

PUBLICATION

The Differences between "Pay if Paid" and "Pay When Paid" Clauses in Construction Contracts

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As attorneys that draft construction contracts and litigate construction disputes on a regular basis, we have seen how construction contract terms are used in contracts and what the practical effects of these terms may be on the rights and obligations of parties to those contracts. While a previous posting on this site discussed the various pricing methods that may be used in construction contracts, this posting provides a brief overview of two related, but distinct, payment terms that appear in most construction subcontracts, but that are often misunderstood: "pay if paid" and "pay when paid" clauses.

If you are a prime or sub-contractor, you have likely heard of pay if paid and pay when paid clauses in construction subcontracts, and may have even seen these terms in a contract to which you are a party. Nevertheless, you may not fully understand what these terms mean, how they differ from each other, and how they each affect your rights and potential liability. While both of these terms affect a prime contractor's obligations to subcontractors when it is not paid by the owner, their practical effects differ in important ways.

A 2010 opinion from the Alabama Supreme Court in *Lemoine Co. of Alabama, L.L.C. v. HLH Contractors, Inc.* discusses the enforceability of "pay if paid" and "pay when paid" clauses under Alabama law. See 62 So. 3d 1020 (Ala. 2010).

The court explained that a "pay when paid" clause (i.e., that the prime contractor will pay the subcontractor within X days of receiving payment from the owner) is simply a timing mechanism and generally will not excuse the prime contractor from having a payment obligation to the subcontractor, regardless of whether the owner has paid the prime contractor.

In contrast, the court found that a "pay if paid" clause (i.e. that the prime contractor only incurs an obligation to pay the subcontractor if, and only if, it is first paid by the owner) may constitute a condition precedent that excuses the prime contractor from having a payment obligation to the subcontractor if the owner does not pay the prime contractor. The court explained, however, that conditions precedent such as pay if paid clauses are viewed with disfavor by courts and will not be enforced if their terms are ambiguous.

Nevertheless, in *Lemoine*, the court found that the contract's pay if paid clause was worded in such a way that it was a condition precedent that excused the prime contractor from having any payment obligations to its subcontractor. It is important to note that the court's analysis depended entirely on the precise language in the pertinent clauses in the subcontract, and differing language in other contracts may cause pay if paid and pay when paid clauses to be interpreted or enforced differently

As illustrated by the opinion in *Lemoine*, contractors and subcontractors need to ensure that they understand the full meaning and effect of the clauses contained in their construction contracts, because they will be bound by the language of these clauses.