

## New Virginia Law Prohibits Pay-If-Paid Clauses in Construction Contracts

On April 27, 2022, Virginia Governor Glenn Youngkin signed Senate Bill 550 into law, amending a portion of the Virginia Prompt Payment Act and a component of the Virginia wage theft statute. Va. Code § 2.2-4354 and VA. Code § 11-4.6. The changes associated with the law now prohibit “pay-if-paid” clauses in both private and public construction contracts in the commonwealth of Virginia. The law is set to take effect on January 1, 2023. As a result, contractors and subcontractors must carefully contemplate their current standard contracts and master agreements to determine whether they will comply with the legislative changes moving forward. By proactively crafting new language within their standard construction contracts, contractors and subcontractors may avoid additional liability outlined in the new statute related to payment for properly invoiced and completed work.

### Pay-If-Paid Versus Pay-When-Paid Clauses

This law, in effect, bans pay-if-paid clauses and permits no more than a pay-when-paid clause. What is the difference? A pay-if-paid clause shifts all of the risk for payment by the owner from the general contractor or upper-tier subcontractors to the lower-tier subcontractors by stating that the general contractor has no obligation to pay the subcontractors until the general contractor receives payment from the owner, making such receipt of payment a condition precedent. In contrast, a pay-when-paid clause provides the general contractor or upper-tier subcontractor with a reasonable time period in which to receive payment from the owner and then remit payment to the lower-tier parties.

Previously, general contractors or higher-tier subcontractors could wait to pay their subcontractors until they received payment for the job from the owner — pay-if-paid as it was styled — shifting the risk indefinitely to the lower-tier subcontractors, as receipt of payment from the owner or upper-tier contractor was a condition precedent to any duty to pay the lower-tier. Once the new law takes effect in January 2023, only pay-when-paid clauses, establishing a reasonable time period for payment, will be enforceable. The law will make a maximum required 60-day provision for payment, making it mandatory for all project owners to pay their contractors within said 60-day timeframe. Lower subcontracts will also require that all higher-tier contractors pay their subcontractors within the “earlier of sixty (60) days after their subcontractor’s invoice submittal or seven days after the receipt of the amount paid by the owner or higher-tier contractor.”

It bears noting that the 60-day payment requirement fails to apply to public bodies who are not defined as an “owner” in the legislation. To be clear, the legislation defines an owner as a person or entity, other than a public body as defined in § 2.2-4301, responsible for contracting with a general contractor for the procurement of a construction contract. Because these provisions will be required for all construction contracts moving forward, all general and subcontractors should review the payment terms of their current construction contracts for compliance, certainly those that will remain in effect as of January 1, 2023.

The legislation leaves some ambiguities. For instance, the law fails to outline what constitutes completion of the outstanding payments. However, project owners are cautioned that if they intend to withhold payment for a project, they must do so in writing and provide reasonable specificity of the reasons for their nonpayment/withholding.

### Subcontractors Have Additional Protection

Subcontractors are shielded from the risk associated with nonpayment at levels above their contract under the new law. Additionally, should an owner fail to make timely payments as defined



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above, it may be liable for interest payments under the Prompt Payment Act. These payments would be set at 1 percent per month (12 percent *per annum*) unless otherwise outlined in the written contract. Owners may consider adding a nominal interest rate to their standard contracts to stunt the potential impact from these changes.

Additionally, every general or subcontractor should still be prepared to make payments to the lower-tier contractors regardless of whether it receives payment from the upstream party. The new statute requires that:

Payment by the party contracting with the contractor shall not be a condition precedent to payment to any lower-tier subcontractor, regardless of that contractor receiving payment for amounts owed to that contractor, unless the party contracting with the contractor is insolvent or a debtor in bankruptcy as defined in § 50-73.79.

In furtherance of this provision, general contractors should consider demanding proof of financial assurance from owners. However, as noted above, should an owner or general contractor be insolvent or file for bankruptcy protections, there is no obligation to pay the subcontractors for their work performed and properly invoiced.

This new law is in follow-up to some other jurisdictions which have, as a matter of statute or common law (case law), found that pay-if-paid clauses are against public policy or otherwise not good law. While the law will create new protections for prime and subcontractors alike, it will undoubtedly result in judicial cases given some of the ambiguities in the law.

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