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You say you want an evolution? Pay-when-paid clauses undergo change

By ROSEMARY HAYES Special to Orlando Business Journal



Rosemary Hayes

Contractors, sureties, owners and their lawyers struggle with the effect of construction contract "pay-when-paid" clauses. Pay-when-paid clauses are intended to make payment by a contractor

to its subcontractors and suppliers conditional on the contractor's receipt of payment from the owner.

The purpose of this article is to examine the evolution of this important contract provision, its interaction with related legislation and the possibility of using it successfully in the future.

OBS vs. Pace and its progeny

In 1990, the Florida Supreme Court dealt a blow to general contractors who relied on a pay-when-paid clause to avoid having to pay down its contractual chain to subs and suppliers, absent payment from the owner.

Pace was the general contractor on a bonded project. Pace subcontracted the drywall portion of work to OBS under a subcontract agreement that contained the following language:

"In addition to any other requirements of this subcontract and the contract documents, final payment shall not become due unless and until the following conditions precedent to final payment have been satisfied ... (c) receipt of final payment for subcontractor's work by contractor from owner. ..."

The above language was the contrac-

tor's sole reason for refusing to make payment to OBS.

The Pace subcontract defined the "contract documents" to include the owner-general contractor agreement, and it incorporated the terms of that "prime contract" into the subcontract with OBS.

It is not surprising or unusual that the prime contract required Pace to pay OBS notwithstanding the failure of the owner to pay Pace. This created a clear ambiguity that the Florida Supreme Court agreed to examine when it accepted jurisdiction of *OBS v. Pace*.

In its analysis, the Florida Supreme Court examined an earlier line of decisions. It already had decided that pay-when-paid clauses were going to be strictly construed with any ambiguity resolved in favor of the unpaid subcontractor or supplier.

In order to shift the burden of nonpayment to the subcontractor or supplier, the subcontract was required to contain a "clear and unequivocal expression" of that fact.

The decision was based on the ambiguity created by the incorporation of the prime contract into the OBS subcontract. Pace had failed to meet its burden of a clear and unequivocal pay-when-paid clause.

Although this ruling constituted another nail in the coffin of the general contractor, the true devastation was realized when the Supreme Court went on to look at Pace's bond as issued by Transamerica Insurance Co. and Seaboard Surety.

The opinion states that, "The payment

bond is a separate agreement, and any inability to proceed against the general contractor (with a subcontract pay-when-paid clause) does not necessarily prevent recovery against the sureties under the bond."

It rejected earlier holdings that the sureties' liability was coextensive with that of the principal. Even with an effective pay-when-paid provision, the surety must make payment to subcontractors and suppliers within a "reasonable time."

Anyone who has been around the construction site or the courthouse knows that the surety will look to its principal for reimbursement of any claims it is required to pay.

The effect is that a general contractor on a bonded job who remains unpaid by the owner will be required to make payment to subcontractors and suppliers even in the presence of a valid pay-when-paid clause.

The birth of the conditional payment bond

The *OBS v. Pace* ruling floored general contractors across Florida. In response to their uprising, the Florida Legislature enlisted the aid of state construction experts and attorneys in creating a statutory creature known as the conditional payment bond.

Good in theory, the conditional payment bond has provided little benefit and may have harmed the contractors of Florida. Hasty drafting without an eye to the future means the bonds seem to create more issues than they resolve.

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