

## “Pay When Paid” Clauses

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We are all familiar with the commercial objective of “pay when paid” clauses - i.e., to protect or control a builder’s cash flow. Two recent decisions have cast further doubt on the effectiveness of such clauses if the purpose is to postpone indefinitely payment to a subcontractor where the builder is never paid.

Two types of “back-to-back” or “pay when paid” clauses often found in subcontracts:

- (i) clauses that defer the time for payment, when the right to payment has already accrued; and
- (ii) clauses that defer the right to payment itself.

Clauses of the first kind operate to defer the subcontractor’s entitlement to payment but have no effect on the builder’s ultimate obligation to pay for work done.

The second type seeks to prevent the builder’s obligation to pay for work done from arising until such time as the builder is paid by its principal. If the builder is never paid, the subcontractor’s right to payment will never arise.

The Supreme Court of Queensland has considered clauses of the second type in two recent unreported decisions. In both cases apparently similar clauses appeared in provisions relating to arrangements for progress payments.

In *Iezzi Constructions Pty Ltd v Currumbin Crest Pty Ltd (In Liquidation) and Others* the clause provided:

“... It is expressly agreed that the Subcontractor’s right to receive payment is entirely dependent upon the Builder having actually received from the Proprietor payment in respect of the work, the subject of the Subcontractor’s claim, and that the Subcontractor shall have no other or further right to payment...”.

In that case the subcontractor sued the builder for payment for work done. The proprietor had gone into liquidation and had not paid the builder. The builder sought (among other grounds) to rely on the clause, saying that because it had not been paid, the subcontractor’s right to payment of the contract sum had not arisen.

The builder submitted that, notwithstanding its location in the provision relating to progress payments, the clause was expressed sufficiently generally to cover payment of the contract sum, particularly in view of the reference to “other or further right to payment”. Moreover, the subcontractor’s right to payment was itself “entirely

dependent” on the builder itself having been paid.

The judge did not accept that argument and found the restrictions on the right to payment were:

“... limited to progress payments and have no effect on the ultimate obligation of the third defendant as Builder to pay to the plaintiff, as Subcontractor, the contract sum upon satisfactory completion of the entire works, or such other sum as may in law be payable on termination of the subcontract...”.

The clause was read down so that it applied only to progress payments despite the generality of its expression and the apparent prohibition on “other or further right to payment”.

The second case was *Parkinson Air Conditioning Pty Ltd v Trade Indemnity Australia Limited*. Although the relevant clause is not set out in the judgment, it is clearly in similar if not identical terms to the clause in the *Iezzi Constructions* case. In this case a subcontractor sued on an insurance policy after non-payment by the builder. The insurer, relying on the pay when paid clause, submitted that it was not liable because the builder’s obligation to pay had never arisen. Until it did, there was no trade debt insured under the policy.

In his judgement Mr Justice de Jersey said:

“... It would be an odd contract, if I may be pardoned for observing, where the subcontractor made his whole right to payment conditional upon the payment of the builder by the proprietor. This is plainly not such a contract ...”.

A copy of this judgment was given to the judge in the *Iezzi Constructions* case, who, when giving his decision, indicated that while he agreed with Mr Justice de Jersey he saw no need to alter the reasons he had already prepared.

These decisions strengthen the view that any attempt to defer the subcontractor’s entitlement to payment of contract sums will have to be tied to the primary obligation of the builder to make payment for the work to be done by the subcontractor rather than to provisions relating to progress payments. It is hard to imagine a situation where such an arrangement would be commercially realistic.

Like Mr Justice de Jersey, we would find such a contract to be unusual indeed!

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