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Word to the Wise: Do Not Blindly Sign Pay Applications

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On most construction projects, the general contractor is paid through a pay application process. The pay application is a necessary project control for the benefit of the owner and the various subcontractors. It may, however, be a trap for the unwary employee who signs and submits the pay application.

Most pay applications require the contractor to certify the percentage completed on the project to-date, and to certify that any and all payments to subcontractors reflected on prior pay applications have been made. Employees signing such pay applications must be aware: Such pay applications are a representation to the owner, and if the representations turn out to be false, the employee who signed the pay application may end up personally liable.

A case from the author's experience serves to highlight the issue. Picture the following facts, based on a real case: General Contractor ("GC") agrees to construct a building for owner. GC subcontracts some portion of the work to a seemingly viable subcontractor. Subcontractor in turn obtains materials from a supplier. Over a period of six months, the subcontractor submits pay applications, signed by its accounting manager, who certifies that all required payments to sub-subcontractors and suppliers reflected on prior pay applications have been made. GC in reliance on the pay applications disburses hundreds of thousands of dollars to subcontractor. Subcontractor then goes bankrupt. As it turns out, subcontractor has not made any payments to supplier, who then asserts a six-figure mechanics' lien claim against the owner and GC.

What happens next? The bankruptcy may preclude claims against the subcontractor. The owner and GC may not have any viable defenses to the supplier's mechanic's lien claim. Recognizing that it may be unfairly on the hook, GC carefully examines the pay applications and discovers that all of them were signed and sworn to by the subcontractor's accounting manager. In legal terms, the accounting manager is not a party to the bankruptcy and is not protected by the automatic stay or discharge that may protect the subcontractor itself. GC then sues the accounting manager personally, claiming breach of a trust fund, intentional misrepresentation, and fraudulent misrepresentation.

Believe it or not, the accounting manager in this circumstance may have personal liability. Why? Because the accounting manager did not verify that the company had in fact made the necessary payments, but made representations to the GC that such payments had been made. In that

circumstance, the accounting manager's personal assets may be on the line, subject only to the willingness and ability of the bankrupt subcontractor to help out, and possibly subject to the bankruptcy court's willingness to allow the subcontractor to help out. This is hardly an enviable position to be in.

Any contractor's employees might be put in a similar difficult position if they are signing verifications without verifying the actual truth of the underlying statements.

Practical Pointers

How can you avoid this potential trap? It is very simple. Do not sign any verifications or certifications unless you have actually verified the underlying facts. Do not assume that the accounting department has made the payment. Consider calling sub-subcontractors or suppliers to verify that they have been paid.

This may seem excessive, but do you want to put your personal assets on the line? The pay application process and the trust fund statute are both meant to ensure that individuals do take the steps necessary to protect the owner or other party making payments and the subcontractors or suppliers who are supposed to be paid. Be aware that there is potentially personal liability associated with failure to properly ensure that payments are made as they should be, and that work is completed as represented.

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