



CONSTRUCTION LAW ALERT

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Joint Checks in the Construction Industry

by Jeffrey S. Wertman, Esq.

Joint checks are commonly used in the construction industry. A joint check, sometimes referred to as a “two party” check, is payable to two parties and for the check to be cashed both parties must endorse the check.

Joint checks are used by owners to ensure that general contractors will pay subcontractors and material suppliers. Owners seek to ensure the payment of subcontractors and suppliers by issuing joint checks, made payable jointly to the general contractor and the subcontractor or material supplier. The owner of a construction project has a fundamental interest in making sure that all subcontractors and suppliers are paid for their work because they may otherwise record mechanic’s liens against the owner’s property.

Typically, a contractor submits an application for payment itemizing the work that was performed by the various subcontractors during that month’s payment period. The owner then issues checks payable jointly to the general contractor and the subcontractors whose work was listed on the application. This arrangement can be advantageous to the subcontractor because it prevents the general contractor from using these monies to satisfy other obligations.

Joint checks are similarly used to ensure that second tier subcontractors (sub-subcontractors) and material suppliers are paid. This gives general contractors additional insurance that monies dispersed are passed on to the appropriate subcontractor or supplier, thereby reducing the risk that a subcontractor will retain or withhold the payment due to the supplier, and that the supplier will record a mechanic’s lien against the owner’s property or make a claim against the general contractor’s payment bond. The supplier may decide to initiate a joint check arrangement because the subcontractor is in financial trouble, lacks assets or because it has never done business with the subcontractor before.

Although joint checks are common in the construction industry, joint checks may present a number of legal complications. The endorsement of a joint check may create a legal presumption that the co-payee has been paid the full amount of the check, even if the other co-payee has withheld part or all of the funds.

The Joint Check Rule

Under the “joint check rule”, when a joint check is made payable to joint payees (e.g., general contractor and subcontractor, or subcontractor and its sub-subcontractor or material

supplier), in the absence of an agreement as to the allocation of the proceeds of the joint check, the contractor or supplier who endorses the check, is presumed to have received all sums owed to it as of the date the check covers, even though it may have received only part or none of the amounts owed.

A joint check arrangement is designed to protect owners and general contractors by eliminating potential lien claims and protect suppliers and laborers by ensuring payment.¹

Issues Raised By Joint Check Arrangements

Joint check arrangements raise a variety of issues. One issue to consider is whether one of the construction parties can unilaterally institute the joint check arrangement. Without a contractual right, a general contractor cannot unilaterally satisfy its payment obligations by issuing joint checks if the subcontractor or supplier has not agreed to the arrangement. To do so, may be a breach of contract.

Another issue that arises with the use of joint checks is how the joint check proceeds are to be allocated between the payees on the check. It is the duty of the co-payee of the joint check to determine the intention of the issuer of the check as to the allocation of the proceeds of the joint

check. This means that a co-payee of a joint check should obtain an agreement or instructions from the issuer of the check prior to endorsing the check. The existence of a written agreement as to the allocation of the proceeds negates the presumption created by the joint check rule that the co-payee who signs a check has been paid everything up to the date the check is endorsed.

A third issue that arises with joint check arrangements is whether endorsing a joint check operates to release or waive lien rights. Courts have held that the owner or general contractor is protected against liens by anyone named on a joint check, up to the amount of the check, even if they do not obtain waivers of lien.

A further issue to consider is the situation where a joint payee negotiates a joint check without the proper endorsements and then does not pay the other joint payee the proceeds it is owed. For example, a joint payee may forge the other payee's endorsement and wrongfully deposit the check or may successfully submit the check for negotiation without endorsement. If a payee on a joint check wrongfully endorses and cashes a joint check, the issuer of the check may still be liable to pay the party that did not receive any of the proceeds of the check. If a bank accepts a joint check endorsed by only one of the two joint payees, then the bank,

the payor, and the payor's surety (if any) may be liable to the non-signing payee.

Another issue that can arise with joint checks is whether arranging to issue joint checks exposes the general contractor to independent liability to pay lower tier subcontractors and suppliers. It has been held that a general contractor was liable for a subcontractor's obligations to a supplier when it executed a joint check agreement. It has also been held that a joint check agreement between a subcontractor, sub-subcontractor and supplier, coupled with an assurance of payment by the subcontractor, made the subcontractor a guarantor to supply all of the required materials for a project. Careful drafting of the joint check agreement can preclude a contractor or subcontractor from taking on direct contractual obligations.

Finally, joint check arrangements can also raise bankruptcy-related issues. The most common issue is whether a debtor/joint payee has sufficient interest in joint check proceeds to establish a preference claim for payments received within ninety days of the filing of the bankruptcy petition. Other issues involve the handling of joint checks which the bankrupt joint-payee has not yet signed and the treatment of two-party checks issued in satisfaction of pre-petition shipments.

Conclusion

Joint check arrangements are common in the construction industry because they offer many advantages. If you are an owner or a general contractor, issuing joint checks can be an effective way to ensure that a subcontractor or material supplier is paid. If you are a sub-subcontractor or supplier, joint checks can be a form of payment security because they significantly reduce the opportunity for a subcontractor to withhold some or all of money that is due to you. Joint checks, however, can create a multitude of problems. A carefully drafted joint check agreement and an understanding of the legal ramifications that often result from the use of joint checks can help avoid many of these potential issues.

¹The joint check rule is recognized in some, but not all jurisdictions. To avoid the consequences of endorsing a joint check, a subcontractor, sub-subcontractor or materialman may protect itself by refusing to endorse the joint check until assured by escrow or other arrangement that it will recover its rightful share of the check.

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Jeffrey S. Wertman

jwertman@bergersingerman.com
(954) 627-9912

Jeffrey S. Wertman is a member of Berger Singerman's Dispute Resolution Team and Construction Law & Design Practice Team. Jeff focuses his practice in the areas of construction law, construction litigation, construction ADR, and general civil, corporate, commercial and complex litigation in state, federal and appellate courts.



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The Construction Law & Design Practice Team

Berger Singerman's Construction Law & Design Practice Team provides comprehensive legal services encompassing all phases of construction projects including pre-construction contract negotiations, contract performance, and post-contract dispute resolution. Our attorneys have extensive experience representing all parties involved in the design and construction process for owners, developers, general contractors, construction managers, trade contractors, suppliers, consultants, sureties, lenders, investors, and design professionals, including architects, engineers and surveyors. We have assisted clients in a variety of construction projects including office buildings, shopping centers, hotels, condominiums, apartments, condominium conversions, residential and commercial developments and high-end residences.

The Construction Law & Design Practice Team assists our clients to complete construction projects in a timely and cost-effective manner and to assist our clients in economically and successfully resolving claims. Our attorneys are involved with bidding, negotiating and drafting contract documents during the planning and transaction phases of a construction project with an emphasis on proper contract administration, claims procedure compliance, effective risk management and efficient resolution of business disputes. We regularly address legal issues and disputes as they arise during the project. We have substantial experience resolving post-construction claims and disputes through a variety of means including pro-active, dispute-avoidance, alternative dispute resolution and state and federal court litigation.

Business Strategies and Planning; Contract Negotiation and Preparation

We have broad experience in design and construction law, starting in the planning and transaction phases. We regularly provide legal services relating to:

- Business structure: corporation, limited liability company, proprietorship, joint ventures
- Tax planning
- Transfer of ownership
- Site acquisition
- Title insurance issues
- Construction loans and financing
- Zoning and land-use
- Licensing requirements for contractors, architects and engineers
- Bid documents
- Contract negotiation and drafting agreements and documents
- Payment and performance bonds
- Sustainable (green) development, design and construction issues

Environmental, Labor and Employment Law

We provide assistance with local, state and federal regulations governing construction projects, including those pertaining to environmental protection, employee termination, employee discrimination, and non-compete issues.

Dispute Resolution and Litigation

When a negotiated resolution of construction-related disputes cannot be achieved, we have extensive experience and skill in aggressively litigating disputes in both state and federal courts, in the alternative dispute areas of mediation and arbitration, and in administrative hearings. We have successfully represented clients in

construction-related disputes, including:

- Bid protests
- Construction lien claims and foreclosures
- Payment and performance bond claims
- Contract disputes
- Negligence claims
- Scheduling and delay claims
- Construction defect
- Design defect claims
- "Failure to disclose" claims
- Change order disputes
- Extra work disputes
- Scope of work disputes
- Professional malpractice claims
- Water intrusion, indoor air quality and mold claims

Bankruptcy and Workouts

We provide guidance and representation to close out or administer projects involving underfinanced, financially troubled or insolvent parties to resolve issues pertaining to bankruptcy. Our attorneys are well-versed in issues such as the principals' use of contract funds or cash collateral, the assumption and rejection of construction contracts, preference and other avoidance actions, proofs of claim and dischargeability. We have also formulated and negotiated workout agreements with owners/obligees, including financing arrangements, tendering completing contractors and takeovers.

For more information, please feel free to contact:

Michael S. Greene
mgreene@bergersingerman.com
(561) 893-8702

Jeffrey S. Wertman
jwertman@bergersingerman.com
(954) 627-9912