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MEMORANDUM

TO: ASA

FROM: Kevin T. Cauley, Esq.

DATE: May 21, 2020

SUBJECT: Pay-When-Paid Clause in Construction Subcontracts

A contract provision requiring a subcontractor to wait until the direct contractor concludes its litigation with the owner before it can seek payment on a payment bond was held unenforceable and against public policy in a recent appellate court decision, *Crosno Construction, Inc. v. Travelers Casualty and Surety Company of America*, 2018 WL 4183622 (Cal.App.4th).

California law distinguishes between “pay-when-paid” clauses and “pay-if-paid” clauses. “Pay-if-paid” clauses were held unenforceable as against public policy by the California Supreme Court in the case of *William R. Clarke Corp. v. Safeco Ins.* In 1997. If a clause is merely a “pay-when-paid” clause, it is enforceable but only for a reasonable time. Once that time has passed the subcontractor must be paid.

The subcontract clause involved in the *Crosno* case was as follows:

“... Contractor 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 required to pursue to conclusion their legal remedies against the owner or other responsible party to obtain payment, including (but not limited to) mechanic’s lien remedies.”

The court ruled that enforcing the “pay-when-paid” provision found in Crosno’s subcontract would postpone Crosno’s right to recover under the payment bond for an indefinite time period until Clark’s litigation against the district concludes. Such a result would unreasonably affect or impair Crosno’s statutory payment bond remedy and is unenforceable for the same reasons as expressed in *Wm. R. Clarke Corp. v. Safeco Ins.*

Although the *Crosno* case concerns the above “pay-when-pay” language as it relates to a claim against a surety on a payment bond, it will likely be argued against a direct contractor’s use of the same “pay-when-paid” language to delay payment under a subcontract as an impermissible waiver of claimant’s mechanic’s lien statutory rights as well as the issue is the unreasonably long payment duration which the courts find run afoul of the statutes governing waiver and release of the claimant’s mechanic’s lien statutory scheme rights.