

SUBJECT: Regulating agreements between subcontractors and contractors

COMMITTEE: Business and Industry — favorable, without amendment

VOTE: 7 ayes — Brimer, Dukes, Corte, J. Davis, Elkins, Solomons, Woolley

0 nays

1 present, not voting — George

1 absent — Giddings

WITNESSES: For — A.R. Armstrong; Mackie Bounds, Texas Construction Association; Paul Odom, P and S Masonry, Inc.; Evelyn J. Page; J. Michael Reed, J.M. Reed Plumbing Company; Thomas J. Walthall, Jr.

Against — None

On — George C. Baldwin, Bob Fretz, Jr., Texas Building Branch-AGC; Robert “Buddie” V. Barnes, Jr., Robert Baylis, Associated General Contractors of America; Robert Bass

BACKGROUND: A contingency payment clause in a construction contract stipulates that the general contractor’s obligation to pay the subcontractor is contingent upon the receipt of payment from the property owner who employed the contractor. There are two type of contingency clauses — paid-when-paid and paid-if-paid.

A paid-when-paid clause states that a general contractor will pay a subcontractor when the general contractor is paid by the owner. This implies that a debt obligation by the general contractor will be paid to the subcontractor in the future. Most subcontractors accept paid-when-paid clauses as a common business practice.

A paid-if-paid clause allows a general contractor to pay a subcontractor only if the general contractor is paid by the owner. Although Texas courts have not yet made a determination, some people in the construction industry believe that a paid-if-paid clause only creates an obligation of debt by the general contractor if and when he is paid by the owner.

**DIGEST:** HB 2311 would add Business and Commerce Code, sec. 35.521 to create the Subcontractor's Right to be Paid Act. The bill would void any provision in a contract or other agreement that made payment of a subcontractor for work performed or materials furnished contingent on the original contractor's receipt of payment from another person, including the owner for whom the improvement (construction, remodeling, or repair) was made. Under this legislation, a person could not waive this provision by contract or other means, and a purported waiver of the provision would be void.

The bill would take effect September 1, 2001, and would apply only to a contract or agreement entered into on or after that date. A contract or agreement entered into prior to September 1 would be governed by the law in effect when that contract or agreement was entered into, and the former law would be continued in effect for that purpose.

**SUPPORTERS SAY:** HB 2311 would give subcontractors the right to get paid for their work. Contingency clauses often prevent subcontractors from being compensated for reasons that have nothing to do with the quality of their work. Subcontractors, however, have to pay their employees and suppliers regardless of whether the subcontractor is paid or not. Large subcontractors have the clout to negotiate contracts to their advantage, while smaller subcontractors often feel as though contingency contracts are forced upon them.

Many in the industry believe that by agreeing to a contingent payment clause, a subcontractor waives any contractual right to sue the general contractor for nonpayment. As a result, subcontractors may not receive payment for the work they perform or materials they provide. HB 2311 would eliminate this possibility by voiding any contract between a general contractor and a subcontractor that contained a contingency clause.

**OPPONENTS SAY:** HB 2311 would require general contractors to pay subcontractors even when the former have not been paid by owners. This would put general contractors in the unintended role of being financiers. As a standard rule, contingency clauses are negotiated into construction contracts. The Legislature should not interfere in the contracting process.

OTHER  
OPPONENTS  
SAY:

Small subcontractors do not exercise much leverage and therefore face the greatest risks under contingency clauses. The Legislature should create a limit on contingency contracts up to \$50,000 in order to protect small “mom and pop” subcontractors, but allow larger subcontractors to negotiate their own terms.

NOTES:

The companion bill, SB 1067 by Harris, was referred to the Business and Commerce Committee on March 6.

A related bill, HB 3122 by Ritter, which involves prompt payment requirements for work performed by contractors and subcontractors on certain real property, is pending in the Business and Industry Committee.