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Are Pay-If-Paid Clauses Really Void In New York? By Michael D. Ganz, Esq., The Light, 2-2023

It has long been held a maxim that a pay-if-paid clause in a construction contract is void under New York law. As such, during contract negotiations the parties often remove such clause as void, or too often, leave the clause in since they assume it is not binding However, as described below and upheld by recent appellate court caselaw, that maxim and assumption is not true.

First things first — what is a pay-if-paid clause? A pay-if-paid clause is a provision in a contract wherein the obligation of a contractor to pay its downstream subcontractor or vendor is conditioned upon the contractor's receipt of payment from the owner. In essence, the provision obliges the subcontractor or vendor to assume the risk of the owner's payment to the contractor. Such a clause was held void and unenforceable as against public policy by the landmark case of West-Fair Elec. Contrs. v. Aetna Cas. & Sur. Co., 87 NYS2d 148 (1995). The underpinning of West-Fair would violate public policy as such a clause would prohibit a subcontractor or vendor from filing a mechanic's lien for unpaid work or materials since it would only be entitled to payment if the owner paid the contractor.

In a recent case however, Entech Eng'g, P.C. v. Dewberry Engrs. Inc., 204 AD3d 467 (1st Dep't. 2022), the appellate court affirmed the lower court's ruling that a pay-if-paid clause is valid in New York if the claimant has no lien rights. Defendant Dewberry Engineers, Inc. (Dewberry) contracted with the New York City Economic Development Corporations' (EDC) Build-It-Back Hurricane Sandy Program to inspect approximately 10,000 New York City homes for structural, asbestos and lead paint issues. The funding for the project was federal HUD funds. Thereafter, Dewberry retained Entech Engineering P.C. (Entech) as a subcontractor to perform approximately 2,000 preconstruction lead paint inspections of single-family residences. Notably, the City's payment to Dewberry for Entech's services was a "condition precedent" to Dewberry's duty to pay Entech (the above-referenced "pay-if-paid" clause). Ultimately, Dewberry terminated Entech for cause, and Entech later brought claims based on three unpaid invoices for lead inspection services totaling $1,464,983. Entech moved for summary judgment on its claims, arguing, among other things, that Dewberry's failure to pay the invoices was a breach of the subcontract, and that the pay-if-paid clause was unenforceable since it violated New York public policy. Dewberry also moved for summary judgment dismissing Entech's complaint on several grounds, including that the pay-if-paid provision was valid since Entech had no lien rights and barred the claims because the City had not paid Dewberry for the invoices at issue.

In this factually noteworthy case, Entech has no lien rights because the work it performed was for home lead inspections and thus did not constitute "labor . . . for the improvement of real property" subject to a private mechanics' lien (see Lien Law § 3). In essence, the work was performed as pre-construction services, in advance of a future and separate construction contract to repair damage to the home. Moreover, Entech had no public improvement lien rights as its public improvement lien was dismissed by the court on the grounds that this was not a public improvement project under the lien law. The court held, "Where a subcontractor has no such Lien Law rights, there is no basis for finding that a pay-if-paid clause violates New York public policy and there is no impediment to enforcement of the pay-if-paid clause."
It was undisputed that Dewberry was not paid by the City for the Entech invoices and accordingly, the appellate court affirmed the lower court's dismissal of Entech's claims based on the pay-if-paid provision in the subcontract. (Note in this matter, there were also questions of choice of law provisions under New York or Virginia law, but the court found the provision enforceable under either New York law or the Virginia law that was then in effect).

Contractors should be aware of the implications of the Entech case. Contractors often perform work where they are prohibited from filing a mechanic's lien (e.g. federal projects, PANYNJ Projects, hybrid projects consisting of private work on public lands, etc.) and a pay-

if-paid clause may well be considered enforceable, forcing the subcontractor or vendor to rely on payment from the owner to the contractor in order to be paid. Moreover, based upon Entech, it is conceivable that a contractor may even seek to enforce such a pay-if-paid clause in a contract where the subcontractor or vendor actually had lien rights but their lien rights expired since ostensibly the pay-if paid clause would no longer implicate their lien rights.

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