



LEGAL CORNER

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"Pay-If-Paid" Clauses May Not Protect Contractors On Bonded Projects

Note: I would like to acknowledge the assistance of my colleague, Michael Healan, who prepared this article. Mike is a partner in Hinckley, Allen & Snyder's Construction & Public Contracts Group.

AS previously reported on the Massachusetts Prompt Payment Act which, among other things, spells the demise of conditional payment provisions (commonly referred to as "pay-if-paid" clauses) on private construction projects in the Commonwealth. However, the Prompt Payment Act applies only to contracts executed on or after November 8, 2010. This means that for the next year or two, many construction disputes will continue to involve contracts with valid pay-if-paid clauses.

Conditional payment clauses have a long history in Massachusetts. While the state's courts view them with disfavor and require them to be stated clearly and explicitly, they will not hesitate to enforce a clear and unequivocal pay-if-paid provision. (This follows from the courts' reluctance to disturb the plain language of contracts that are freely entered into.) However, contractors should be aware of an important caveat to reliance on these clauses: when the contractor has provided a payment bond covering the project, the pay-if-paid clause may not provide any practical protection.

The general rule is that a payment bond surety may assert any defense available to its principal (or, to put it another way, the surety is only liable under the bond if the contractor is liable under the construc-



tion contract). Nevertheless, a few Massachusetts trial courts have found that the standard payment bond language - "every claimant as herein defined, who has not been paid in full ... may sue on this bond" - creates an "unconditional" obligation to pay claimants, regardless of any pay-if-paid defense the contractor principal may have.

The most recent such case is *P.J. Riley & Co., Inc. v. URS Corporation*, in which a sub-subcontractor on a job at Logan Airport brought claims for non-payment against the general contractor and its payment bond sureties. The contractor and sureties moved to dismiss the payment bond claim on the basis of a clear pay-if-paid clause. The court followed the reasoning of a prior trial court case, holding that this clause in the subcontract did not protect the sureties because the bond did not refer to any particular subcontract and did not refer to the pay-if-paid provision in particular. The court reasoned that

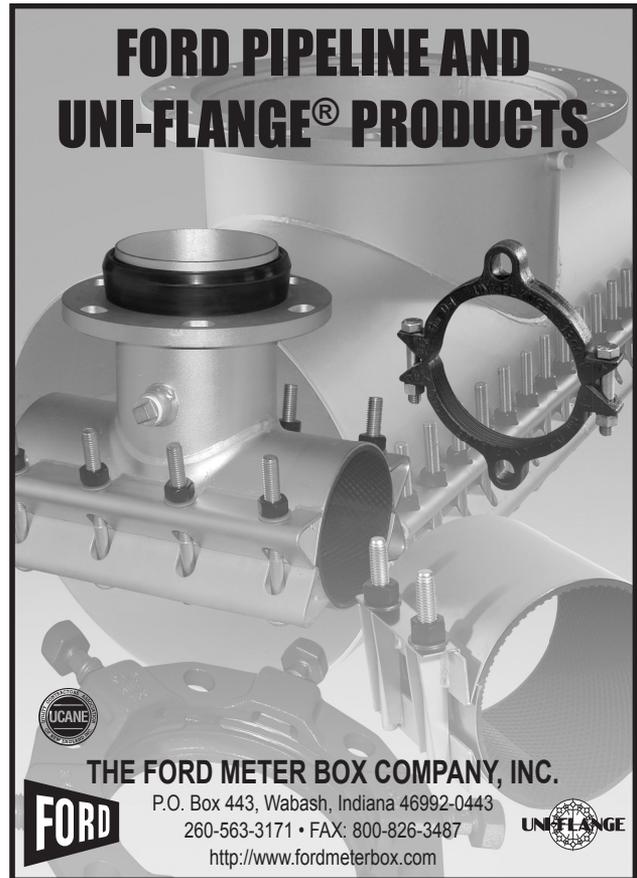
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"if the sureties had wanted to assert such a defense it had to have been expressly stated in the bond."

Payment bonds typically do not expressly incorporate the terms of any particular subcontract, nor do they refer to any pay-if-paid provision. While the issue has not been decided by the Massachusetts appellate courts (and at least one trial court judge has come to the opposite conclusion from *P.J. Riley*), it is likely that some trial court judges will continue to deny sureties the right to rely on pay-if-paid clauses. This directly affects not only sureties, but also contractors who are the principals on payment bonds: when a payment bond surety is forced to pay a claimant, it will nearly always have the right to be indemnified in full by the principal for that payment. The principal (typically the General Contractor) will therefore have exactly the same liability as if there were no pay-if-paid clause in the first place. In this way, the courts have created an "end run" around pay-if-paid provisions on bonded projects.

The court in *P.J. Riley* made a point of holding that the contractor principal had no liability to the sub-subcontractor on the bond, but that "protection" is illusory in light of the duty to indemnify. Contractors should keep this in mind when assessing the risk of owner non-payment. ■



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