

Practice Update

REMINDER: Starting January 1, 2023, Virginia Will Prohibit Pay-If-Paid Clauses and Limit Pay-When-Paid Clauses

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As explained in a prior [update](#), Virginia recently enacted laws prohibiting pay-if-paid clauses in construction contracts and limiting the effectiveness of pay-when-paid clauses in certain agreements for public and private construction projects. The restrictions included in Virginia Code §§ 2.2-4354 and 11-4.6 will go into effect on **January 1, 2023**.

Pay-if-paid clauses generally provide that a construction contractor will pay the subcontractor only *if* it receives funds from the owner. If the owner fails to pay the contractor, the contractor will never have an obligation to pay the subcontractor. A pay-when-paid clause, on the other hand, provides that the general contractor will make payment to the subcontractor *when* it has received payment from the owner. While they sound similar, many courts have held that pay-when-paid clauses only allow the contractor a reasonable time to delay payment to the subcontractor, because the owner's payment to the contractor is not a true condition precedent to the contractor's obligation to pay the subcontractor.

For decades, Virginia approved of such pay-if-paid and pay-when-paid clauses in construction contracts. *See Galloway Corp. v. S.B. Ballard Constr. Co.*, 250 Va. 493, 464 S.E.2d 349 (Va. 1995); *W. O. Grubb Steel Erection, Inc. v. 515 Granby, LLC*, 2009

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WL 8618873 (Va. Cir. Ct. 2009). Virginia's new law will prohibit these pay-if-paid clauses and limit the effectiveness of pay-when-paid language.

On private construction projects, the new laws render unenforceable any provision in a subcontract providing that payment from a higher-tier party is a condition precedent to the contractor's obligation to make payment to the subcontractor. As for pay-when-paid clauses, the new laws require a contractor to pay a subcontractor within the earlier of (a) 60 days of the satisfactory completion of the work for which the subcontractor has invoiced, or (b) seven days after receipt of amounts paid by the owner to the general contractor or by the higher-tier contractor to the lower-tier contractor for work performed by a subcontractor.

The new laws do not prohibit retainage provisions, but if a contractor withholds some or all of the amount invoiced by a subcontractor, it must notify the subcontractor in writing of the withholding, with the reason for nonpayment and the amount being withheld. The laws also require project owners to pay the general contractor within 60 days of receipt of an invoice following satisfactory completion of the work for which the general contractor has invoiced. Owners may also withhold amounts when permitted by the prime contract, but the owner must notify the general contractor in writing of the withholding and the reason for nonpayment. Failure to comply may result in interest penalties under Virginia law.

With respect to public projects, a separate law similarly makes unenforceable any provision providing that payment from a higher-tier party is a condition precedent to the contractor's obligation to make payment to the subcontractor, but it does not limit the use of pay-when-paid clauses. Note though that the Virginia Public Procurement Act already requires a contractor, within seven days of payment from the government, to either make payment to subcontractors or notify them of the withholding and the reasons for withholding.

These new laws create additional risk for general contractors related to non-payment by an owner, in that the general contractor no longer has the option of shifting such payment risks to a subcontractor with a strict pay-if-paid clause, or delaying payment to the subcontractor under a pay-when-paid provision. Fortunately, the law does include exceptions on private projects if the owner is insolvent or a debtor in bankruptcy. Additionally, contractors may include payment terms in subcontracts establishing that no amount is “due” until the owner approves the amount. General contractors on projects in Virginia may consider modifying their subcontracts to account for this change in law. Owners should also ensure that prime contracts provide for a payment cycle that is consistent with Virginia law. All of changes become effective, and apply to construction contracts executed on or after January 1, 2023.

Akerman construction attorneys can assist with understanding and navigating these amendments to Virginia law.

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