When It Comes to Getting
Here Are a Few Precautions You Can Take

The Pay-When-Paid Issue from Both

A lot has been written lately about the pay-when-paid debate, and since I’ve never been one to let a good opinion (well, actually any opinion) go unexpressed, I felt compelled to weigh in. PWP is an emotional subject for many people because it “hits ‘em where they live (money)” and, when discussed in open forum, often provokes some rather hot and passionate responses from those prepared to debate.

But volatility of this sort isn’t all bad. It’s good that it often doesn’t require a lot of time or much cajoling to figure out where any particular person stands on PWP at any given time. However, it’s not so good that this brief pleasure may turn quickly to pain when, after being asked for his opinion, the debater rages on passionately and pedantically for what seems like an eternity!

PWP also has an insidious cousin known as Pay If Paid, which is as ominous as it sounds: You (the subcontractor) get paid only if (not when) the owner pays the general contractor. Now, for the purpose of this piece, we’ll forego discussion on PIP because, quite frankly if you’re even close to entering into a pay-if-paid agreement, you are clearly too far gone to be helped. I do, however, have a piece of ocean-front property in Montana that I’d love to show you!

We construction-rats have always been a pack of risk-takers, so I say we plough ahead! So, without further ado (having taken PWP’s potentially perilous nature into account) let’s move on and attempt to examine both sides of the PWP debate.

Pay-When-Paid might be more aptly described as the “we’ll-pay-you-when-we-get-paid” subcontractor (and sometimes supplier) payment policy employed by many of today’s general contracting firms. Under the policy, the general contractor essentially asks (demands?) the subcontractor to share in the risk of collecting money from the owner; a risk historically owned exclusively by the GC. Many generals even go so far as to bind the subcontractor to PWP through written clauses in their own internal subcontracts. Now, most of the time, the clause lingers in blissful anonymity, that is, right up until the time something goes wrong. Then, of course, it’s every man (woman, child, dog, etc.) for himself.

In This Corner . . .

So, the battle lines are drawn, most of the time pitting the general contractor against the subcontractor and often (in turn) sucking into the fray other, less-willing, peripheral players such as the owner, supplier(s), bonding companies,
Debate: Viewing the Sides of the Fence

By S.S. Saucerman

banners and virtually anyone else with financial interest in the project. Why such a black hole of an issue? Well, primarily because PWP intimately embraces the single most highly treasured and devotedly passionate business activity performed in American business today: the collection of money.

Yes, it doesn’t make us proud, but money is what makes the construction business (and any business) spin round. Given that for most construction projects there is generally only one main money pipeline, if that conduit becomes plugged at any juncture (such as with the non-payment of a subcontractor), it normally isn’t long before a detrimental trickle-down effect finds its way to other players. Then, they’re involved!

We also know that when money is at the root of any argument, it generally isn’t long before some partisan, passionate and (sometimes) moronic justification begins being spewed about, hampering the debate. So, unfortunately, attempting to determine whether PWP is genuinely a good or bad policy (based solely on its own merits, faults and attributes) can be difficult—if not impossible—to discern, with the result often having more to do with which side you talk to than what the policy actually is. So, we’re only left to explore and explain the opposing points of view in the singular hope that one side may manifest a modicum of empathy and understanding for the other.

The Subcontractor

Suffice it to say that the subcontractor isn’t crazy about pay-when-paid. Why would he be? From his point of view, PWP is just another in a continuing series of attempts to transfer onto his shoulders a risk that he feels should be inherently borne by the general contractor. Remember, too, that this is on top of (in the sub’s mind) a deliberate and steady campaign of more and more responsibility and liability being diverted away from the owner, architect and GC, only to land in the lap of the subcontractor. What steady campaign? Well, the sub would say that you need only look so far as the recent and rampant proliferation of design-build, which many subcontractors view as classic and textbook labor and liability shifting.

But additional responsibility and liability aside, there are other concerns the subcontractor harbors over PWP, concerns of a more technical nature. First, if PWP is implemented-and payment is withheld or delayed—what control does the sub have over the collection process? The answer is very little. Being “once removed” from the loop, the subcon-
tractor basically bows to the mercy (and the tenacity) of the GC to collect any outstanding money from the owner. Now, certainly most GCs will make a concerted effort to collect, but the sub can’t be sure. If the GC isn’t tenacious, or has other outstanding issues with the owner that affect the (non)payment, all the sub can do is sit idly and wait for resolution—hardly a fiscally responsible way to run a business.

The General Contractor

But not surprisingly, the General Contractor views things a bit differently. “Why shouldn’t the subcontractor share in the risk,” he asks? “After all, the sub makes the same (if not more) profit on a normal construction job as we do! All we’re doing is leveling the playing field.” In the general contractor’s view, collecting money is a natural, inherent risk of running any business and if the rewards are the same—so too should be the risk.

Another and perhaps a more legitimate, argument is that often the subcontractor (who is waiting for his money) is the very reason the payment was withheld in the first place. Now, no matter how you slice it, this is a pretty good argument and, in a nutshell, why PWP will never go away. Most subcontractors are complete and professional, but as long as there are a few who periodically fail (yes, it does happen) to perform their work as specified, in a quality manner and/or according to schedule, the GC will always possess a justifiable reason (in his mind) to withhold or delay payment. Of course, breaking it down, the next major rub is with the definition of “fail to perform,” where both sides (and the owner) are likely to hold different interpretations.

An Unsolvable Issue?

So, the debate rolls on. One thing is for sure, though: PWP doesn’t appear to be going anywhere soon. So, what can you—the subcontractor—do to protect yourself and your business? Realistically, it’s unlikely you will ever be able to steer entirely clear of PWP,
but there are a few precautions you can take to limit your exposure and damage.

First, educate yourself. PWP isn’t a new issue (like many think), but rather a philosophical fight that has been waging for quite some time. There are precedents and judicial examples out there of which some general conclusions could be drawn but, unfortunately like all things legal, the results are virtually never guaranteed to apply to your situation, so there is never any real assurance that you will enjoy the same outcome.

But, running the (great) risk of generalizing, here are a few tidbits that you might latch onto for possible guidelines:

- Generally, courts have allowed that PWP can go only so far as restricting the timing of a payment and may not restrict the payment altogether. A pay-when-paid clause normally can’t prevent payment entirely unless it clearly states that payment by the owner is a “condition precedent” (or other such wording) to payment of the subcontractor.

- Check your own state for the laws regarding PWP? Some states have restricted or even banned PWP-type clauses.

- Almost without exception, the subcontractor still owns the ability and right (where normally appropriate) to file a mechanic’s lien and/or to sue for collection through normal court system proceedings.

- There is some legal precedent on the side of the subcontractor. Recently, in a case involving PWP the Court of Appeals of New York held that “pay-when-paid clauses that attempt to transfer the risk of an owner’s default from the general contractor to a subcontractor violate the public policy of New York.”

In *O.B.S. Co., Inc. v. Pace Construction Corporation*, 558 So.2d 404 (Fla. 1990) the Florida Supreme Court added an unusual twist to what appeared to be settled law. The court held that a surety on a payment bond would be liable to an unpaid subcontractor, regardless of the existence of an enforceable pay-when-paid clause.

- Of course, you always have the option of signing any contract that includes a PWP clause. If you have any doubt about PWP wording in your contract—don’t sign it! Yes, you risk losing the work, but it may be worth it.

- You can include a clause in your own bid documents that states—should your bid be accepted—a future subcontract between yourself and the general contractor containing PWP wording will not be acceptable.

- Everything is open to negotiation. If you are asked to sign a contract with a PWP clause that you find detrimental, approach the GC and ask for the clause to be altered or deleted. Speaking as a GC, if I had enough faith and trust in you as a subcontractor—and you voiced an express objection to the clause—I’d be very open discussing its removal or alteration.

- A PWP clause in a subcontract may not necessarily offer a defense to a surety against a subcontractor’s payment bond claim. Also, if the owner goes “belly-up”, the prime contractor (often the GC) is generally not absolved from his obligation to pay subcontractors, regardless of whether a PWP clause exists or not.

- Regardless of the existence of PWP always be precisely clear as to when you will get paid. Without this benchmark, it’s hard to build a case later on. Get dates and/or number of days from the time your billing goes in. Often, this is the first of the month, with (perhaps) payouts being made 10 days, 30 days, (or whatever’s agreed upon) later. Also, often this payout arrangement has been previously set forth and described in the specification manual that came with the bid documents.

**Subcontractor Responsibilities**

Now of course, the subcontractor is still responsible for holding up his end by providing quality, professional and punctual service to the GC and owner. You also have to be open-minded and
responsive enough to remedy your own sub-standard work when it does exist. If the terms of the contract have been truly satisfied, any problem with PWP will generally remedy itself.

Another critical consideration is that you, as a subcontractor, must remain cognizant of the consequences of the bidding process itself. When you submit a bid to a general contractor, you should always have already carefully examined and scrutinized the contracts, subcontracts and specifications to which you will be bound later on, should your bid be accepted. You see, once the owner accepts the general contractor’s bid, the terms of the contract and subcontract become fixed and are generally not open to further negotiation.

After the subcontract is awarded is no time for the subcontractor to realize that there are terms and clauses that are unacceptable. So basically it comes down to this: If you’re not prepared to enter into a subcontract based on the terms as spelled out in the invitation to bid, don’t bid the job or, at the very least, qualify your bid clearly and completely, keeping in mind that it may be grounds for your disqualification later on.

**The Future of PWP**

Will PWP ever land you in court? And will it be enforced by that court? The answer is “who knows?” The debate over whether something is truly enforceable may be over if someone wants to extend the time, effort and money to make it so . . . and nothing is enforceable if no one is willing to enforce it!

One thing is predictable though: Pay-when-paid is far from disappearing. Recently, the American Subcontractors Association sent out a series of action alerts to its members, strongly opposing some of the wording included in some Associated General Contractors of America contract documents (particularly forms 650 and 655). The forms are often used in construction project administration.
Much of the opposition to the forms has to do with clauses that the ASA views as containing PWP language that is detrimental to the interests of its membership.

Court histories can be ambiguous or inconclusive, and situations are never the same, so (like most things), the handling of PWP ultimately comes down to using good common sense.

Most of want nothing to do with the court systems, and it normally takes an extreme issue (or extreme ego) to actually push the envelope all the way out . . . and even then, a settlement can often occur before things get too far.

But, that being said, we mustn’t be naive. Dispute does happen, and PWP is the type of clause that appears only to fuel the fire. So, be prepared, read all contracts completely and use your best judgment based on the individual situations that arise. Good luck!

About the Author

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