

# CONSTRUCTION LAW

# NEWS

## Condition Precedent Language In Contract May Not Shift The Risk Of Owner’s Payment Default To Subcontractor

By Thomas E. Weiers, Jr., Esquire

General contractors who believed that their subcontract language contained enforceable “pay-if-paid” clauses may have to redraft those clauses in light of a recent federal court case issued in August, 2009 from the Eastern District of Pennsylvania, *Sloan Co. v. Liberty Mutual Ins. Co.* Conversely, subcontractors may be surprised to learn they are not bound to an enforceable “pay-if-paid” provision.

Contractors routinely use language in subcontracts such as “payment by owner is a condition precedent to contractor’s obligation to pay subcontractor.” This type of phrasing alone was commonly believed to shift the risk of an owner’s payment default to the subcontractor when, in fact, the owner had not made payment to the general contractor of amounts owed to the subcontractor. The recent *Sloan* decision may require general contractors to redraft their contract payment provisions to provide for an enforceable “pay-if-paid” clause.

### Distinguishing a “Pay-if-Paid” from a “Pay-when-Paid” Contract Clause.

Depending on the contract language used, payment from the owner may be deemed “pay-if-paid” or “pay-when-paid.” If a clause is deemed to be a “pay-when-paid”

clause, the payment provision serves merely as a timing mechanism permitting a subcontractor to file a legal action to secure payment from a general contractor after a reasonable time has passed even if the owner has not paid the general contractor. Under a “pay-when-paid” provision, the risk of an owner’s payment default is not shifted from the general contractor to the subcontractor. General language indicating the subcontractor will be paid after the contractor receives payment from the owner is usually viewed as a “pay-when-paid” clause.

However, if the payment provision is deemed a “pay-if-paid” clause, the risk of the owner’s payment default is shifted to the subcontractor and, a subcontractor has no valid claim against the general contractor unless and until the owner actually makes payment to the general contractor for the subcontractor’s work. For an enforceable “pay-if-paid” provision, Pennsylvania law generally required use of the words such as actual payment by the owner is a “condition precedent” to the general contractor’s obligation to pay the subcontractor, or that payment will be made “if and only if” payment has been made by the owner to convey the parties’ intention that payment to a subcontractor is wholly contingent on

the general contractor’s receipt of payment by the owner.

### The *Sloan* Decision May Require Additional Language for an Enforceable Pay-if-Paid Clause.

The *Sloan* decision may require additional language in a subcontract to ensure that a provision which purports to be a “pay-if-paid” provision will actually be enforced as a “pay-if-paid” provision. In *Sloan*, the subcontract stated that:

“Final payment [to Sloan] shall be made within thirty (30) days after the last of the following to occur, the occurrence of all of which, shall be conditions precedent to such final payment: . . . (6) contractor shall have received final payment from the Owner for the Subcontractor’s Work . . .”

The Court found this section to be a “pay-when-paid” clause because it did not clearly demonstrate that the parties intended to shift the risk of loss – the owner’s payment default – to the subcontractor, Sloan. The Court reasoned that the above clause served as a timing mechanism and did not cut off the

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## Subcontractors: Prohibiting An Owner’s Negligence Claim Against Subcontractors Under The Economic Loss Doctrine

By Danny P. Cerrone, Jr., Esquire

In *American Stores Properties, Inc. v. Spotts, Stevens & McCoy, Inc.*, the United States District Court for the Eastern District of Pennsylvania held that an owner’s negligence claim against various subcontractors was barred by the economic loss doctrine. The economic loss doctrine bars the recovery of damages on negligence claims against parties that are not in privity of contract, that result solely in economic damages unaccompanied by physical injury or property damage.

In this case, the property owner, American Stores Properties, Inc. (“American”), filed a Complaint against numerous contractors and subcontractors arising out of the alleged failure of three retaining walls at a food distribution center located in Denver, Pennsylvania. In the Complaint, American asserted negligence claims against various

subcontractors. American could not assert a breach of contract claim against those subcontractors because American had no direct contractual relationship with the subcontractors. In response to the Complaint, various subcontractors filed Motions to Dismiss on the basis that American’s negligence claim against them was barred by the economic loss doctrine.


The Court held that the economic loss doctrine barred recovery against the subcontractors because no cause of action exists for American’s negligence claim, which resulted solely in economic damages in the form of repair or replacement costs to the retaining walls and was unaccompanied by physical injury or property damage. First, the Court held that, contrary to American’s assertion, an actual contract between

American and the subcontractors was not required in order to assert the economic loss doctrine against negligence claims.

Second, the Court held that damages related to the cost of repair or replacement of the retaining walls was not considered physical injury or property damage. Physical injury relates to actual bodily harm, while property damage relates only to items that are not the “product” itself. Thus, if the retaining walls had fallen onto a person or another item that was not the product itself, i.e. a car or building, then, and only then, would the economic loss doctrine not bar American’s negligence claim against the subcontractors.

Finally, the Court noted that American’s negligence claim was not permitted under the Pennsylvania Supreme Court’s holding in *Bilt-Rite Contractors, Inc. v. Architectural Studio*. In *Bilt-Rite*, a very limited exception to the economic loss doctrine was created for negligent misrepresentation claims. Following the holding of several courts interpreting *Bilt-Rite*, the Court held that *Bilt-Rite* applied only to negligent misrepresentation claims and not to negligence claims. The Court noted that several courts have held that *Bilt-Rite* applies only to architects and similar design professionals. The Court did not take a position as to whether *Bilt-Rite* created such a limitation.

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**Q:** The Contractor’s contract required that, for extra work performed on a project, the Owner and the Contractor execute Change Orders recommended by the Engineer. The Engineer recommended a Change Order for extra work which both the Owner and the Contractor signed. The Owner now claims that it will not pay the Contractor for the Change Order. Can the Contractor recover those Change Order monies from the Owner?

**A:** Yes. Pennsylvania case law establishes that the Owner must pay a contractor for extra work performed at the direction of the Engineer or the Owner. If the contractor complied with the terms of the parties’ contract, relates to the execution of Change Orders, the Contractor is entitled to payment from the Owner for the extra work performed.

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## Contractors: A General Contractor May Be Liable For Its Subcontractor's OSHA Violations

By Thomas E. Weiers, Jr., Esquire

Recently, the Occupational Safety and Health Review Commission (OSHRC) reversed its own initial determination and upheld an OSHA citation against a general contractor for a safety violation that the general contractor did not commit and to which none of the general contractor's own employees were exposed.

In *Sec. of Labor v. Summit Contractors, Inc.*, the OSHRC found a general contractor on a college dormitory project in Little Rock, Arkansas was properly cited with a "serious" violation of the OSHA Safety Standards when one of its subcontractors at the project was working on scaffolds without adequate fall protection. When the citation was originally issued in 2003, the OSHRC initially determined that the general contractor could not be cited because none of its employees were ever exposed to the potential injuries caused by

the subcontractor's failure to have adequate fall protection while working on scaffolds. The matter was then appealed by the Secretary of the Department of Labor to the U.S. Court of Appeals for the Eighth Circuit.

On appeal, the OSHRC reversed its initial determination finding that the general contractor was a "controlling employer properly cited under the multi-employer citation policy for violative conditions it did not create and to which none of its employees were exposed." The OSHRC's reversal of position was based in large part on the fact that the general contractor was aware of the unsafe conditions relating to the scaffolding, but failed to inform the subcontractor of the safety violations and its subcontract with the subcontractor permitted the general contractor to terminate and remove the subcontractor if it disregarded OSHA regulations.

General contractors must be aware that, in addition to their general duty to comply with OSHA safety regulations, any contractor deemed to have general supervisory control over a work site; especially if that responsibility specifically includes the power to correct safety violations, must exercise reasonable care to detect and prevent violations at a project. This is true whether or not those violations would affect the general contractor's own employees or the contractor faces the risk of penalties associated with OSHA citations.

If you have any questions, you may direct any inquiries to Thomas E. Weiers, Jr., Esq., Thorp Reed & Armstrong, LLP, One Oxford Centre, 14th Floor, Pittsburgh, PA 15219, (412) 394-7750, [tweiers@thorpreed.com](mailto:tweiers@thorpreed.com).

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subcontractor's right to payment from either the general contractor or its surety. The general contractor's surety, Liberty Mutual Insurance Co., argued that the clause's use of the words "conditions precedent" to payment transformed the clause into a valid "pay-if-paid" clause, but the Court disagreed. The Court ruled that although the words "conditions precedent" can trigger a valid "pay-if-paid" clause, they alone are not enough to demonstrate the parties' intent to shift the risk of the owner's non-payment to the subcontractor.

To determine whether either progress payment or final payment provisions will be construed as enforceable "pay-if-paid" provisions, language which clearly shows that the general contractor will never be obligated to pay the subcontractor unless and until it has received payment by the owner and that the subcontractor will contractually bear the risk of the owner's payment default will need to be added to create an enforceable "pay-if-paid" contractual relationship.

Subcontractors who believed that they had signed "pay-if-paid" contracts merely

because the contract provided that payment by the owner was a "condition precedent" may be able to assert claims against the general contractor and/or its surety under the *Sloan* decision if a general contractor is refusing to make payment as a result of an owner's payment default.

If you have any questions concerning "pay-if-paid" contract provisions or the impact of the *Sloan* decision, you may direct any inquiries to Thomas E. Weiers, Jr., Esq., Thorp Reed & Armstrong, LLP, One Oxford Centre, 14th Floor, Pittsburgh, PA 15219, (412) 394-7750, [tweiers@thorpreed.com](mailto:tweiers@thorpreed.com).

## What's New In Pennsylvania: Contractors May Be Entitled To Recover Attorneys Fees To Collect On A Judgment

By Mark F. Nowak, Esquire

In a case of first impression in Pennsylvania, the Pennsylvania Superior Court has ruled that contractors and subcontractors may recover legal fees incurred while trying to collect on a judgment. Pennsylvania's Contractor and Subcontractor Payment Act ("CASPA") at Section 512(b) provides that a "substantially prevailing party in any proceeding to recover any payment under this Act shall be awarded a reasonable attorney fee in an amount to be determined by the court or arbitrator, together with expenses." To the extent a contractor is found to be the substantially prevailing party in either an arbitration or litigation proceeding, it may make claim and may receive all of its attorneys fees and related costs to pursue a favorable arbitration award or judgment.

In a decision published in October, 2009, the Pennsylvania Superior Court expanded the reach of CASPA §512(b) to cover attorneys fees caused by a defendant's "obstructionist's tactics" after entry of a judgment and while trying to collect on the judgment. In *Zimmerman v. Harrisburg Fudd*, Zimmerman received a stipulated arbitration award of \$21,000 for its principal claim, interest, penalties and attorneys fees under the CASPA. However, Harrisburg Fudd failed to satisfy the stipulated award and filed a claim for exemption from execution proceeding

and an emergency motion to stay execution to ward off Zimmerman's attempts to collect on the stipulated award. The rationale for the Superior Court's decision to expand the coverage of §512(b) was that:

"CASPA's underlying objective of making an unpaid collector whole by awarding him his litigation costs when he is the substantially prevailing party is compromised and, in deed, can be gutted, when he is subjected to expensive litigation costs, including those incurred in the collection of fees phase."

Under the *Zimmerman* decision, a contractor or subcontractor is entitled to be made whole by an entitlement to interest and additional attorneys fees incurred when the losing party fails to satisfy a judgment or arbitration award and forces the prevailing party to resort to additional legal proceedings to collect on an award or judgment. The *Zimmerman* decision is a clear pronouncement by the Pennsylvania Superior Court that a prevailing contractor will not be required to use "his award to pay attorneys fees" to collect on the award.

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