



## **Pay If Paid Clauses and the Prevention Doctrine**

By Scott D. Cessar | Sunday, July 28, 2019

Pay if paid clauses make payment from the owner to the contractor an express condition precedent of the contractor's duty to make payment to the subcontractor. The purpose of a pay if paid clause is to shift the risk of the owner's nonpayment under the contract from the general contractor to the subcontractor. Pay if paid clauses are routinely held to be enforceable.

Along with indemnity clauses, pay if paid clauses represent one of the most significant contractual risks to subcontractors. Savvy subcontractors will attempt to negotiate language in the pay if paid clause that allows the contractor to withhold payment only if the owner's withholding of payment from the contractor is tangentially related to the subcontractor's performance.

But what if the subcontractor has not negotiated such a limitation on the enforcement of the pay if paid clause? Must the subcontractor wait forever? Does the subcontractor have any possibility of redress? The answer is perhaps yes.

While the common law allows parties to make owner payments a precondition to payments by the contractor to the subcontractor, the law also recognizes—under what is known as the prevention doctrine—that there is an implied duty on the contractor to not prevent the fulfillment of the condition precedent. In other words, the law imposes on the contractor an implied duty not to frustrate conditions precedent to the payment of monies by the owner to the contractor.

What does this mean? Under the prevention doctrine, if the general contractor is responsible for the refusal of the owner to not pay the contractor, then the contractor cannot take advantage of its failure to perform in order to avoid payment to the subcontractor.

This makes sense, for example in the extreme, if the owner does not pay the contractor based on the contractor's deliberate failure to submit proper paperwork for payment. Certainly, the contractor cannot use its own deliberate failure to perform in such a manner to avoid paying the subcontractor.

A recent case from the Federal District Court of the Eastern District of Pennsylvania, *Connelly Constr. Corp. v. Travelers and Walsh Healy Joint Venture*, however, signals that a subcontractor might also prevail in overcoming a pay if paid clause where the contractor's failure to perform was inadvertent, as opposed to deliberate as outlined in the above example of failing to supply appropriate paperwork.



In *Connelly*, the subcontractor sought to overcome the pay if paid clause of its subcontract with the contractor, based on the prevention doctrine, in order to secure release of retention from the contractor. The subcontractor pointed to correspondence from the owner in which the owner noted “several potentially problematic issues with the [contractor’s] work on the project” and that the contractor continues to appear oblivious to the fact that the project encompasses design and construction of a sophisticated maximum-security prison.”

Reviewing this evidence, the court found that the contractor “appears to be at least partly responsible for the project delay.” The court labeled this conduct as “inadvertent” conduct precluding the release of payment from the owner, as opposed to “deliberate” conduct.

The court then considered whether inadvertent conduct, as opposed to deliberate conduct, justified the dismissal of the subcontractor’s claim for recovery of the retention in view of the application of the pay if paid clause in the parties’ subcontract.

Following a review of case law from a number of jurisdictions and treatises on contract law, the court held that “the invocation of the prevention doctrine does not distinguish between deliberate conduct and inadvertent conduct.” The court based its holding, in part, on the concept that “the duty of good faith and fair dealing ... may require some cooperation” on the part of the general contractor to satisfy a condition precedent “and to refrain ‘from conduct that will prevent or hinder the occurrence of that condition’ or must ‘take affirmative steps to cause its occurrence.’”

his holding is significant in that it portends that, if a subcontractor is not culpable in causing the owner to not pay the contractor, but the contractor is at fault due to inadvertence, then the contractor may not be able to rely on the pay if paid clause to avoid paying the subcontractor. Stated another way, if payment is being held by the owner due to performance disputes with the contractor, not related to the subcontractor, then the contractor may not refuse to pay the subcontractor based on a pay if paid clause.

The potential ramifications of the holding of *Connelly* was confirmed by the contractor in *Connelly* who argued to the court that, if the court accepted the subcontractor’s arguments as to inadvertent conduct, this would “eviscerate” pay if paid clauses. The court rejected this argument.