

The Effects of “Pay When Paid” Clauses

BY RYAN SHARP



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A subcontractor must be mindful of “pay when paid” clauses, or possibly assume the risk that it won’t get paid at all.

It is not uncommon to see subcontracts which include a clause indicating that the subcontractor will not be paid for its work until the contractor has been paid by the project owner. Clearly this can create additional risk for the subcontractor and consideration should be given to such a clause prior to committing to work for the contractor.

These “pay when paid” clauses have been considered several times by courts across the country. The courts have unfortunately failed to reach a consensus regarding the interpretation of such a clause. There have been differing interpretations on this issue.

The first interpretation is that “pay when paid” clauses are simply provisions which speak to the timing of payments from the contractor to its subcontractors.

Favourably for subcontractors, this interpretation is more often the one followed. A leading case for this principle is **Arnoldin Construction & Forms Ltd. v. Alta Surety Co.** (1995). In this case, the subcontractor was partially paid for its work by the contractor, but the contractor refused to pay the balance owed as it had not been paid by the project owner (which had gone into receivership). The court held that in order for a contractor to interpret a “pay when paid” clause to mean “pay only if paid,” the language must be very

clear. Such a drastic interpretation can never be derived from obscure language.

There was no such clarity with respect to the clause in this case, so the subcontractor was entitled to payment under the bond that had been put in place by the contractor. The “pay when paid” clause at issue read: “The balance of the amount of the requisition as approved by the Contractor shall be due to the Subcontractor on or about one day after receipt by the Contractor of payment from the owners”.

Note that if a court finds the wording of the actual “pay when paid” clause to be ambiguous, it will likely rule in favour of the subcontractor over the contractor (as it is typically the contractor who has drafted the contract).

However, a different interpretation suggests that clear “pay when paid” clauses may result in the contractor having no obligation to pay its subcontractors at all if it has not been paid by the owner (i.e. the subcontractor being paid for its work is conditional on the contractor being paid by the owner). It is this possible interpretation that subcontractors should be particularly mindful of prior to signing an agreement with a contractor.

The most cited case interpreted this way is an Ontario Court of Appeal decision, **Timbro Developments Ltd. v. Grimsby Diesel Motors Inc.** (1988), heard by the Ontario Court of Appeal. The court held that the relevant “pay when paid” clause in this case clearly specified the subcontractors’ legal entitlement to payment, and not

merely the timing of the payment, which “will be made not more than thirty (30) days after the submission date or ten (10) days after certification or when we have been paid by the owner, whichever is the later”.

Another, more recent, case considering a “pay when paid” clause is **Voka Steel Inc. v. Edgecon Construction Inc.** (2011). Although there were multiple issues in this case that the court had to consider, it was held that the “pay when paid” clause was clear enough for the contractor to only have to pay the subcontractor once they had been paid by the owner.

In summary, case law suggests that it is difficult for a contractor to enforce “pay when paid” clauses as more than a provision for the timing of payment (i.e. “pay only if paid”). However, in certain circumstances if the contract is sufficiently clear the subcontractor can be left without payment for their work as a result of the owner’s failure to pay the contractor. Ultimately, the proper interpretation of a “pay when paid” clause will depend on the specific language used in the contract.

It is important that subcontractors look out for “pay when paid” clauses in contracts and seek legal advice when necessary to ensure that the clause does not eliminate their entitlement to payment solely because the contractor has not been paid. **CB**

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