IN THE COURT OF APPEALS OF OHIO
TENTH APPELLATE DISTRICT

Acoustic Ceiling & Partition of Ohio, Inc.,	:	
	:	
Appellee,	:	Appeal No. 12-AP-859
	:	
v.	:	(REGULAR CALENDAR)
	:	
Continental Building Systems, LLC and Continental Real Estate Companies dba Continental Building Systems	:	
	:	
Appellants.	:	
	:	

BRIEF OF *AMICI CURIAE* AMERICAN SUBCONTRACTORS ASSOCIATION AND AMERICAN SUBCONTRACTORS ASSOCIATION OF OHIO IN SUPPORT OF PLAINTIFF-APPELLEE ACOUSTIC CEILING & PARTITION OF OHIO, INC.

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STATEMENT OF INTEREST OF THE AMERICAN SUBCONTRACTORS ASSOCIATION

The American Subcontractors Association ("ASA") is a national non-profit corporation supported by membership dues paid by approximately 5,000 member companies throughout the country. Membership is open to all commercial construction subcontractors, material suppliers and service companies. ASA members represent the combined interest of both union and non-union companies, and range from the smallest private firms to the nation's largest specialty contractors. Thousands of ASA's member company employees live and work here in Ohio. ASA of Ohio is a statewide chapter of the national ASA. ASA of Ohio was formed in 2008 to consolidate the former chapters in Columbus, Cincinnati, and Cleveland. The first ASA chapter formed in Ohio was the Cincinnati Chapter which was originally established in 1965.

The issues set forth in this Appeal profoundly impact ASA's member companies in Ohio, as well as the thousands of Ohioans who are gainfully employed by these companies. The ASA is especially interested in assisting the Courts of Ohio in interpreting and applying various construction contract provisions, Ohio's Fairness in Construction Contracting Act as embodied in Ohio Revised Code §4113.62, as well as the public policy in Ohio as it relates to the tens of thousands of Ohioans employed by contractors, subcontractors and suppliers engaged in construction projects within the State of Ohio. This Court's decision will impact construction projects throughout the State of Ohio.

This Amicus Brief filed on behalf of the American Subcontractors Association supports hardworking contractors and suppliers who struggle to get paid for their work in a marketplace that seems to have become embroiled in legalities. In particular, this brief seeks to help clarify the legal rules that help to ensure that contractors and suppliers are fairly paid for their work.

Only inequity and injustice will arise if large prime and general contractors are able to unjustly shift the bulk of the financial risk of the construction industry upon the small subcontractors and suppliers who can least afford to shoulder such risk. Nor are subcontractors and suppliers in a position that would allow them to properly assess such risk at the time that they are bidding a new project. For example, in the case at bar, the subcontractors were being asked to expend funds in reliance upon receiving payment from a project owner who was unknown to the subcontractor at the time of bidding. Even where the name of the project owner is known at the time of bidding, it would be ludicrous to believe that during the bidding process a project owner would voluntarily provide an audited financial statement to subcontractors and suppliers with whom he is not yet under contract or that the bidding subcontractors could adequately analyze the financial information if it were to be provided as no subcontractor would be able to analyze the entire project, understand the construction practices of the various contractors or the entire scope of work in relation to their portion of the project. Accordingly, the law and policy espoused by Appellant would shift the risk of the project owner's insolvency onto subcontractors and suppliers even though these parties have absolutely no ability to gauge such risk nor any ability to monitor the risk as the project moves forward.

STATEMENT OF THE CASE

This action was commenced on April 22, 2010 when Plaintiff-Appellee Acoustic Ceiling and Partition of Ohio, Inc. (hereafter "Acoustic") filed an action against Defendant-Appellant Continental Building Systems, LLC et al. (hereafter "Continental") seeking payment for certain amounts remaining due on a project known as the Corazon Club at Tartan West in Dublin, Ohio (hereafter referred to as the "Project"). After cross-motions for summary judgment were prepared and submitted, the trial court granted summary judgment in favor of Acoustic and

against Continental. The Court found that the applicable contract language did not create a condition precedent or otherwise shift the risk of the owner's insolvency onto the subcontractor Acoustic. The central issue to be addressed on appeal is whether the trial court was correct in holding that the contract language in the agreement between the parties did not create a "condition precedent" that would shield the general contractor from the obligation to pay the subcontractor Acoustic for materials and labor honestly and properly supplied to the project.

STATEMENT OF FACTS

Appellant Continental was the general contractor on the construction project known as "the Corazon Club" in Union County, Ohio. In furtherance of the project, Appellant Continental entered into a subcontract agreement with Plaintiff-Appellee Acoustic. As is customary in the industry, the general contractor required Acoustic to execute the general contractor's "standard form" agreement. However, it turned out that the "standard form" utilized by Continental was not really "standard" at all. In addition to the voluminous other project documents, the Continental "standard form" included Paragraph 5.2.5 entitled "Time of Payment." That section states as follows:

> Progress payments to the subcontractor for satisfactory performance of the subcontractor's Work shall be made no later than seven (7) business days after receipt by the Contractor of payment from the Owner for the Subcontractor's Work. Payment to the Subcontractor is expressly conditioned upon receipt by the Contractor of payment by the Owner for the Subcontractor Work and will be adjusted for any charge-backs (offsets) owed to the Contractor.

Similarly, Paragraph 5.3.3(b) of the Subcontract states as follows:

> Final payment is expressly conditioned on receipt by the Contractor of payment by the Owner for the Subcontractor's work…."

Unfortunately, through no fault of any of the subcontractors, including the Appellee Acoustic Ceiling & Partition of Ohio, Inc., the project ultimately fell into receivership and the subject real property was foreclosed upon by the financing bank.

SUMMARY OF THE ARGUMENT

A reversal of the Trial Court's just decision that Appellee Acoustic is entitled to be paid for the labor and materials supplied in furtherance of the construction project would have a catastrophic impact on Ohio's construction industry. First of all, this Court would be reversing its own well-reasoned decision in *Evans, Mechwart, Hambleton & Tilton v. Triad Architects, LTD*, 196 Ohio App.3d 784 (Ohio App. 10 Dist. 2011), where the Court found that "pay-if-paid" clauses work a forfeiture against the subcontractor and as such are disfavored by the courts. The *Evans* decision went out of its way to identify specific contract language that is required in order for the prime contractor to work a forfeiture against its subcontractors.

Secondly, in Ohio construction projects, there is generally only one owner and usually only one prime contractor. The prime contractor therefore enjoys a monopsony[1], where the prime contractor is the only buyer and has the power to dictate inefficient, impossible, and illogical contract terms. Courts across the nation have long recognized and controlled the dangers posed by both monopolies and monopsonys. The "impossible" and "unworkable" terms of a forfeiture clause place subcontractors in an untenable position. Because of the monopsony enjoyed by the prime contractors, they are able to demand unreasonable terms from their subcontractors. Under such conditions, the choice for prospective subcontractors is either to go out of business for lack

[1] Similar to a monopoly, a monopsony exists where there is only one buyer, and that buyer dictates the terms of a transaction. A monopoly exists when there is only one seller, and that seller therefore has the power to dictate all terms.

of work or to reluctantly undertake work from prime contractors who utilize unconscionable contract provisions such as the provision at issue in this appeal.

A "pay-if-paid" clause makes payment by the owner to the prime contractor a condition that must be satisfied before the prime contractor must pay its subcontractors. Such a clause shifts the risk of nonpayment by the owner from the prime contractor[2] to its subcontractors. In many circumstances, the subcontractors never receive fair payment. In essence, a pay-if-paid clause completely shifts the burden of financial risk from the prime contractor to its subcontractors. In the modern construction industry, a prime contractor may serve simply as a job broker while performing little if any actual construction work while passing all of the risk of non-payment to the subcontractors.

Every other member of the construction team may suffer if the prime contractor fails to manage or otherwise control the job. The owner may suffer from delays, reduced quality and increased costs. The subcontractor may not be able to pay their employees or material suppliers. Suppliers may have cash flow problems. Workers may lose their jobs if subcontractors are forced out of business because of slow or no payment. Fringe benefit payments on behalf of laborers may go unpaid. Prime contractors owe a great duty of care to all parties to the construction project. Permitting prime contractors to avoid payment to subcontractors and suppliers through pay-if-paid clauses causes the most harm to parties who have no control over their own future, the subcontractors, suppliers and everyone who works with them. Frequently, contracts with

[2] We refer to the contractor that has a contract directly with the project owner as the "prime" contractor to avoid the confusion which could be created by referring to such a contractor as a "general" contractor, which is more descriptive of a "general trades" contractor, an "original" contractor as it is referred to in the private construction sections of the Ohio Mechanic's Lien Law or a "principal" contractor as it is referred to in the public construction sections of the Ohio Mechanic's Lien Law.

pay-if-paid clauses also contain other clauses, which require subcontractors to continue working, and prohibit them from filing mechanic's liens or bond claims to protect their claims, notwithstanding the prime contractor's failure to pay.

Such clauses frequently work a hardship even when a subcontractor or supplier believes that it is protected because it is bidding to a well-known, highly creditworthy prime contractor or because of the existence of a payment bond, or the ability to file a mechanics lien. Despite the fact that it is working for an otherwise creditworthy prime contractor, if that prime contractor has no obligation to pay because of a pay-if-paid clause, the existence of that clause works as a forfeiture for the right of the subcontractor or supplier.

If the surety bond is in place, the surety will step into the shoes of the contractor and raise as a defense the contractor's pay-if-paid clause. If the subcontractor chooses to file a mechanics lien to protect its right to be paid, the owner will defend by saying that the subcontractor or supplier's right to file a mechanics lien is based in contract, and it has no contractual right to be paid. The subcontractor or supplier is left at best with an uphill battle and at worst no right whatsoever to be paid for its labor and materials.

The owner has a direct contractual relationship with the prime contractor rather than the subcontractor. Therefore, the subcontractor has no legal recourse by which to collect payment should the owner fail to pay the prime contractor. When a prime contractor inserts a pay-if-paid clause in its subcontract, it asks the subcontractor to assume the risk of nonpayment by the owner. If the subcontractor signs the subcontract, it is essentially extending credit to the owner and the prime contractor with no available avenue through which to either effectively analyze the creditworthiness of the owner or collect payment from either the project owner or the prime

contractor. Accordingly, ASA takes the position that "pay-if-paid" clauses are inequitable and against public policy.

The contract language utilized by Continental Building Systems tries to circumvent the just holding in Evans. This Court should follow its own precedent in *Evans* and hold that Acoustic has the right to be paid on its contract for the work performed on this construction project.

LEGAL ARGUMENT

I. STANDARD OF REVIEW

Decisions regarding contract interpretation are matters of law, and are also subject to a *de novo* review on appeal. *Taylor Bldg. Corp. of Am. v. Benfield*, 117 Ohio St. 3d 352, 2008-Ohio-938, 884 N.E.2d 12, ¶ 37. However, an appellate Court presumes that a trial court's factual findings are correct, and must affirm the trial court's judgment if those factual findings are supported by some "competent, credible evidence going to all the essential elements of the case." *C.E. Morris Co. v. Foley Constr. Co.*, 54 Ohio St.2d 279, 376 N.E.2d 578 (1978), syllabus. This is because the trial court is in the best position to weigh the evidence and judge the credibility of witnesses. *Seasons Coal Co. v. Cleveland*, 10 Ohio St.3d 77, 79-80, 461 N.E.2d 1273 (1984).

II. LEGAL DISCUSSION

A. THE TRIAL COURT CORRECTLY RULED THAT THE PAYMENT AGREEMENT BETWEEN THE PARTIES WAS A "PAY-WHEN-PAID" PROVISION RATHER THAN A "PAY-IF-PAID" PROVISION

The Court in *Evans* chose to carefully analyze the law relating to "pay-if-paid" clauses. Although the court could have easily disposed of the matter in *Evans* without such detail, it

clearly understood the importance of this subject matter to the those in the construction industry in Ohio. The Court chose its words carefully:

> Payment provisions qualify as pay-if-paid provisions if they expressly state that (1) payment to the contractor is a condition precedent to payment to the subcontractor… (2) the subcontractor is to bear the risk of the owner's nonpayment… or (3) the subcontractor is to be paid exclusively out of a fund the sole source of which is the owner's payment to the subcontractor. *Id.*, at 791

The Court went on to note that:

> Although unnecessary to our analysis, AIA commentary complements our conclusion that section 12.5 is a pay-when-paid, and not a pay-if-paid, provision. According to the AIA's Guide for Amendments to the AIA Owner-Architect Agreements (Document B503-2 007), 'AIA Standard Architect-Consultant agreements do not contain a pay-if-paid clause.' The guide goes on to caution that '[A] pay-if-paid clause must clearly establish the intent of the parties to shift the credit risk of the Owner's insolvency and should include the words 'condition precedent.' *Id.*, at 792.

The Court in *Transtar Electric, Inc. v. A. E. M Electric Services Corporation*, 2012-Ohio-5986, L-12-1100 (Ohio App. 12th Dist., 2012) followed this Court's decision in *Evans* when confronted with a clause that read as follows:

> The Contractor [appellee] shall pay to the Subcontractor [appellant] the amount due [for work performed] only upon the satisfaction of all four of the following conditions: (i) the Subcontractor has completed all of the Work covered by the payment in a timely and workmanlike manner, * * * (ii) the Owner has approved the Work, * * * (iii) the Subcontractor proves to the Contractor's sole satisfaction that the Project is free and clear from all liens * * * and (iv) the Contractor has received payment from the Owner for the Work performed by Subcontractor.
>
> **RECEIPT OF PAYMENT BY CONTRACTOR FROM OWNER FOR WORK PERFORMED BY SUBCONTRACTOR IS A CONDITION PRECEDENT TO PAYMENT BY CONTRACTOR TO SUBCONTRACTOR FOR THAT WORK.** (Emphasis sic)

The *Transtar* Court, in reviewing language that is less ambiguous than the language in the Continental contract, held that, "we find no language sufficient to clearly and unambiguously indicate that the parties intended to transfer the ultimate risk of nonpayment to the subcontractor. Consequently, the clause at issue must be interpreted as a pay-when-paid provision." *Id* at ¶31.

The *Transtar* Court, also discussed some examples of "pay-if-paid" provisions around the country. It found that various states found different types of methods, including both statutory and judicial remedies, for eliminating pay-if-paid provisions as void and unenforceable.

It noted that, pay-if-paid provisions are disfavored:

> Many jurisdictions, including North Carolina and Wisconsin, have enacted legislation voiding such clauses as against public policy… North Carolina Gen.Stat. § 22C-2, Wis.Stat.Ann. § 799.135(1). Illinois, Maryland and Missouri have also enacted legislation limiting such clauses. New York and California have judicially declared pay-if-paid provisions to be against public policy as abrogating the states' lien laws. *West-Fair Elec. Constrs. v. Aetna Cas. & Sur. Co*., 87 N.Y.2d 148, 153, 661 N.E.2d 967 (1995), *Wm. R. Clarke Corp. v. Safeco Ins. Co*., 15 Cal.4th 882, 896, 938 P.2d 372 (1997). *Id* at ¶18.

In addition to these states, other states are recognizing the unconscionable nature of the pay-if-paid clause and have begun to address pay-if-paid clauses through legislative efforts: **Delaware**, Delaware Code Ann. title 6 § 3507 (e) [Makes void any clause in a Subcontract that makes payment by the owner a condition precedent to the subcontractor's payment]; **Wyoming**, Wyoming Statutes § 16-6-602 [For a public contract, contractors must be paid within 45 days of the receipt of the invoice]. **Hawaii,** does not prohibit pay-if-paid clauses, but places additional burdens on prime contractors to assure that they are negotiating on a level playing field with all subcontractors. Hawaii Revised Statutes § 444-25 requires that prime contractors clearly state the fact that pay-if-paid clauses will be utilized in its subcontracts thereby permitting all subcontractors to recognize the risk and adjust their bids accordingly.

Similarly, the Nevada Supreme Court in *LehrerMcGovern Bovis, Inc. v. Bullock Insulation, Inc.*, 2008 Nev. LEXIS 46 (Nev. 2008) has interpreted Nev. Rev. Stat. Ann. §§624.624-624.626 as making void any contractual pay-if-paid provision in a construction subcontract.

The Trial Court in the instant action made the correct decision, has followed this Court's precedent, in *Evans* and is in concert with the *Transtar* decision of the Lucas County Court of Appeals, just last month. This Court should affirm the Trial Court's decision, if not even go further to expand the decision to hold forfeitures caused by clauses relieving prime contractors from the obligation of payment for properly performed work and supplied materials if that prime contractor did not properly exercise its duty to qualify the project owner to assure that the project owner could pay for the construction.

CONCLUSION

"Pay-if-paid" clauses are disfavored under Ohio law as well as under the laws of numerous jurisdictions around the country. Courts across this country have recognized that such clauses are harsh and unconscionable and that such terms will often cause an inequitable forfeiture. Courts in Ohio and around the country hold that such forfeiture provisions must be strictly construed and that they must "clearly and unambiguously condition payment to the subcontractor on receipt of payment from the owner."

Strong public policy weighs against the continued use of "pay-if-paid" clauses in construction subcontracts because such clauses unreasonably and improvidently transfer the risk of loss from the party best able to analyze and control the loss, the prime contractor. This Court should at minimum follow its own precedent set forth previously in *Evans* and affirm the decision of the Franklin County Court of Common Pleas or optimally expand the decision to

hold contingent payment clauses, known as pay-if-paid clauses, void and unenforceable as against public policy.

Therefore, the American Subcontractors Association and the American Subcontractors Association of Ohio urge this Court to affirm the Trial Court's decision determining that forfeitures are contrary to public policy and that pay-if-paid clauses must be explicit so as to convey the inherent risk of nonpayment by the project owner, or eliminated altogether as being void and unenforceable as against public policy.

DATED: January 14, 2013

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned counsel for the American Subcontractors Association and American Subcontractors Association of Ohio hereby certifies that copies of the foregoing were served electronically and regular U.S. Mail, postage prepaid, on the following counsel of record this 14th day of January, 2013.

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