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When Must A Subcontractor Be Paid Under A "Pay-When-Paid" Clause?

It is not unusual for a contract between the general contractor and a subcontractor to contain payment terms such as, "All progress payments of the Subcontract Sum shall be made within 10 days after payment is received by the General Contractor from the Owner." But who bears the risk if the owner does not pay? At first glance, one may believe that the general contractor would not have to pay the subcontractor until the general contractor has received payment from the owner for the work completed. A closer reading would, however, reveal that this payment language may actually be a "pay-when-paid" provision, and not "pay-if-paid". There is a significant difference.

Under a "pay-if-paid" clause, the general contractor is required to pay the subcontractor only if the owner pays the general contractor. The condition precedent to the general contractor's obligation to pay the subcontractor is the owner's payment. If the owner does not pay the general contractor, there is no obligation to pay the subcontractor who bears the risk of the owner's non-payment. The use of the word "if" in the payment provision must be undeniably clear and unambiguous evidence of the parties' intention to condition payment to the subcontractor upon receipt of payment from the owner.

Under a "pay-when-paid" clause, there is no condition precedent to the general contractor's obligation to pay the subcontractor. The "pay-when-paid" language is an absolute agreement of the general contractor to pay the subcontractor within a period of time after the general contractor is paid by the owner. The general contractor bears the risk if the owner does not pay. The general contractor has made an unconditional promise to pay with the time of payment postponed until the happening of a certain event, or for a reasonable period of time if the owner's payment does not happen. Such provisions do not absolutely bar payment, but merely delay the payment by the contractor to the subcontractor for only a reasonable period of time to allow the general contractor to attempt to collect payment from the project owner.

What is a "reasonable time" for the general contractor to wait for payment from the owner before paying the subcontractor? One must look to either: (1) other provisions in the contract which set forth time periods for performance of similar acts or (2) determine when a reasonable time has elapsed. In one recent Ohio case, the court held that 30 to 60 days was a reasonable time to wait before payment would be due after the owner had failed to pay the general contractor.

Just remember, a "pay-when-paid" provision does not relieve a general contractor of its obligation to pay a subcontractor after the owner fails to pay the general contractor. If the intent of the general contractor is to not be responsible for the owner's insolvency or refusal to pay, then such intent must be unequivocally expressed in a "pay-if-paid" clause. The contract language must be precise to shift the risk of payment failure by the owner to the subcontractor. Also keep in mind that a written change order authorizing payment for extra work may supersede a pay-if-paid or a pay-when-paid provision.

If the owner is relying on a source of funding for the project, such as a governmental agency, then the general contractor, likewise, must closely review the contract to determine whether it contains a "pay-if-paid" provision. Some states have outlawed the use of pay-if-paid clauses, or limited their applicability. For example, Ohio Revised Code Section 4113.62(E) provides that any construction contract that conditions payment upon the receipt of payment from another person shall not affect a party's right to file a mechanics' lien or a claim against the payment bond. There may be circumstances where the surety must pay a subcontractor money that is not yet due under the pay-if-paid contract provision between the general contractor and the subcontractor; and under these circumstances the general contractor will ultimately have to pay those sums as well, because of the surety's subrogation rights. (*Chapman Excavating Co., Inc. v. Fortney & Weygandt, Inc.* (July 22, 2004), Cuyahoga App. No. 84005, 2004-Ohio-3867.) ■

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Bankers, Analysts Back **New Asian M&A Rules**

Investment bankers and analysts in Shanghai and Hong Kong have shown strong support for the proposed new rules on mergers and acquisitions for mainland publicly traded companies. The new draft rules will boost takeovers in terms of both scale and volume, and will attract more foreign investors to a market currently dominated by domestic players. Competitive acquisition by more than one bidder and anti-acquisition behavior by current controlling shareholders and management, who will now have specific rules to follow, will emerge to make the market more active.

A major change proposed by the new draft rules is that the acquiring party is no longer compelled to make a tender offer to the rest of the target company when the acquirer holds a 30 percent stake and seeks to further increase its holding. The new draft rules would make the full bid offer voluntary. In addition, the acquiring company will be given another alternative under the draft regulations to make a partial bid to the target's remaining shares with the lower limit capped at 5 percent.

The draft rules would for the first time allow acquiring companies to offer stock or assets as payment for the target firm where the payment is structured in terms of a stock or asset swap.

The new draft rules also propose a change to the role of independent financial advisers and other intermediaries; stipulating that it is compulsory to appoint a certified financial adviser when making acquisitions in publicly traded companies. Currently only big domestic brokerages are certified by the CSRC to act as financial advisers.

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