

Pay-if-Paid Clauses: Still Alive in Nevada

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In a time of economic turmoil, the issue of which party bears the risk of owner insolvency or non-payment is a hot issue. In Nevada, contractors can still pass this risk downstream. With an initial decision in June and a revised opinion in October, the Nevada Supreme Court indicated that pay-if-paid clauses are valid in Nevada in the *Lehrer McGovern Bovis, Inc. v. Bullock Insulation, Inc.* case.

The case arose from a subcontractor's claim for payment on the Venetian project in Las Vegas. A subcontractor filed a lien claim and then sued to recover amounts owed. The owner and general contractor asserted that a prospective lien waiver and a pay-if-paid provision in the subcontract agreement barred the subcontractor's claim.

The subcontract agreement incorporated a provision from the prime contract through which the subcontractor effectively contracted "not [to] suffer or permit any lien or other encumbrance to be filed' against the project." The subcontract agreement also contained a pay-if-paid clause where the subcontractor agreed that it had no right to payment against the general contractor unless the owner paid the general contractor for work performed by the subcontractor.

The court refused to enforce the prospective lien waiver and noted that, as drafted, the "lien waiver provision applies regardless of whether [subcontractor] received any payment," and therefore concluded that "such provision violates public policy, as it fails to secure payment for [subcontractor]."

In the initial opinion, the court held that the pay-if-paid provision in the subcontract agreement was unenforceable because "a pay-if-paid provision limits a subcontractor's ability to be paid for work already performed," and therefore "such a provision impairs the subcontractor's statutory right to place a mechanic's lien on the construction project." This language caused many to opine that pay-if-paid clauses were effectively unenforceable in Nevada.

In the revised opinion, the court clarified, "Pay-if-paid provisions entered into subsequent to the Legislature's amendments [of NRS 624] are enforceable only in limited circumstances and are subject to the restrictions laid out" in NRS Chapter 624. This was a significant restatement of the court's first opinion which noted that "the prompt payment provisions [of NRS 624]... make pay-if-paid provisions unenforceable." Although the court's interpretation of NRS Chapter 624 was dicta and not the issue before the court, the restated decision clarifies

that contractors can use pay-if-paid provisions in their contracts.

The practical effect of the decision does not alter existing Nevada law. As a result of the restated decision, contractors are left with the same rights that they had before the decision: pay-if-paid clauses in construction contracts are enforceable.

The question remaining for contractors is: what are the apparently "limited circumstances" in which the court deems pay-if-paid provisions to be enforceable? The language of the opinion offered no guidance as to why the court read NRS 624 to limit pay-if-paid clauses. NRS 624 itself does not contain any such limiting language. While the risk of a pay-if-paid clause actually violating NRS 624 appears small, the greater issue is that the decision's limiting language may confuse district courts about the enforceability of pay-if-paid provisions. This risk challenges contractors to carefully draft their pay-if-paid clauses to avoid a challenge or determination that the clause violates the provisions of NRS 624.

In addition to the pay-if-paid discussion, the court further determined that the enforceability of a lien waiver clause is a case-by-case determination. The court did not offer guidance as to what types of lien waiver provisions would be enforceable without full payment. The articulated public policy against prospective lien waivers, coupled with NRS 108.2453(1), suggests that without payment in full, mechanic's lien rights cannot be waived.

Lehrer McGovern Bovis, Inc. v. Bullock Insulation, Inc., 197 P.3d 1032 (Nev. October 2008), *withdrawing*, 185 P.3d 1055 (June 12, 2008).

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