



ALERT

PAY-WHEN-PAID PROVISION IN CONSTRUCTION SUBCONTRACT CANNOT HAVE INDEFINITE TIME PERIOD

Crosno Construction, Inc. v. Travelers Casualty & Surety Co. of America (2020) 47 Cal.App.5th 940

For many years, general contractors liked to use either of two common provisions in their agreements with subcontractors in order to ensure that the generals did not have to pay the subcontractors before receiving payment from the project owners. One form of this provision is a “pay-if-paid” clause: the general contractor is only required to pay the subcontractor *if* the general receives payment from the owner. Since 1997, however, pay-if-paid provisions have been illegal in California construction subcontracts. (*Wm. R. Clarke Corp. v. Safeco Ins. Co.* (1997) 15 Cal.4th 882, 886 “[We conclude that pay if paid provisions like the one at issue here are contrary to the public policy of this state and therefore unenforceable because they effect an impermissible indirect waiver or forfeiture of the subcontractors' constitutionally protected mechanic's lien rights in the event of nonpayment by the owner”].) Shortly after issuance of the *Wm. R. Clarke* decision, an appellate court invoked the same principles to prohibit enforcement of a pay-if-paid provision in a public works project. (*Capitol Steel Fabricators, Inc. v. Mega Construction Co.* (1997) 58 Cal.App.4th 1049, 1061.)

The second type of provision is a “pay-when-paid” clause: the general contractor agrees to pay the subcontractor when the general is paid by the owner. Pay-when-paid provisions can be enforceable so long as they are drafted in a manner providing that, at the latest, the subcontractor will be paid in a “reasonable amount of time” after completing the subcontract work.

In the recent case of *Crosno Construction, Inc. v. Travelers Casualty & Surety Co. of America* (2020) 47 Cal.App.5th 940 (“*Crosno*”), the California Court of Appeal affirmed a trial court’s ruling that the pay-when-paid provision used in the subcontract at issue was unenforceable because it provided the general contractor with the right to delay payment for an indefinite period of time. In *Crosno*, the general contractor (“Contractor”) entered into a contract with a water district (“Owner”) to build an arsenic removal water treatment plant. Contractor entered into the subcontract with Plaintiff Crosno Construction (“Subcontractor”) in which the subject pay-when-paid provision stated that the Contractor would pay Subcontractor within “a reasonable time,” which would be determined by “the relevant circumstances,” but that this reasonable time “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.” (*Id.* at 947.)

Approximately six months into the project, Subcontractor was ordered to stop work because a dispute had arisen between Contractor and Owner. At that point, Subcontractor was owed approximately \$562,000 for the work it had completed. Shortly thereafter, Contractor advised Subcontractor that Owner had terminated its contract and that it could not pay Subcontractor. Thereafter, Subcontractor provided the issuer of Contractor’s payment bond (“Surety”) with a written notice of its claim under the payment bond. Surety rejected the bond claim; it asserted that, under the pay-when-paid provision in the subcontract, no funds were due until Contractor’s then-pending lawsuit against Owner was completed. Subcontractor commenced the action against Surety.

Subcontractor filed a motion for summary judgment against Surety. Subcontractor argued that the pay-when-paid provision was unenforceable because it acted as a waiver of its statutory bond rights

under Civil Code section 8122. (Cal. Civ. Code § 8122 [Stating that contract provision attempting to waive or impair claimant’s bond rights is void and unenforceable].) The trial court granted Subcontractor’s motion, finding that the pay-when-paid provision in the subject subcontract was void because it violated the antiwaiver policies contained in Civil Code section 8122.

Surety appealed the trial court’s order. On appeal, the court framed the issue before it as whether a payment bond surety could rely upon a pay-when-paid provision in a subcontract to delay payment on the bond “until some unspecified point at which litigation between the direct contractor and project owner concludes.” The appellate court agreed with the trial court and found the pay-when-paid provision in the subject subcontract to be unenforceable because it attempted “to define as ‘reasonable’ an indefinite time period already determined to be unreasonable in” a prior appellate decision. (*Id.* at 956 citing *Yamanishi v. Bleily & Collishaw, Inc.* (1972) 29 Cal.App.3d 457.) The appellate court also noted that “the purpose behind the public works payment bond is to provide subcontractors such as Crosno `a quick, reliable and sufficient means of payment.” (*Id.* at 956 citing *Cooley v. Freeman* (1928) 204 Cal. 59, 62.) If Surety was allowed to enforce the pay-when-paid clause as written, it could nullify the bond whenever the general contractor’s litigation with the owner extended beyond the limitations period.

Therefore, pay-when-paid provisions may still be used in subcontracts, but they should be carefully drafted. There is no definitive line on what constitutes a reasonable time and what is an unreasonable time, but the prudent course is to define the outside time period for when the subcontractor will get paid following completion of its work.

If you have any questions or would like further clarification, please feel free to reach out to us.



Author

[Mark V. Isola](#)
T 925.944.9700
msiola@brothersmithlaw.com

BROTHERS SMITH LLP provides its clients, professional advisors and its friends with up-to-date reports on recent developments in business, real estate, employment, estate planning and taxation.

CIRCULAR 230 DISCLOSURE – Pursuant to rules and regulations imposed by the Internal Revenue Service, any tax advice contained in this communication, including any attachments, is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding tax penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another person any transaction or matter addressed herein.

The summary which appears above is reprinted for information purposes only. It is not intended to be and should not be considered legal advice nor substitute for obtaining legal advice from competent, independent, legal counsel. If you would like to discuss these matters in more detail, please feel free to contact us so that we can provide the clarification and resources you need to make effective decisions.



2033 North Main Street, Suite 720
Walnut Creek, California 94596
T 925.944.9700 F 925.944.9701

www.brothersmithlaw.com

