

Michigan Legislature Introduces Bill Prohibiting 'Pay-When-Paid' Clauses on Public Contracts

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Sticks & Bricks

If the Michigan Legislature's Committee on Commerce and Tourism agrees with provisions in Senate Bill No. 1319 (S.B. 1319), people providing labor, supplies, equipment or materials in a governmental contract will get the money that's owed to them – on time and not when the contractor gets paid.

In S.B. 1319, new language was introduced that prohibits “pay-when-paid” clauses, as well as provides penalties and remedies for claimants. Specifically, the bill would amend the public works bond statute (MCL 129.201, et seq) by prohibiting, as a condition of payment to a subcontractor on a public construction project, the general contractor's receipt of its payment from a governmental unit. S.B. 1319 would also add fee-shifting and interest provisions for the prevailing party.

Performance and payment bonds are required, at the expense of the proposed contractor, to provide external funds to finance expenditures. A performance bond is used to protect the governmental unit from paying the awarded amount for a construction, alteration, demolition or repair contract. The payment bond is solely for the protection of the people providing services, supplies or equipment.

“Pay-when-paid” clauses in construction contracts are quite common. Under this provision, a subcontractor will be paid when the contractor is paid by the owner. These types of clauses deal only with the timing of payment and are construed merely as timing mechanisms, rather than as waiver or forfeiture clauses.

They are referred to as pay-when-paid clauses, but they do not operate to preclude payment indefinitely. In other words, the clauses merely provide a general contractor with some reasonable period within which to make payment.

These clauses serve as both a sword and shield with respect to payment of subcontractors on construction projects. If a general contractor fails to pay a subcontractor after it gets paid, the general contractor can be liable for interest and attorney's fees to the subcontractor. This “sword” is used to force prompt payment.

The clause is a “shield” for the contractor, who does not get paid by the owner and who faces multiple lawsuits from subcontractors.

MICHIGAN LEGISLATURE INTRODUCES BILL PROHIBITING 'PAY-WHEN-PAID' CLAUSES ON PUBLIC CONTRACTS Cont.

As of the release of this newsletter, it is unclear of the committee's opinion, and it is unknown if its members will agree favorably with the bill. It was referred to the Committee on Commerce and Tourism on May 6.

If S.B. 1319 passes, the amendment takes effect on Jan. 1, 2011 and would apply to any contract entered into on or after that date.

When the Committee on Commerce and Tourism makes a decision on Senate Bill No. 1319, Plunkett Cooney's Construction Law Practice Group will report the results in the following edition of the Sticks & Bricks newsletter.

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