

# Mass. Court Addresses General Contractor's Pay-When-Paid Clause

**I**n a case of first impression, the Massachusetts Superior Court issued a decision in favor of a sprinkler subcontractor, finding that a payment bond surety could not assert its general contractor principal's "pay-when-paid" defense to defeat the subcontractor's undisputed payment bond claim on a private construction project. Although based on a unique set of facts, general contractors should note this ruling as well as take immediate steps to avoid what is now a clearly defined trap for the unwary.

In the lawsuit, the plaintiff sprinkler subcontractor brought a payment bond claim, along with claims of breach of contract and quantum meruit against the general contractor and its payment bond surety. The general contractor acknowledged that the subcontractor's claim was undisputed, but took the position that because it had not been paid in full by the project owner, it did not have to pay the subcontractor. The surety answered the lawsuit, and likewise raised the defense that the pay-when-paid clause in the subcontract not only made payment by the general contractor to the subcontractor contingent upon receipt of monies from the project owner, but also made the payment obligations of the surety on a payment bond claim contingent as well.

In its decision, the Superior Court reaffirmed the effect of a properly worded pay-when-paid clause in a construction subcontract, ruling that a well-worded subcontract requiring payment by the owner to the general contractor as a condition precedent to payment by the general contractor to the subcontractor is enforceable. However, as to the general contractor's payment bond surety, the

court held that there are exceptions to the rule that a surety's liability is "co-extensive" with that of its principal, and ruled that when a subcontractor has completed its work, has an undisputed balance owed and has taken all of the steps necessary to assert a claim against the general contractor's payment bond, the surety may not assert the general contractor's pay-when-paid clause as a defense to the subcontractor's claims.

This decision should not send a shudder through the general contracting community because it was based on a unique set of facts. First, the case was a private project and the bond in question was not a G.L. c. 149, §29 lien bond, but rather it was a private labor and material payment bond that was so broadly worded that it was virtually a blank check for the claimant subcontractor. Second, the owner accepted all of the subcontractor's work in question, approved it, and the general contractor had no backcharges against the subcontractor and no punch list items for the subcontractor to complete. Third, prior to this decision, the general contractor and owner went through a lengthy arbitration where specific findings were made, awarding monies directly on account of the sprinkler subcontractor's claims(s).

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contractor/subcontractor disputes, it is important to note that both the general contractor and its surety could have protected themselves from this result simply by carefully drafting and issuing a private payment bond that expressly incorporated by reference the existing subcontract. By failing to incorporate by reference the subcontract terms into the payment bond, the "teeth" of its properly worded pay-when-paid clause were ineffective.

To avoid the fate of the general contractor and its surety in this case, general contractors should immediately take the following precautionary measures:

- Amend the existing form of subcontract to specifically provide that the pay-when-paid provisions apply to the subcontractor's rights and remedies against any payment bonds issued on a particular project; and
- Contact the bonding company to ensure that private labor and material payment bonds incorporate by reference all terms of the subcontract including a properly worded pay-when-paid clause.

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