

Pay When Paid Clauses: Approach with Caution

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What is a “Pay When Paid” Clause?



A “pay when paid” clause is one of the more contentious contractual provisions that can be found in a construction contract. As its name suggests, a “pay when paid” clause provides that a subcontractor is not entitled to be paid for its work until the contractor receives payment from the owner of the project. This clause seeks to shift the risk of an owner’s non-payment from contractors to subcontractor. In the absence of such a clause, if an owner fails to pay the contractor for work completed by the subcontractor, the contractor must still pay the subcontractor for the work completed.

Contractors are obviously in favour of the enforcement of “pay when paid” clauses. Without it, a contractor may have to pay for work that was performed by a subcontractor for the benefit of an owner who fails to pay. On the other hand, subcontractors are just as enthusiastic about limiting the applicability of “pay when paid” clauses as the work has been performed and they feel that they are entitled to payment from the contractor to whom they agreed to perform the work.

No Unified Approach

Courts across Canada have had the opportunity to consider “pay when paid” clauses in light of the above conflict in position, with largely inconsistent results. In Ontario and Alberta, the courts have upheld the parties’ right to contract by strictly interpreting construction contracts, and often enforce “pay when paid” clauses. On the other hand, the Nova Scotia Court of Appeal in *Arnoldin Construction & Forms Ltd. v. Alta Surety Co.* (1995), 137 N.S.R. (2d) 281 (“*Arnoldin*”) attempted to limit the effect of “pay when paid” clauses by ruling that subcontractors have a legal right to be paid within a reasonable time for their work, regardless of the fact that the contractor may not have been paid by the owner. Manitoba, Prince Edward Island, Saskatchewan and British Columbia have followed the lead of Nova Scotia in this regard.

Interestingly, in Ontario, a private members bill has been introduced (the *Prompt Payment Act*) which would impose mandatory payment terms on construction parties, both in terms of timing and consequences of non-payment. The *Prompt Payment Act* remains before the Standing Committee on Regulations and Private Acts and it remains to be seen as to whether

it will become law. Yet, the *Prompt Payment Act* will be worth paying attention to, as it proposes significant changes to standard industry practices.

Consideration of “Pay When Paid” in Manitoba

In Manitoba specifically, the Court of Queen’s Bench has recently commented on “pay when paid” clauses in *A&B Mechanical Ltd. v. Canotech Consultants Ltd. et al*, 2013 MBQB 287 (affirmed by the Manitoba Court of Appeal in *A&B Mechanical Ltd. v. Canotech Consultants Ltd. et al*, 2014 MBCA 80 on other grounds) (“*A&B Mechanical*”). In *A&B Mechanical*, A&B Mechanical Ltd. (“A&B”), was a subcontractor who had not been fully paid by the general contractor, Canotech Consultants Ltd. (“Canotech”), for work it had fully performed.

A&B sought summary judgment in the amount of its completed work on the project. Canotech acknowledged the non-payment to A&B for the work performed, for which it admitted funds were properly owing, but relied upon the subcontract and took the position that no further funds were payable by Canotech to A&B until Canotech was paid by the owner of the project, 5994731 Manitoba Ltd. (the “Owner”). The subcontract contained the following provision:

The Contractor agrees to pay the Sub-Contractor for the performance of the Sub-contract as follows:

Payments will be made monthly on progress estimates as approved by the Architect and/or Engineer and the Contractor's Superintendent covering 92.5% of the value of the work completed by the Sub-Contractor to the end of the previous month, such payments to be made five days after the Contractor receives payment for such work from the Owner.

Payment of the balance of 7.5% owing under the Sub-Contract will be made within five days after final payment has been received by the Contractor.

In granting summary judgment, the court held that A&B had fulfilled the only condition precedent to it being paid under subcontract, namely, the provision of statutory declarations for each progress billing submitted. The disputed “pay when paid” clause was not so clear as to justify interpretation that it was the parties’ intention that A&B was waiving its right to be paid.

The court further held that the disputed clause was more logically interpreted as a timing mechanism for payment of A&B, not a condition precedent to payment. In that regard, the timeline clause in the prime contract between Canotech and the Owner provided the relevant reference point. The prime contract provided that Canotech was entitled to receive payment from the Owner within 15 days after making application for payment, and no other conditions were attached. If Canotech’s position was accepted, the result would be that A&B might never be paid the amount owing if Canotech was never paid by the Owner. The court found it

difficult to believe that any subcontractor would agree to do work if payment was contingent on the general contractor being paid by the Owner.

The court acknowledged that the Manitoba Court of Appeal has not yet considered “pay when paid” clauses (which is still the case today), but notably the Manitoba Court of Appeal in *Winfield Construction Ltd. v. B.A. Robinson Co.* (1996), 110 Man. R. (2d) 41 has stated that it appreciates the reasoning of the Nova Scotia Court of Appeal *Arnoldin*.

Lessons to Take Away

While there is no unified Canadian approach to the interpretation of “pay when paid” clauses, the takeaway for contractors and subcontractors in Manitoba is that courts will approach “pay when paid” clauses cautiously and may favour findings which hold this type of clause unenforceable unless the clause is so plain as to demonstrate the parties’ clear intention to affect payments related to the construction contract.

Contractors who wish to include a true “pay when paid” clause must include clear language and bring it to the attention of the subcontractor. Subcontractors must be aware of the risk of non-payment that they are taking on in such cases, and if confronted with a “pay when paid” clause that they are not willing to accept, should confirm same with the contractor in writing.

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