



# Lake County Contractors Association Professional Practice Report

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February, 2005

## Joint Check Agreements

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Joint Checks and Joint Check Agreements are tools that are sometimes utilized in the construction industry. The use of these tools can affect general contractors, subcontractors, sub-subcontractors, and material suppliers. There are benefits that might be available to all of them, and pitfalls they should all be aware of and seek to avoid through the use of Joint Check Agreements.

The major problems with a joint check arises in the very situation in which they are most likely to be used, that involving an impending bankruptcy and subsequent bankruptcy of one of the subcontractors or material suppliers in the tier of those who provide labor or materials for a construction project.

The problem is that under the Bankruptcy Code certain payments made to or for the benefit of a subcontractor's creditors may subsequently be recovered by the Bankruptcy Trustee as a voidable "preference", which means that any joint checks written within 90 days of the date the subcontractor files bankruptcy may be recovered by the Trustee from the subcontractor's creditors, such as a sub-subcontractor or material supplier. If the Bankruptcy Court finds that the bankrupt subcontractor had an "interest" in the money paid, then any monies received by the joint payee from the check would have to be returned to the Trustee.

The Bankruptcy Trustee argues that because a subcontractor was a joint payee on the joint check it has requisite interest. Suppliers and general contractors, on the other hand, contend that the checks were written so that the sub-subcontractor or

material supplier would receive payment for the labor and materials it provided and relinquish lien claim rights in return.

In the absence of a Joint Check Agreement, the Bankruptcy Trustee prevails and the sub-subcontractor's material suppliers must return the money they received from negotiating the joint check to the Trustee even if they had relinquished lien rights in exchange for the joint check. If they still had lien rights, they would be free to assert those even though the general contractor had issued a joint check which was supposed to have covered payment for the labor and materials the sub-subcontractor or material supplier had provided and received lien waivers in exchange. The lien waivers would now fail for failure of consideration because the sub-subcontractor or material supplier gave the releases in consideration for the expectation of receiving the proceeds from negotiation of the joint check.

These pitfalls, however, can be avoided through the use of a Joint Check Agreement indicating clearly that the subcontractor who owes for the sub-subcontractor labor and/or material supplier is named as a payee and receives any funds from negotiating the check, and in fact receives the check itself, as a trustee for the benefit of its sub-subcontractor and/or material suppliers. A joint check agreement should include a specific disclaimer by the subcontractor as to whatever portion of the check, or all of the check if that is the case, is due the sub-subcontractor or material supplier. The agreement should also stipulate that

the subcontractor is named as a payee on the joint check strictly as a trustee of its subcontractors and material suppliers in order that the funds may be remitted to them by the joint check.

One legal scholar has also suggested the following practice pointers for attorneys when writing joint checks: (1) write the joint check only for amount due supplier, (2) make suppliers party to Joint Check Agreements, (3) define subcontractor duties under Joint Check Agreement, and (4) subcontractor serving as trustee under Joint Check Agreement.

Properly using joint checks and Joint Check Agreements can facilitate completion of a construction project when one of the subcontractors or sub-subcontractors in the contracting tier is in some financial distress. Its use may even allow the subcontractor to overcome financial difficulties, and certainly is a benefit to general contractors and to those sub-subcontractors and material suppliers who need to be paid for the labor and materials they provided. However, just like a lifeboat, one should always check for leaks before getting in.

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