

# Legal Spotlight



## **Joint Check Agreements: Another Important Tool for Sureties and Contractors**

In the May/June issue of *Pipeline*, the Legal Spotlight column focused on an important tool for sureties and contractors: funds administration. In this current issue, the Legal Spotlight focuses on another important tool for sureties and contractors: joint check agreements.

Proper cash flow is the lifeblood of any contractor, indeed, of any construction project. One of the most common tools used by owners, contractors, subcontractors, suppliers, and sureties to ensure proper cash flow on projects is a joint check agreement. Although joint checks are often used in the construction industry to avoid payment problems and credit risks, they are also often misunderstood. This article is intended to shed some light on the subject.

A joint check, also called a two-party check, is a check issued by one party, the payor (generally, the owner or the general contractor), and made payable to two parties, the co-payees (for example, the general contractor and its subcontractor). Under a joint check agreement, an owner or a contractor agrees to issue a check(s), made payable to the party with whom it has a contract and jointly payable to a third-party subcontractor or material supplier. In order for the check to be deposited or cashed, both parties must endorse the check. Using this tool, owners and contractors can ensure that the subs and suppliers are paid for their work or materials; and the owner avoids liens against its property and the contractor avoids payment bond claims, a matter of great interest also to the surety that bonded the contractor.

A surety that issues payment bonds has a profound interest in whether its principal is paying downstream parties. If the surety is uncertain about a proper cash flow to downstream parties from its principal, it may exert control of the flow of project funds to lower-tier subcontractors and suppliers, by requiring a joint check agreement among the owner, contractor, and subcontractors and suppliers.

Some standard form contracts and subcontracts expressly authorize the issuance of joint checks;

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without such authorization, the owner or contractor has no right to issue joint checks. For example, AIA A201-2007, *General Conditions of the Contract for Construction*, at Section 9.5.3, allows the owner to issue joint checks, if the architect withholds certification for payment as a result of the contractor's failure to make payments properly to subcontractors or to lower-tier subcontractors and suppliers.

It is not uncommon for subcontracts to include a provision that allows the general contractor to unilaterally decide to issue a joint check to a subcontractor and its suppliers. It is also common for a lower-tier subcontractor or supplier that does not trust the funds flow from the subcontractor to require the general contractor execute a joint check agreement before the supplier will extend credit to the subcontractor.

Joint check agreements are creatures of contract. The parties to the agreement are typically the check issuer (such as the owner), the party with whom it has a contract (the contractor), and the downstream party that will be the joint-payee on the check (the subcontractor or supplier). There are no standard form joint check agreements, and it is important to understand the terms and conditions, and negotiate them, if necessary, before signing.

Joint check arrangements authorizing such payments should always be memorialized in a written agreement with unambiguous terms. While joint check arrangements are simple in concept, they can be complex in the application. Any party entering into a joint check arrangement should have a knowledgeable attorney represent them in the drafting and/or negotiation of the agreement's terms.

For instance, the agreement between the owner and the contractor may have payment terms that are very different than those in the subcontract or purchase order between the contractor and the subcontractor or supplier. The joint check agreement should address the amount of funds to be paid, when they should be paid, and the conditions by which they should be paid. In order to avoid unintended liabilities, the agreement should include language that the payor—the party writing the check—is not assuming any liabilities to the downstream subcontractor or supplier, except as expressly authorized in the agreement. This is important as the payor now has a direct contractual relationship with the downstream party, and the scope of the payor's liability should be clear.

As a condition to joint check payment, the agreement should require the co-payees to release any claims and lien rights against the payor by the amounts being paid. A payee that attempts to negotiate a joint check without the properly authorized signature of a co-payee may have committed theft by conversion.

All parties to a joint check agreement should be familiar with the "joint check rule," which has been adopted in a number of jurisdictions. Under the joint check rule, absent an agreement concerning the allocation of proceeds, when a lower-tier payee endorses a joint check, he will be deemed to have received all money that is due him, regardless of whether such payment was actually received. The lower-tier payee can protect himself by declining to endorse the joint check until he either receives

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the payment or has taken steps to assure himself that payment will be made.

Joint check arrangements are an effective tool for sureties and contractors (and owners and subcontractors and suppliers) to ensure that downstream parties are paid, minimizing the possibility of liens against the property and of payment bond claims. Joint checks are a valuable risk mitigation tool. Parties on a construction project should carefully draft and negotiate joint check agreements and be familiar with the joint check rule.



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