

When the Bill Has to Be Paid By A Date Certain: California Court of Appeal Rules That Pay-When-Paid Provision, Timed Upon Resolution of Prime Contractor's Disputes With Owner, Is Too Expansive Time-Wise and Not Enforceable

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One of the hallmarks of California construction payment law is the rule, arising from the California Supreme Court decision in William R. Clark Corp. v. Safeco Insurance Co. (1997) 115 Cal.4th 882, that a pay-**if**-paid provision in a California construction contract is not enforceable as a defense to a payment claim by a subcontractor (i.e. the prime contractor MUST pay the subcontractor even if the owner fails to pay for the subcontractor's work). However, the courts have generally agreed that a "pay-**when**-paid" clause, based upon a reasonable time provision, is enforceable. The question then has been whether a pay-when-paid provision that calls for the contractor not to pay the subcontractor until it has concluded its pursuit of legal remedies against the owner, is a "reasonable" timeframe for payment to the subcontractor.

In a decision which will likely have significant impacts, the California Court of Appeal, 4th Appellate District, in Crosno Construction, Inc. v. Travelers Casualty and Surety Company of America (2020) Westlaw 1899278 ("Crosno case"), ruled that an "expansive" pay-when-paid provision in a subcontractor contract may not be invoked by the surety for the prime contractor as a defense to a payment bond action.

The facts of the Crosno case are relatively routine. North Edwards Water District (the "District") selected Clark Brothers, Inc. ("Clark") as its general or direct contractor on a public works project to build an arsenic removal water treatment plant. Clark then hired a subcontractor, Crosno Construction ("Crosno") to build and coat two steel reservoir tanks. The Clark-Crosno subcontract contained a "pay-when-paid" provision that stated that Clark would pay Crosno within a reasonable time of receiving payments from the District, but that this reasonable time frame would be measured based on the resolution of the dispute resolution process with the owner. Quoting the subcontract:

“If Owner or other responsible party delays in making any payment to Contractor from which payment to Subcontractor is to be made, Contractor and its sureties shall have a reasonable time to make payment to Subcontractor. ‘Reasonable time’ shall be determined according to the relevant circumstances, but in no event shall be less than the time Contractor and Subcontractor require to pursue to conclusion their legal remedies against

Owner or other responsible party to obtain payment, including (but not limited to) mechanics' lien remedies.”

After Crosno completed most of its work, a dispute arose between the District and Clark which halted the project. Clark sued the District. At the same time, Crosno sought to recover payments owed under the Public Works payment bond that Clark had obtained for the project. Crosno, in pursuing its bond action against the surety, Travelers Casualty and Surety Company of America ("Travelers"), filed a Motion for Summary Judgment, claiming that the pay-when-paid clause impaired Crosno's payment rights, in violation of Civil Code § 8122. The trial court granted summary judgment and entered a judgment in Crosno's favor for the principal amount owed due, plus prejudgment interest.

Travelers appealed.

In its appeal, Travelers asserted that the trial court misconstrued the William R. Clark decision and erred in failing to enforce the pay-when-paid provision against the bond claim. Nevertheless, the Court of Appeal, after considering the parties' arguments, held that the trial court's analysis was sound and affirmed. It bears mention that Travelers argued that upholding the trial court's ruling would effectively make direct contractors and their sureties "financers of public works projects when the owner delays making payment..." To that point, the Court of Appeal acknowledged that there likely will be circumstances where a subcontractor will be paid when the prime contractor was not paid by the owner and commented "that is precisely the point. A payment bond shifts the risk of nonpayment from subcontractors to direct contractors *and their sureties* by affording public works subcontractors the equivalent of a mechanics lien remedy available in private works projects." (emphasis supplied) The Court of Appeal went on to hold that enforcing the pay-when-paid provision found in Crosno's subcontract would postpone Crosno's right to recovery under the payment bond for an "indefinite time period" because the timing was (only) based upon when Clark's litigation against the District concluded. The Court of Appeal ruled that such a result, as sought by Travelers, would unreasonably affect or impair Crosno's statutory payment bond remedies, and was unenforceable for the same reasons expressed in the William R. Clark case.

The Crosno case is important in that it holds that an expansive pay-when-paid clause will not likely be enforceable, and that a defined time period will likely be required.

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