

# CONSTRUCTION LAWLETTER

For Industry Professionals, Owners, Developers, Managers, Trades & Suppliers

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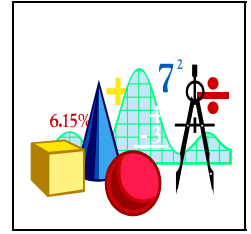
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## “PAY WHEN PAID” CLAUSES IN CONSTRUCTION CONTRACTS

Construction contracts that contain either “Pay When Paid” clauses have been the subject of frequent, heated disagreements, claims and litigation.

This clause makes payment by the Owner to the General Contractor, or from the General Contractor to Subcontractors, or to suppliers, conditioned upon certain events before the obligation to pay. Essentially, it shifts the risk of receiving payment to the recipient, who must wait for a particular happening to trigger payment flowing downstream in the construction industry “foodchain”.

Many states have either legislated against such clauses, or the courts have either dampened the effectiveness or have held such provisions void and unenforceable as against public policy.

The Ohio Supreme Court declined to review the opinion of the Court of Appeals in Power & Pollution Services, Inc. v. Suburban Power Piping Corp. (1991), 74 Ohio App.3d 89, 90: “Ohio courts have not previously addressed the issue of how “pay-when- paid” clauses should be interpreted and enforced.(fn1) However, the Sixth Circuit Court of Appeals dealt with this issue in depth in Thomas J. Dyer Co. v. Bishop Internatl. Eng. Co. (C.A.6, 1962), 303 F.2d 655. In Dyer, the contractor relied on a “pay-when-paid” clause (fn2) in refusing to pay a subcontractor where the owner filed for bankruptcy. The Sixth Circuit Court of Appeals held the clause delayed payment for a “\* \* \* reasonable period of time after the work was completed, during which the general contractor would be afforded the opportunity of procuring from the owner the funds necessary to pay the subcontractor \* \* \*.” Id. at 661. The court reasoned as follows: “In the case before us

we see no reason why the usual credit risk of the owner's insolvency assumed by the general contractor should be transferred from the general contractor to the subcontractor. It seems clear to us under the facts of this case that it was the intention of the parties that the subcontractor would be paid by the general contractor for the labor and materials put into the project. We believe that to be the normal construction of the relationship between the parties. If such was not the intention of the parties it could have been so expressed in unequivocal terms dealing with the possible insolvency of the owner. \* \* \*” Id.

Applying the reasoning of the court in Dyer to the present case, we find the provision in dispute here does not set a condition precedent to the general contractor's duty to pay the subcontractor, but rather constitutes an absolute promise to pay, fixing payment by the owner as a reasonable time for when payment to the subcontractor is to be made. If the parties intended to shift the risk of solvency of the owner to the subcontractor, such intention should have been unambiguously expressed in the contract. \* \* \*

### **MORE CONSTRUCTION HUMOR**

**Apparent Low Bidder** - A contractor who is wondering what he inadvertently omitted.

**Engineer's Preliminary Estimate** - The cost of construction in heaven.

**Project Manager** - The conductor of an orchestra in which every musician is in a different trade association.

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