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FISCAL IMPACT REPORT

ORIGINAL DATE 2/23/2007

SPONSOR Cisneros LAST UPDATED _____ HB _____

SHORT TITLE Prohibit Certain Contract Agreements SB 641

ANALYST Schuss

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY07	FY08		
	NFI		

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Regulation and Licensing Department (RLD)
 Administrative Office of the Courts (AOC)
 Attorney General's Office (AGO)

SUMMARY

Synopsis of Bill

Senate Bill 641 would provide that *“Payment by the owner to a contractor shall not be a condition precedent for payment to a subcontractor, and payment by a contractor to a subcontractor shall not be a condition precedent for payment to any other subcontractor. An agreement to the contrary is void, unenforceable and against the public policy of the state.”*

FISCAL IMPLICATIONS

AOC notes that there will be a minimal administrative cost for statewide update, distribution and documentation of statutory changes. Any additional fiscal impact on the judiciary would be proportional to challenges to the law's prohibition. New laws, amendments to existing laws and new hearings have the potential to increase caseloads in the courts, thus requiring additional resources to handle the increase.

SIGNIFICANT ISSUES

AOC has included the following in their analysis:

Clauses in construction contracts that condition payment to the subcontractor on the general contractor's receipt of payment from the owner are generally referred to as “pay when paid” or “pay if paid” provisions. American courts differ on the enforceability and interpretation of such clauses. There is a distinction to be made between the two types of provisions. As attorneys associated with the International Association of Foundation Drilling explain:

Simply put, the difference between the two clauses is that, under a "pay-if-paid" provision, the subcontractor will be paid only if the general contractor is first paid by the owner, whereas under a "pay-when-paid" provision, the subcontractor will be paid when the contractor is paid by the owner. A pay-if-paid provision creates a condition precedent to the contractor's duty to pay its subcontractor and the risk of an owner's non-payment is shared by the contractor and the subcontractor. With a pay-when-paid clause, the contractor has a duty to pay the subcontractor whether or not the contractor receives payment from the owner, and payment will be due the subcontractor within a reasonable time after the owner should have paid the contractor.

It appears that SB 641 does not draw a distinction between “pay when paid” or “pay if paid” provisions. If it did, and if it permitted “pay when paid” provisions calling for payment to a subcontractor within a reasonable time after the owner should have paid the contractor, it would be more likely to withstand legislative and legal challenge.

According to AGO, presumably the bill would apply to all contracts entered into between private parties and governmental agencies. It does not restrict or define the agreements to which it applies. Its prohibitions are not restricted to construction contracts, even though the bill uses terms commonly found in those contracts.

The bill seems to require payment to subcontractors regardless of whether the primary contractor has received payment from an “owner”. This could be problematic for contractors with insufficient funds available prior to receiving payment themselves. Although the bill appears intended to prevent a primary contractor from granting payment priority to certain subcontractors, it also prohibits subcontractors from withholding payment to *their* subcontractors regardless of whether the primary contractor has paid the first subcontractor. This raises the same issue regarding availability and sufficiency of funds.

BS/nt