

Nos. 31869 and 31870 – *Wellington Power Corporation, a Pennsylvania corporation, v. CNA Surety Corporation, dba CNA Commercial Insurance, a Delaware corporation, and W. G. Tomko, Incorporated, a Pennsylvania corporation, v. CNA Surety Corporation, dba CNA Commercial Insurance, a Delaware corporation*

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Albright, Chief Justice, dissenting:

In reaching its conclusory decision that the need to encourage freedom to contract outweighs the public policy which underlies the legislative enactment of mechanic's lien and public bond statutes, the majority has seriously undervalued and misweighed the various interests implicated by the question of enforcing conditional payment provisions in construction contracts. Accordingly, I must respectfully dissent.

Because encumbrances to public property are disallowed as a general rule, mechanic's liens cannot be filed against public property. *See J.E. Moss Iron Works v. Jackson Co. Court*, 89 W.Va. 367, 109 S.E. 343 (1921). To avoid the problem created by exempting public property from mechanic's liens, the Legislature enacted the payment bond statute set forth in West Virginia Code § 38-2-39 (Supp. 2004). Without question, the purpose of the payment bond statute is to serve as a substitute mechanism for contractors and their laborers to collect moneys which they are owed in connection with work performed on public buildings or property. *See syllabus, in part, Morton Motor Co. v. Fidelity & Cas. Co.,*

109 W.Va. 67, 152 S.E. 860 (1930) (recognizing that the payment bond required by W.Va. Code § 38-2-39 “secures [people contracting to perform work on public structures]. . . for the reasonable price of such materials, machinery, equipment, and labor sold and furnished by them for which they would be entitled to a mechanics’ or laborers’ lien if the structure were a private instead of a public one”); accord *Everett Painting Co. v. Padula & Wadsworth Constr., Inc.*, 856 So.2d 1059, 1062 (Fla. App. 2003) (stating that purpose of public bond statute is “to protect subcontractors and suppliers by providing them with an alternative remedy to mechanic’s liens on public projects”). Despite recognizing that “[t]he public policy of this state is to secure payment to the materialmen and laborers in the building of structures to be used by the public,” the majority nonetheless turns its collective back on this long-recognized and much-valued tenet of construction law. *State ex rel. E.I. Du Pont De Nemours & Co. v. Coda*, 103 W.Va. 676, 685, 138 S.E. 324, 328 (1927).

Preferring to protect the right of freedom to contract, the majority disavows the public policy of securing payment for materials furnished by vendors and work performed by laborers that is at the core of our mechanic’s lien and public bond statutes. In doing so, the majority takes a position that is at odds with numerous jurisdictions throughout this country. See, e.g., *Wm. R. Clarke Corp. v. Safeco Insur. Co.*, 938 P.2d 372, 378-79 (Cal. 1997) (holding that pay if paid provision was in effect waiver of mechanic’s lien rights in violation of legislative anti-waiver scheme and ruling that such provision does not insulate

either general contractors or their payment bond sureties from their contractual obligations to pay subcontractors for work performed); *West-Fair Elec. Contrs. v. Aetna Cas. & Sur. Co.*, 661 N.E.2d 967, 971 (N.Y. 1995) (holding that “pay-when-paid clause which forces the subcontractor to assume the risk that the owner will fail to pay the general contractor is void and unenforceable as contrary to public policy”); *see generally* 8 *Williston on Contracts* § 19:58 at 490-91 (4th ed. 1998) (stating that “recent decisions and statutory enactments with respect to ‘pay when paid’ or ‘pay if paid’ clauses in construction contracts reveal . . . a number of important jurisdictions declaring that such clauses violate public policy and will not be enforced”).¹

Those jurisdictions that uphold conditional payment clauses do so only where the intent of the contracting parties is unquestionably clear.² In *Thomas J. Dyer Co. v. Bishop International Engineering Co.*, 303 F.2d 655 (6th Cir. 1962), the court rejected the general contractor’s defense that the contractual language which provided that no money owed to the subcontractor was due until five days after the contractor’s receipt of funds from

¹Statutes in both North Carolina and Wisconsin expressly make “pay if paid” or “pay when paid” clauses void as against public policy. *See* N.C. Gen. Stat. § 22C- 2 (1991) (Repl. Vol. 2003); Wis. Stat. Ann. § 779.135(1), (3) (2001)). In addition, at least three other states have enacted legislation that limits, in some fashion, the effect of such provisions. *See* 8 *Williston on Contracts* § 19:58 at 491, n. 1 (discussing legislation adopted by Illinois, Maryland, and Missouri).

²In Virginia, the introduction of parol evidence is permitted on the issue of intent to resolve the enforceability of such contract provisions. *See Galloway Corp. v. S.B. Ballard Constr. Co.*, 464 S.E.2d 349 (Va. 1995).

the owner was a condition precedent that prevented payment where the owner was insolvent. Concluding “that it was the intention of the parties that the subcontractor would be paid by the general contractor for the labor and material put into the project,” the Sixth Circuit determined that the provision was designed to allow the contractor a reasonable period of time in which to pay the subcontractor for work performed. *Id.* at 661. The Sixth Circuit opined that the credit risk inherent in the general contractor’s undertaking could be shifted to the subcontractor, but only where the contract contained express language “clearly showing that to be the intention of the parties.” *Id.*

While the *Dyer* case is relied upon by those who seek to enforce conditional payment provisions where the contracts at issue contain specific “pay if paid” or “pay when paid” language, enforcement of such language is still not automatic. Those courts that have adopted the *Dyer* approach of enforcing conditional payment clauses only when the contract terms undeniably demonstrate the intent of the parties still “recognize a general presumption against the enforcement of the clauses” and require “that the presumption can be overcome only by the use of clear and unambiguous contract language.” Francis J. Mootz, III, *The Enforceability of Pay When Paid Clauses in Construction Contracts*, 64 Conn. B.J. 257, 265 (1990).

Emphasizing that the contract at issue clearly states the intention of the parties that the “pay if paid” language operates as a condition precedent to payment, the majority fails to consider the ever increasing recognition by scholars and courts alike that there is no true bargaining that occurs with regard to these construction contracts.³ Both commentators and jurists have suggested that when issues concerning “pay if paid” provisions arise, contracts containing these provisions should be evaluated in terms of unconscionability due to the clearly unequal bargaining position that exists between the general contractor and the subcontractors. *See* Gerald B. Kirksey, “*Minimum Decencies*” - *A Proposed Resolution of the “Pay-When-Paid”/“Pay-If-Paid” Dichotomy*, 12 *Construction Lawyer* 1, 43-44 (Jan. 1992); *see also* *Clarke*, 938 P.2d at 385, n. 2 (Chin, J., dissenting) (recognizing that pay if paid clause might be invalidated on grounds of misrepresentation, unconscionability, or contractor’s inappropriate attempt to exculpate himself from liability for payment due to his misconduct); 8 *Williston on Contracts* 19:58 at 507 (recognizing that “a subcontractor is often, if not typically, at a bargaining disadvantage as compared to the contractor, and contractors may abuse either their bargaining power or the freedom from liability that a truly conditional ‘pay if paid’ clause gives them”).

³Some commentators have gone so far as to refer to these construction contracts as adhesion in nature given their form nature and the lack of bargaining that precedes their execution. *See* Eric N. Larson, *Freedom from the Freedom-to-Contract: California Supreme Court Invokes Public Policy to Invalidate “Pay-if-Paid” Clauses in Construction Contracts*, 21 *Thomas Jefferson L. Rev.* 253, 275 (Oct. 1999).

Only if it can be shown that the parties truly engaged in equal bargaining⁴ and fully intended that non-payment by the owner would justify non-payment by the general contractor to the subcontractor (thereby agreeing to the shifting of the risk of non-payment) should such contractual language be upheld. The use of the terminology alone should not be conclusive evidence of such intent, given the probable lack of any true bargaining that accompanies the execution of these contracts. This area of the law is replete with reasons for concluding that the legislative policy of protecting laborers in this state tips the scales in favor of such public policy and against the freedom to enter into contracts containing these much-debated and certainly controversial conditional payment clauses.⁵ Consequently, I must disagree with the majority's conclusion that the public policy inherent in the lien statutes is trumped by the freedom to contract.⁶

⁴The majority concludes far too easily that the subcontractors were commercially sophisticated and thus dismisses any real consideration of the lack of bargaining that goes on with regard to these construction contracts. Regardless of their level of sophistication, the reality is that if you want the work you have to sign the contract.

⁵Noting that “the judicially elusive and practically unpredictable provision [“pay-when-paid” or “pay-if-paid”] has been the subject of debate and demand for clarification,” commentators have observed that “[a]lthough debated for years, not much has changed.” William M. Hill and Donna M. Evans, *Pay When Paid Provisions: Still a Conundrum*, 18 Const. Lawyer 16, 20, n. 4 (April 1998).

⁶If the majority's decision was affected by the general contractor's argument that absent such “pay if paid” provisions the costs associated with obtaining payment bonds would increase, I note that this contention amounts to pure conjecture as there is no supporting evidence for this claim in the record.

I also must part ways with the majority's conclusion that the surety can rely upon the "pay if paid" language to avoid complying with its contractual obligation to serve as a guarantor of payment to the affected laborers and materialmen. The majority rests its decision on the principle that "[a]s a general rule, the liability of the surety is coextensive with that of the principal." Syl. Pt. 2, *Gateway Commun., Inc. v. Hess*, 208 W.Va. 505, 541 S.E.2d 595 (2000). Reasoning that since the general contractor has no liability given the enforceability of the "pay if paid" clause, the majority concludes that there is no liability upon which the surety can be required to pay. Other courts have squarely rejected this reasoning. In *Moore Brothers Co. v. Brown & Root, Inc.*, 207 F.3d 717 (4th Cir. 2000), the appellate court addressed "whether a surety can assert the principal's defense based on 'pay when paid' language in the subcontract, where the surety did not expressly incorporate the 'pay when paid' language into the contract payment bond." *Id.* at 723. In rejecting the surety's attempt to rely upon the contractor's defense, the Fourth Circuit reasoned:

there is no indication that the parties intended the phrase "sums justly due" to incorporate the contingency of payment by the Owners. On the contrary, the very purpose of securing a surety bond contract is to insure that claimants who perform work are paid for their work in the event that the principal does not pay. *To suggest that non-payment by the Owners absolutely absolves the surety of its obligation is nonsensical, for it defeats the very purpose of a payment bond.*

Id. at 723 (emphasis supplied); accord *OBS Pace Co. v. Pace Constr. Co.*, 558 So.2d 404 (Fla. 1990); *Brown & Kerr, Inc. v. St. Paul Fire and Marine Ins. Co.*, 940 F. Supp. 1245

(N.D. Ill. 1996); *Shearman & Assoc., Inc. v. Continental Cas. Co.*, 901 F.Supp. 199 (D. V.I. 1995).

Just as in *Moore Brothers*, the payment bond in this case did not incorporate the “pay if paid” language that is set forth in the contract between the general contractor and the subcontractors. Because the subcontractors are suing on the payment bond and not their subcontracts, and because there is no language in the payment bond that hinges payment by the surety on the contractor’s receipt of payment from the owner, there is no basis for denying the subcontractors payment under the performance bond. As the Fourth Circuit aptly noted in *Moore Brothers*, such a denial would frustrate the very purpose of the payment bond.

Based on the foregoing, I respectfully dissent.

I am authorized to state that Justice Starcher joins in this dissenting opinion.