

February 23, 2023

Maryland Senate Finance Committee

SB0453 – State and Private Construction Contracts – Prompt Payment Requirements

Document in Support of Oral Testimony in Favor of the Bill

- A. Condition Precedent Payment Clauses (“Pay if Paid” clauses) are contractual conditional payment provisions intended to shift risk of loss related to non-payment downward to lower-tier subcontractors. Pay if Paid clauses are customarily viewed extremely unfavorably, as the transfer risk is usually viewed as inequitable and patently unfair because the “lower” entities and individuals are the most likely to suffer the greatest from such risk increase. Most jurisdictions invalidate Pay if Paid clauses in construction contracts because they interfere, frustrate, or prohibit the lower-tiered Subcontractors’ exercise of their statutory mechanics’ lien rights. (Source: American Bar Association, 12/11/20 “Construction Law 101,” Craig L. McCloud)
- B. Below is a Sample Condition Precedent Payment Clause (“Pay if Paid” clause) that is included in contracts of adhesion (i.e., “non-negotiable” terms) provided by General Contractors (“GCs”) to Subcontractors in commercial construction contracts in Maryland (emphasis added):

*Contractor shall pay the Subcontractor for the Subcontract Work, the "Subcontract Amount". Subcontractor shall submit invoices according to the Payment Procedures attached hereto as Exhibit B, together with a Partial Lien Waiver and Release on the Contractor form attached as Exhibit D hereto. Invoices shall be paid within seven (7) calendar days after receipt by Contractor of payment from the Owner, less any deductions for improperly or untimely performed work or for work performed by Contractor for the Subcontractor's account. **Payments to Subcontractor are expressly conditioned upon the receipt of payment by Contractor from the Owner as a condition precedent, and Subcontractor assumes the risk of nonpayment by the Owner.** Also, the Subcontractor may be required, as a condition precedent to any payment, to furnish evidence satisfactory to Contractor **that all payrolls, material bills, and other indebtedness applicable to the Subcontract Work have been paid.** Contractor reserves the right to make payment to Subcontractor in advance of these terms, however, any such early payment to Subcontractor or failure by Contractor to insist on any prerequisite for payment shall not be deemed a waiver of Subcontractor's obligations under this Subcontract, nor shall it alter the process required by this Subcontract for subsequent payments. All payments to Subcontractor are subject to set-off for any valid claim of Contractor against Subcontractor arising out of or related to this, or any other transaction.*

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- C. Pay if Paid clauses do not give the Subcontractor any right to information regarding when the GC is paid by the owner for the Subcontractor's work, so the Subcontract cannot determine the status of their mechanics' lien rights.
- D. Subcontractors are reluctant to file mechanic's liens out of fear that it will adversely affect their relationship with the GC and, consequently, their ability to be awarded projects by the GC, placing the Subcontractor's ability to sustain their business as a going concern within the complete discretion of the GC.
- E. Pay if Paid clauses expressly shift the risk of the project Owner's ability to fund the project from the GC to the Subcontractors. This is especially egregious during recessionary pressures, when Subcontractors are more likely to accept additional risks included in a contract of adhesion, at an unsustainably low bid price, in order to be awarded a project.
- F. Pay if Paid clauses expressly require the Subcontractor to fund all costs of their work, including labor and materials, for an undetermined amount of time prior to receiving payment for work completed, placing an extreme financial cash flow burden on the Subcontractor.
- G. 13 States currently prohibit Pay if Paid clauses in public and private commercial construction projects:
- California
 - Kansas
 - Illinois
 - Indiana
 - Nevada
 - Montana
 - North Carolina
 - New York
 - South Carolina
 - Utah
 - Virginia
 - Wisconsin
- H. Courts in other jurisdictions have found that Pay if Paid clauses are unenforceable in the typical circumstances reflecting the unequal bargaining power of the parties to construction contracts.

Respectfully submitted,
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