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Testimony in Support of H. 3053

AN ACT TO PROMOTE FAIR PAYMENT PROVISIONS

Before the Joint Committee on State Administration

June 18, 2009

H. 3053 promotes fairness in construction contracts by setting strict limits on the use of so-called “pay-if-paid” clauses in construction contracts.

Pay-if-paid clauses are one of the most controversial provisions in a contract between general contractor and subcontractor. With a pay-if-paid clause, a general contractor essentially says to the subcontractor, **“If I get paid, then you get paid; if for any reason the owner doesn’t pay me, then I don’t have to pay you.”** Such clauses effectively shift all financial risk to subcontractors, which is **unfair** since subcontractors have no contract (and usually no contact) with the owner, and have little way to assess the owner’s ability to fund the project and pay for work performed.

A pay-if-pay clause hits two ways: First, it makes it easy for a general contractor to take on a risky, speculative project, since he knows he won’t be responsible to subcontractors if the owner or developer goes bankrupt. Second, it allows a general contractor to escape responsibility for payment even in cases where the owner isn’t paying due to problems with the general contractor himself, not the subcontractors. Meanwhile, this pay-if-paid clause can mean financial disaster to subcontractors, since they do 80% of the work on the project and pay most of the cost of labor and materials. By contrast, the general contractor is often a construction manager, with relatively little invested in the project and little to lose if trouble develops.

The proposed legislation restores fairness by prohibiting pay-if-paid clauses EXCEPT in two very limited situations:

- 1) **Where non-payment by the owner is due to problems with the subcontractor’s work.** Pay if paid *cannot* be used when non-payment is due to problems with the general contractor’s work.
- 2) **Where the owner is bankrupt and insolvent BUT the general contractor claimed a lien at the start of the project,** maintained it and pursued all legal remedies to obtain payment on behalf of himself and the subcontractor.

Contractors are often reluctant to claim liens at the start of a project, believing it sours relations with the owner. **H. 3053 does not require a general contractor to claim a lien against his will; it gives him a choice:**

- 1) If a general contractor wishes to use a pay-if-paid clause and shift the risk of non-payment to the subcontractor, he **MUST** protect the subcontractor by claiming a lien at the start of the project.
- 2) If a general contractor does **NOT** wish to claim a lien to protect payment rights, he must bear the risk of non-payment himself. Any pay-if-paid clause in the contract would be null and void.

The bill ties in perfectly with the Massachusetts Mechanics Lien Law, and encourages contractors to use the lien law as it was intended, to ensure that all parties get paid. Ideally, it will make the filing of liens standard operating procedure, and remove any stigma attached.

It does not go as far as recent legislation and court cases in other states (California, North Carolina, Wisconsin, New York, Colorado), which have struck down pay-if-paid clauses altogether as void and against public policy. Instead, it is a classic legislative compromise negotiated between ASM and the Associated General Contractors of Massachusetts, that protects the interests of both parties and has the support of the entire construction industry.

In 2004, the Legislature recognized the merits of this measure, and enacted it in both branches, with no opposition. Unfortunately, it was vetoed by the Governor, due to apparent misunderstanding of the legislation. We urge the Committee to once again to act favorably on this bill, and set it on the path to the Governor's desk.

Respectfully,

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The Associated Subcontractors of Massachusetts, Inc. (ASM), founded in 1950, is a statewide trade association representing specialty contractors and suppliers in the commercial construction industry. Members include over 400 companies, both large and small, union and open shop, who together employ over 25,000 workers on private and public building construction in the Commonwealth.