

# Virginia's Ban on Pay-if-Paid Contracts: What it is and What to Do

## Pay-if-Paid

“Payment from Owner for Subcontractor’s work shall be an express condition precedent to Contractor’s obligation to pay Subcontractor.”

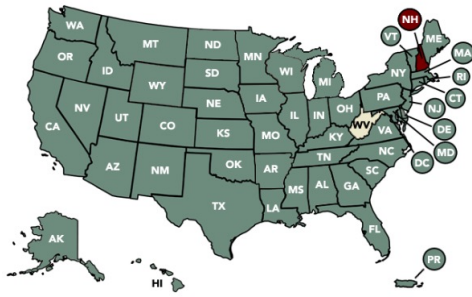
## Pay-When-Paid

“Contractor shall pay Subcontractor upon receipt of payment from Owner for Subcontractor’s work.”

Pay-if-Paid	Pay-When-Paid
<ul style="list-style-type: none"><li>• The <i>entire</i> risk of Owner non-payment shifts to subcontractor.</li><li>• The <i>entire</i> risk of certain kinds of change order requests shifts to subcontractor.</li></ul>	<ul style="list-style-type: none"><li>• Contractor gets a “reasonable time” to pay Subcontractor interest-free if Owner fails to pay.</li><li>• Contractor can float change order disputes until the end of the project interest-free.</li></ul>

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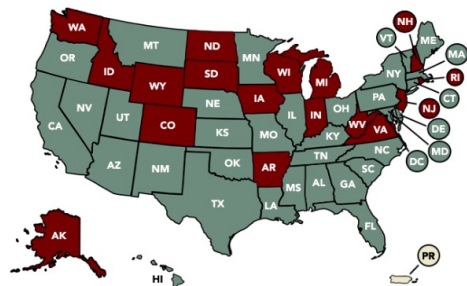
Prompt Pay: Public



Everyone but New Hampshire

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Prompt Pay: Private



Alaska, Washington, Idaho, Wyoming,  
Colorado, Nebraska, South Dakota, Iowa,  
Arkansas, Wisconsin, Michigan, Indiana,  
West Virginia, New Jersey, Rhode Island,  
New Hampshire

### Virginia's Old Law for Public Contracts (Virginia Code Section 2.2-4354)

- Contractor must pay subcontractor within 7 days of receipt of payment from government.

OR

- Contractor must notify government that it is withholding payment from subcontractor and the reason for withholding.

### Virginia's Old Law for Private Contracts

## Changes to the Law Effective January 1, 2023 (SB 550)

- General Assembly overhauls the public contracts prompt payment act, and creates a prompt payment act for most private construction contracts.
- Surprising change—effective lobbying by various subcontractors and subcontractor groups.

## Virginia's New Law for Public Contracts (Virginia Code Section 2.2-4354)

- Contractor liable for the “entire amount owed to any subcontractor with which it contracts.
- Same 7 day pay or notify requirement.
- Must be incorporated down the chain.

### Changes to Public Contracts: Where Does it Matter?

Hypothetical 1: Contractor hires subcontractor on a public project. Subcontractor performs \$100,000.00 of work. Commonwealth pays \$50,000.00, then fires Contractor.

Old Law:

- All else equal, Contractor pays subcontractor \$50,000.00. If the Contractor has a strong contract—that's it.

### Changes to Public Contracts: Where Does it Matter?

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New Law:

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### Changes to Public Contracts: Where Does it Matter?

Hypothetical 2: Contractor hires Subcontractor on a public project. Subcontractor is delayed and incurs \$100,000.00 in extra costs to complete the work. The Government, Contractor, and Subcontractor cannot agree on who caused the delay. Subcontractor and Contractor ask Government for a change order, Government says no.

#### Old Law:

- Contractor makes Subcontractor float the cost until the project is over. Subcontractor is forced to sue. If Subcontractor is right, it gets \$100,000.00 but no pre judgment interest.

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### Virginia's New Law for Private Contracts (Virginia Code Section 11-4.6)

- “Owner” must pay General Contractor within 60 days of completion of work and invoice.
- To backcharge, Owner must notify General Contractor in writing with “reasonable specificity” of:
  - Intent to withhold
  - Amount of withholding
  - Reason for withholding

### Virginia's New Law for Private Contracts (Virginia Code Section 11-4.6)

- Higher-tier contractor must pay lower-tier contractor within the *earlier* of:
  - 60 days after satisfactory completion of the work and invoice; or
  - 7 days after higher-tier entity pays
- If higher-tier contractor wants to backcharge, it must give written notice to the lower-tier contractor within the applicable 7 or 60 days period. The notice must:
  - State the amount of the backcharge
  - State the reason for the backcharge
  - “specifically identify the contractual noncompliance”



### Changes to Private Contracts: Where does it matter?

Hypothetical 1: Contractor hires Subcontractor on a private project.  
Subcontractor does \$100,000.00 of work, but Owner wont pay.

Old Law:

All else equal, Subcontractor does not get paid.

### Changes to Private Contracts: Where does it matter?

Hypothetical 1: Contractor hires Subcontractor on a private project.  
Subcontractor does \$100,000.00 of work, but Owner wont pay.

New Law:

All else equal, Subcontractor gets paid. If Contractor does not pay  
Subcontractor, Subcontractor gets interest.

### Changes to Private Contracts: Where does it matter?

Hypothetical 2: Contractor hires Subcontractor on a private project. Subcontractor is delayed and incurs \$100,000.00 in extra costs to complete the work. The Owner, Contractor, and Subcontractor cannot agree on who caused the delay. Subcontractor and Contractor ask Owner for a change order, Owner says no.

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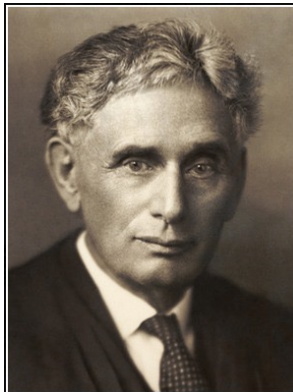
New Law:

All else equal, if Subcontractor is right, Subcontractor gets paid \$100,000.00.

## Exceptions

- Supplier Contracts
- Owner insolvency or bankruptcy

## The Gray Areas



There is no great writing, only great rewriting.

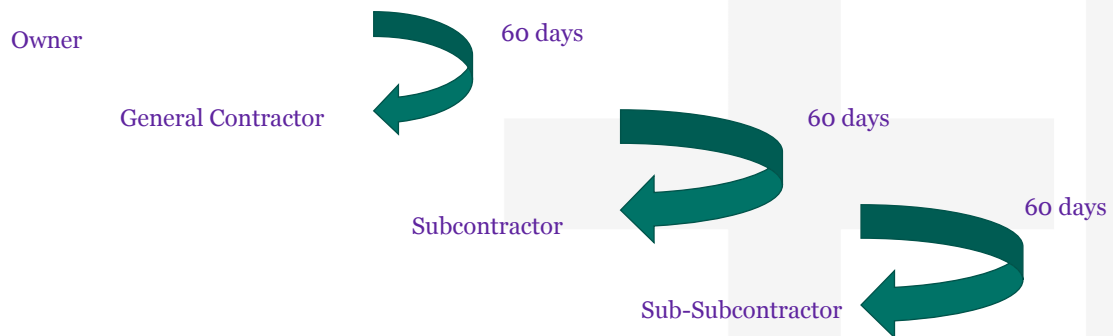
— *Louis D. Brandeis* —

AZ QUOTES

### The Gray Areas

- Choice of law in another state for Virginia project
- Incorporation of prime contract
- Unknown costs at time of notice
- Timing gap

### Gray Areas: The Timing Gap



### Gray Areas: The Timing Gap

- Sub-sub submits pay app on day 1.
- Sub submits pay app on day 15.
- Contractor submits pay app on day 30.
- Sub must pay sub-sub by day 61.
- Contractor must pay sub by day 75.

### Problems Specific to Project Accounting

- General theme: Higher-tier contractor better be right. Higher-tier contractor will be responsible to:
  - Pay certain change orders/interest that get denied by owner
  - Pay subs more than before if higher-tier contractor breaches
  - Be responsible for interest at different rates through the chain of contracts.

## How to Mitigate Risks (This is not legal advice specific to you, please don't sue me)

## Operational Best Practices: An Ounce of Prevention is Worth a Pound of Cure

1. Read the contract. Do what it says.
2. Document, document, document (and organize, organize, organize).
3. Proactive project accounting.
4. Get it in writing.
5. Break-up milestones.
6. Never miss a lien waiver.

## Operational Best Practices: An Ounce of Prevention is Worth a Pound of Cure

### Biggest Risk: The Notice Requirements

- Absolutely crucial reliance on PMs, Superintendents, and subcontractors. 7 days is not a lot of time.
- Train folks in the field, have forms ready, implement tracking system.

## Stuff They Don't Teach in Law School

- The only way to completely avoid this law (maybe) is to choose another state's law for your contracts. This is only going to work sometimes.
- How else can you mitigate in your contracts?
  1. Pretend to be the Government.
  2. Pretend to be the IRS.
  3. Centralize information.

### Strategy 1: Pretend to be the Government

Channel your inner bureaucrat:

“Contractor must issue any backcharge to Subcontractor within the later of 7 days of receipt of payment from Owner, or 60 days of Subcontractor’s invoice. In the event that Subcontractor disputes the backcharge, Subcontractor must submit a written Dispute of Claim to Contractor within 3 days. The Dispute of Claim must be titled “Dispute of Claim,” and must specifically describe and document Subcontractor’s reasons for opposing the backcharge.”

### Strategy 1: Pretend to be the Government

1. Change orders must be approved before work begins.
2. Delay claims must be made within 3 days of the onset of the delay.
3. Claims for money must be made within x days of the onset of the claim and Subcontractor can’t get more than that.



### Strategy 2: Pretend to be the IRS

- Very specific forms to very specific people with very specific labels.
- Specify what happens if you don't get the right form.

### Strategy 3: Centralize Information

- The number one thing you can do in a construction dispute: be organized.
- Someone needs to know the whole story on each project. If you get caught sleeping, it's going to hurt.
  - Daily reports
  - Weekly progress meetings

Questions?