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Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

A Newly Recognized Exception to Pay-if-Paid Provisions

A pay-if-paid provision provides that a general contractor does not have to pay its subcontractors unless the project owner pays the general contractor first. The logic behind such provisions is that if the general contractor were not paid first, it would essentially be giving the subcontractors an interest-free advance with the hope that it might be repaid by the owner sometime in the future. As general contractors will explain, they do not have the financial resources necessary to come out of pocket to make these types of advances. On the other hand, subcontractors will point out that such provisions penalize them even if they have done nothing wrong and the owner's nonpayment has nothing to do with their work. In other words, if they did the work and did the work well, the owner nonpayment should not be their problem. Both sides have a point.

Until recently, the courts have been inclined to agree with the subcontractors' arguments. In fact, the courts have historically construed pay-if-paid provisions in as limited a fashion as possible, sometimes even torturing the language of the provisions in order to conclude they are not true conditions precedent. That trend largely ceased after the Third Circuit's decision in *Sloan v. Liberty Mutual Ins. Co.* (http://www2.ca3.uscourts.gov/opinarch/101725p.pdf), 653 F.3d 175 (3d Cir. 2011). Sloan held that pay-if-paid provisions are valid and enforceable under Pennsylvania law and should be applied rather than construed (or misconstrued).

Recently, however, a federal court interpreting Pennsylvania law has recognized a new exception to the enforceability of pay-if-paid provisions. *Connelly Constr. Corp. v. Travelers Cas. & Sur. Co. of Am.* (https://www.stradley.com/~/media/Files/Publications/2018/11/Connelly%20Construction%20Corporation%20v%20Travelers.pdf), 2018 WL 3549281 (E.D. Pa. 2018). In *Connelly*, the court found that the "prevention doctrine" precludes a general contractor from relying on a pay-if-paid clause when it was the general contractor's own conduct that contributed in some way to the owner's nonpayment. The prevention doctrine provides that a party who materially contributes to the nonoccurrence of a condition precedent is deemed to have waived the condition. The *Connelly* court held that the general contractor's conduct did not have to be deliberate or intentional for the prevention doctrine to apply; mere inadvertence was enough. Therefore, because the general contractor had inadvertently contributed to the owner's nonpayment, it could not invoke the pay-if-paid provision as a defense to the subcontractor's nonpayment claim.

The general contractor in *Connelly* argued that applying such a low threshold (i.e., inadvertence) to the application of the prevention doctrine would "eviscerate" the enforceability of pay-if-paid provisions. The point of such provisions is to protect the general contractor from having to pay out for work – even good work – that the owner has not yet paid for. The court rejected this argument and suggested that pay-

if-paid provisions would still be fully enforceable for owner nonpayment that was not caused by deliberate or inadvertent general contractor conduct, such as weather delays.

The federal court in *Connelly* was merely anticipating Pennsylvania law on this subject. It remains to be seen whether the "prevention doctrine" becomes widely accepted.

For more information, contact Patrick R. Kingsley at pkingsley@stradley.com or 215.564.8029.

Construction Practice Group

Patrick R. Kingsley, *Chair*	215.564.8029	pkingsley@stradley.com
Scott H. Bernstein	212.812.4132	sbernstein@stradley.com
Chelsea Biemiller	215.564.8550	cbiemiller@stradley.com
Adriel J. Garcia	215.564.8022	agarcia@stradley.com
Bridget C. Giroud	215.564.8740	bgiroud@stradley.com
Benjamin E. Gordon	215.564.8752	bgordon@stradley.com
Jeffrey D. Grossman	215.564.8061	jgrossman@stradley.com
Eric M. Hurwitz	856.321.2406	ehurwitz@stradley.com
Karl S. Myers	215.564.8193	kmyers@stradley.com
Adam C. Sasso	215.564.8792	asasso@stradley.com