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BY SCOTT G. WOLFE

SAFETY COLLABORATION WORKS – Why Not Pave the Way for Payments?



The construction industry is one of the most dangerous industries for both personal safety and business prosperity. However, industry participants – from project owners to GCs to subcontractors – have collaborated over the past several decades to improve worker safety.

As a result, worker deaths are down from about 38 per day in the 1970s to 13 per day in 2015, and worker injuries and illnesses are down from 10.9 incidents per 100 workers in 1972 to 3.0 per 100 in 2015.¹

While ensuring worker safety is a top priority, little action has been taken to address construction payment issues. Why is the road to payment so treacherous for contractors, and how can parties take a similar collaborative approach to improving it as they have for worker safety?

BEWARE THE LIABILITY SHIFT

As in any industry, the party with more leverage typically has greater influence on the contract terms. Therefore, GCs and higher-tiered subcontractors are able to shift risk down the chain to lower-tiered subcontractors and suppliers.

Since owners often bear the financial brunt of such incidents as fraud, project abandonment, and faulty craftsmanship, it is easy to see why payments intended for lower-tiered subcontractors are handled with care. If something goes awry with payments, an owner may have to pay twice or acquire a lien on its property.

Similarly, for GCs, an issue with a subcontractor could create a domino effect, causing expensive delays and hiccups. For these reasons, GCs often withhold payment as protection. As a result, the fears of owners and contractors create the same wariness among lower-tiered subcontractors.

Subcontractors have fewer resources than higher-tiered parties, which results in less leverage when contracting and collecting payment. Because they have no relationship with the property owner, subcontractors are wholly dependent on the GC for payment.

They often cannot afford to move on to the next job before payment is received, and similarly cannot afford to fight for that payment, resulting in an unfavorable outcome. The fears of parties up the chain affect how payments are sent down the chain, creating distrust among those at the bottom.

PAYMENT LIABILITY-SHIFTING STRATEGIES

When parties treat each other as adversaries rather than collaborators, problems multiply and liability-shifting devices become more apparent. Each party passes along the risk of nonpayment while hoping for no repercussions.

Pay-When-Paid & Pay-If-Paid

Two of the most common liability-shifting provisions are pay-when-paid and pay-if-paid clauses.

In most states, pay-when-paid provisions are timing mechanisms.² If a higher-tiered contractor has not been paid, then the lower-tiered contractor is entitled to payment from the contracting party within a reasonable time. If the higher-tiered contractor is never paid, then the lower-tiered contractor is usually still entitled to payment. However, with the nature of the construction industry, delays in payment under these provisions can have dire consequences.

Rather than shift time, a pay-if-paid provision purports to shift risk.³ Under such a provision, no obligation exists between a higher-tiered contractor and a subcontractor unless that higher-tiered contractor has received payment.

Without being party to the contract, under a pay-if-paid provision, that subcontractor has taken on the risk that the owner will not pay the contractor.⁴ Because the stakes are so high in this scenario, most states will typically enforce this provision similarly to pay-when-paid (as a time-shifting device) unless it has been explicitly worded.⁵ Other states have banned them altogether.⁶

Even when provisions are clear and unambiguous, states also often refuse to enforce pay-if-paid provisions that conflict with mechanics lien laws.⁷

No Lien & Subrogation Clauses

Another device contractors and owners use in their attempts to shift liability is the no lien clause – a contractor, subcontractor, or supplier waives its rights to a mechanics lien before the work has been completed.⁸ Because this represents a serious forfeiture of rights, however, such clauses are disallowed in most states.⁹

Since no lien clauses are largely ineffective, owners and contractors may attempt to diminish lien rights¹⁰ through lien

subrogation clauses. By agreeing to such a clause, a subcontractor agrees to let other parties “jump them in line” in the event of a foreclosure. Mechanics liens typically have strong priority, so a lien holder would otherwise be among the first in line to be paid.

While courts have limited other liability-shifting or limiting provisions, lien subrogation clauses have not received similar treatment. For now, states have protected subcontractors by preventing GCs from passing along too much of their liability, especially if a party is deprived compensation even after performance completion. Without protection from the courts, liability-shifting would be impossible to reign in.

DIFFERENT APPROACHES TO SAFETY & PAYMENT ISSUES

Safety legislation efforts have been sweeping, clear, and consolidated. Coupling this with improved technology (e.g., anti-collision software; smart helmets; and the use of drones for dangerous, previously manual tasks), the industry has greatly reduced construction safety risk.

By comparison, construction payment legislation has been piecemeal, but technology is bridging the gap.

Legislation

The *Miller Act* is arguably the best federal legislation on construction payment practices. While it has proven incredibly helpful in limiting the risk taken on by subcontractors, it only applies to federal projects.¹¹

Little Miller Acts across the country also afford protection for down-the-chain parties, but again are limited to federal projects.¹² And, neither the *Miller Act* nor Little Miller Acts afford GCs protection for payment rights.

For private projects, prompt payment acts and mechanics lien laws significantly bolster payment rights. Prompt payment laws ensure that parties are paid in a timely fashion. In order to combat slow and tardy payments, a party may be eligible under prompt payment laws to collect interest, demand attorney fees, or put extra pressure on the opposing party.¹³

Using a mechanics lien, a contractor, subcontractor, or supplier can enforce its right to payment by encumbering the project owner’s property. Some states allow a property owner to substitute a bond in place of the lien, but nothing inspires action like threatening the owner’s title.

Ultimately, prompt payment laws and mechanics liens have proven to be powerful tools for unpaid parties, but they can be difficult to navigate.



Why Not Pave the Way for Payments?

Technology

Technology has not only made a direct and recognizable impact on construction safety, but it has also created an opportunity to support construction payment. Often, parties have neither the time nor the resources to hire an attorney to guide them through the maze of lien laws, prompt payment laws, and Miller and Little Miller Acts.

Information has never been more easily available and has provided opportunities for smaller parties to better understand and leverage their rights.

For example, platforms that address construction payment issues help small businesses navigate the complexities of construction payment laws. If industry collaboration and legislation are not the right approaches, technology might be able to serve as the middle ground.

IDEAS TO PAVE THE WAY FOR IMPROVEMENT

While not as powerful as legislative action or embracing technology, optimizing communication and transparency with systems that are already in place can help improve construction payment issues.

Notices help to ensure that an owner or higher-tiered contractor is fully aware of a subcontractor or supplier's presence on the project. A conditional lien waiver assures that the property owner will not have to pay twice, allowing payments to flow more freely through the payment chain.

Depending on the situation, notices may already be required to secure lien rights. Regardless, parties should utilize notices as much as possible. With improved communication, the project then becomes more transparent and all parties to the payment chain can be cognizant of when and to whom payments are made.

Because a conditional waiver is conditioned on the receipt of payment, the party issuing the waiver will only be giving up rights equal to payment received.¹⁴ Unlike with an unconditional waiver or a no lien clause, a contractor, subcontractor, or supplier retains the right to file a mechanics lien for any other unpaid sums.¹⁵

Effectively, conditional waivers act like receipts for payments made to parties down the chain. While these parties should always be wary of waiving lien rights, so long as the rights given up are proportional to payment received, agreeing to issue a conditional waiver in exchange for payment can accelerate the speed at which payment comes down the chain.

CONCLUSION

Construction safety and construction payment are both critical components of the industry. While both have room for improvement, gains in construction worker safety have been more noticeable and more rapid.

The industry must prioritize improving the construction payment system in the same fashion. Collaborative and technological solutions can help cut through the confusion from which construction payment issues sprawl. ■

Endnotes

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SCOTT G. WOLFE is CEO of *zlien*, a cloud-based platform that makes lien rights easy, empowering a fair payment process for the construction industry.

A CFMA member and longtime author for *CFMA Building Profits*, Scott also contributes to Construction Executive Risk Management eNewsletter, MultiBriefs, Funding Gates Blog, and frequently writes about construction payment and credit on *zlien's* blog.

Scott earned a BA in History and Political Science from Southern Methodist University and JD from Loyola University New Orleans College of Law.

Phone: 866-720-5436

E-Mail: scott@zlien.com

Twitter Handle: @scottwolfej