"Pay-When-Paid" Clauses: What happens when the Owner doesn't pay"

Jan 22, 2007

Categories:

Publications

You are the general contractor on a large project. All of the work on the project has been successfully completed, and you have submitted your final pay application to the owner. Then disaster strikes — the owner files bankruptcy! You know you've probably lost at least your profit and overhead, but do you also have to pay your subcontractors out of your own funds? The answer may depend on the wording and interpretation of the "pay-when-paid" clause in your subcontractor agreement and other contract documents.

General contractors frequently include "pay-when-paid" clauses in their subcontractor agreements in order to avoid the cash flow problems that can occur if they have to pay subcontractors before receiving payment from the owner. These clauses typically provide that the subcontractor will not be paid for its work until some time after the general contractor is paid by the owner. (e.g. "Final payment of the balance due of the contract price shall be made to the Subcontractor within seven (7) days after receipt by the Contractor of final payment from the Owner for such Subcontractor's Work.") But what if the owner never pays? Is payment by the owner to the general contractor a "condition precedent" to the general contractor's obligation to pay the subcontractor?

The leading case on this issue is Thos. J. Dyer Co. v. Bishop International Eng. Co., 303 F.2d 655 (6th Cir. 1962). In Dyer the subcontractor agreement provided that "no part" of the price to be paid to the subcontractor "shall be due until five (5) days after Owner shall have paid Contractor therefore. . . ." The owner became insolvent before either the contractor or the subcontractor had been paid in full, and the subcontractor sued the contractor for payment. The court held that the pay-when-paid clause did not allow the contractor to avoid paying the subcontractor but merely to delay payment for a "reasonable period" after the work was

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

completed, during which the contractor could attempt to obtain the funds to pay the subcontractor from the owner.

Most courts, including an Ohio appellate court in Power & Pollution Services, Inc. v. Suburban Power Piping Corp., 47 Ohio App. 3d 89 (Cuyahoga County 1991), have agreed with the analysis in Dyer. The general rule in most jurisdictions is that, unless the contract clearly shows that the parties intended to make payment from the owner a "condition precedent" to payment of the subcontractor, the pay-when-paid clause governs only the timing of payments to the subcontractor but does not allow the general contractor to avoid paying the subcontractor altogether. As in Dyer, most courts interpret pay-when-paid clauses to require the general contractor to pay the subcontractor within a "reasonable time" after the work is completed, even if the owner has not paid the general contractor.

General contractors that intend to shift the risk of non-payment by the owner to the subcontractor should state clearly in the subcontractor agreement that payment from the owner to the general contractor is a "condition precedent" to the general contractor's obligation to pay the subcontractor. Such provisions are commonly referred to as "pay-if-paid" clauses and are generally enforceable in most states if clearly drafted. However, courts are reluctant to enforce these types of provisions and will generally construe any ambiguities against the general contractor as the drafter of the contract.

Subcontractors generally should be wary of signing contracts containing these types of clauses, especially clauses that do not clearly relate only to the timing of payment. Before signing a contract with a pay-if-paid clause, the subcontractor should at least perform its own investigation of the owner's financial condition.

Published in The Constructor (Allied Construction Industries/AGC-Ohio) *Scott Gurney is a Member of the Construction Law Group of Frost Brown Todd LLC. He can be contacted at (513) 651-6841 or sgurney@fbtlaw.com.* *This article is presented for educational purposes. Neither the author nor Frost Brown Todd LLC, nor their present or future clients, can be bound by the opinions, comments*

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

and interpretations expressed herein.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons