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Contractors' Duty to Seek Payment Under Provisional Payment Clauses

Unpaid contractors cannot sit back and refuse to pay subcontractors based on a provisional payment clause. The recent decision in *6157734 Canada Inc v Bluetime Enterprises Inc ("Bluetime")*¹ affirms that contractors have a duty of good faith that requires them to make "best efforts" to recover payment from owners. However, there is little guidance on what constitutes "best efforts". Will writing a demand letter suffice? Does a contractor need to sue the owner? What if the lawsuit seems unlikely to succeed?

Failing to make "best efforts" could result in the contractor being ordered to pay the subcontractor even if the owner never pays. On the other hand, taking unnecessary steps to make "best efforts" can be expensive. Contractors should adopt a strategy that minimizes enforcement costs while still making "best efforts".

Provisional payment clauses can, at the least, extend the time for payment of subcontractors' claims

In general, provisional payment clauses provide that the contractor is not obligated to pay the subcontractor until the contractor has been paid by the owner. These clauses are of two types: "pay if paid" clauses and "pay when paid" clauses. A "pay if paid" clause is one which transfers the risk of owner non-payment to the subcontractor, while a "pay when paid" clause is merely a timing device, delaying the contractor's obligation to pay while the contractor seeks payment

¹ 2016 ONSC 1794.

from the owner but not absolving the contractor of its ultimate obligation to pay the subcontractor's account.

One example of such a clause might read as follows:

Payments will be made not more than thirty (30) days after the submission date or ten (10) days after certification or when we have been paid by the owner, whichever is the later.

In a seminal decision on this subject in the case of *Timbro Developments Ltd v Grimsby Diesel Motors*,² the Ontario Court of Appeal, in a 2 to 1 decision, held that a clause identical to this provided that a subcontractor was not entitled to be paid unless the contractor has been paid.³ The subcontractor assumed the risk of non-payment by agreeing to the clause.

However, a provisional payment clause may *not* provide a defence to payment if the meaning of the clause is unclear,⁴ or if the clause, properly interpreted, was a "pay when paid" timing device only and not a "pay if paid" clause.⁵ Moreover, a contractor cannot rely on a provisional payment clause if its own act or default caused the owner not to pay.⁶

Contractors' duty of good faith to make "best efforts" to obtain payment

Although these clauses can be a defence in Ontario, unpaid contractors are not automatically absolved of their duties to pursue payment by virtue of having a provisional payment clause in the subcontract. In *Bluelime*, the Divisional Court held that a contractor has a duty of good faith to seek payment from an owner. Although *Bluelime* is not a construction case, it provides helpful guidance on the duty of good faith and what constitutes "best efforts".

² [1988] OJ No 448 (CA).

³ [1988] OJ No 448 (CA) at para 3.

⁴ *Harris Steel Ltd v Seaboard Surety Co of Canada / Cie de garantie Seaboard du Canada* (2003), 29 CLR (3d) 104 (Ont SCJ).

⁵ For example, in *Arnoldin Construction & Forms Ltd v Alta Surety Co* (1995), 137 NSR (2d) 281 (CA), the Nova Scotia Court of Appeal held that a standard "pay when paid" clause only affects the *timing* of payments due under the contract. Accordingly, if a contractor is not ultimately paid, it can still be liable to pay the subcontractor.

⁶ See e.g. *603878 Ontario Ltd v St Clair College of Applied Arts and Technology*, 2014 ONSC 6107 at para 11; *Kor-Ban Inc v Pigott Construction Ltd* (1993), 11 CLR (2d) 160 (Ont Gen Div); *McBrien v Shanly* (1874), 24 UCCP 28.

In *Bluelime*,⁷ 6157734 Canada Inc. (the "**subcontractor**") and Bluelime Enterprises Inc. (the "**contractor**") entered into an agreement under which the subcontractor would provide services to the Alberta Ministry of Justice (the "**Ministry**"). Before starting work, the subcontractor stated that its principal had never been convicted of any criminal or penal offences. After the subcontractor's principal performed work, the Ministry discovered that he had in fact been convicted of serious insider trading offences. The Ministry refused to pay the amounts owing to the contractor for the subcontractor's work on the basis that it had incurred significant costs in implementing security measures to ensure that its environment had not been compromised by the subcontractor's principal.

The subcontract contained a provisional payment clause. Although the contractor sent demands for payment, it did not sue the Ministry. The key issue was whether the contractor had a duty to seek payment from the Ministry and, if so, whether it made sufficient good faith efforts in fulfilling that duty. The subcontractor argued that the contractor had not made sufficient efforts and that, as a result, it should not be entitled to rely on the provisional payment clause.

The Divisional Court upheld the trial judge's finding that a contractor has a duty of good faith to make "best efforts" to seek payment from an owner. In considering the meaning of "best efforts", the Divisional Court held that the trial judge correctly articulated the legal obligation of a payor to "make every effort to collect the commissions or to negotiate a reasonable settlement."⁸ Indeed, as reinforced in *Harris Steel Ltd v Seaboard Surety Co of Canada / Cie de garantie Seaboard du Canada*,⁹ the contractor is required, *at the very least*, to use its best efforts to resolve the issues related to obtaining the owing payments.

The Divisional Court held that the contractor had fulfilled its duty to make "best efforts" by making many attempts to get an explanation from the Ministry for its non-payment. Further, the Court found that the Ministry's reasons for not paying were fair.¹⁰ The contractor did

⁷ 2016 ONSC 1794.

⁸ 2016 ONSC 1794 at para 37 citing *Crompton v Norman Hill Realty*, [1995] OJ No 3407 (Gen Div) at para 17.

⁹ (2003), 29 CLR (3d) 104 (Ont SCJ) at para 75.

¹⁰ 2016 ONSC 1794 at para. 48.

not pursue the matter further because the security costs incurred exceeded the amounts owing to the contractor such that it was unlikely that the contractor would ever recover the monies through litigation.¹¹ As a result, it was not necessary for the contractor to sue the Ministry in order to satisfy its "best efforts" obligation to recover payment.

Guidance for contractors on seeking payment

Bluelime affirms that contractors must make some effort to seek payment from owners. At a minimum, contractors should seek an explanation for the non-payment. Where the explanation is compelling such that a lawsuit would likely fail, a contractor need not sue the owner to recover payment. However, where the lawsuit is likely to succeed, the contractor may be required to sue the owner.

Consequently, *Bluelime* puts the contractor in the difficult position of having to judge the strength of a potential lawsuit against the owner. If the contractor fails to sue, it may not be permitted to rely on the provisional payment clause. However, if it sues and is unsuccessful, it will be exposed to legal fees and a potential cost award at the end of the litigation. Legal counsel can help contractors adopt a strategy that minimizes enforcement costs while still making "best efforts".

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a cautionary note

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¹¹ 2016 ONSC 1794 at para. 52.