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Thomas Heintzman is counsel at McCarthy Tétrault in Toronto. His practice specializes in arbitration and mediation and litigation relating to corporate disputes, shareholder's rights, securities law, broadcasting/telecommunications and class actions.

He has been counsel in many important actions, arbitrations, and appeals before all levels of courts in many Canadian provinces as well as the Supreme Court of Canada.

Thomas Heintzman is the author of Goldsmith & Heintzman on Canadian Building Contracts, 4<sup>th</sup> Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Goldsmith & Heintzman on Canadian Building Contracts has been cited in 183 judicial decisions including the two leading Supreme Court of Canada decisions on the law of tendering:

*M.J.B. Enterprises Ltd. v. Defence Construction (1951)*, [1999] 1 S.C.R. 619 and

*Double N Earthmovers Ltd. v. Edmonton (City)*, 2007 SCC3, [2007] 1 S.C.R. 116-2007-01-25 Supreme Court of Canada

## **Pay-When-Paid: When Is the Contractor Not Obligated to Pay the Subcontractor?**

### **Construction Law - Building Contract - "Pay When Paid"**

The Ontario Superior court recently wrestled with the issue of how to interpret and apply a "Pay When Paid" clause in a subcontract.

In *1473662 Ontario Limited v. Avgroup Consulting Services Limited*, the Court appears to apply the traditional approach to this clause, but opened a door for subcontractors to avoid its severity.

Avgroup was the general contractor for a hotel construction project. The numbered company (which carried on business as "Dyson Electric") was the electrical subcontractor. Avgroup alleged that the parties had contracted pursuant to the CCDC subcontract, and that the contract contained a "Pay When Pay" clause which read: "The Contractor shall pay the

Subcontractor no later than thirty (30) days after the Submission Date or three (3) working days after the Contractor receives payment from the Owner, whichever is the later.”

However, that contract was never signed. Dyson alleged that the contract was found in the invoices which it had submitted to Avgroup and which Avgroup had accepted as the basis for payment. Those invoices did not contain a Pay When Paid clause.

The Court appeared to accept that the Pay When Paid clause in the form of CCDC contract relied upon by Avgroup was substantially similar to the clause in the contract which had been considered by the Ontario Court of Appeal in *Timbro Developments Ltd. v. Grimsby Diesel Motors Inc* (1988) 32 C.L.R. 32 (Ont. C.A.). The clause in that case stated: “Payments will be made not more than thirty (30) days after the submission date or ten (10) days after the certification or when we have been paid by the owner, whichever is the later.”

The Court of Appeal in *Timbro* held that such a clause was not just a payment-timing clause operating during the project, but entirely precluded the sub-contractor from recovering from the contractor in the event that the contractor was not paid by the owner.

The court in the present case evidently felt itself to be bound by the *Timbro* decision. But the court held that there was a triable issue relating to whether the contract was in the form of the CCDC subcontract or in the form of the subcontractor’s invoices. Accordingly, the court dismissed Dyson’s motion for summary judgment.

This decision highlights the need for the Supreme Court of Canada to review the Pay When Paid issue. There is conflicting authority in Nova Scotia (*Arnoldin Construction & Forms Ltd. v. Aslta Surety Co* (1995), 19 C.L.R. (2d) 1 (N.S. C.A.)) and leave to appeal that decision was dismissed by the Supreme Court of Ontario. Moreover, members of the construction industry, and the drafters of the CCDC subcontract, should clarify their intention about the meaning of a Pay When Paid clause.

The fundamental questions are these: Who should bear the risk of the owner’s insolvency, the contractor or the subcontractor?

Why should the subcontractor, who has no dealings with the owner and no means of managing the risk of the owner’s insolvency, bear that risk rather than the contractor? A sub-contractor may reasonably be expected to bear the risk of the timing of the payments by the contractor during the project, but it is more difficult to understand why the subcontractor should bear the risk of the owner’s insolvency.

The same issue can, of course, arise in a sub-subcontract or a supply contract if that contract contains a Pay When Paid clause. Here, the risk is the contractor’s insolvency. Is it reasonable for the sub-subcontractor or supplier to the subcontractor to bear the risk of the contractor’s insolvency when they have no dealings with the contractor?

These are questions which the courts and the construction industry need to carefully consider.

See Goldsmith and Heintzman, *Canadian Building Contracts* (4<sup>th</sup> ed), Chapter 4, part 2).

**Construction Law - Building Contract - "Pay-when-Paid":**

*1473662 Ontario Limited v. Avgroup Consulting Services Limited*, 2011 ONSC 2900 (CanLII)

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