Pay-if-Paid Clause Found Ambiguous

By

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This article appeared in *St. Louis Construction News & Real Estate*, p. 30-31, November-December 2007.

A pay-if-paid clause in a subcontract must be very clear to be enforced without the need for testimony from the contractor and the subcontractor about their intent, the Eastern District Court of Appeals decided recently. The case is *Lobo Painting, Inc. v. Lamb Construction Company*, 231 S.W.3d 256 (Mo. App. E.D. 2007).

In reaching this result, a Missouri appellate court once again has emphasized that pay-if-paid clauses may be enforceable but they must be clearly worded and unambiguous. Otherwise, the parties to the contract can offer their competing interpretations about whether payment is due and ultimately will have to rely on a judge or jury to decide who should prevail.

Pay-if-paid clauses are common in construction subcontracts. They provide in some fashion that the contractor is not required to pay the subcontractor until the owner has paid the contractor. The assumption is that if the owner does not pay, then the contractor does not have to pay out of its own pocket.

In this case, Lamb Construction Company as the contractor had a painting subcontract with Lobo Painting. The project was at a building for West County EMS. Lamb Construction paid everything except for the retainage of $2,441, because the owner was withholding final payment from Lamb.

At trial Lamb Construction's representative and sole member Kevin Lamb testified that he did not know why the owner was withholding final payment. Lamb further testified that he believed under the subcontract that he could withhold payment to his subcontractor until he received the money from the owner.

The subcontract provision in question read:

> Final payment, constituting the entire unpaid balance of the Subcontract Sum, shall be made by the Contractor to the Subcontractor when the Subcontractor's Work is fully performed in accordance with the requirements of the Subcontract

> Documents, the Architect has issued a certificate for payment covering the Subcontractor's completed Work and the Contractor
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> has received payment from the Owner. If, for any cause which is not the fault of the Subcontractor, a certificate for payment is not issued or the Contractor does not receive timely payment or does not pay the Subcontractor within three working days after receipt of payment from the Owner, final payment to the Subcontractor shall be made upon demand.

The Eastern District, contrary to the trial court, found this provision to be ambiguous. Ambiguity exists where the words in the contract "are susceptible of more than one meaning so that reasonable persons may fairly and honestly differ in their construction of the terms."

The second sentence, the appellate court found, can be read different ways. On the one hand, it could be read that the clause "for any cause which is not the fault of the Subcontractor" only applies to the next part of the sentence that a "certificate for payment is not issued." In this case, if the reason for not paying was other than subcontractor fault that caused a certificate for payment not to be issued, payment would be due three days after a demand from the subcontractor, regardless of whether the owner had paid.

On the other hand, the second sentence could condition the contractor's payment on receiving the money from the owner. In this case, if subcontractor fault caused the owner not to pay, then the contractor would have a contractual reason to withhold payment from the subcontractor.

Naturally, at trial Lamb and Lobo had different understandings about what the contract meant and what was their true intent. "The ambiguity in the contract cannot be resolved without first resolving the conflicting testimony, which requires determining the witnesses' credibility," the appellate court held. Credibility is decided by the trial judge or jury, not the appellate court.

The appellate court sent the case back to the trial court for it to "determine the party's intent," meaning who is more believable. That can be difficult when neither party may have actually read the provision at the time they entered into the contract.

Prior to this case, the Southern District Court of Appeals in Missouri held that a pay-if-paid provision is enforceable if clearly written and unambiguous. The case is *Meco Systems, Inc. v. Dancing Bear Entertainment, Inc.*, 42 S.W.3d 794 (Mo. App. S.D. 2001).

In Meco, the Southern District found a reasonably clear pay-if-paid provision in a subcontract became much more unclear and ambiguous because the subcontract incorporated the main contract between owner and contractor. The main contract was a cost-plus fee arrangement and required, as they often do, the contractor to pay its subcontractors before seeking reimbursement from the owner. The court found this to be in conflict with the subcontract language, thereby making the subcontract ambiguous.

These cases reinforce the importance of having clearly worded contracts on how payment is to take place. Ambiguity invites conflicting testimony at trial, leaving the outcome up in the air.

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