CANADIAN DESIGN-BUILD INSTITUTE
1900-275 Slater Street Ottawa ON K1P 5H9
Tel: 613.236.9455
Fax: 613.236.9526
www.cdbi.org

The Risk Management Committee is pleased to provide this risk management article for the members of CDBI. The following article addresses the risks and issues associated with contract management and trying to ensure that your firm is paid for services rendered.

The Risk Management Committee of the Canadian Design-Build Institute will continue to circulate articles of this nature to members as they become available. We trust this will be found to be of interest and beneficial to the members.

Avoiding Pay When Paid Pain
By Paul Stocco

There is an old saying that "cash is king". Adapted for challenging economic times, the saying should be "cash flow is king". Ensuring that accounts receivable are paid in a timely way, and having enough cash flow to pay accounts payable, are prime concerns for any business. Adequate cash flow is especially important for the construction industry where the flow of money from the top to the bottom of the contract pyramid determines the success, or failure, of a construction business.

To deal with the uncertainties caused by cash flow issues, some parties have begun to insert "pay when paid" clauses into their contracts. Essentially, if the payor on a contract gets paid by its client (i.e. someone further up the contract pyramid), the payor will then, and only then, pay money owed to its payee. These clauses are not new, and given current economic uncertainties, these clauses have enjoyed a resurgence.

However, before there is widespread adoption and acceptance of "pay when paid" clauses in all construction contracts, consideration should be given to recent judicial treatment of "pay when paid" clauses.

In the ***Bluelime Enterprises*** [1]case, the Ontario Divisional Court reviewed the efforts undertaken by a payor to collect money owed to it so that the payor could in turn pay its payee. In the ***Bluelime Enterprises*** case, the payor contracted to provide IT services to Alberta Justice. Due to the sensitive nature of the IT work, Alberta Justice required that all service providers have no prior criminal record. The payor had subcontracted some of the IT work to its payee. During the course of the work, it came to light that the payee had failed to disclose prior breaches of US and Canadian securities legislation. When Alberta Justice became aware of this, the payor's contract was terminated. The payor's account went unpaid. Alberta Justice incurred significant costs to conduct a security sweep of the IT system in order determine if the payee had compromised IT system. Alberta Justice's costs were greater than the monies owed to the payor. As a result of non-payment by Alberta Justice, the payor refused to pay its payee.

[1] ***6157734 Canada Inc. v. Bluelime Enterprises Inc***. 2016 ONSC 1794.

When analyzing the efforts that the payor took to collect the outstanding account, the Court noted that the payor made a few calls to Alberta Justice, but the payor stopped short of commencing a lawsuit against Alberta Justice—largely on the grounds that the payor did not want to upset the good customer relationship it had with Alberta Justice.

As a matter of law, the Court found that payor was bound to take "reasonable steps" to collect the outstanding account; however, this obligation was not boundless. If no money was forthcoming from such reasonable collection efforts, then the payor would not be required to pay its payee. This "reasonable efforts" requirement is consistent with a recent decision of the Supreme Court of Canada[2] which recognized a party's obligation of "honest performance" of its contractual obligations.

What does this mean for the construction industry? If a payor seeks to rely on a "pay when paid" clause as an excuse for not paying, the payor must take reasonable steps to attempt collection. What is reasonable will depend on many circumstances. It is clear that doing nothing, or only making half-hearted attempts will not be enough. By contrast, a payee should ensure that it is not the reason for its payor to not be paid by someone further up the contract pyramid.

The outcome in this case underscores the need for greater cooperation and better communication between all contracting parties. This is especially important in the construction industry. Construction projects typically embrace "teaming concepts" at the start; however, things can quickly change. Collaborative approaches and clear communication can be easily forgotten when conflicts arise. Eliminating all conflict on construction projects is likely impossible; however, there are a variety of ways to effectively manage conflict e.g. entering into teaming agreements; adopting Integrated Project Delivery; appointing third party neutral project mediators, etc. Different projects will require different proactive conflict management strategies. Underlying all of these strategies are relatively simple concepts: better communication and honest performance of contractual obligations.

If both parties follow these straightforward suggestions, there will be more "payin" than "pain".

Paul Stocco
Partner, Brownlee LLP
Paul V. Stocco is a partner and the head of the Construction Law Team for the Alberta based law firm of Brownlee LLP. Paul's practice involves providing advice to his clients on issues relating to all aspects of construction contracts including design-build and P3s, and construction procurements involving tenders and RFPs. Paul also represents clients involved in construction litigation at all levels of Courts. Paul is the editor of Brownlee LLP's Constructive Thinking newsletter and is a member of the Law Society of Alberta and the Law Society of Upper Canada (Ontario). The Construction Law Team at Brownlee LLP practices in conjunction with a number of lawyers at the firm whose practice includes Municipal Litigation and Corporate Commercial Litigation.

[2] ***Bhasin v. Hrynew*** 2014 SCC 71.