner's nonpayment under the subcontract from the contractor to the subcontractor. In many jurisdictions, courts will enforce a pay-if-paid provision only if that language is clear and unequivocal. Judges generally will find that a pay-if-paid provision does not create a condition precedent, but rather

a reasonable timing provision, where the pay-if-paid provision is ambiguous.

Like pay-when-paid, the enforceability of pay-if-paid clauses varies dramatically from jurisdiction to jurisdiction. The moral of the story when dealing with these clauses is to be sure to understand the applicable case law and legislation affecting them to determine whether these clauses are enforceable as written. Indeed, it is critical for any subcontractors, including plumbing subcontractors, to understand whether risks of nonpayment will be shifted to them as a result of such contract language.

ONE COURT'S ANALYSIS OF PAY-WHEN-PAID

To understand the application of conditional payment provisions such as pay-when-paid or pay-if-paid in context, it is helpful to review an actual case, *Fixture Specialists, Inc. v. Global Construction, LLC,* from the U.S. District Court for the District of New Jersey. While this case applies New Jersey's interpretation of pay-when-paid, the Court offers an instructive analysis.

The case addressed a contract dispute between Global, the general contractor, and Fixture, its plumbing subcontractor. The Court looked at two issues, only the first of which concerns us: whether under New Jersey contract principles the pay-when-paid clause in the parties' contract established a condition precedent to any obligation of Global to pay Fixture.

The Court began its analysis by looking at the relevant contractual provision:

> 5.3. Pay When Paid—Subcontractor agrees that Contractor shall never be obligated to pay Subcontractor under any circumstances, unless and until funds are in hand received by Contractor in full, less any applicable retainage, covering the Work or material for which Subcontractor has submitted an Application for Payment. This is a condition precedent to any obligation of Contractor, and shall not be construed as a time of payment clause. This condition precedent also applies to Contractor's obligation to pay retainage, if any. Contractor shall never be obligated to pay retainage to Subcontractor until Contractor has received its retainage in hand in full. This paragraph governs all other portions of this Subcontract, and any conflicting language shall be modified or deemed to be consistent herewith.

Global argued that under this provision, full payment by the owner was a condition precedent to any obligation of Global's duty to pay Fixture. Since Global did not receive full payment from the owner, it claimed that it could withhold payment from Fixture. Arguing against this position, Fixture claimed that under case authority the parties' subcontract did not transfer the risk of collection to Fixture and that Global only had a reasonable time in which to pay Fixture.

Parties' Intention, Express Language Control

The District Court analyzed one or two New Jersey cases that addressed pay-when-paid clauses as well as out-of-state authority. The Court ultimately found that under New Jersey law, a pay-when-paid clause generally *postpones* payment to the subcontractor for a *reasonable period* of time rather than creating a conditional promise to pay by the general contractor, unless express language in the clause shows the parties' intention to shift the collection risk to the subcontractor. The Court found such express language in the clause at issue:

> Here, the express language employed in the payment clause in Section 5.3 is clear—the parties intended to shift any and all circumstances of Owner's nonpayment to Fixture. Undoubtedly, the all-encompassing nature of the phrases "never be obligated to pay" and "under any circumstances" clearly and unambiguously expressed that Fixture has agreed to assume the risk of the Owner's nonpayment. The Court's construction is further supported by the fact that the parties do not dispute that there is no ambiguity in any of the provisions in the Subcontract, nor does the Court find any. Thus, Plaintiff's motion on this basis is denied.

Again, it bears repeating that the Court's analysis in *Fixture* is only one federal court's interpretation of New Jersey law on pay-when-paid clauses, but it is a sound analysis that other jurisdictions have followed as well. Regardless, the important thing to keep in mind when examining conditional payment provisions in subcontracts is that, like disclaimers on the back of a dry cleaning ticket, they may not always mean exactly what they say. Rather than engage in a guessing game, the plumbing subcontractor is best off consulting his or her attorney for an interpretation of the clause at issue—and an analysis of the cases and statutes—in the relevant jurisdiction. PSD

RECOMMENDED READING

MidAmerica Constr. Mgmt. Co. v. Mastec N. Am., Inc., 436 F.3d 1257 (10th Cir. 2006).

Fixture Specialists, Inc. v. Global Constr., LLC, No. 07-5614 (FLW), 2009 U.S. Dist. LEXIS 27015, 2009 WL 904031 (D.N.J. March 30, 2009).

Robert F. Carney & Adam Cizek, "Payment Provisions in Construction Contracts & Construction Trust Fund Statutes: A Fifty-State Survey," 24 *Construction Lawyer* 5 (Fall 2004).

Steven Nudelman is a partner at the law firm of Greenbaum, Rowe, Smith and Davis LLP in Woodbridge and Roseland, New Jersey. He is a member of the firm's Litigation Department and its Construction, Green Building, and Dispute Resolution Practice Groups. He may be reached at 732-476-2428 or **snudelman@greenbaumlaw.com**. To comment on this article, e-mail **articles@psdmagazine.org.**