
CONSTRUCTION LAW BULLETIN

PAY WHEN PAID

Having regard to the reasoning applied in a recent English court decision¹, “pay when paid” clauses may not be quite the source of comfort to main contractors as previously thought.

A “pay when paid” clause is the clause that is typically put into contracts between main contractors and subcontractors stipulating that the subcontractor will only be paid once the main contractor has received payment from the employer.

Naturally this type of clause is universally detested by subcontractors who perceive, often rightly so, that the clauses are manipulated by main contractors to their prejudice. Subcontractors have no means of knowing when payment is received by the main contractor and what amount in any such payment relates to the subcontract works. In addition, main contractors protected by such clauses do not have much incentive to challenge under-certification of the subcontract works.

The English court in the Durabella case has given some useful insights into how such clauses should be interpreted and implemented which will be welcomed by subcontractors.

Jarvis & Sons was employed to construct 36 flats for an employer. It subcontracted the flooring to Durabella in terms of a subcontract which contained a “pay when paid” clause.

During the execution of the main contract, the employer became dissatisfied with Jarvis & Sons’ performance and terminated the main contract. Jarvis & Sons, being unhappy with this state of affairs, instituted proceedings against the employer. The proceedings were ultimately settled in terms of a written agreement which stated that the settlement payment included nothing in respect of Durabella’s subcontract work.

Unsurprisingly, Durabella took umbrage at this and instituted court proceedings against Jarvis & Sons.

The court held that, in raising the shield of a “pay when paid” clause, the onus is on the main contractor to prove that the payments received by it do not relate to the subcontract works.

The court disregarded the statement contained in the settlement agreement and went into a detailed analysis of the background circumstances and relevant financial information and concluded that Jarvis & Sons was unable to prove that it had not received any payment on account of the subcontract works. In the result, Durabella’s claim against Jarvis & Sons was upheld.

The court went on to set out two important limitations on the application of “pay when paid” clauses.

Firstly, the court stated that a contractor cannot rely on this type of clause to avoid paying a subcontractor if the non-payment by the employer is attributable to a breach by the main contractor under the main contract. This approach is consistent with the doctrine of fictional fulfilment in our law which is to the effect that if a party’s

¹ Durabella Ltd v J.Jarvis & Sons Ltd (Technology and Construction Court, September 2001)

performance is subject to the fulfilment of a condition and that party does something which prevents fulfilment of the condition, the condition will be deemed to have been fulfilled.

Secondly, the court laid down that a main contractor would not be entitled to rely on the clause unless it had pursued such means as were available to it to secure payment in respect of the subcontractor's work. Such steps would include pressing for payment by means of negotiation and, if appropriate, pursuing the claim either in arbitration proceedings or, if applicable, litigation.

If these principles are espoused by our arbitrators and/or our courts, as they may well be, it is apparent that blind reliance by a contractor on a "pay when paid" clause to resist a subcontractor's claim would be ill advised.

A main contractor would naturally have little or no difficulty in relying on such a clause if the employer's non-payment is specifically attributable to deficiencies in the subcontract works.

In terms of legislation promulgated in the United Kingdom a few years ago², "pay when paid" clauses are no longer legally operative, in most types of construction contract, unless the non-receipt of payment by the main contractor is due to the insolvency of the employer.

As a matter of logical extension, there would appear to be no reason why the same limitations would not apply to clauses which make payment to a subcontractor conditional on certification of payment, in respect of the subcontract works, as opposed to actual receipt of payment.

It seems that it would be as well for main contractors to exercise some circumspection in future when intending to place reliance on "pay when paid" clauses. Efforts should be made to try and order one's affairs so that even upon the application of the above principles, reliance on the clause is sustainable.

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² Section 113 of the Construction Act.