

# **CONTRACTOR ALERT**

---

Contractor Alert is a joint publication by this Contractor and the Law Offices of Richard M. Sissman, Esquire, located at 1485 Chain Bridge Road, Suite 105, McLean, VA 22101. This newsletter is designed to give general information on the matters covered. Space limitation prevents exhaustive treatment or analysis of this topic. This newsletter is not intended to substitute for advice on specific legal problems. If you are interested in receiving a complimentary issue or to be placed on our mailing list, contact Richard M. Sissman, Esquire. We welcome and appreciate your suggestions for future article topics.

---

Publication by the Law Offices of Richard M. Sissman, Esquire  
XCV-FEB-Mar 2004

## **THE ENFORCEABILITY OF "PAY WHEN PAID" CLAUSES IN VIRGINIA**

Most subcontractors today must sign the prime contractor's contract which usually will contain a "pay when paid" clause that will bind the subcontractor to await payment until such time that the prime contractor has been paid. In Virginia, these type of clauses are binding upon the parties.

Set forth below is the seminal case of Galloway v. Ballard Construction, 464 S.E. 2d 349 (Va. 1995). Galloway, the prime contractor claimed that its contract form used in the subcontracts provided it with a "pay when paid" defense. That is, that the phrases "after the Contractor receives payment from the Owner" and "has received payment from the Owner," created a condition precedent that Galloway must first receive payment from the Owner before being required to make payment to Ballard.

The Court took testimony. Following the conclusion of the evidence, the trial court determined that Galloway did not have an absolute "pay when paid" defense based on the contracts as written. Rather, the trial court found that the phrases "after the Contractor receives payment from the Owner" and "has received payment from the Owner" only permitted Galloway to "delay payment[,] but the contract[s] cannot be construed to say that each sub [contractor] must bear its own loss if Galloway never got paid [on its contract with the owner]."

The Supreme Court of Virginia then awarded Galloway an appeal to consider the question of the "pay when paid" defense.

The Supreme Court based its decision on another case Dyer v. Bishop Int'l from the federal court, 6<sup>th</sup> Circuit. The Dyer court reasoned that the credit risk inherent in the general contractor's undertaking may be shifted to the subcontractor, but in order to do so, the contract between the general contractor and subcontractor should contain an express condition clearly showing that to be the intention of the parties.

In Galloway, the Virginia Supreme Court reasoned that to construe the language in said contract requiring the subcontractor to wait to be paid for an indefinite period of time until the general contractor has been paid by the

owner, which may never occur, is to give to it an unreasonable construction which the parties did not intend at the time the subcontract was entered into. The court further held that the credit risk inherent in the general contractor's undertaking may be shifted to the subcontractor, but in order to do so, "the contract between the general contractor and subcontractor should contain an express condition clearly showing that to be the intention of the parties.

There are certain jurisdictions whereby the legislature has determined that to shift the risk all upon the subcontractor is against public policy and therefore it will not permit absolute

"pay when paid" clauses to be enforceable. Virginia is not such a jurisdiction. If the language in the contract is ambiguous, then it will be construed against the party that drafted it which usually is the prime contractor.

In conclusion, before you sign the contract with a prime contractor, determine whether there is a "pay when paid" clause and if there is one, whether the language of the clause is unequivocal as to your payment. In other words if the language holds that you will not be paid until and only until the prime contractor is paid for your work, then you will have the risk of loss shifted to you. Are you willing to absorb such a risk? If not, then don't sign the contract or attempt to strike it or negotiate a less harmful outcome.

If you should have any questions on this topic or any other related topic, please contact Mr. Sissman at his website at [www.contractoralert.com](http://www.contractoralert.com) or by phone at (703) 903-9646 or (301) 762-0402.