

Subcontractors' Rights and Woes: Enforceability of Pay-if-Paid Clauses in New Jersey and New York Contracts

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Construction contracts between general contractors and subcontractors can include a 'pay-if-paid' clause, whereby the general contractor typically renounces responsibility to pay the subcontractor until after the general contractor receives payment from the owner. On their face, such clauses may appear to unfairly place the risk of nonpayment by the owner on the subcontractor. However, in New Jersey, these clauses are enforceable if the contract contains specific language. On the other hand, New York courts have determined that such provisions are invariably against public policy.

New Jersey: Enforceability Requires Explicit and Unambiguous Shifting of Risk

While New Jersey does not have a specific statute regulating pay-if-paid provisions, such provisions are enforced if they explicitly and unambiguously shift the risk of nonpayment from the owner to the subcontractor.¹ In *Fixture Specialists, Inc. v. Global Construction, LLC*, the Federal District Court of the District of New Jersey held the following provision enforceable:

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.²

The subcontractor argued that the clause was a time of payment provision because it did not expressly state a shifting of the risk.³ In rejecting the subcontractor's argument, the court reiterated the decision in *Avon Brothers,*

Inc. v. Tom Martin Construction Company, Inc., wherein the Appellate Division held that "it is not the use of 'when' or 'if' that is dispositive of the enforceability of the clause, but whether there is clear evidence of an intent by both parties to shift the risk of collection," and such risk is "not [to] be assumed or inferred."⁴ The *Fixture* court held that the use of specific phrases such as "never be obligated to pay" and "under any circumstances" clearly and unambiguously expressed that the subcontractor agreed to assume the risk of the owner's nonpayment.⁵

Additionally, the court rejected the subcontractor's argument that pay-if-paid clauses are against public policy because they violate New Jersey's anti-waiver statute of the Construction Lien Law.⁶ The court cited *Thomas Group v. Wharton Senior Citizen Housing*, where the New Jersey Supreme Court reasoned that even if payment was not technically due under a contract between the parties, a contractor may still file a lien against the owner's property to protect its interest; however, foreclosure of the lien by the owner would be stayed until all the contractual preconditions to payment were satisfied.⁷ Based on *Thomas*, the *Fixture* court held that the subcontractor had a legal remedy against the owner—to file a lien—even though the preconditions of the contract had not been met and, thus, the subject pay-if-paid clause did not violate public policy.⁸

Subsequently, the Appellate Division affirmed the enforceability of the following clause:

It is expressly understood and agreed that the receipt by the Contractor of payment for the Subcontractor's work shall be a condition precedent to the Contractor's obligation to pay the Subcontractor. That is, the Contractor shall have no liability or responsibility for any amounts due or claimed to be due the Subcontractor for any reason whatsoever except to the extent that

the Contractor has actually received funds from the Owner specifically designated for disbursement to the Subcontractor.⁹

Regardless of the validity of the above clause, the subcontractor claimed the contractor had received payment from the owner but refused to pay the subcontractor.¹⁰ The contractor argued it had settled with the owner for a lump sum for all the work performed on the project, and there was no indication the owner made a payment specifically designated for the subcontractor's work.¹¹ The Appellate Division rejected the contractor's argument, holding that a general contractor could not avoid its responsibility to pay any of its subcontractors by entering into a "global" settlement with an owner that did not specifically designate payment for each particular subcontractor.¹²

New York: Unenforceable as Against Public Policy

The subcontractor in *Fixture* cited to New York case law in support of his argument that the pay-if-paid clause in his contract was against public policy. In direct contrast to the case law in New Jersey, the New York Court of Appeals has held that pay-if-paid provisions are contrary to public policy and are void and unenforceable.¹³ In interpreting New York's Lien Law, the New York Court of Appeals has determined that pay-if-paid provisions violate subcontractors' mechanics' lien rights in the event of nonpayment by the owner because mechanics' liens may not be enforced until a debt becomes due and payable.¹³

However, the New York Court of Appeals distinguished provisions that merely fix the time for payment rather than expressly make payment from the owner to the contractor a condition precedent to any payment to

the subcontractor.¹⁵ Such pay-when-paid provisions are enforceable because they do not violate the public policy of the Lien Law.¹⁶

Significantly, the New York Court of Appeals has also held that New York's public policy is "not so fundamental that it should override the parties' choice of law."¹⁷ Thus, New York courts have found pay-if-paid provisions enforceable where the contract is governed by state law that allows such provisions.¹⁸

Conclusion

Subcontractors entering into contracts in New Jersey (where the choice of law is New Jersey) should carefully review the terms of the contracts for any payment contingency provisions, which may leave them with no immediate recovery if the owner does not pay the general contractor. In New York, all parties to construction contracts, whether general contractors, subcontractors or owners, must be aware that explicit clauses conditioning payment to the subcontractor on the owner paying the general contractor will not be enforced. If the parties are not New York entities and they desire to include a pay-if-paid provision, they should determine whether their state allows such provisions, and if so, have their contract governed by that state's law. ■

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Endnotes

1. See *Fixture Specialists, Inc. v. Global Construction, LLC*, 2009 WL 904031/2009 U.S. Dist. LEXIS 27015 (D.N.J. March 30, 2009).
2. *Id.* at *4-5.
3. See *Id.* at *5.
4. See *Id.* at *16 (quoting *Avon Bros, Inc. v. Tom Martin Construction Co.*, 2000 WL 34241102 (App. Div. Aug. 30, 2000)).
5. See *Fixture Specialists, Inc.*, *supra*. at *15.
6. See *Id.* at *17-18.
7. See *Id.* at *19-22 (citing *Thomas Group v. Wharton Senior Citizen Hous*, 163 N.J. 507, 519 (2000)).
8. See *Id.* at *22.

9. *O.A. Peterson Constr. Co., Inc. v. Englewood Hosp. and Med. Ctr.*, 2010 WL 2696758/2010 N.J. Super. Unpub. LEXIS 1452 (App. Div. June 30, 2010).
10. *See Id.* at *2.
11. *See Id.* at *3.
12. *See Id.* at *7.
13. *See West-Fair Elec. Contractors v. Aetna Cas. & Sur. Co.*, 87 N.Y.2d 148 (N.Y. 1995); *see also JC Ryan EBCO/H&G, LLC v. Lipsky Enters. Inc.*, 911 N.Y.S.2d 136 (N.Y. Sup. Ct. 2010); *Nevco Contracting Inc. v. R.P. Brennan Gen. Contractors & Builders, Inc.*, 33 N.Y.S.3d (N.Y. Sup. Ct. 2016).
14. *See West-Fair, supra.* at 158-59.
15. *See Id.* at 155-56.
16. *See Id.* at 158.
17. *Welsbach Elec. Corp. v. MasTec N. Am., Inc.*, 7 N.Y.3d 624,627 (N.Y. 2006).
18. *See Id.*; *see also Hugh O’Kane Elec. Co., LLC v. MasTec N. Am., Inc.*, 846 N.Y.S.2d 51 (N.Y. Sup. Ct. 2007).