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Fletcher Tilton building blocks: Don't be fooled by pay-if-paid clauses - by Adam Ponte

June 16, 2017 - Construction Design & Engineering

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Subcontractors on private construction projects likely have experienced the pursuit of general contractors or higher-level subcontractors for payment after completing their subcontracted work. Today, despite the status of the law requiring “prompt payment” to subcontractors, it is common for general contractors to blame payment delays, or lack of funds, on the project owner. As a result, the project general contractor often tells the subcontractor that payment will not be made until the owner first pays. Indeed, the general contractor might even argue that payment to the subcontractor is explicitly contingent upon the owner’s payment, pursuant to a “pay-if-paid” provision in the subcontract.

In an effort to alleviate the risk of nonpayment to lower-tier contractors, the Massachusetts legislature enacted the Prompt Payment Act, and, consequently, pay-if-paid clauses are now rendered unenforceable on certain projects.

I. Prompt Payment Act Does Not Apply To All Projects.

The Prompt Payment Act, including its prohibition against pay-if-paid clauses, applies to private construction projects in which the prime or general contract has a total price of \$3 million or more. The law applies to general contractors, subcontractors and material suppliers and anyone entitled to file a mechanic’s lien on the private project, such as second-tier subcontractors. Notably, residential construction projects with four or fewer habitable units are not subject to the Prompt Payment Act. M.G.L. c. 149, §29E(a).

II. Pay-If-Paid Clauses Are Generally Unenforceable.

In 2010, the Massachusetts legislature enacted the Prompt Payment Act, which explicitly declares that “pay-if-paid” provisions are void and against public policy, subject to two highly limited exceptions. The law states:

A provision in a contract for construction which makes payment to a person performing the construction conditioned upon receipt of payment from a third person that is not a party to the contract shall be void and unenforceable ...

M.G.L. c. 149, §29E(e).

The statute then goes on to identify two narrow exceptions to the rule prohibiting pay-if-paid clauses. The first exception allows enforcement of pay-if-paid provisions in the event that the subcontractor seeking payment has failed to properly perform under the subcontract, after notice and an opportunity to cure. If the written subcontract does not include a cure period, then the law provides a default cure period of 14 days after the subcontractor's receipt of written notice of the non-performance. M.G.L. c. 149, §29E(e)(1).

The second exception permits nonpayment to a subcontractor when the project owner (or in the case of a sub-subcontractor seeking payment, the general contractor) is insolvent or becomes insolvent within 90 days after the subcontractor submits a payment application. Under this exception, however, the party seeking to enforce the pay-if-paid clause must have: (i) obtained a preliminary mechanic's lien before the submission of the first application for payment on the project; (ii) perfected the lien pursuant to M.G.L. c. 254; and (iii) prosecuted the mechanic's lien and all other claims against the insolvent party until there is a reasonable likelihood that prosecution of said claims will not result in payment. M.G.L. c. 149, §29E(e)(2).

Therefore, pay-if-paid clauses are generally unenforceable. If you are a subcontractor on a private project that is subject to the Prompt Payment Act, the general contractor cannot avoid payment based on a pay-if-paid clause, unless that general contractor can satisfy one of the limited exceptions addressed above. Stated differently, a subcontractor's payment claims likely are enforceable despite any pay-if-paid clause in the subcontract.

III. Other Benefits Of The Prompt Payment Act.

In addition to the prohibition against pay-if-paid clauses, the Prompt Payment Act provides additional safeguards for subcontractors seeking payment for properly completed work or change order approval.

A. Reasonable time periods for payment application submission, review and approval.

The law provides that periodic payment applications must be submitted within a time period that does not exceed 30 days. After submission, the payment application must be approved or rejected within 15 days of receipt. If a lower-tier subcontractor is submitting a payment application to a contractor with a direct relationship with the project general contractor, then the 15-day deadline to approve or reject the payment application is extended by 7 days. If a payment application is rejected, in whole or in part, a written explanation must be provided with a certification that said rejection is made in "good faith." M.G.L. c. 149, §29E(c).

B. Reasonable time periods for approval or rejection of written change orders.

The time period for the approval or rejection of change order requests may not exceed 30 days of either receipt of the change order or commencement of the change order work, whichever occurs later. Similar to the time period for approval or rejection of payment applications, if a lower-tier subcontractor submits a change order request to a higher-tier subcontractor, the deadline to approve or reject the request is extended by 7 days. Further, if the change order is rejected in whole or in part, there must be a written basis for the denial and a certification that the decision was made in “good faith.” M.G.L. c. 149, §29E(d).

C. Prompt dispute resolution after rejection of requisition or change order.

In the event that a subcontractor disputes the general contractor’s rejection of any requisition or change order request, the aggrieved subcontractor is entitled to commence dispute resolution procedures, as called for in the contract, in a timely manner. In particular, if there is any clause in the subcontract that requires the subcontractor to delay the commencement of any litigation or arbitration “until a date later than 60 days after the rejection,” such clause “shall be void and unenforceable” under the Prompt Payment Act. M.G.L. c. 149, §29E(c)-(d).

IV. Conclusion.

The Prompt Payment Act provides useful safeguards to assist subcontractors in getting paid in a timely manner on private construction projects. In the event that a general contractor attempts to avoid payment by asserting a pay-if-paid clause, subcontractors must be aware of the recent changes to the law that generally render such provisions unenforceable. Further, subcontractors also should be familiar with the other protections afforded by the Prompt Payment Act, which requires timely approvals or rejections of requisitions and change orders.

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