

## CONSTRUCTION

# CONFLICTING CONTRACT CLAUSES CAN CAUSE CATASTROPHE

In Florida, pay-if-paid clauses that shift the risk of the owner non-payment from the prime contractor to the subcontractors are enforceable. In *International Engineering Services, Inc. v. Scherer Const. & Engineering of Cent. Florida, LLC*, 74 So.3d 531 (Fla. 5th DCA 2011), the court considered a subcontract that contained a clear and enforceable pay-if-paid clause. However, the subcontract also contained another standard clause: a flow-down provision that incorporated the terms of the prime contract into the subcontract. The prime contract provided that the owner was not obligated to make final payment to the prime contractor until the prime contractor had fully paid all of its subcontractors. This created a classic Catch-22 scenario: no subcontractor was entitled to be paid until the prime contractor was paid, but the prime contractor was not entitled to be paid until all subcontractors were paid. The Florida Court of Appeal held that this created an ambiguity that was sufficient to render the pay-if-paid clause unenforceable.

An identical result was reached by the Missouri Court of Appeals in *MECO Systems, Inc. v. Dancing Bear Entertainment, Inc.* 42 S.W.3d 794 (2001). There, the prime contract was an American Institute of Architects (AIA) standard form, and required the prime contractor to certify, with each payment application, that all subcontractors had been paid. In the absence of such a certification, the prime contractor was not entitled to payment. As with the Florida court, Missouri's Court of Appeals found that the conflicting provisions in the prime contract, which were incorporated into the subcontract, rendered the subcontract's pay-if-paid clause ambiguous and unenforceable.

It is fair to consider these opinions as yet another manifestation of judicial hostility towards pay-if-paid clauses. Certainly, contractors can expect the courts to look for ways to invalidate such clauses, even in states like Florida that are relatively generous with freedom of contract considerations. The opinions also demonstrate the importance of adapting subcontract language where necessary to conform with the prime contract.

In these cases, it is clear that no one in the prime contractor's office sat down with a copy of the prime contract and noted its payment procedures before they entered into their standard form subcontracts. As a result, the prime contractors set up a Catch-22 that, ultimately, they were penalized for.

These opinions also highlight the importance of carefully drafted order of precedence clauses in subcontracts. It is an open question whether the Florida Court of Appeal would have reached the same conclusion if the subcontract had a clause that simply stated, "Whenever the terms of this Subcontract are inconsistent with any term of the Prime Contract, the terms of this Subcontract shall prevail and take precedence over the terms of the Prime Contract." In such a circumstance, the Florida Court of Appeal would have had to think long and hard about how to use a term from the prime contract to make the subcontract ambiguous and invalidate the pay-if-paid clause.



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The subcontracts in MECO Systems contained order of precedence clauses that provided that the subcontract governed over any inconsistent terms in the prime contract. The Missouri Court of Appeals rejected the prime contractor's argument that this order of precedence clause resolved any ambiguity caused by the prime contract. The court noted that the prime contract had its own order of precedence clause, which provided that, "If anything in the other Contract Documents is inconsistent with this Agreement, this Agreement shall govern." The court found that, because the subcontract's flow-down provisions incorporated the prime contract's order of precedence clause, the subcontract remained ambiguous despite having its own order of precedence clause because of the two order of precedence clauses were in conflict.

The problem with the Missouri court's analysis is that the AIA standard form prime contract defines the term "Contract Documents," and the definition does not include subcontracts. Ergo, the prime contract's order of precedence clause has no application to the subcontract. It is unclear from the court's opinion whether this issue was ever brought to the court's attention, and the opinion discloses that there were substantial deficiencies in the briefs submitted by the prime contractor during the appeal. It may be that a subcontractual order of precedence clause that expressly states that it takes precedence over the prime contract's order of precedence clause would be effective to resolve this ambiguity. It may also be that in Missouri, subcontracts should exclude the prime contract's order of precedence clause from the flow-down provision.

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