HOW TO WITHHOLD MONEY FROM A SUBCONTRACTOR OR SUPPLIER WITHOUT RUNNING AFOUL OF THE LAW

PREVENTATIVE MEASURES

There often are many legitimate reasons to withhold payments to subcontractors or suppliers, including defective performance or materials, unexcused delays, overbilling, damage to the work of others, improper or inflated liens or payment bond claims, or wrongful suspension of work. There also could be a need to withhold a scheduled payment to a subcontractor or supplier if you have not received timely payment from your customer on the project. However, when these, or similar circumstances arise, you must be sure to proceed with caution to limit your liability for withholding payments to subcontractors or suppliers.

Generally, failure to pay subcontractors or suppliers constitutes a material breach of contract and can expose you to liability for liens or payment bond claims, interest on unpaid amounts, the subcontractor’s or supplier’s attorneys’ fees, and, in some instances, personal liability to your company’s principals in the event successful litigation is pursued to collect on the money owed. Withholding of payment also could result in work stoppages or other delays on a project, which, in turn, could result liquidated damages assessed against you.

The best protection against these or other adverse consequences associated with withholding payments to subcontractors or suppliers is a thoughtfully drafted subcontract or purchase order that clearly details the circumstances under which you may withhold payment from subcontractors or suppliers. Prudent roofing contractors create and use their own - more -
WITHHOLDING MONEY FROM SUBCONTRACTOR/SUPPLIER/2

Subcontract and purchase order forms, which should include a general statement that the roofing contractor may withhold any amounts otherwise due the subcontractor or supplier to cover the roofing contractor’s reasonable estimate of any costs or liabilities the roofing contractor has incurred or may incur for which the subcontractor or supplier may be responsible. If you are asked to use a subcontract or purchase order form drafted by a subcontractor or material supplier, be sure to examine the contract carefully and revise it to allow for the withholding of payments as discussed before signing it.

Your contracts or purchase orders also should contain language that allows you to withhold payment in the event you are not paid by your customer on the project. This type of clause, which is referred to as a “pay-if-paid” clause, should state payment to you from the party with which you have contracted is an express “condition precedent” to your obligation to pay your subcontractors or suppliers. If a properly drafted clause of this type appears in a contract or purchase order, you will only be required to pay subcontractors or suppliers when you have received payment from your customer.

FOLLOW THE TERMS OF YOUR CONTRACT

Assuming your contract contains provisions that allow you to withhold money from subcontractors or suppliers because of nonpayment to you or to protect against legitimate risks or claims caused by their actions, be sure to strictly follow the procedure set forth in your contract for withholding payment. Depending on the contract terms or purchase order, you may be required to provide subcontractors or suppliers with written notice of the basis for your withholding of payment and, in the event your withholding of payment is because of your
WITHHOLDING MONEY FROM SUBCONTRACTOR/SUPPLIER

subcontractor’s or supplier’s actions, possibly afford them an opportunity to cure the default before withholding payment.

ENSURE COMPLIANCE WITH APPLICABLE STATE LAWS

When considering whether to withhold payment to subcontractors or suppliers, it also is important to have a clear understanding of the full scope of protections afforded to subcontractors and suppliers under applicable state law. Of course, nonpayment to subcontractors or suppliers could result in liens on a project or payment bond claims that will likely affect your relationship with your customer and bonding company. Additionally, your decision to withhold funds to your subcontractors or suppliers could result in violation of your state’s prompt pay acts and/or trust funds statute.

Just about every state has some form of prompt payment act that could affect your decision to withhold payment to subcontractors or suppliers. These acts generally set statutory deadlines for payment on construction projects, public and private, and provide for penalties, such as costs, interest and attorneys’ fees, if payment is delayed and a successful claim is made against the party withholding payment. Prompt payment acts typically include provisions requiring payment from the owner to the prime contractor and from the prime contractor to subcontractors within a given time period. Sometimes, these laws will set similar time limits for payment further down the contractual chain, including to sub-subcontractors and suppliers. Prompt payment acts generally do not invalidate pay-if-paid clauses or other contractual conditions precedent to payment set forth in contracts or purchase orders, so the withholding of payment under those terms should not be affected. However, if your contracts do not provide a
basis for withholding payments to subcontractors or suppliers, you will need to assess the risks that may be imposed under your state’s prompt payment act before withholding payment. The key questions to ask when determining whether you could be potentially liable under your state’s prompt pay act follow:

1. Does your state’s prompt pay act actually apply to this project and your payments to subcontractors or suppliers?
2. Would your basis for the withholding of payment be considered justifiable after an objective evaluation?

The second question is important because the remedies provided by your state’s prompt payment act will only be available to your subcontractors and suppliers if they prevail in a lawsuit against you.

A number of states also have enacted legislation that treats payments received by a contractor for the labor and materials supplied by its subcontractors or suppliers as trust fund monies. A common feature of these trust fund statutes is language holding corporate officers and directors liable for the wrongful use of monies held in trust. Therefore, if payments provided by your customer are used for purposes other than paying your subcontractors or suppliers, personal liability may arise.

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