

Assessing the Enforceability of a Pay-When-Paid Clause in Canada

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In construction, a ‘pay-when-paid’ clause provides that the payer won’t have to pay until its paid by the person above it in the construction ladder. A ‘pay-if-paid’ clause goes further and says the payer only has to pay *if* it is paid by the person above it. Although our analysis will apply consistently at lower rungs of the construction ladder, in this Article we will discuss a contractor’s use of such a clause. This Article also focuses on the law in Canada’s common law jurisdictions, and does not speak to the application of the Civil Code in Quebec.

Some 35 years ago, a pay-when-paid clause came before the Ontario Court of Appeal in *Timbro Developments Ltd. v. Grimsby Diesel Motors Inc.*ⁱ. The clause called for payment “not more than thirty (30) days after the submission date or ten (10) days after certification or when we have been paid by the owner, whichever is the later”. The majority held in a 2-1 decision that “*the clause clearly specifies the condition governing the contractor's legal entitlement to payment and not merely the time of payment.*” Finlayson J.A. dissented, however, holding that “*the clause relates to the timing of payments due ... and in no sense puts the subcontractors at risk that they will not be paid if the contractor is not paid.*”

Seven years later, a clause calling for payment “on or about one day after receipt by the Contractor of payment from the owners” came before the Nova Scotia Court of Appeal in *Arnoldin Construction & Forms Ltd. v. Alta Surety Co.*ⁱⁱ The Court held that the clause would not apply if the contractor was *never* paid, stating:

“Appropriate words would have been that the balance claimed by the subcontractor ... would only be paid “if” the owner paid the contractor. ... Any provision intended to diminish or remove the subcontractor's right to be paid should clearly state that”

The clauses before the two Courts were, of course, substantially similar: one tied payment to “when the contractor was paid by the owner” and the other to “receipt by the Contractor of payment from the owners”. The Nova Scotia Court of Appeal accordingly took a different overall approach to pay-when-paid clauses than did the Ontario Court. Nonetheless, the Supreme Court of Canada denied leave to appeal in both cases. Although each clause has to be interpreted in its own right, there is thus no clarity from Ottawa on whether a ‘pay-when-paid’ clause, without something more, applies when the contractor is *never* paid by the owner.

Timbro remains binding on lower courts in Ontario and has been followed and applied in a number of Ontario cases.ⁱⁱⁱ It has not, however, been *consistently* applied: one Ontario case followed *Arnoldin* without referencing *Timbro*^{iv}, while another found a very similar clause to be insufficiently clear.^v A further held that a pay when paid arrangement “would not constitute a waiver” by the subcontractor of its right to be paid,^{vi} while a deputy judge of the small claims court said *Timbro* “should not be construed to support broad overarching principles which are not specifically addressed in them”^{vii}. (That case was recently referenced by the Alberta Court of King’s Bench, where Justice Summers, in what may be an overstatement, said that most of the Ontario decisions before him distinguished, minimized or ignored *Timbro*, preferring *Arnoldin*).^{viii}

Outside of Ontario, the *Arnoldin* approach appears to be preferred: non-Ontario courts will not generally interpret “pay when paid” to mean “pay if paid”, without something more.^{ix} We have found no non-Ontario decision which followed *Timbro*.

The CCA-1 standard form subcontract, which is heavily used in Canada, calls for payment on the later of “30 calendar days of the subtrade’s invoice or 10 calendar days after the date of a Consultant’s certificate”, subject to applicable prompt payment legislation. This, of course, is similar to the clause in *Timbro* (which also tied payment to 30 days from submission or 10 days from certification). Although no Court has, so far as we are aware, weighed in on the issue, it is possible (if not probable) that the CCA-1 clause would (without anything more) be interpreted in Ontario to create a true condition precedent to payment (as per *Timbro*), rather than a mere timing provision (as per *Arnoldin*). Accordingly, and at least until clarity is brought by either a further decision of the Ontario Court of Appeal or an appeal to the Supreme Court of Canada, the importance of the certification requirement may accordingly vary depending on where the subcontract in question was entered into.

The scope of a “pay-when-paid” clause is, however, only part of the analysis, particularly in Ontario. First, a contractor in Ontario will cannot rely on a pay-when-paid if it was not paid because of its own breach of contract or negligence, having nothing to do with the unpaid subcontractor.^x In addition, it is well established in Ontario that a contractor cannot rely on a pay-when-paid clause to refuse payment unless it has made good faith efforts to *actually* recover from the owner.^{xi} It has also been held that good faith or best efforts require that all reasonable steps be taken (although each case must be decided on its own facts and circumstances).^{xii}

As regards the relationship between pay-when/if-paid and lien legislation, subcontractors can clearly preserve a construction lien before they are actually owed the money they lien for. This, of course, makes perfect sense: lien claimants have to be able to lien for the holdback before their lien rights expire (and therefore before it comes due). Nonetheless, if the clause is ultimately interpreted to be a valid and enforceable pay-if-paid clause (as per *Timbro* or otherwise) the lien may have no value. This, because the quantum of the lien is generally (and sometimes expressly) limited to the amount actually owed to the subcontractor. See section 17 of Ontario's *Construction Act*, s. 34 of B.C's *Builders Lien Act* and s. 23 of Manitoba's *Builders' Lien Act*, for example.

With respect to prompt payment legislation, it will take time for case law to establish the relationship between the legislation and pay-when-paid clauses. Oversimply put, however, a universal characteristic of the legislation requires that a contractor who wants to rely on a pay-when-paid clause give the appropriate notice to preserve that right. It will then be required, in some circumstances, to commence an adjudication against the owner to recover the amounts not paid.

Lessons to be learned generally include the following. For a "pay when paid" or "pay if paid" clause to be enforceable, the intention of the clause parties be clear. Each clause has to be interpreted in its own words, in the context of the overall agreement and surrounding circumstances, towards determining the true intention of the parties. That having been said, a clear "pay-when-paid" is likely to be interpreted to mean "pay-if-paid" in Ontario, whereas something more will be required in the rest of common law Canada, to make it clear that no payment will be made even if the payer is never paid from above. These differing approaches have potentially different consequences in relation to both liens (because lien entitlements are often capped at what the claimant is owed in contract) and the interpretation of the standard form CCA-1. In Ontario, however, case law has developed to limit application of the "pay-when-paid": the payer will only be able to rely on the clause if it has made good faith efforts to recover the money from above and only if the reason for its not being paid is not attributable to its own breach of contract or negligence (having nothing to do with the unpaid trade).

There is, perhaps, this to be added: a clear pay-when-paid or pay-if-paid clause is enforceable, absent unconscionability which will rarely be proven. Thus, if an unpaid subcontractor "drops tools" for non-payment in the face of such a clause, it runs a serious risk of being in breach of contract and/or of "repudiating" its subcontract, exposing it to all of the premium costs associated with the completion of the subcontract work by other forces, inclusive of delay related impacts. ^{xiii}

Care should thus be taken to understand the risk of associated with pay-when-paid clauses, before they are agreed to and, later, if options to deal with non-payment need to be considered.

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ⁱ (1988), 32 C.L.R. 32

ⁱⁱ (1995), 19 C.L.R. (2d) 1

ⁱⁱⁱ In *Kor-Ban Inc. v. Pigott Construction Ltd.*, 1993] O.J. No. 1414, Justice Bell found a clause which called for payments five days after payment to the contractor, to be "as " clear or are even clearer than the words used in *Timbro*" and held that *Timbro* had "put to rest in Ontario" whether the clause allowed the contractor to avoid payment if it was never paid. In *Commercial Union Assurance Co. of Canada v. Kunst Corp.*, 2000 CarswellOnt 2229, the Court held that a similar clause governed "legal entitlement to payment and not merely the time it takes when payment should be made". In *1473662 Ontario Ltd. v. Avgroup Consulting Services Ltd.*, 2011 ONSC 2900 Justice Di Tomaso observed that *Timbro* was the leading case on pay-when-paid clauses in Ontario and, more recently, in *Quadform Ltd v Rock Con Forming Ltd*, 2020 ONSC 7903, Justice Stribopoulos held that, under a "pay when paid" arrangement, a subcontractor's obligation to pay will only arise once the it received payment from the subcontractor above it.

^{iv} *Crompton v. Norman Hill Realty Inc.*, [1995] O.J. No. 3407

^v *Smith-Peat Roofing & Sheet Metal Ltd. v. Matassa Inc.*, [2000] O.J. No. 5011, where the clause called for payment "within 10 days of receipt of payment from owner".

^{vi} *Mosé Drywall Systems Ltd. v. JDM Developments Inc.* [2005] O.J. No. 245

^{vii} *Online Security Inc v Maxion Construction Management-The Uptown Inc* , 2018 CanLII 99157, adopting language from a Supreme Court of Canada decision dealing with completely different issues.

^{viii} *Canadian Pressure Testing Technologies Ltd v. EllisDon Industrial Inc.*, 2022 ABKB 649

^{ix} In addition to *Canadian Pressure Testing*, *supra*, see the Manitoba Court of Appeal in *Winfield Construction Ltd. v. B.A. Robinson Co.* (1996), M.J. No. 121, the Nova Scotia Court of Appeal in *APM Construction Services Inc. v. Caribou Island Electric Ltd.* 2013 NSCA 62, the Manitoba Queen's Bench in *A&B Mechanical Ltd. v. Canotech Consultants Ltd.*, 2013 MBQB 287 the Prince Edward Island Supreme Court in *R. & G. Masonry Ltd. v. Maxim Construction Inc.*, [1997] P.E.I.J. No. 111, the British Columbia Supreme Court decision in *Viking Fire Suppression Ltd. v. Sertex Plumbing B.C. Ltd.* [1996] B.C.J. No. 1986 and the Yukon Territory Supreme Court decision in *Cardinal Contracting Ltd. v. Seko Construction (Vancouver) Ltd.* 2017 YKSC 51, 2017.

^x See *Kor-Ban Inc.*, *supra*, *Coco Paving Inc. v. Durham (Municipality)*, 2018 ONSC 2849, *1603878 Ontario Ltd. v. St. Clair College of Applied Arts and Technology*, 2014 ONSC 6107, *Applied Insulation Co. v. Megatech Contracting Ltd.* (1994), 22 C.L.R. (2d) 251 and *Metal-Air Mechanical Systems Ltd. v. Ledcor Construction Ltd.* (2008), 76 C.L.R. (3d) 284

^{xi} See *Kor-Ban Inc. v. Pigott*, *supra*, *Crompton v. Norman Hill Realty Inc.*, *supra*, *Canadian Pressure Testing*, *supra*, *6157734 Canada Inc. v. Bluelime*, *supra*, and *PBW High Voltage Ltd. v. Metrolinx*, 2021 ONSC 6715

^{xii} See *Sheffield District Railway Co. v. Great Central Railway Co.* (1911), 27 T.L.R. 451, *OEB International Ltd. v. Leyden* (1995), 59 A.C.W.S. (3d) 234 (Ont. Gen. Div.) and *Atmospheric Diving Systems Inc. v. International Hard Suits Inc.*, [1994] 5 W.W.R. 719,

^{xiii} See, for example, *Voka Steel Inc. v. Edgecon Construction Inc.*, 2011 ONSC 1938. See also *D & M Steel Ltd. v. 51 Construction Ltd.*, 2016 ONSC 1335, upheld 2018 ONSC 2171, and the cases referenced therein.