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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
IN THE SUPREME COURT

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

The Honorable Walton J. McLeod, IV, Circuit Court Judge

Opinion No. 6022 (S.C. Ct. App. filed August 30, 2023)

Clayton Construction Company, Inc.....Petitioner,

vs.

J&H Grading & Paving, Inc..... Respondent

RETURN TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Court of Appeals correctly hold that *Elk & Jacobs Drywall v. Town Contractors, Inc.* and S.C. Code Section Ann. 29-6-230 (2000) of the Subcontractors and Suppliers Payment Protection Act(S.C. Code Ann. 29-6-210 et seq.) do not allow a contractor to hold contract retainage for an unreasonable time from a subcontractor by using a contract clause requiring that the contractor receive payment from the owner as a condition precedent for the subcontractor being paid where there are no issues with the subcontractor's work? (Petitioner Questions 2 and 3).

2. Did The Court of Appeals correctly hold that the circuit court had sufficient evidence to find that Petitioner violated South Carolina Code Section 27-1-15 by failing to investigate Clayton's claim and by otherwise unreasonably refusing to pay the claim? (Petitioner Questions 1 and 6).

3. Did the Court of Appeals correctly hold that Petitioner refused to pay the Respondent within a reasonable time? (Petitioner Questions 4 and 5).

STATEMENT OF THE CASE

Respondent, J&H Grading & Paving, Inc. ("J&H"), filed this action against the Appellant, Clayton Construction Company ("Clayton") on May 21, 2018. (R. p. 28). This case arose out of subcontract work that J&H was performing pursuant to a contract with Clayton on property owned by Herlong Family Properties, LLC ("Owner"). J&H brought this action to foreclose its mechanic's lien against the owner's property and in the alternative for breach of contract against Clayton. J&H sent Clayton a demand for payment pursuant to South Carolina Code Section 27-1-15 on March 2, 2018. (R. p. 30, ¶ 18). Clayton answered on June 21, 2018. (R. p. 39). The parties mediated the case on February 19, 2019. As a result of the mediation, the parties entered into a settlement agreement. (R. p. 48). The Settlement Agreement called for the Owner to Pay J&H $75,298.00, and it gave the Owner credit for that amount for any amount due and owing to Clayton by the Owner. J&H reserved its claims

against Clayton, including interest and attorney's fees pursuant to S.C. Code 27-1-15. (R. p. 49, ¶ 5).

On August 14, 2019, a bench trial was held before the Honorable Walton J. McLeod IV. The issues at trial were whether Clayton had failed to conduct a fair and reasonable investigation of J&H's claim and pay any undisputed amount pursuant to South Carolina Code Section 27-1-15, and if so, whether J&H was entitled to interest and attorney's fees under the statute. (R. p. 100). The Court filed its order finding for J&H on October 4, 2019. (R. pp. 12). Clayton filed its Motion to Reconsider the order on October 9, 2019, (R. p. 93) which was denied by the Court on October 29, 2019. (R. p. 10). Clayton filed its Notice of Appeal on October 29, 2019. The Court of Appeals affirmed the trial court's order on August 30, 2023. Petitioner submitted its Petition for Rehearing on September 14, 2023, which was denied by the Court of Appeals on October 11, 2023.

Clayton is a commercial contractor based in Spartanburg, South Carolina. Clayton contracted with the Herlong Family Partnership ("Owner") to build an automobile dealership in Lexington County (the "Project"). On September 24, 2015, Clayton subcontracted with Respondent, J&H Grading & Paving, Inc. ("J&H"), for site work for the new dealership (R. p. 136). J&H substantially completed its subcontract in early 2017. The Town of Batesburg-Leesville issued a Certificate of Occupancy for the project on March 20, 2017 (R. p. 144). Thereafter the Owner began using the project for its intended purpose (R. p. 111, lines 1-23). After J&H completed its work on the Project, Clayton still owed the J&H for work performed on the project in the amount $75,298.00, which included the 10% retainage and a small outstanding contract balance (R. p. 107, line 25-p. 108, line 8).

Although J&H's work was substantially completed in early 2017, Clayton refused to pay J&H the outstanding balance and retainage despite repeated requests (R. p. 145, p. 147, p. 149, p. 151) (R. p. 107, line 20-p. 110, line 1). On August 1, 2017, Clayton's project manager, Brandon Klein, responded to J&H's request for payment by stating that the Owner had not paid Clayton, and therefore Clayton could not pay J&H (R. p. 145). On January 19, 2018, Harry Clayton of Clayton Construction informed J&H that the Owner had still not paid them and indicated that Clayton had filed a lawsuit against the Owner (R. p. 147). Notably there was never any claim that there was a problem with J&H's work and the lawsuit between the owner and general contractor was not related to J&H's scope of work. J&H requested payment again on January 25, 2018 (R. p. 149). No payment was received.

Thereafter, on March 2, 2018, counsel for J&H properly mailed a demand pursuant to South Carolina Code Section 27-1-15 to Clayton and its registered agent, requesting that Clayton and the owner conduct a fair and reasonable investigation of J&H's claim and pay any undisputed portion of the claim (R. p. 151). Clayton replied, through its counsel, on March 9, 2018 (R. p. 153). Clayton did not address the merits of J&H's claim, but merely repeated its excuse that the Owner had not paid Clayton, and that J&H's contract with Clayton did not allow J&H to receive its payment until the owner paid Clayton in full (R. p. 153). Clayton cited the subcontract provision "payments. . . shall be made to [J&H] for Work satisfactorily performed no later than seven (7) days after receipt by [Clayton] of payment from Owner to for [J&H]'s work." (R. p. 153). J&H filed a lien against the property on February 27, 2018, supported by punch list work performed in December 2017 (R. p. 36). No payment was forthcoming. J&H filed the underlying action on May 21, 2018.

The parties mediated the case on February 19, 2019. As a result of the mediation, the parties entered into a settlement agreement. The settlement agreement called for the Owner to Pay J&H $75,298.00, and it gave the Owner credit for the J&H payment against any amount due to Clayton from the owner. J&H reserved its claims against Clayton, including for interest and attorney's fees pursuant to S.C. Code 27-1-15 (R. p. 49, ¶ 5).

Clayton has not compensated J&H for the nearly two-year delay in payment of the undisputed amount due for work performed by J&H, the attorney's fees J&H expended to protect its interest, and for J&H's costs incurred to obtain payment for work it properly performed. Even though there is no question that Clayton owed J&H the sum demanded, J&H was forced to retain counsel, record a mechanic's lien, file a lawsuit, prosecute the case, engage in discovery, participate in mediation, and pay court costs to obtain the funds. Because there is no dispute that payment was due and owing to J&H, yet Clayton deliberately withheld payment based solely upon its "pay when paid" clause, while financing an unrelated lawsuit against the Owner, the court properly found that J&H is due the penalties provided by S.C. Code Section 27-1-15.

ARGUMENTS

1. THE COURT OF APPEALS CORRECTLY HELD THAT *ELK & JACOBS DRYWALL V. TOWN CONTRACTORS, INC.* AND SOUTH CAROLINA CODE SECTION 29-6-230 BOTH PREVENT A CONTRACTOR FROM USING A PAY WHEN PAID CLAUSE IN A CONSTRUCTION CONTRACT AS A CONDITION PRECEDENT TO PAYMENT AND THAT PAYMENT IS RQUIRED WITHIN A REASONABLE TIME.

Clayton justified not paying J&H based upon the following clause from the subcontract between the parties: "Final payment of the balance due shall be made to Subcontractor no later than seven (7) days after receipt by Contractor of final payment from Owner Subcontractor'(sic) Work." (R p. 34). Clayton used this clause against J&H as a condition precedent to J&H receiving payment for the work it performed for Clayton. A general

contractor withholding funds in this manner puts subcontractors in the precarious situation of financing a general contractor's dispute with an owner. This action is particularly egregious when the dispute has nothing to do with the subcontractor's work and the owner may be well within its rights to never pay the general contractor due to setoffs, liquidated damages, or construction defect claims.

The Court of Appeals did not overturn *Elk & Jacobs Drywall v. Town Contractors, Inc., 267 S.C. 412, 418, 229 S.E.2d 260, 262 (1976),* but recognized its holding as consistent with South Carolina Code Section 29-6-230 of the South Carolina Subcontractors and Suppliers Payment Protection Act. Clayton erroneously argues that the Court of Appeals overturned this Court's holding in *Elk.* The Court of Appeals' decision supported the most important holdings in *Elk* that were embodied in the South Carolina Subcontractor's Prompt Payment Act twenty-five years later:

> As a practical matter the suppliers and small contractors on large construction projects need reasonably prompt payment for their work and materials in order for them to remain solvent and stay in business. 'In the absence of a clear expression in the contract papers that the credit risk of the general contractor and the delay in payment frequently attending on construction projects are meant to be shifted to such suppliers and subcontractors, the contract instruments should not be construed as intending such assumption.' *Elk* at 418, 262.

Petitioner argues that *Elk* and the Prompt Payment Act provide that "pay when paid" clauses are by definition not "conditions precedent." This argument misconstrues the holding and the meaning of the Payment Protection Act. *Elk's* holding is that "pay when paid" clauses must not be interpreted as conditions precedent for payment to subcontractors. The General Assembly codified this holding with the passage of S. C. Code Section 29-6-230. *Elk* reflects the majority rule that when "pay when paid" clauses are to be interpreted as requiring payment to the subcontractor within a reasonable amount of

time. "Further, we note that the majority of other jurisdictions construe pay-when-paid clauses in a similar manner—i.e., the majority of jurisdictions construe such a provision as allowing payment under the contract to be delayed but not stopped altogether." *Fed. Ins. Co. v. I. Kruger, Inc.*, 829 So. 2d 732, 740 (Ala. 2002), See, e.g., *Thos. J. Dyer Co. v. Bishop Int'l Eng'g Co.*, 303 F.2d 655 (6th Cir.1962); *Dancy v. William J. Howard, Inc.*, 297 F.2d 686 (7th Cir.1961); *Statesville Roofing & Heating Co. v. Duncan*, 702 F.Supp. 118 (W.D.N.C.1988); *Robinson & Son, Inc. v. Ground Improvement Techniques*, 31 F.Supp.2d 881 (D.Col.1998); *Brown & Kerr Inc. v. St. Paul Fire & Marine Ins. Co.*, 940 F.Supp. 1245 (N.D.Ill.1996); *Southern States Masonry, Inc. v. J.A. Jones Constr. Co.*, 507 So.2d 198 (La.1987); *Koch v. Construction Tech., Inc.*, 924 S.W.2d 68 (Tenn.1996); and *Byler v. Great Am. Ins. Co.*, 395 F.2d 273, 277 (10th Cir.1968).

The Court of Appeals recognized the *Elk* decision as supporting the circuit court's ruling and that *Elk* was consistent with South Carolina Code Section 29-6-230. The Prompt Payment Act was passed almost twenty-five years after *Elk* and addresses the same issues. The prime contractor cannot condition payment to the subcontractor on receiving payment from the owner. Petitioner admits in its petition and the underlying briefs that it conditioned paying Respondent on receiving payment from the owner and for no other reason. The "pay when paid" clause is the sole reason that Clayton offers in its defense of refusing to pay J&H. It is the contractor's refusal to pay solely because an owner has not paid them that makes a "pay when paid" clause a condition precedent to payment, not the clause itself. The decision in this matter is the same as *Elk*, where the court ruled that the retainage may not be held indefinitely and must be paid within a reasonable time, or it becomes a condition precedent to payment. Here, Petitioner withheld payment for almost

two years past substantial completion and then the Respondent was only paid by the Owner at mediation.

The South Carolina Subcontractors' and Suppliers' Payment Protection Act ("SPPA") provides:

> Notwithstanding any other provision of law, performance by a construction subcontractor in accordance with the provisions of its contract entitles the subcontractor to payment from the party with whom it contracts. The payment by the owner to the contractor or the payment by the contractor to another subcontractor or supplier is not, in either case, a condition precedent for payment to the construction subcontractor. Any agreement to the contrary is not enforceable. SC Code Section 29-6-230 (2016).

The Prompt Payment Act codifies the holding in Elk that the payment by the owner to contractor cannot not be a condition precedent to the subcontractor receiving payment. The distinction between "pay when paid" and "pay if paid" is meaningless when years go by without the contractor paying the subcontractor because of the prime's dispute with a owner. The Court in *Elk* recognized at the time that "pay when paid" clauses as a matter of public policy should not be condition precedents to payments and placed a reasonable time requirement one these clauses, which is the rule recognized by the majority of jurisdictions and the Prompt Pay Act. The General Assembly codified that "pay when paid" clauses cannot be a condition precedent to payment in the Prompt Pay Act. Clayton used its "pay when paid" clause as a condition precedent to J&H receiving payment and admitted it at trial, in its briefs, and in this petition.

In this case, the were no issues with J&H's work quality and the work was complete. Clayton's only reason for non-payment was its ongoing dispute with the owner. "'Retainage' is defined as 'a percentage of a contract price retained from a contractor as assurance that subcontractors will be paid and that the job will be completed.'" *Gamewell*

Mech, LLC v. Lend Lease (US) Constr., Inc., 273 N.C. App. 407, 846 S.E.2d 860 (2020)(*citations omitted)*. In this case, the retainage held was to ensure that J&H did its job and paid its suppliers. The purpose of the retainage was fulfilled and allowing the contractor to hold onto those funds indefinitely violates the Prompt Payment Act and public policy as set forth in *Elk* at 262, as the subcontractors and suppliers are not meant to shoulder the risk for the general contractor in unrelated disputes with an owner. The decision by the Court of Appeals was not retroactive and fully consistent with the previous common law under *Elk* and the Prompt Payment Act.

2. THE COURT OF APPEALS CORRECTLY HELD THAT THE EVIDENCE SUPPORTED THE CIRCUIT COURT'S FINDING THAT THE PETITIONERS' REFUSAL TO PAY RESPONDENT WAS BASED SOLELY UPON PETITIONER NOT BEING PAID BY THE OWNER AND WAS UNREASONABLE AND A VIOLATION OF S.C CODE ANN. 27-1-15.

By the time the Petitioner received the demand letter from J&H invoking S.C. Code Section 27-1-15, Petitioner had already held J&H's funds for almost a year. (R. 151-153), itself an unreasonable amount of time. Under 27-1-15 whether the contractor made a reasonable and fair investigation of the merits of J&H's claim is a question of fact. *See Hardaway Concrete Co. v. Hall Contracting Corp.*, 374 S.C. 216, 229, 647 S.E.2d 488, 495 (Ct. App. 2007), *Moore Elec. Supply Inc., v. Ward* 316 S.C. 367, 374-75, 450 S.E.2d 96, 100 (Ct. App. 1994). Section 27-1-15e also provides that the contractor will be liable for fees and interest if the contractor "otherwise unreasonably refuses to pay the claim." The Court of Appeals was correct in finding that there was no evidence presented as to an investigation by Clayton of J&H's claim and that Clayton was unreasonable in failing to pay J&H within a reasonable time based solely upon the subcontract's "pay when paid" clause.

The circuit court found that Clayton did not pay any portion within forty-five days of a proper demand. Clayton did not dispute the amount claimed, the work performed, or any merits of the claim. (R. pp. 14-15). Calyton's response to the 27-1-15 demand was sent on March 9, 2018:

> As you may also be aware, Clayton has not received payment for the work from the owner of the project, Herlong Family Partnership ("Herlong"), and is currently in litigation against Herlong seeking same. In accordance with the provisions with the subcontract, therefore, there are no amounts due and owing to J&H at this time. (R. p. 74).

Clayton's response to J&H's demand letter was using the subcontract "pay when paid" clause as a condition precedent to payment without any other meritorious reasons. Using the "pay when paid" clause as a condition precedent was prohibited by *Elk*, and later by the Prompt Payment Act. Therefore, the Court of Appeals is correct in holding that Clayton's actions were unreasonable as its withholding of J&H's payment was a complete disregard for the law.

III. THE COURT OF APPEALS CORRECTLY HELD THAT OVER NINETY DAYS IS AN UNREASONABLE AMOUNT OF TIME FOR A GENERAL CONTRACTOR TO WITHHOLD PAYMENT FROM A SUBCONTRACTOR SOLELY BASED UPON THE CONDITION PRECEDENT THAT THE GENERAL CONTRACTOR BE PAID IN FULL BY THE OWNER BEFORE THE GENERAL CONTRACTOR PAYS ITS DEBT TO THE SUBCONTRACTOR.

The Court of Appeals was correct in upholding the trial court's ruling that a general contractor's failure to pay a subcontractor withing ninety days, based solely upon the condition precedent of the contractor being paid by the owner is unreasonable. Clayton's argument would operate as a *defacto* waiver of the subcontractor's right to perfect its mechanic's lien. A subcontractor's lien rights do not begin and end from when the payment is due, but from the last day that the subcontractor performed work or supplied material. (S.C. Code 29-5-10 et seq.) Therefore, if a prime contractor takes the position, as Clayton

has in this case (that nothing is due and owing until the owner pays), then the "pay when paid" clause would waive the subcontractor's lien rights. The mechanic's lien statute requires a sworn statement of "a just and true account due him" to perfect the mechanic's lien. (S.C. Code § 29-5-90). A waiver of mechanic's lien rights is against the public policy of the state of South Carolina. "Provided, however, that an agreement to waive the right to file or claim a lien for labor and materials is against public policy and is unenforceable unless payment substantially equal to the amount waived is actually made." S.C. Code Section 29-7-20(2).

The ninety-day timeframe is not the only standard for unreasonableness for a general contractor to hold a subcontractor's funds but reflects a clear maximum amount of time in contracts where mechanic's liens rights are involved. There may be fact specific issues in other contractual relations that create a shorter amount of time that would deem withholding funds unreasonable, such as when a payment bond is involved.

Clayton's argument regarding pursuing the foreclosure action below as it relates to timing is disingenuous and merely prove that it acted unreasonably. In its answer in the foreclosure action, Clayton specifically took the position that "no amounts are currently due and owing pursuant to the written agreement between the parties." (R. 41 ¶ 19). Clayton's argument regarding the ninety days also ignores the fact that J&H's work was not involved in the dispute between Clayton and Herlong and Clayton was using the money it owed J&H to finance Clayton's lawsuit with the owner.

Finally, any question as to reasonableness is a factual determination. The court followed both *Elk* and the Prompt Payment Act in finding that ninety days is an unreasonable time to hold undisputed funds based upon a pay when paid clause.

Conclusion

For the foregoing reasons, J&H Grading and Paving, Inc. respectfully asks that this Petition for a writ of certiorari be dismissed.

Respectfully Submitted,

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November 29, 2023

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PROOF OF SERVICE

The undersigned hereby certifies that a true copy of J&H Grading and Paving, Inc.'s RETURN TO PETITION FOR WRIT OR CERTIORARI in the captioned matter has been served on all parties of record by emails a copy of the same this 29th day of November 2023, addressed as follows:

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