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Strategic Considerations for Pay-If-Paid Provisions in Ohio

By Lowell T. Woods Jr. of Taft Stettinius & Hollister LLP. Reprinted with permission

In Ohio, as confirmed by the Ohio Supreme Court in *Transtar Electric, Inc. v. A.E.M. Electric Services Corp.*, 140 Ohio St.3d 193, 2014-Ohio-3095, pay-if-paid clauses are enforceable provided that appropriate language is used. While such provisions are considered unreasonable from a subcontractor's perspective, many general and/or prime contractors view pay-if-paid clauses as a logical means to equitably spread risk, particularly in situations where the project owner becomes intractable or insolvent. Subcontractors will counter that pay-if-paid provisions unfairly require them to assume the risk of a general contractor's poor performance or unwillingness to pursue legitimate claims on behalf of lower-tier parties and that general contractors are much better positioned to assess and assume the risk of owner non-payment. Where a pay-if-paid provision is purportedly in place and becomes an issue in the

recovery of requested compensation, strategic considerations will vary depending upon the position of the party.

An initial issue is whether the pay-if-paid provision is enforceable. In the *Transtar* case, the Ohio Supreme Court held that the use of the term "condition precedent" in reference to the owner's payment to the general contractor "clearly and unequivocally shows the intent of those parties to transfer the risk of the project owner's nonpayment from the general contractor to the subcontractor." Additional language broadly indicating that the subcontractor assumes the risk of non-payment by the owner will also strengthen the provision. Conversely, a poorly worded clause that fails to make payment from the owner an express and unambiguous condition precedent to the subcontractor's right to payment is likely be viewed as a pay-when-paid clause, obligating the general

(Continued on page 4)

Inside this issue:

Pay-if-Paid Provisions	1
Tech Tip: Fastcase Alerts	2
Free CLE	5
Aspen Treatises Moving to Fastcase	6
Subscriber Renewals	6
Intellectual Property Resources	7

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By: Julie Koehne, Assistant Law Librarian, Systems

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94%	2. Misewicz v. City of Memphis (W.D. Tenn., 2012)	March 26, 2012	0

...of the EMS Act. As explained above, the EMS Act provides that each county may develop an emergency medical services program (§ 1797.200) and that each local EMS agency shall "annually submit an emergency medical services plan for the EMS area to the authority." (§ 1797.254.) If a county establishes an EMS agency and develops an EMS plan, and a city or fire district finds that the plan proposed by the local EMS agency allows it to continue its control over local emergency medical services, that...

...obtaining a paramedic certification within a specified time." (Id. ¶ 2.) The newly disclosed documents included copies of the following forms: Availability of Applicant, City of Memphis Fire Services Division Fire Recruit EMT-IV Certification/Recertification Agreement ("EMT-IV Agreement"), City of Memphis Fire Services Division Fire Recruit and Firefighter/Paramedic-Probationary Firefighter I & II Certification Agreements ("Firefighter I & II Agreement"), Emergency Medical Technician-Paramedic Certification...

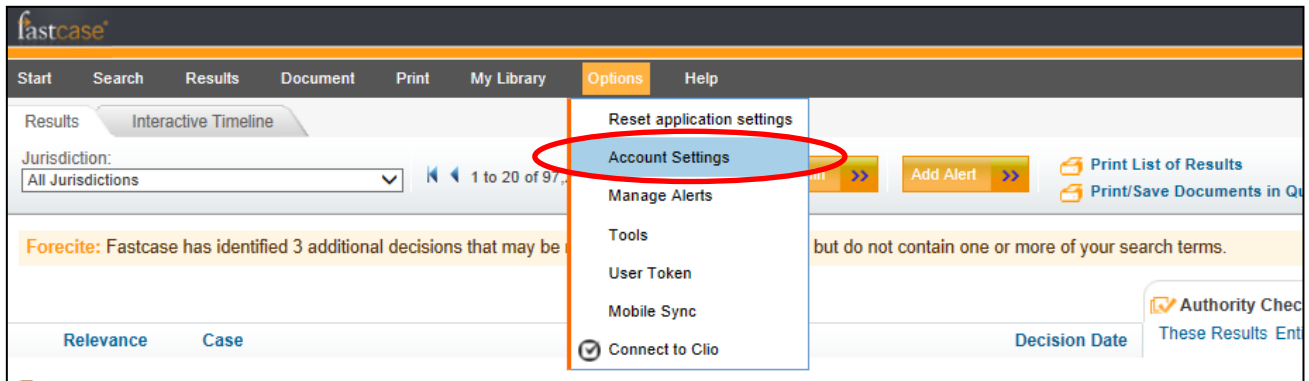
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(Continued from page 1)

contractor to make payment to the subcontractor within a reasonable period of time. While the determination of a reasonable period of time will vary from court to court, the subcontractor will ultimately be entitled to receive payments found to be due and owing.

If confronted with an enforceable pay-if-paid provision, subcontractors need to determine whether there are any alternative means to secure payment. Absent contractual provisions to the contrary, the mere existence of a pay-if-paid provision will not limit a subcontractor's lien rights or other potential remedies, such as the ability to pursue direct recovery from the project owner under the equitable theory of unjust enrichment where the project owner received benefits without making payment for the reasonable value of the improvements. That being said, a general contractor seeking to thwart any potential recovery against the project owner can incorporate front-end lien waivers and/or prohibit direct claims against the project owner in the contract documents. Of course, such contractual waivers clearly undercut any argument that the pay-if-paid provision is intended to fairly spread the risk of owner non-payment.

If available, a payment bond may provide subcontractors another source of recovery that may be immune to pay-if-paid provisions and other associated contractual waivers. Under O.R.C. 4113.62(A), commonly referred to as the Fairness in Construction Contracting Act (the "Act"), any provision of a construction contract that waives rights under a surety bond is void and unenforceable as against public policy. While there is

no controlling Ohio authority directly on point, a subcontractor in a payment dispute on a bonded project can argue that a broad pay-if-paid provision constitutes an unenforceable waiver of rights with respect to any available payment bond. However, the general contractor may assert that the pay-if-paid provision does not directly reference the payment bond (presumably the case), and the bond would still be available to address certain claims, such as where the general contractor has received payment from the owner but disputes the subcontractor's entitlement due to defective workmanship or for other reasons. Accordingly, the general contractor has the ability to argue that since the pay-if-paid provision does not constitute a complete bar to rights under the available payment bond, it should be enforceable regardless of the resulting limitations to certain bond claims. Lacking clear and settled authority on this issue, both general contractors and subcontractors should be prepared to make the appropriate arguments in support of their respective positions.

Beyond the above, subcontractors pursuing the recovery of certain delay damages can raise additional arguments against the enforceability of pay-if-paid provisions. O.R.C. 4113.62(C) states that any contract provision that waives a subcontractor's entitlement to delay damages that are the proximate result of the owner's or general contractor's act or failure to act is void as against public policy. While somewhat similar to the protection of bond claims, this language focuses on the cause of alleged damages (owner or general contractor caused delay) as opposed to the source of recovery (bonds). As with an attempted contractual waiver of bond claims, a subcontractor can and should argue that the

enforcement of a pay-if-paid provision to escape damages for owner or general contractor caused delays constitutes a clear and unambiguous violation of O.R.C. 4113.62

(C). Indeed, to the extent a project experiences delays that involve damages primarily incurred by a subcontractor, and an enforceable pay-if-paid clause exists, the owner and general contractor may have a significant incentive to engage in collusive conduct to deprive the subcontractor of recovery contrary to the express intent of the Act.

While the Ohio Supreme Court has not ruled on the primacy of pay-if-paid provisions versus O.R.C. 4113.62(C), at least one unreported Ohio Court of Appeals decision has held that a claims process that does not entirely preclude, but instead merely limits, the potential recovery of delay damages does not violate O.R.C. 4113.62(C). *B.I. Chipping Co. v. R.F. Scurlock Co.* 10th Dist. Franklin No. 04AP-1219, 2005-Ohio-6748. In *B.I. Chipping*, the court found that a portion of a subcontract limiting the subcontractor's recovery of delay damages to amounts the general contractor recovered from the Ohio Department of Transportation through ODOT's claims process did not fall within the scope of O.R.C. 4113.62(C), as the subcontractor agreed to seek relief through such process and further agreed to allow the general contractor to act on its behalf in pursuing such claims. Of course, this holding should provide little comfort to subcontractors that their interests will be aggressively pursued in similar situations, and subcontractors would be well-advised to contest the applicability of the *B.I. Chipping* decision if raised as a defense.

In Ohio, both general contractors and sub-

contractors should recognize that an appropriately drafted pay-if-paid provision is a valid and enforceable means to shift the risk of owner non-payment, and they should further understand potential strategies to enhance their respective positions when owner non-payment is a concern. From the general contractor's perspective, care should be taken to draft an enforceable provision. Further, if the intent is to block any alternative sources of recovery to the subcontractor, appropriate supplemental contract language should be drafted. If included in the contract documents, subcontractors should evaluate whether a pay-if-paid provision and other language limiting recovery of compensation can be removed and/or mitigated through pre-contract negotiation, and, if not, subcontractors should engage in a front-end assessment of possible strategies to secure compensation if owner non-payment becomes an issue.

For more information, contact [Lowell T. Woods Jr.](#)

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Presenter: Mary Jenkins

Wednesday, December 2, 2015

1.0 hour of general CLE is pending in Ohio and Kentucky.

Note: this seminar was previously presented on May 13, 2015.

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Aspen Treatises on Fastcase

Aspen treatises in a wide array of practice areas are moving from LoisLaw to Fastcase. Fortunately, we are a current Fastcase customer, so our users will have access to this excellent resource when the treatises move on December 1, 2015. As of this writing, some details are unclear so we cannot say exactly where you will find the Aspen content. We will share more information when we have it. Please contact a librarian with questions come December.

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Demystifying intellectual property : a guide for the nonspecialist
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Drafting patent license agreements
KF3145 .M35 2012

Drafting patents for litigation and licensing
KF3145 .D727 2013

Horwitz on patent litigation
KF3155 .W5 2015

How to write a patent application
KF3125.C5 S472 2015-

Intellectual property deskbook for the business lawyer : a transactions-based guide to intellectual property law
KF2980 .I63 2013

Intellectual property protection in China
KNQ1155 .I5836 2015

IP strategy : complete intellectual property planning, access, and protection
KF2979 .I727 2014

McCarthy on trademarks and unfair competition
KF3180 .M29 2014

Music Law 101
KFO330 .M87 2015

Patry on copyright
KF2991.5 .P382

Online Resources-Remote Access

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IP Law Daily

Copyright Law Newsletters

Guide to Computer Law Newsletters

Trademark Law Report Letter

Title 21 C.F.R. - Food & Drugs

Title 37 C.F.R. - Patents, Trademarks & Copyrights

Copyright Law Reporter

Guide to Computer Law

Patent Reform Law - Leahy-Smith America Invents Act

Trademark Law Guide

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Copyright Handbook

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Legal Guide to Web & Software Development

Patent, Copyright & Trademark

Patent Savvy for Managers

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-Happy Holidays-



December 2015 Law Library Newsletter

- Pay-if-Paid Provisions
 - Tech Tip: Fastcase Alerts
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- INSIDE THIS MONTH**

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