

# Mastering the Ability to Stop Work for Nonpayment



***Published by***

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# Mastering the Ability to Stop Work for Nonpayment

## Introduction

Everyone's heard the safety message, "Stop, drop and roll." It's one of those simple sayings that you're supposed to be able to remember — even if you're on fire! This well-known safety message conveys a simple solution to a pretty dramatic problem.

Wouldn't it be nice in the construction industry if subcontractors could, when not paid on time, just stop work, drop everything and roll away from the project until the progress payment (plus additional costs for stopping work) arrived? Dealing with slow payment is not as simple as "stop, drop and roll," but stopping work for nonpayment can be a critical, effective tool when properly wielded.

Subcontractors may be nervous about proposing the right to stop work in a subcontract agreement. They need not be. Most prime contractors preserve the right to stop work for delayed owner payment. The major model contract documents that deal with the relation between the owner and its prime contractor/construction manager contain provisions dealing with the ability to suspend work, including ConsensusDocs 200 and the American Institute of Architects 201.

Subcontractors should consider incorporating the right to stop work in their written agreements too. The ConsensusDocs Form 750, the AIA A401, and ASA's "Subcontract Addendum," all give the subcontractor the right to stop work with appropriate notice.

In addition, a few state laws provide a bright-line test so subcontractors know precisely when they may stop work for nonpayment, including cases where a subcontract includes a pay-if-paid provision and the owner fails to pay. In other states, incorporating the right to stop work directly into the subcontract documents should make it crystal clear when and how the subcontractor may exercise this right.

Whatever language the subcontractor uses, it should be clear that suspension of work and termination of the subcontract are different things. After all, the subcontractor does not want the contract to terminate if its purpose is to get paid and continue its work!

When a subcontractor's contract negotiations are well conceived, a clearly spelled-out ability to stop work for nonpayment will be the result. In this scenario, a subcontractor has much more leverage with its customer in the unfortunate circumstance that the customer does not pay on time for work the subcontractor properly performed.

## Analysis

Every subcontractor has faced the problem of not being paid for work that was properly performed and invoiced. The question is: "What is the next step?" The logical answer is to suspend work. Although such a step may be the ultimate solution, it may not be as simple as it sounds. Business practices along with common law and statutory law on the subject are evolving.

## ASA Member Concerns

According to the ASA 2015-member needs assessment, 79 percent of those surveyed considered the inability to stop work as either a very serious or somewhat serious issue. This reflects concern over the current practices and contracts that require subcontractors to continue work even when they have not been paid.

## ASA Policy

ASA supports the ability of subcontractors to stop work for nonpayment. All too frequently, prime contractors include clauses in their subcontracts that can make it difficult or increase the risk to a subcontractor from stopping work for nonpayment. ASA also supports efforts to make it clear that subcontractors have a right to stop work for nonpayment and that a timetable is set forth.

## Existing Laws and Trends

Subcontractors' legal rights are determined by both the statutory law which appears in the state and federal code books, and by judge-made law or "common law." Under the common law, construction contract payments generally are due to a subcontractor within a "reasonable time," absent pay-if-paid payment provisions.

If the owner never pays, or pays late, the prime contractor's payment to the subcontractor will still be due within a "reasonable time," absent a pay-if-paid clause. The determination of what is a reasonable time is a question of fact, involving consideration of the situation and intention of the parties and their actual performance of their contractual obligations. In other words, the answer to what constitutes a "reasonable time" will be different in every case.

If the subcontractor can establish that it has a right to be paid within a reasonable time, and that it has not been paid within that time, then the subcontractor may demand adequate assurance of payment and may, if reasonable, stop work until it receives such assurance. The subcontractor does not have to terminate the contract, or sacrifice any of its rights to complete the contract, by stopping work pending receipt of adequate assurance of payment. In fact, if the subcontractor has properly stopped work, then the prime contractor must either provide payment assurance or itself breach the contract. The prime contractor is not free simply to terminate the subcontractor.

The subcontractor's right to stop work pending receipt of adequate assurance of future payment, is at once a source of uncertainty for the subcontractor and a solution to that uncertainty. The subcontractor may stop work only if the breach is material; that is, it is sufficiently serious to warrant this response. A decision either to stop work or to terminate a contract due to nonpayment is risky. If an arbitrator or court should determine that the subcontractor's work stoppage was unwarranted, the subcontractor will have been guilty of material breach

A subcontractor can avoid this risk simply by deciding not to stop work or terminate, choosing instead to continue performance and claim damages for partial breach. But even this course is not entirely risk free because the subcontractor may then be

deemed to have waived its right to treat the late payments as a material breach. The subcontractor's suspension of performance pending receipt of adequate assurance of payment is a less precipitous action than terminating the contract altogether, because it gives the prime contractor an opportunity to cure or correct the problem.

Of course, the foregoing discussion presupposes that the subcontractor has, in fact, a right to be paid by the prime contractor within a reasonable time of submitting an invoice. If a subcontract has contingent payment language, which makes the owner's payment of the prime contractor a condition precedent to the prime contractor's obligation to pay the subcontractor, then the subcontractor has a different problem. Because the subcontractor has no privity of contract with the owner, it may not be able to stop work under ordinary, common-law contract principles, for coercing the owner to make past-due payments. If the prime contractor is not itself inclined to stop work, then the subcontractor may have no choice but to continue performing under its subcontract.

However, prompt pay statutes may give subcontractors the right to stop work when the owner has failed to make a payment. Statutory law not only can serve to alleviate uncertainty by establishing a bright line test for when the subcontractor may safely suspend performance, but also may provide the subcontractor with remedies that are entirely distinct from, or improve upon, common law remedies for nonpayment.

In addition to common law on this important issue, at least four states— Arizona, Montana, New York and Texas—have passed significant laws on the right to stop work for nonpayment.

Since its enactment in 2002, the Arizona law has been considered a model for other states. The ability to stop work for nonpayment is addressed in the Arizona Revised Statutes Title 34-1129.04. The law gives both contractors and subcontractors the right to stop work when payment is not received promptly, without voiding the contract. The law addresses four specific types of nonpayment.

- (1) A contractor may suspend or terminate if the owner fails to make timely payment to the contractor of the amount certified and approved. Under these circumstances, the contractor must give written notice at least seven calendar days before the intended suspension or termination.
- (2) A subcontractor may suspend or terminate if the owner fails to make timely payment of amounts certified and approved for the subcontractor's work and the contractor fails to pay the subcontractor for the certified and approved work. In this case, the subcontractor must give written notice to the contractor and the owner at least three calendar days before work is stopped.
- (3) A subcontractor may suspend or terminate if the owner makes timely payment of amounts certified and approved for the subcontractor's work but the contractor fails to pay the subcontractor for the certified approved work. In this case, the

subcontractor must give written notice to the contractor and the owner at least seven calendar days before stopping work.

- (4) A subcontractor may suspend or terminate if the owner declines to certify the contractor's billing or estimate for that subcontractor's work but the reasons for that failure by the owner to approve and certify are not the fault of or directly related to the subcontractor's work. In this case, the subcontractor must give at least seven calendar days' notice prior to stopping work. The law also provides for demobilization and remobilization.

A contractor or subcontractor that has suspended work is not required to furnish labor, materials, or services until the contractor or subcontractor is paid the amount that was certified and approved, together with any cost incurred. Finally, a contractor or subcontractor cannot be deemed in breach for suspending or terminating a construction contract due to slow payment. The time periods for contractors and subcontractors to suspend or terminate cannot be extended in the construction contract.

The 2002 New York law (Laws of New York, Chapter 127, Article 35-E, § 756-b 2) and the 2003 Montana law (Montana Revised Code §28-2-2103) track the language and intent of the Arizona statute.

The Texas prompt payment law (Texas Property Code § 28.009) provides contractors and subcontractors with the right to suspend work on 10 days' notice, if the owner fails to pay. However, if the contractor unjustifiably delays payment to the subcontractor, then the statute affords no protection of the subcontractor other than its contractual and common law rights.

## Industry Practice

The major model contracts that deal with the relationship between the owner and the prime contractor contain provisions dealing with the ability to suspend work for nonpayment between the owner and the prime contractor.

The ConsensusDocs 200, Standard Agreement Between Owner and Constructor, states:

“9.5 PAYMENT DELAY If for any reason not the fault of Constructor, Constructor does not receive a progress payment from Owner within seven (7) Days after the time such payment is due, then Constructor, upon giving seven (7) Days' written notice to Owner, and without prejudice to and in addition to any other legal remedies, may stop Work until payment of the full amount owing to Constructor has been received, including interest for late payment. If Constructor incurs costs or is delayed resulting from shutdown, delay, and start-up, Constructor may seek an equitable adjustment in the Contract Price or Contract Time under ARTICLE 8.”

The American Institute of Architects 201, General Conditions of the Contract for Construction, states:

“§ 9.7 Failure of Payment If the Architect does not issue a Certificate for Payment, through no fault of the Contractor, within seven days after receipt of the Contractor’s Application for Payment, if the Owner does not pay the Contractor within seven days after the date established in the Contract Documents, the amount certified by the Architect or awarded by binding dispute resolution, then the Contractor may, upon seven additional days’ notice to the Owner and Architect, stop the Work until the payment of the amount owing has been received. The Contract Time shall be extended appropriately and the Contract Sum shall be increased by the amount of the Contractor’s reasonable costs of shutdown, delay and start-up, plus interest as provided for in the Contract Documents.”

The provisions addressing the relationship between the prime contractor and the subcontractor also are addressed in the most frequently used model contract documents.

The ConsensusDocs 750, Standard Agreement Between Constructor and Subcontractor, states:

“8.2.6 PAYMENT DELAY If Constructor has received payment from Owner and if for any reason not the fault of Subcontractor, Subcontractor does not receive a progress payment from Constructor within seven (7) Days after the date such payment is due, as defined in the subsection immediately above, or, if Constructor has failed to pay Subcontractor within a reasonable time for the Subcontract Work satisfactorily performed, Subcontractor, upon given seven (7) Days’ written notice to Constructor, and without prejudice to and in addition to any other legal remedies, may stop work until payment of the full amount owing to Subcontractor has been received. The Subcontract Amount and Time shall be adjusted by the amount of Subcontractor’s reasonable and verified cost of shutdown, delay, and startup, which shall be effected by an appropriate Subcontractor Change Order.”

The AIA A401, Standard Form of Agreement Between Contractor and Subcontractor, states:

“§ 4.8 REMEDIES FOR NONPAYMENT If the Contractor does not pay the Subcontractor through no fault of the Subcontractor, within seven days from the time payment should be made as provided in this Agreement, the Subcontractor may, without prejudice to any other available remedies, upon seven additional days’ notice to the Contractor, stop the Work of this Subcontract until payment of the amount owing has been received. The Subcontract Sum shall, by appropriate Modification, be increased by the amount of the Subcontractor’s reasonable costs of demobilization, delay, and remobilization.”

The ASA “Subcontract Addendum,” part of the ASA [Subcontract Document Suite](#), states:

“Should Subcontractor’s payment be delayed because (a) Customer fails to receive timely payment of amounts certified and approved, or (b) Customer fails to make timely payment after itself receiving payment for Subcontractor’s work, or (c) because Customer’s payments are not received by Customer for reasons not the fault of or directly related to Subcontractor’s work, then Subcontractor may suspend work after giving at least seven (7) days written notice to Customer of the intent to suspend and the date of intended suspension. Should Subcontractor’s work be thereafter suspended for at least twenty-one (21) days, Subcontractor may terminate this subcontract upon written notice of termination to Customer.”

The ASA “Subcontract Addendum” also provides for reimbursement of the cost of suspension, including demobilization and remobilization.

The fact that these model documents include the right to suspend work is indicative of the best practices in the construction industry. Given the state of statutory and common law, clear and unequivocal contract language is advisable for a subcontractor to exercise the right to suspend work for nonpayment on a project.

## Protecting Your Business

The right to stop work for nonpayment is one of the most important rights a subcontractor can have to assure prompt pay. Many courts believe failure to pay is not a material breach of contract. In addition, the right to stop work should be distinguished from the right to terminate the contract. The prime contractor shouldn’t be able to replace the subcontractor who hasn’t been paid because the subcontractor stopped work and left the project. The subcontractor must still have the beneficial right to enforce all the terms of the contract, subject to the subcontractor’s right to stop work, or the subcontractor might never be paid. Replacement of the subcontractor would defeat the very purpose of prompt pay laws.

Subcontractors sometimes hear from their lawyers that the prime contractor’s failure to make progress payments may not be a material breach of contract, as would justify them to stop work. Subcontractors are told to borrow working capital against their accounts receivable until payment arrives. One major flaw in that reasoning is that the bankers are reluctant to lend against accounts receivable that are over 90 days old. Who can blame them? Even if the loans were available such loans put subcontractors in the position of financing the investment portfolio of the owner or the prime contractor.

Prime contractors find themselves in the same “Catch 22” when the owner doesn’t pay. Should the prime contractor keep working, and keep the subcontractors on the job by evading or paltering in response to, subcontractor inquiries about payment?

With these considerations in mind, there are five key elements to a statutory right to stop work for nonpayment detailed below.

### **(1) Right of Prime Contractor to Stop Work for Lack of Payment**

The prime contractor must have the right to suspend performance or terminate the contract for failure of the owner to make timely payment. Then the prime contractor isn't forced into delayed payment fraud, by a situation in which it must string the subcontractors along.

### **(2) Right of Subcontractor to Stop Work for Lack of Payment by Owner**

A subcontractor must also have the right to stop work or terminate the contract if the owner fails to make payment to the prime contractor for the subcontractor's work. Here, the required notice period should be very short (e.g. three days). For one thing, the owner already knows that it hasn't paid the bills; additional notice is hardly necessary. Furthermore, the subcontractor will have already committed too many resources without payment. Consider the time that has passed: the time from the completion of the items in the subcontractor's invoice to the prime contractor, to the time of the prime contractor's invoice to the owner, and the time from then to the deadline for payment by the owner to the prime contractor. The time for the prime contractor to pay the subcontractor also will have passed. The owner will have known for at least a week that its payment was overdue. By allowing work to continue long after the owner saw the problem coming, the owner basically has been defrauding the prime contractor and the subcontractors. It's no surprise to the owner that the subcontractors haven't been paid, and the subcontractors are already substantially out-of-pocket. The right to give notice on Friday, and suspend on Monday, is completely reasonable, and necessary.

### **(3) Right of Subcontractor to Stop Work for Lack of Payment by the Prime Contractor**

When the owner has paid the prime contractor for work performed and materials delivered by a subcontractor, the subcontractor should be able to force payment by the prime contractor. Thus, on written notice to the owner and the prime contractor, the subcontractor must have the right to stop work, without breaching the contract, when the prime contractor fails to make payment to the subcontractor within seven days after its receipt of payment from the owner.

### **(4) Right of Subcontractor to Stop Work When Payment is Held Up by Failure of Another Subcontractor**

Too often, the prime contractor has an incentive to delay and deny payment to all subcontractors, so that the price of remedying the defective or incomplete work can be extracted from the subcontractors who performed properly. When the prime contractor can get away with delayed payment, then the prime contractor's incentive to select capable subcontractors on bid day is diminished. Moreover, all the subcontractors should consider the risk that their payments will be tied to the work of an incompetent subcontractor when determining the price to bid.



For that reason, if the owner declines to approve and certify portions of the prime contractor's billing for the work of a subcontractor, the prime contractor should pay those subcontractors who are not at fault, notwithstanding lack of payment from the owner. If the prime contractor declines to live up to its obligations, and instead pursues a strategy of delayed payment to recover the losses caused by its failure to select responsible bidders, then the subcontractors who have not been paid, through no fault of their own, must have the right to stop work on written notice to the prime contractor and to the owner.

#### **(5) Right to De-mobilization and Re-mobilization Costs**

Suspension of performance has costs of its own. For example, continued rental costs for equipment must be considered when suspending performance. Does the subcontractor remove a huge scaffolding from the inside of a building, assembled for painting a domed ceiling, when rent must be paid on the scaffold? Who pays to take it down? Who pays to renew the lease and re-assembly of the scaffold when work is resumed? The costs to de-mobilize, and to re-mobilize, have the potential to completely frustrate the right to stop work, rendering it functionally valueless. Consequently, the subcontractor must not be required to return to work, after suspending performance, unless paid these costs in addition to the unpaid progress payments.

These rights currently rarely are guaranteed by statute but instead are subject to contract language and the interpretation of the courts. Subcontractors must be consistent and deliberate in their approach to contract language to protect their right to stop work for nonpayment.

Only by a combination of consistent business practices, sound contract language and statutory law, where applicable, can a subcontractor protect its right to stop work for nonpayment.

#### **Conclusion**

A subcontractor must clearly establish the right to stop work for nonpayment. This is especially true when dealing with the potential inconsistencies in common law. Given the fact that most prime contractors will assure that the ability to suspend work is accorded them by the owner before any work begins, a subcontractor should consider insisting on the same rights and considerations. The delivery of work on time, a sound subcontract, and good business practices may not be enough. The need and the emerging trend for a clear statutory remedy to this long-standing issue are apparent.