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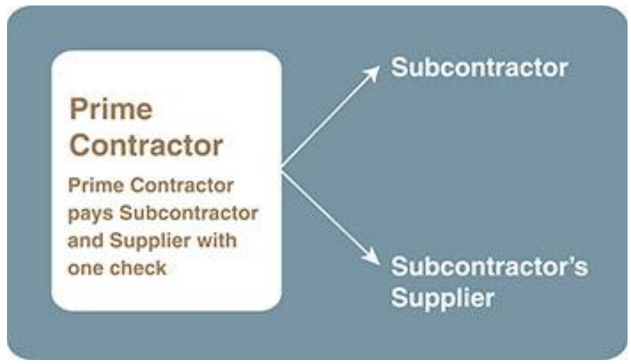
Joint Check Agreements: Take a Second Look



It is hardly news that the economic difficulties this country has faced since 2008 have had a profound effect on the construction industry. Firms that had survived generations have shut their doors for the last time, vital projects have been put on the back burner, and bidding for available work has become staggeringly competitive.

One outcome of the recession likely to last well beyond any recovery is the increased use of joint check agreements. In its simplest terms, a joint check agreement is an agreement between three parties in which one party agrees to make payment to another by issuing checks made payable to two parties. For example, a typical joint check agreement might involve a prime contractor, a subcontractor, and a supplier. As a condition of supplying materials for a project, the supplier may require the prime contractor to issue its payments to the subcontractor by way of checks made jointly payable to the subcontractor and the supplier. This provides the supplier more assurance that payments issued by the prime contractor are received by the supplier. As the financial footing of many firms has become uncertain and tight project budgets have forced contractors to expand their network of subcontractors and suppliers, the use of these agreements has expanded greatly in the past several years.

Despite the apparent simplicity of the joint check arrangement, the language used can have significant consequences. This article examines key issues to consider when crafting a joint check agreement.

NEW CONTRACTUAL RIGHTS

The most significant issue is establishing whether a direct contractual relationship exists with the party issuing the check and the lower-tiered contractor/supplier that is the beneficiary. Courts have been inconsistent in their determinations concerning when joint check arrangements result in enforceable contract rights between the payor and payee. While simply issuing joint checks does not create contractual rights in most instances, some courts have allowed suppliers and subcontractors to maintain lawsuits when payment is not made directly to them by joint check. In these situations, the courts have looked to the joint check agreements to determine whether a contractual right of action was intended. Therefore, the parties should be explicit in any joint check agreement regarding what contractual rights the beneficiary has against the party issuing the checks.

LIEN AND BOND RIGHTS

A joint check agreement's effect on lien and bond rights is another area often overlooked at the time the agreement is executed. From the beneficiary's perspective, protection of those rights is always a primary consideration. Using the example of a prime contractor, subcontractor, and subcontractor's supplier, consider the situation in which the prime contractor issues a joint check for a sum larger than the supplier has actually earned. In that situation, the subcontractor often endorses the check for deposit by the supplier, and the supplier, in turn, remits payment back to the subcontractor in the amount of the balance. This arrangement, while seemingly straightforward, may undermine the supplier's bond or lien rights for later payments, as some courts have held that endorsing a joint check constitutes payment in the full amount of the check, not just the sum actually retained by the supplier. While application of this rule has been inconsistent, before entering into any joint check agreement, it is important to determine how such an agreement will affect lien and bond rights and to structure the agreement and payments in a way that protects all parties.

PAYMENT BOND RIGHTS

Payment bond rights under the Miller Act and its state counterparts should also be considered in drafting joint check agreements. In the area of public construction at the federal level, the Miller Act entitles first- and second-tier contractors and suppliers to assert claims against statutorily required payment bonds. However, the right to assert such claims is not necessarily available to those whose relationship to the prime contractor is more remote than a second-tier subcontractor. Take the situation where a first-tier subcontractor has entered into a joint check agreement with the second-tier subcontractor and its supplier. In such a situation, suppliers have argued that the joint check agreement establishes the necessary contractual proximity for a payment bond claim. Again, the parties should be specific as to exactly what rights are being extended to the beneficiary-and what rights are not. As most states have adopted state-level provisions similar to those contained in the Miller Act (known as little Miller Acts), parties should be conscious of these considerations in both state and federal public works contracting.

LIMITS ON CONTRACTUAL EXPOSURE

Finally, when entering into a joint check agreement, the parties may wish to consider placing limits on the prime contractor's obligation to pay by joint check. Because a joint check agreement necessarily arises in the absence of a direct contractual relationship between the party issuing the joint check and the beneficiary, the issuing party generally has little direct control over the performance and billings of the beneficiary. As such, fixed limitations such as providing a monetary cap or giving the issuer sole discretion as to each joint payment obligation allows some protection for the issuing party, where the alternative may result in potentially unlimited liability to the beneficiary.

While joint check agreements ensure that proper entities receive payment, it is imperative that owners, contractors, subcontractors, and material suppliers have a complete understanding of agreements they enter into and how they will limit or expand their rights.

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