

California Appellate Court Finds Open-Ended Pay-When-Paid Clause Unenforceable

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Highlights

A California appellate court found unenforceable a pay-when-paid clause in a contract between a general contractor and subcontractor on a California public works project.

The court found that the clause unreasonably delayed payment to the subcontractor until some undefined, unspecified point in time.

The court noted that not all pay-when-paid clauses are unenforceable under California law, but the time period for payment in the clause at issue was too unspecified and undefined.

On April 17, 2020, the Fourth District California Court of Appeals in [Crosno Construction, Inc. v. Travelers Casualty](#), found unenforceable a pay-when-paid clause in a subcontract between a general contractor and subcontractor. The appellate court held that the pay-when-paid clause violated California public policy and did not provide for payment within a reasonable time.

In *Crosno Construction*, a general contractor was engaged by the North Edwards Water District to serve as the general contractor to build an arsenic removal water treatment plant. The general contractor engaged Crosno Construction as its subcontractor to build and coat two steel reservoir tanks. Crosno Construction's subcontract contained a pay-when-paid clause, which stated that the general contractor and its sureties would pay Crosno Construction for its work within "a reasonable time ... 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 Construction performed and invoiced \$562,435 worth of work, the North Edwards Water District terminated the general contractor's contract, prompting a lawsuit by the general contractor. Crosno Construction subsequently made a claim on the project's payment bond seeking full payment of amounts invoiced to the general contractor. Travelers Casualty, the surety on the payment bond, invoked the pay-when-paid clause in the subcontract and rejected the claim, stating that Crosno

Construction had to wait for resolution of the general contractor's then-pending lawsuit against the North Edwards Water District for payment. Crosno Construction sued.

The California lower court found that the subcontractor's pay-when-paid clause was unenforceable because it impermissibly impaired Crosno Construction's payment rights under California's anti-waiver statute, Cal. Civ. Code § 8122. That statute governs payment rights on public works projects in California and renders void any provision of a contract that impairs a contractor's payment rights.

Previously, California courts had found that pay-*if*-paid clauses—which make payment by the owner to the contractor a condition precedent to the contractor's obligation to pay a subcontractor for its work—were unenforceable and violated the anti-waiver statute. Conversely, pay-when-paid clauses, which instead establish a time period for payment to the contractor, may not violate California's anti-waiver statute if the time period is reasonable.

However in this case, the trial court found that the pay-when-paid clause was open-ended and unreasonable, and therefore unenforceable. The California appellate court agreed.

The appellate court noted that the purpose behind a public works payment bond is to “provide subcontractors ... a quick, reliable and sufficient means of payment.” The pay-when-paid clause was essentially open-ended, in that it provided for payment to Crosno Construction “until some unspecified and undefined point in time when [the general contractor's] litigation with the district concluded.” This, the appellate court found, unreasonably impaired Crosno Construction's payment bond rights. And while California's anti-waiver statute allows a subcontractor to waive the protections of the statute, Crosno Construction had never executed such a release.

The appellate court was careful to tailor its holding to the specific language of the pay-when-paid clause at issue. The court noted that it did “not suggest that all pay-when-paid provisions are unenforceable against a payment bond claim—just that this one is.” In fact, even though Crosno Construction was eventually repaid the full balance, it took over three years after it first made a claim on the payment bond. In the eyes of the appellate court, this “protracted delay” conflicted with the remedial purpose behind California's public works statute.

The court's decision in *Crosno Construction* is important in that it expressly defines an unreasonable, and unenforceable, time period in a pay-when-paid clause in California. Notably, the court did not find that pay-when-paid clauses are always unenforceable. But a provision that delays payment to a public works contractor until some undefined, unspecified point in time when litigation concludes will not pass muster.

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