



## Negotiating & Navigating a Pay-if-Paid Provision

The risk that a project owner won't pay is a substantial one. Rather than absorb this risk, general contractors pass down the risk to subcontractors in "contingent payment" provisions also known as "pay-if-paid" provisions. Pay-if-paid clauses make a general contractor's obligation to pay its subcontractor contingent on when and whether the general contractor receives payment from the owner. A subcontractor with a pay-if-paid provision in its subcontract could face lengthy payment delays or, in some cases, see no payment at all. Though prohibited in some states, pay-if-paid clauses are fully enforceable in Texas...with three notable caveats. Knowing these caveats can help subcontractors both negotiate and navigate the contingent payment provision in their subcontracts.

First, the Texas Business & Commerce Code allows a contingent payee (typically, the subcontractor) to object to the enforcement of a pay-if-paid clause by giving notice to the contingent payor (typically, the general contractor). The notice must meet certain timeframe and content requirements and is defeated by a general contractor's response that the withholding is due to the subcontractor's failure to meet contractual obligations. Because the objection can be refuted and does not cover labor and materials provided *before* the objection is made, it has limited effectiveness.

Second, the Code prevents the enforcement of a pay-if-paid clause "to the extent that nonpayment is the result of the contractual obligations of the [contingent payor/general contractor] not being met unless the nonpayment is the result of the [contingent payee/subcontractor's] failure to meet [its] contractual requirements." This exception to enforcement prevents the general contractor from penalizing subcontractors for its own misdeeds or the misdeeds of other subcontractors. For example, a general contractor cannot rely on a pay-if-paid clause to justify withholding from the mason when the owner's nonpayment resulted from defects in the HVAC work.

Finally, the Code prevents enforcement of a pay-if-paid clause where enforcement would be "unconscionable." While the Code does not define when clauses are "unconscionable," it does state that clauses are *not unconscionable* when the general contractor has communicated in writing the financial viability of the owner to the subcontractor and has either made reasonable efforts to collect the amounts owed by the owner or offered to take an assignment of the subcontractor's claim.

Knowing these legal limitations can be helpful in negotiating the pay-if-paid provision. While subcontractors might not be able to negotiate the provision out of the contract entirely, they can

make revisions clarifying: (1) that contingent payment applies only to the extent nonpayment results from the subcontractor's failure to meet contractual obligations, (2) what sort of documentation is necessary to trigger the contingent payment provision, and (3) the timeline in which that documentation must be provided by the general contractor. Even if all modifications to the pay-if-paid provision are rejected, subcontractors can still protect themselves by implementing the Code's provisions for temporarily pausing enforcement or prohibiting enforcement of a pay-if-paid provision altogether.

**For more information, please contact [Lauren Scroggs](#).**