



Construction Law Update: Are “Pay if Paid” and “Pay when Paid” Provisions Enforceable in New York?

General contractors often provide their subcontractors with a standard form contract providing little opportunity for the subcontractor to negotiate a change of any of the terms. Sometimes, the standard form agreement includes a “pay if paid” or “pay when paid” provision. Even though subcontractors may be accustomed to seeing these provisions, it might not be entirely clear how they differ and, more importantly, whether they are even enforceable under New York Law.

“Pay if Paid” and “Pay when Paid” Provisions – What do they mean?

A “pay if paid” provision is, in effect, a condition precedent that requires payment from the owner before the general contractor has a duty to pay a subcontractor. In other words, if such a provision is contained within the contract, the subcontractor will be paid only if the general contractor is paid by the owner. This provision attempts to shift the risk of non-payment by an owner from the general contractor over to the subcontractor.

On the other hand, a “pay when paid” provision is a condition that establishes the timing for when a general contractor is required to make payments to its subcontractor.

The key question raised by the two provisions is whether the general contractor has a legal duty to pay the subcontractor if the general contractor is never paid by the owner.

Are These Provisions Actually Enforceable?

A “Pay if paid” provision is unenforceable in New York State as against public policy. Put another way, a contract that seeks to transfer the risk of an owner’s failure to pay the general contractor to the subcontractor will not be enforced, or held to be valid, by New York Courts. The logic behind this rule in New York is based on the protections that exist within the Lien Law, which provide subcontractors a right to file a mechanic’s lien only when payment is due and payable from the general contractor. Obviously, if a “pay if paid” provision was enforceable, and an owner never makes payment to the general contractor, then the subcontractor would never even have a right to payment and, therefore, would never have a right to file a mechanic’s lien. The Courts in New York have ruled that subcontractors must be able to take advantage of the Lien Law, and as such, a “paid if paid” provision will not be enforced.

On the other hand, a “pay when paid” provision might be enforceable. The key to whether the provision will be enforced by the courts is if it designates a reasonable time for payment, and does not make payment to the general contractor a condition precedent to the subcontractor’s right to payment.

The Court in West-Fair Elect. Contr. v. Aetna Cas. & Sur. Co., 87 N.Y.2d 148 (1995), and subsequent cases, distinguished “pay if paid” provisions from “pay when paid” provisions by holding that in order to be valid or enforceable, the provision must not attempt to shift the risk of the owner’s failure to pay from the general contractor to the subcontractor, and that such a shift of risk does not occur where the provision provides a timing mechanism for payment. Whether the timing mechanism is “reasonable” will vary and is dependent on several factors, including the scope and value of the project in general.

What Are Your Options If Your Contract Has a “Pay if Paid” or “Pay when Paid” Provision?

All contractors have an obligation to be familiar with and understand each term of their contracts. However, if a general contractor asks you to sign a subcontract containing a “pay if paid” provision, the subcontract should be reviewed by one of the experienced attorneys in the construction law group at Ruskin Moscou Faltischek, P.C. We can negotiate with the contractor to eliminate the provision by explaining that it is unenforceable. We can also help determine if the provision is really a “pay when paid” provision that might be enforced by the courts in the event of a payment dispute. If enforceable, our construction attorneys can help negotiate more favorable timing terms to ensure that you are not waiting for too long to receive payment for work you have completed in good faith.

Having the benefit of experienced legal counsel before the subcontract is signed can help save you substantial time and costs later on if you have performed the work, but have not been paid and you are in a position of having to file a mechanic’s lien and/or commence a lawsuit in an effort to be compensated.

ABOUT THE AUTHOR:

Craig H. Handler is an experienced attorney dedicating much of his practice to working with construction industry professionals and property owners in contract drafting and negotiation and in disputes related to defective construction, delay, scope of work, mechanic’s lien foreclosure and defense, OSHA violations, ECB violations, and Labor Law claims. Mr. Handler’s prior experience working with the insurance industry has afforded him a broad understanding of the complex insurance coverage and indemnity issues that regularly impact the construction industry. Mr. Handler routinely applies this expertise to his practice in order to help his clients cut costs, limit exposure and avoid the many risks associated with this fast-paced industry.

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