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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
IN THE COURT OF APPEALS

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

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

Appellate Case No.: 2019-001950

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

vs.

Clayton Construction Company, Inc.....Respondent

INITIAL BRIEF OF RESPONDENT J&H GRADING & PAVING, INC.

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II. The Trial Court correctly found that Clayton did not conduct a fair and reasonable investigation and did not pay J&H within a reasonable time after J&H's work was completed.

III. The Trial Court correctly ruled that Clayton failed to make a reasonable and fair investigation of J&H's demand and then pay the undisputed amount pursuant to South Carolina Code Section 27-15-15.

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. (Complaint). 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. The Complaint noted in Paragraph 18 that J&H sent Clayton a demand for payment pursuant to South Carolina Code Section 27-1-15 on March 2, 2018. (Complaint). Clayton answered on June 21, 2018. (Clayton Answer). The parties mediated the case on February 19, 2019. As a result of the mediation, the parties entered into a settlement agreement. (Settlement Agreement). 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. (Settlement Agreement).

The parties' cross-motions for summary judgement were heard by Judge Stilwell, and he issued orders denying those motions on June 4, 2019, finding that material of issues of fact

existed. (Stilwell Order). 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. (Tr. Trans.) The Court filed its order finding for J&H on October 4, 2019. (Tr. Order). Clayton filed its Motion to Reconsider the order on October 9, 2019, (Mot. to Reconsider) which was denied by the Court on October 29, 2019. (Order on Motion to Recon.). Clayton filed its Notice of Appeal on October 29, 2019.

Standard of Review

In an action at law, tried without a jury, the findings of fact of the judge will not be disturbed on appeal unless found to be without any evidence which reasonably supports them *Moore Elec. Supply, Inc. v. Ward*, 316 S.C. 367, 369, 450 S.E.2d 96, 97 (Ct. App. 1994) *citing*, *Republic National Bank v. DLP Industries, Inc.*, 314 S.C. 108, 441 S.E.2d 827 (1994). "Determining the proper interpretation of a statute is a question of law, and this Court reviews questions of law de novo." *Lambries v. Saluda Cty. Council*, 409 S.C. 1, 7, 760 S.E.2d 785, 788 (2014).

Facts

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 contracted with Respondent, J&H Grading & Paving, Inc. ("J&H"), for site work for the new dealership (Tr. Exhibit 1). J&H substantially completed its work on the project in early 2017. The Town of Batesburg-Leesville issued a Certificate of Occupancy for the project on March 20, 2017 (Tr. Ex. 2). Thereafter the Owner began using the project for its intended purpose (Tr. Trans. p. 12:1 - 23). After J&H completed its work on the Project, Clayton still owed the amount remaining to be paid of $75,298.00, which included the 10% retainage and a small outstanding contract balance (Tr. Tran. pp. 8:25 - 9:8).

Although J&H's work on the project was substantially completed in early 2017, Clayton refused to pay J&H the outstanding balance and retainage despite repeated requests (Tr. Exhibits 4, 5, 6, and 7) (Tr. Tran. pp. 8:20 - 11:1). 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 (Tr. Ex. 4). 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 (Tr. Ex. 5). J&H requested payment again on January 25, 2018 (Tr. Ex. 6). 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 (Tr. Ex. 7). Clayton replied through its counsel one week later, on March 9, 2018 (Tr. Ex. 8). 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 (Id.). 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." (Id.). J&H filed a lien against the property on February 27, 2018, supported by punch list work performed in December 2017 (Mech. Lien). 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 (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 (Settlement Agreement).

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, 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

I. The Trial Court correctly found that the South Carolina Subcontractors and Suppliers Payment Protection Act rendered the "pay when paid" clause in the Clayton subcontract unenforceable as a matter of law.

The trial court correctly ruled that Clayton was not entitled to indefinitely withhold payment rightfully due to J&H solely on reliance of the clause in the subcontract that stated that J&H would be paid within seven days of Clayton being paid by the owner, where Clayton withheld payment for almost two years past substantial completion.

The South Carolina Subcontractors' and Suppliers' Payment Protection Act ("SPPA"), provides that "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." S.C. Code Ann. § 29-6-230. The statute explicitly forbids "pay when paid" clauses from being used to withhold payment from subcontractors. "The payment by the owner to the contractor or the payment by the contractor to another subcontractor or supplier is not, a condition precedent for payment to the construction subcontractor. "**Any agreement to the contrary is not enforceable.**" *Id.* (emphasis added).

Clayton recognized through emails and letters that it owed J&H for its work. (MFSJ Exhibits 4, 5, 6, and 8). J&H was never asked to perform any corrective work. (Tr. Tran. 12:21-23). The only testimony presented to the trial court was that Clayton refused to pay J&H the funds due because Clayton had not been paid by the Owner. (Tr. Tran. pp. 8:9 – 11:23). Clayton refused to pay J&H on the basis that Clayton's contract provided that it would

pay J&H "for Work satisfactorily performed no later than seven (7) days after receipt by Contractor of payment from Owner for Subcontractor's Work" (Ex. 1, Subcontract, Article 1) (Exhibit 8, March 9, 2018 letter from counsel). Therefore, it was Clayton's position that it was entitled to withhold payment from J&H indefinitely.

Clayton claims that its withholding of payment otherwise due to J&H did not violate the SPPA, claiming that the SPPA only bars "pay if paid" clauses and that "pay when paid" clauses are not addressed by the SPPA. Practically there is no difference if the owner never pays the prime contractor. Clayton's arguments beg but do not address the question of at what point a "pay when paid" clause becomes "pay if paid." The litigation in which Clayton was involved with the owner was over issues unrelated to J&H's work. Clayton argues that its clause was not a "condition precedent." This argument contradicts counsel's March 9, 2018 response which clearly states that there are, "are no amounts due and owing to J&H at this time," because Clayton had not received payment from the owner. "A condition precedent to a contract is 'any fact other than the lapse of time, which, unless excused, must exist or occur before a duty of immediate performance arises.'" *Brewer v. Stokes Kia, Isuzu, Subaru, Inc.*, 364 S.C. 444, 449, 613 S.E.2d 802, 805 (Ct. App. 2005) (citing *Worley v. Yarborough Ford, Inc.*, 317 S.C. 206, 210, 452 S.E.2d 622, 624 (Ct. App. 1994)). *See also M & M Grp., Inc. v. Holmes*, 379 S.C. 468, 477, 666 S.E.2d 262, 266 (Ct. App. 2008). In this case Clayton states that the owner must pay Clayton before Clayton's duty to pay J&H arises. However, Clayton's claim against the Owner could fail, resulting in no further payment to Clayton from the Owner. Following Clayton's logic, no payment would ever be due to J&H, as the condition precedent would never occur.

North Carolina recognized that contractors cannot use a pay when paid clause to refuse to pay a subcontractor the amount due. North Carolina's similar statute states that payment by the owner to a contractor cannot be a condition precedent for payment to a subcontractor. North Carolina courts recognized that such contract terms are unenforceable under its similar payment statute. *See Am. Nat'l Elec. Corp. v. Poythress Commer. Contractors, Inc*., 167 N.C. App. 97, 101, 604 S.E.2d 315, 317 (2004) (applying N.C. Gen. Stat. § 22C-2).

The plain language of the SPPA does not mention a "pay if paid" or "pay when paid" situation. The plain language states that a contractor cannot refuse to withhold payment because the owner has not been paid by the contractor. "[I]f a subcontractor performs in accordance with the terms of its contract, it is entitled to payment. . . . Payment to the subcontractor by the contractor is not conditioned upon payment to the contractor from the owner. Importantly, **the parties cannot contract around this**." Joshua D. Spencer, *You Can't Rob Peter to Pay Paul: South Carolina Statutory Payment Protections in Construction Projects*, S.C. Lawyer, Sept. 2012 at 24 (emphasis added).

Prior to the passage of the SPPA, South Carolina recognized that pay when paid clauses in subcontracts had the potential to be unfair to subcontractors. As such, the pay when paid clauses could not be used to create a condition precedent to payment, but they required that subcontractors be paid within a reasonable time regardless of the contractor receiving payment from the owner.

> 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.' *Schuler-Haas Elec. v. Aetna Cas. & Sur.*, 49 A.D.2d 60, 371 N.Y.S.2d 207 (1975).

Elk & Jacobs Drywall v. Town Contractors, Inc., 267 S.C. 412, 418, 229 S.E.2d 260, 262 (1976).

The same reasoning would apply under the SPPA – once a reasonable time has passed, the contractor is using the pay when paid clause as a condition precedent. J&H demanded its undisputed payment since at least August 1, 2017. The Certificate of Occupancy allowed the property to be used for its intended purpose since March 20, 2017. Clayton never requested any remedial work from J&H. By refusing to pay J&H in a reasonable time, Clayton forced J&H to file a lien against the owner, file a foreclosure action, participate in discovery, and finally attend mediation. J&H only received payment after a settlement with the Owner. The owner then received a credit to funds potentially owed to Clayton. At no point has Clayton ever claimed it did not owe J&H the money for any other reason than it had not received money from the Owner. It is undisputed that Clayton did not intend to pay J&H until it received payment from the Owner, if that ever happened. Furthermore, Clayton knew it was not going to receive payment any time soon, as it was in litigation with the owner over matters unrelated to J&H's work on the project.

II. The Trial Court correctly found that Clayton did not conduct a fair and reasonable investigation and did not pay J&H within a reasonable time after J&H's work was completed.

Neither party in this matter disputes that a contractor has a "reasonable time" in which to pay the subcontractor upon presentation of the subcontractor's invoice. Clayton cites numerous such cases supporting this proposition from other jurisdictions in its brief. However, Clayton does not address the reasonableness of its actions in withholding undisputed funds for completed work from J&H for an indefinite period.

Under S.C. Code Section 27-1-15, the General Assembly defined the reasonable amount of time that the contractor has to pay an undisputed claim when demand is made under that statue, which is forty-five days. The *Elk* decision recognized that the question of reasonableness in time was for the trier of fact to decide. The Court in this matter sat as the trier of fact. Elk also recognized that the balance of power lies with the contractor, and that subcontractors and suppliers need reasonably prompt payment. The Court quoted language from the Sixth Circuit that noted that "to construe it as requiring the subcontractor to wait to be paid for an indefinite period of time until the general contractor has been paid by the owner, which may never occur, is to give it an unreasonable construction which the parties did not intend at the time the subcontract was entered into." *Elk,* 267 S.C. at 415, 229 S.E.2d at 261, quoting *Thos. J. Dyer Co. v. Bishop Int'l Eng'g Co.,* 303 F.2d 655 (6th Cir. 1962)). That is the same in this case.

The trial court found, as the trier of fact, that a reasonable period of time could not exceed ninety days from the date payment was due to a subcontractor, as laborers must file mechanic's liens for amounts due prior to ninety days from their last day of work on a project. (S.C. Code Ann. § 29-5-10 et seq.) This requires subcontractors to expend funds in attorney's fees and costs in court filings. Therefore, a contractor is required to pay subcontractor within at least ninety days from the presentation of an invoice, even if there is a pay when paid clause in the contract. J&H would argue that a 27-1-15 demand letter shortens that time to forty-five days, as explicitly provided in the statute.

Clayton's arguments regarding payment defenses and the prime contractor filing liens that protect the subcontractors interest have nothing to do with the reasonableness of time that the contractor has to pay an undisputed amount due. Again, this goes against the

reasoning in the SPPA and *Elk*, which recognize that subcontractors and suppliers need to be paid promptly. As the Court stated, at this point, the contractor has forced the subcontractor, through no fault of its own, to expend funds to collect money it is due. The Court was also correct that Clayton's actions were unreasonable because Clayton had received the value of J&H's work as contracted. Clayton's position that it was reasonable to withhold payment for twenty-three months from the date that the owner occupied the property, where J&H's work was complete, is not supported by any definition of reasonableness.

III. The Trial Court correctly ruled that Clayton failed to make a reasonable and fair investigation of J&H's demand and then pay the undisputed amount pursuant to South Carolina Code Section 27-15-15.

Whether Clayton conducted a reasonable and fair investigation of J&H's claim is a question of fact for the Court. *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). The Court was correct in holding that Clayton failed to conduct a reasonable and fair investigation and that Clayton had no reasonable reason to withhold payment from J&H. Clayton withheld the payment where the amount claimed was undisputed and there was no dispute that J&H completed its work properly.

> Whenever a contractor, laborer, design professional, or materials supplier has expended labor, services, or materials under contract for the improvement of real property, and where due and just demand has been made by certified or registered mail for payment for the labor, services, or materials under the terms of any regulation, undertaking, or statute, it is the duty of the person upon whom the claim is made to make a reasonable and fair investigation of the merits of the claim and to pay it, or whatever portion of it is determined as valid, within forty-five days from the date of mailing the demand. If the person fails to make a fair investigation or otherwise unreasonably refuses to pay the

> claim or proper portion, he is liable for reasonable attorney's fees and interest at the judgment rate from the date of the demand.

S.C. Code Ann. § 27-1-15.

It is undisputed that J&H expended labor and materials for the improvement of real property. It is also undisputed that J&H made a proper demand under that statute. (Ex. 7). Therefore, Clayton had a duty to make "a reasonable and fair investigation of the merits of the claim and pay it . . ." Clayton did nothing other than have its attorney send a letter stating that it had not been paid by the owner and therefore no payment was due. This letter was sent seven months after J&H's first email inquiring as to its payment (Exhibits 8 and 4). Clayton did not address any problems with J&H's work or any other reason for withholding payment. The undisputed testimony is that there were no problems with J&H's work. (Tr. Tran. 12:21 - 22). Clayton's action on its face was not fair, as the SPPA act makes the clause it was relying on unenforceable and Clayton is charged with knowledge of that statue. *See Gregory v. Gregory*, 292 S.C. 587, 589. 358 S.E.2d 144, 146 (Ct. App. 1987).

It is also undisputed that Clayton unreasonably refused to pay the claim. In fact, Clayton specifically negotiated for credit for the payment from the owner in regard to the settlement. (Tr. Ex. 13, ¶4). The result is that Clayton financed its lawsuit against the Owner for matters unrelated to J&H's work by withholding money undisputedly due to J&H. The trial court correctly found that Clayton violated South Carolina Code Section 27-1-15, where after receiving J&H's demand for payment, Clayton reviewed the claim, admitted that the work was completed, but refused to pay the amount due claiming that the owner had yet to pay Clayton, and using that as a condition precedent to payment despite

the prohibition by the SPPA. Importantly, the dispute between the owner and Clayton did not relate to J&H's work.

The investigation for Clayton under 27-1-15 should have been very simple, as Clayton knew that the payment was due to J&H even prior to receiving the demand letter. Clayton argues that the trial court erred in considering matters prior to the demand letter; however, the communication prior to the letter demonstrates Clayton's violation of its duty under 27-1-15, where it already knew the funds were due to J&H. The Project was satisfactorily completed, and a certificate of occupancy was issued on March 20, 2017. (Tr. Ex. 2). On July 25, 2017, J&H resubmitted its final pay application. Clayton replied stating "We have not been paid retainage by Mr. Herlong and therefore we cannot issue your remaining retaining(sic) until paid." (Tr. Ex. 4). On January 19, 2018, J&H inquired again regarding its payment. Clayton replied that the owner had still not paid Clayton. (Tr. Ex. 5). J&H wrote Clayton again on January 25, 2018. (Tr. Ex. 7). J&H's demand letter pursuant to SC. Code 27-1-15 was mailed on March 2, 2018. (Tr. Ex. 7). Clayton replied through its counsel on March 9, 2019 - one week later. (Tr. Ex. 8). The letter stated that J&H's claim was not being paid because the J&H contract with Clayton contained a contract clause which stated Clayton should be paid for "Work satisfactorily performed no later than seven (7) days after receipt by [Clayton] of payment from Owner for [J&H]'s Work." (Id.). Clayton concluded that there was nothing due and owing to J&H at that time, despite having previously recognized that the work was complete. Nowhere did the letter cite any work deficiencies or request correction of work. The sole reason that Clayton refused to pay J&H was Clayton's reliance on the "pay when paid" clause in its contract. Notably, there was no determination of the claim being valid or invalid as required by the

statute. Clayton's letter itself establishes a prima facia showing that Clayton 1) did not make a reasonable and fair investigation of the claim, and 2) Clayton refused to pay the undisputed portion of the claim, both in violation of its duty under S.C. Code Section 27-1-15.

Conclusion

For the foregoing reasons, J&H Grading and Paving, Inc. respectfully asks that this Court affirm the findings of the Lower Court that the South Carolina Subcontractors and Suppliers Payment Protection Act rendered the "pay when paid" clause in the Clayton subcontract unenforceable as a matter of law, that Clayton did not conduct a fair and reasonable investigation and did not pay J&H within a reasonable time after J&H's work was completed, and that Clayton failed to make a reasonable and fair investigation of J&H's demand and then pay the undisputed amount pursuant to South Carolina Code Section 27-15-15.

Respectfully Submitted

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PROOF OF SERVICE

I, Lacey A. Segars, a Legal Assistant at Bruner, Powell, Wall & Mullins, LLC, attorneys for the Respondent, J&H Grading & Paving, Inc., do hereby certify that on the 15th day of June, 2020, I served the *Initial Reply Brief of Respondent and Designation of Matter to be included in the Record on Appeal* upon opposing counsel by depositing the same in the U.S. Mail, postage prepaid, and addressed as follows:

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June 15, 2020

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