



CCM+S Newsletter: Getting Paid - Are Promissory Notes Another Empty Promise?

In these tough economic times, the construction, architectural, engineering and land surveying industries have been greatly impacted. Financing that was readily available several months ago is no longer available. Simply put, the constriction of financial lending has made it harder to get paid.

Lenders are being more scrupulous and selective in their lending, so projects are being put on hold, properties are being foreclosed, and owners and developers are going into bankruptcy. These times are particularly difficult for design professionals whose livelihoods are intertwined with this industry, the landscape of which has so drastically changed. This story may sound familiar:

You have provided professional services on a project, but the owner/developer (your client) is three months late on payment. Your client reassures you that he intends to pay you everything you are owed, but he is just waiting for some additional financing to come through. Time continues to pass without your client making any payment and your client is now six months late on payment. As your accounts receivable continue to grow from this project and other projects, you want to put additional pressure on your client to pay. You hear the same story from your client that the lending should come through any day now. However, as a showing of your client's good faith intent to pay you what is owed, your client offers to give you a promissory note for the outstanding balance owed. A promissory note sounds good to you so you cross your fingers and hope that you have just improved your position and increased your chances of getting paid, but have you?

At first glance, one would think that the promissory note has greatly increased the chance of getting paid. However, this promissory note has only forced your client to agree in writing to the outstanding amount owed under the original agreement. While this makes it more difficult for your client to later dispute the outstanding amount, the more important question in today's economy is - How has this promissory note secured payment of the outstanding debt?

In reality, it has done little to actually secure payment. In addition, this tactic may have delayed the inevitable and it may have subordinated your interests to other secured creditors of your client.

The reason that getting a promissory note from your client has done very little to secure payment is that you already have an original written agreement with your client whereby your client agreed to pay you for your services. Your client already breached this original agreement by failing to comply. At the end of the day, all you may have is another empty promise from your client to pay. You are still in a similar position with regard to securing payment as when your client breached the original agreement.

Increase Your Chances of Getting Paid

So how can you increase your chances of getting paid after your client has already breached your original agreement and is now offering to give you a promissory note? Your best option is to accept the promissory note from your client on the condition that the promissory note is secured by an asset, such as the client's real property.



While this is something that you can do after your client has already breached your agreement, there are also affirmative and preventive steps that you can take to increase your chances of getting paid even before your client has breached your agreement, especially in light of the continually changing economic climate.

You Should Consider These Three Simple Tips for Each New Project

Contract with the Landowner. Design professionals often contract with an entity that does not have any ownership interest in the project land where the project is located. You will often see this in projects where you contract with one entity that is developing the project, but another entity with a similar name is the actual entity that owns the land. By contracting with the landowner, it will be easier to comply with the strict statutory lien requirements. You also increase your chances of actually being able to use the land as an asset to secure a debt.

Own your Drawings. Design professionals often enter into contracts, sometimes unknowingly, in which they have transferred all of their rights, title, and interest, including copyrights, in their drawings to the owner. However, maintaining ownership of your drawings can be a tremendous bargaining tool when the owner wants to terminate the contract and hire another design professional to finish the work. If you maintain ownership of your drawings, then you can essentially take your drawings with you off the job. This forces the owner to either pay you what you are owed so he can continue to use your drawings or to hire and pay a new design professional to recreate all of your drawings so as not to violate your copyright in the drawings.

Negotiate and Manage your Contract. Design professionals can better protect themselves by negotiating their contracts so that they contain more favorable provisions to increase their chances of getting paid, such as termination clauses that provide you more leeway to get out of the contract and payment clauses that do not contain any contingencies tied to payment. In addition, design professionals can better manage their contracts by tracking their accounts receivable, demanding payment from the owner, and taking more affirmative steps to collect payment, before the accounts receivable get out of control.

So in these tough economic times when you are owed money under an agreement and you are presented with a promissory note by the owner, always look to secure that promissory note with a physical asset, such as real property. Always remember to: (1) Contract with the Landowner, (2) Own your Drawings, and (3) Negotiate and Manage your Contract. If you remember these tips, then you will not only increase your chances for getting paid, but you will also be able to identify whether that promissory note is just another empty promise or a step in the right direction.

Please contact us at either the South Pasadena or Orange offices to discuss further.

Robert H. Stellwagen, Esq.
1100 El Centro Street
South Pasadena, CA 91030
Phone: (626) 243-1100
Fax: (626) 243-1111
rstellwagen@ccmslaw.com
www.ccmslaw.com

Nothing contained within this article should be considered the rendering of legal advice. Anyone who reads this article should always consult with an attorney before acting on anything contained in this or any other article on legal matters, as facts and circumstances will vary from case to case.