



NASBP Virtual Events



A Deep Dive Into The Recent *Crosno* Decision And Its Impact On Pay-When-Paid Clauses In California

BY JONATHAN DUNN AND ALI SALAMIRAD, SMTD LAW LLP

Discussion Overview

“Pay When Paid” Clauses Are Enforceable in CA

The *Crosno* Decision

- Factual circumstances
- Pay-When-Paid language involved
- Parties’ arguments
- Holding and its implications

What are *Crosno*’s long-term implications to contractors and sureties

“Pay When Paid” Clauses Are Enforceable

In *Wm. R. Clarke Corp. v. Safeco Ins. Co.* (1997) 15 Cal.4th 882 the California Supreme Court held “pay if paid” clauses were void as against public policy because they act as an indirect waiver of a subcontractor’s mechanic’s liens rights in violation of former Civil Code section 3262 (now Civil Code section 8122).

Under Section 3262/8122 (commonly known as the anti-waiver statute) any contract clause or release that waives, affects, or impairs a claimant’s right to pursue their mechanic’s lien are “void and unenforceable.”

A pay if paid clause was interpreted as a waiver of the lien right as it states that the subcontractor is not owed any money if the owner fails to pay the general contractor.

On the other hand, that same Court approved the use of “pay when paid” clauses if the subcontractor is paid within a reasonable time after completing its work. Payment by the owner is not a condition precedent to the subcontractor’s right to receive payment. The subcontractor is owed the money – the general contractor has a reasonable period of time to obtain that money from the project owner before being required to make the payment.



NASBP Virtual Events

What is a “Reasonable Time”

Very little, if any, guidance from the Court’s about what is a reasonable time to seek payment from the owner prior to paying a subcontractor.

Many contracts define this time period as the time necessary for the general contractor to be able to enforce all of its legal rights and remedies against the owner in order to obtain payment.

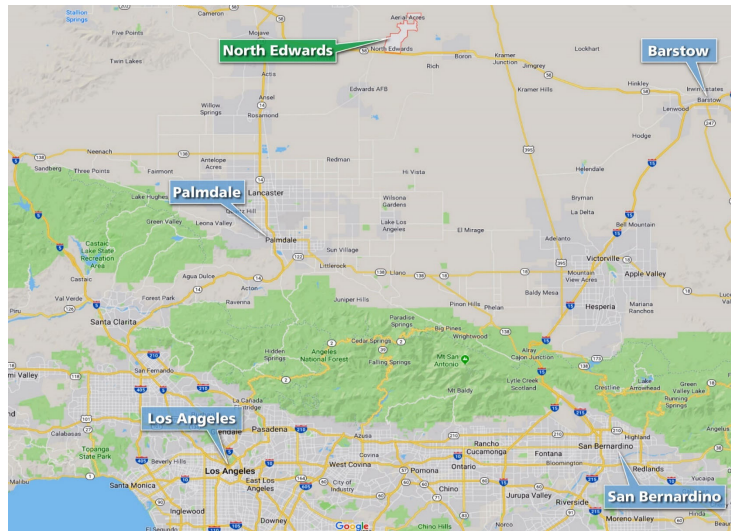
Others include a firm deadline.

Crosno is a case about what the Court considered to be an “unreasonable” time and, while answering some questions, leaves plenty of questions unanswered.



NASBP Virtual Events

Crosno: facts



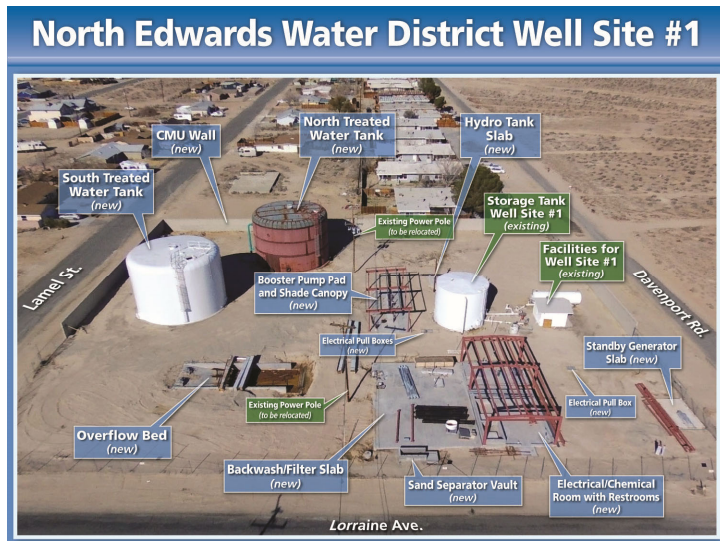
5

Crosno: facts



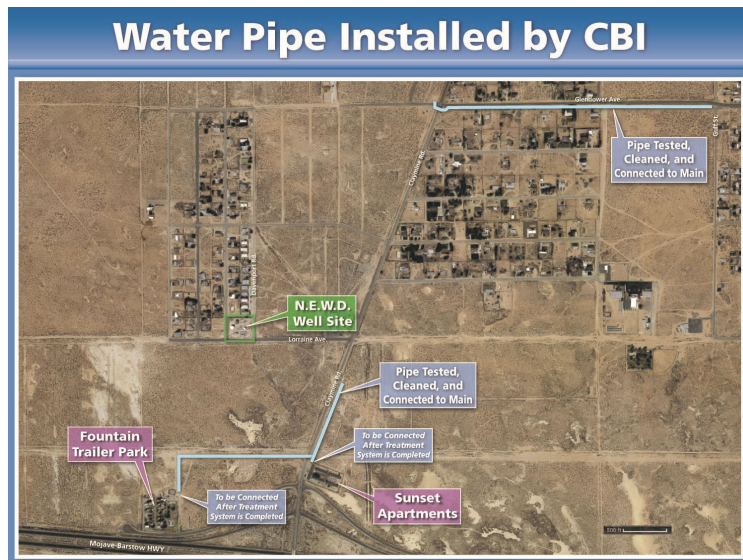
6

Crosno: facts



7

Crosno: facts



8

Crosno: facts

Ms. Kostopoulos' Deposition Testimony



March 8, 2019
116:14-117:3

Q. Ms. Kostopoulos, do you remember you filed a Declaration of Opposition of Opposition to the motion for a receiver in this lawsuit?

A. I remember that.

Q. Do you recall that in that Declaration you said the following and signed it under oath under penalty of perjury for Item No. 7 on Page 732 and it said:

"I know from personal knowledge that the water currently being provided to the 250 members of the North Edwards Water District is safe for drinking."

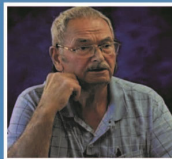
Do you recall that you put that in a sworn declaration?

A. I do.

9

Crosno: facts

Mr. Moyle's Trial Testimony



March 13, 2019 PM
53:2-53:17

A. ...EPA changed the requirements. It was 50 parts, now it's down to ten. It's just their -- their changing of it that made a difference.

Q. So in your mind the EPA is a little out of touch, they made it too safe?

A. No. They made it to get the builders more work. If you remember, when they changed it, it was an increased workload for "A" contractors in the working business, way back when. I don't know if you remember that.

Q. I want to make sure I understand this testimony. You think the EPA and, you know, the State of California did the same thing; right?

A. They follow EPA, yes.

Q. You think they lowered the allowable legal limit of arsenic to give work to contractors?

A. That's right.

10

Crosno: facts

Mr. Moyle's Deposition Testimony



Q. Do you have any intention to complete the remaining work on the project?

A. Some day I hope. EPA requires us to have it done or we wouldn't have had it done in the first place.

October 14, 2015
354:25-355:4

11

Crosno: facts

Mr. Moyle's Trial Testimony



A. And you don't think there's anything wrong with that water?

Q. The water doesn't taste great. Okay. I don't drink it.

March 13, 2019 PM
53:18-53:21

12

Crosno: facts

How NEWD Dealt with Professionals	
Bill Black, AECOM	"Lied to us" "We fired him"
AECOM Design Team	"Incompetent"
Mike Shahbakhti, AECOM	"Lied" "Had to get rid of him"
Clark Bros, Inc.	"Lied" Fired without notice
Krieger & Stewart	Disagreed with NEWD; Fired
Robert Hartsock	Advised to let CBI Return; Fired

13

Crosno: facts

- No dispute on Crosno's work
- No dispute as to amounts otherwise due Crosno
- Crosno brought summary judgment 2-1/2 years after suit
 - NEWD charged Clark Bros with delay
 - NEWD charged Clark Bros with faulty workmanship
 - NEWD claimed \$13M in damages
- Clark Bros made the strategic decision to refute NEWD's claims and did not bring cross-claims against any subs
- Court held nearly 2-years of settlement conferences
- Clark Bros obtained payment of principal from owner after trial court granted summary judgment to Crosno

14

Crosno's Pay-When-Paid Clause

If owner delays in paying Clark, then Clark and its surety "shall have a reasonable time to make payment to Subcontractor." In the subcontract, Crosno agreed to define a "reasonable time" under the pay-when-paid provision for delayed payment as follows:

"Reasonable time" shall be determined according to the relevant circumstances, but in no event shall be less than the time Contractor and Subcontractor require to pursue to conclusion their legal remedies against Owner or other responsible party to obtain payment, including (but not limited to) mechanics' lien remedies."

15

Crosno's Arguments: Pay-When-Paid Unenforceable

- Cal. Civ. Code §8122 made the PWP provision void
- Independent nature of the payment bond obligation prevents Travelers from asserting the PWP provision as a defense

16

Crosno's 8122 Argument

- Cal. Civ. Code §8122 provides:

An owner, direct contractor, or subcontractor may not, by contract or otherwise, waive, **affect, or impair** any other claimant's rights under this part, whether with or without notice, and any term of a contract that purports to do so is void and unenforceable unless and until the claimant executes and delivers a waiver and release under this article.

17

Crosno's 8122 Argument

- “Parade of horrors” response ...
 - 8122 is “anti-waiver” provision, not applied to terms & conditions re payment / performance
 - **Retention** would violate
 - **Pass-through** provisions would violate
 - **Notice** provisions would violate
 - **Quality** of work requirements would violate
 - **Payment** of labor terms would violate
 - Numerous other statutes that are contrary to literal interpretation promoted by Crosno (prompt payment statutes / progress payments / fixed price agreements / licensing)

18

Crosno's "Independent" Obligation Argument

- California Supreme Court "entitlement" rationale
 - *Powers Regulator Co. v. Seaboard Surety* (Cal App. 1962), 204 Cal. App. 2d 338.*
 - *Pneucrete Corp. v. USF&G Co.*, (Cal. App. 1935) 7 Cal. App. 2d 733

This rationale – taken to its extreme – potentially conflicts with other recognized in California Supreme Court cases.

19

Response to "Independent Obligation"

- Correctly applied only to address non-privity issues
- Must be reconciled with Supreme Court Cases of
 - *Flickinger v. Swedlow Engineering Co.* (1955) 45 Cal. 2d 388; and
 - *Lewis & Queen v. N. M. Ball Sons* (1957) 48 Cal. 2d 141.

20

Flickinger ...

"[A]ny right which plaintiff might have had to recover upon the bond was necessarily dependent upon plaintiff's right to recover upon his contract with [the general contractor]. ... such defense to this action is available to [the general contractor] as the principal, it is likewise available to . . . the surety on the bond."

Flickinger, supra, 45 Cal. 2d 388, 394.

21

Lewis & Queen ...

"The obligation of the sureties on defendant's bonds was not to pay for labor merely by virtue of the fact that it had been expended on [the public work]. It was an obligation to pay only if plaintiff established, without reference to the bond, a legal and valid claim for compensation."

Lewis, supra, 48 Cal. 2d 141, 155

22

Wm. R. Clarke Corp v. Safeco

"Neither *Flickinger* nor *Lewis*, nor any other case that has come to our attention, has addressed Safeco's hypothesized situation, in which a subcontractor is able to establish, without reference to the terms of a payment bond, a legal and valid mechanic's lien claim but not a legal and valid claim for breach of contract."

Wm. R. Clarke Corp., *supra*, 15 Cal.4th at 896.

23

Wm. R. Clarke Corp v. Safeco

"Where the bond is conditioned, as is the Safeco bond at issue here, on the payment of mechanic's lien claims on a particular private work, *Flickinger* and *Lewis* require only that a claimant on the bond establish, without reference to the terms of the bond, a legal and valid mechanic's lien claim for that project."

Wm. R. Clarke Corp., *supra*, 15 Cal.4th at 895-896.

24

What does *Crosno* mean for sureties in California ...

Conservative view: **One-Off decision**

- *"We do not suggest that all pay-when-paid provisions are unenforceable against a payment bond claim—just that this one is. The provision is in effect an attempt to define as "reasonable time" as a period previously construed by courts as unreasonable."*
Crosno, (2020) 47 Cal. App. 5th 940, 957-958.
- *"Insofar as subcontract provisions delay ultimate payment due, Travelers maintains they would affect or impair Crosno's payment bond rights. We need not dwell on this hypothetical parade of horrors. The effect of pass-through provisions, prelitigation dispute resolution clauses, notice requirements, retention provisions, and liquidated damage clauses is not before us. Suffice to say, Travelers misconstrues both the trial court's ruling and our decision today that affirms it. We do not suggest that every pay-when-paid provision is unenforceable as an impairment of payment bond rights under section 8122. Instead, we conclude that this one is unenforceable because it **unreasonably forestalls accrual of Crosno's payment bond rights for an indefinite period of time** while the direct contractor pursues litigation against the owner."*
- *Crosno*, (2020) 47 Cal. App. 5th at 960.

25

What does *Crosno* mean for sureties in California ...

Liberal interpretation: *Crosno* has broad implications that will expand the law

- *Civil Code 8122 does not include the words "**unreasonably forestalls accrual of Crosno's payment bond rights for an indefinite period of time** while the direct contractor pursues litigation against the owner."*
- *Instead: "waive, affect or impair" is used in Civ. Code 8122. Literal meaning will be applied*
- *Separate analysis of "lien" or "bond" rights from contract terms and conditions is dangerous, expands the law, and eviscerates Flickinger and Lewis & Queen and its progeny.*
- *The "parade of horrors" will be pushed and pursued by claimants going forward*
- *Court's comment that general contractors and sureties are required to finance owner non-payment (the point of the bond) is troubling. May lead to change in underwriting, limit competition to only the most well-healed GCs.*

26

What are GC's doing about *Crosno* ...

- *Modifying their pay-when-paid provisions back to vague terms or setting a sunset three (3) years or less**
- *Quickly negotiate "liquidation" agreements / pass-through provisions*
- *Consider paying undisputed sums in order to avoid liability for penalties*
- *Hoping and praying they will not get into prolonged disputes with owners on un-funded change orders or claims*

27

What are Subs doing about *Crosno* ...

- *Arguing that claim resolution with the owner is not an excuse for non-payment*
- *Arguing against stays of litigation pending the resolution of those claims*
- *Focusing their attention on payment bond sureties*
- *Expanding the reach of *Crosno* by arguing that pay when paid clauses have been rendered unenforceable*

28



NASBP Virtual Events



A Deep Dive Into The Recent *Crosno* Decision And Its Impact On Pay-When-Paid Clauses In California

BY JONATHAN DUNN AND ALI SALAMIRAD, SMTD LAW LLP