STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

The Honorable Walton J. McLeod, IV
Case No. 2018-CP-32-01746

Appellate Case No. 2019-001950

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

v.

Clayton Construction Company, Inc.…….. Appellant.

FINAL BRIEF OF APPELLANT
CLAYTON CONSTRUCTION COMPANY, INC.

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STATEMENT OF THE CASE

On or about May 21, 2018, Plaintiff/Respondent J&H Grading & Paving, Inc. ("J&H") brought this action against Defendant/Appellant Clayton Construction Company, Inc. ("Clayton") as well as other defendants, Herlong Family Properties, LLC and Herlong Chevrolet Buick, Inc. (collectively hereinafter "Herlong"), for foreclosure of its Mechanic's Lien, breach of contract and quantum meruit. (R. p. 25).

On June 21, 2018 Clayton filed its Answer. (R. p. 39). On July 27, 2018, Herlong filed its Answer and Counterclaims against J&H for breach of contract. On February 19, 2019, J&H, Clayton and Herlong held a mediation wherein J&H's contract balance under its subcontract with Clayton was paid and all claims by and between J&H and Herlong were resolved. (R. p. 48). Herlong was, thereafter, dismissed from the case with prejudice.

On February 26, 2019 Clayton filed a motion for summary judgment on all J&H's claims. (R. p. 46). On February 27, 2019, J&H filed a cross motion for summary judgment as to all its causes of action against Clayton. (R. p. 53). On June 4, 2019, the Honorable Robin B. Stilwell issued Orders denying both Clayton and J&H's motions for summary judgment for reasons that material factual disputes remained as to each party's causes of action. (R. pp. 1, 4). On August 13, 2019, Clayton filed its pre-trial brief for the bench trial to be heard by the Honorable Walton J. McLeod, IV. (R. p. 77). At trial, J&H, with Clayton's consent, moved to amend its Complaint and bring cause of action against Clayton under *South Carolina Code Ann*. § 27-1-15. As J&H had already been paid its subcontract balance, the only issue presented at trial was whether J&H was entitled to attorneys' fees under *South Carolina Code Ann*. § 27-1-15. On October 4, 2019, Judge McLeod issued an Order finding that J&H was entitled to attorneys' fees under *South*

Carolina Code Ann. § 27-1-15 as the "pay when paid" clause in the subcontract between Clayton and J&H was unenforceable and the delay in payment to J&H was unreasonable. (R. p. 12).

On October 9, 2019, Clayton filed a Motion to Reconsider Judge McLeod's Order. (R. p. 93). On October 29, 2019, Judge McLeod denied Clayton's motion and this appeal ensued. (R. p. 10).

STATEMENT OF FACTS

Clayton and Herlong entered into an agreement wherein Clayton agreed to be the general contractor for the construction of a Chevrolet dealership (hereinafter the "Project") located in Lexington County, South Carolina. Thereafter, Clayton entered into subcontracts with certain subcontractors, including J&H. On September 24, 2015, Clayton and J&H entered into a written subcontract (hereinafter the "Subcontract") for J&H to perform certain site work on the Project. (R. p. 136). The Subcontract provided, among other things, that "[p]rogress payments less retainage of 10%, shall be made to Subcontractor for work satisfactorily performed no later than seven (7) days after receipt by Contractor of payment from Owner for Subcontractor's work". *Id, Article 1.*

On August 10, 2017, after not receiving payment from Herlong, Clayton filed a mechanics lien against the Project and on August 21, 2017, Clayton filed suit against Herlong for the monies owed on the Project in a civil action titled *Clayton Construction Co., Inc. v. Herlong Family Properties, LLC and Ally Bank*; having a C.A. No.: 2017-CP-32-030362.

On February 27, 2018, after not receiving payment, J&H filed a mechanics lien against the Project. (R. p. 36). On March 2, 2018, J&H mailed a demand letter to Clayton pursuant to *South Carolina Code Ann*. § 27-1-15. (R. p. 151). Clayton investigated J&H's claim and responded in a letter dated March 9, 2018, stating:

> "… J&H's subcontract agreement with Clayton on the Herlong Chevrolet Dealership project provides that "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 for [J&H]'s work. 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. 153). Clayton's investigation was within the forty-five (45) day requirement under *South Carolina Code Ann*. § 27-1-15. *Id.* Further, as no money was owed under the Subcontract, no money was required to be remitted under *South Carolina Code Ann*. § 27-1-15. *Id.*

In February 2019, by and through a mediation settlement, J&H was paid its Subcontract balance directly by Herlong, fulfilling Clayton's contractual obligation to pay J&H within seven (7) of the owner paying. (R. pp. 48, 136).

ARGUMENT

I. THE COURT WAS ERRONEOUS IN FINDING THAT CLAYON'S INVESTIGATION WAS NOT FAIR AND REASONABLE UNDER SOUTH CAROLINA CODE ANN. § 27-1-15

South Carolina Code Ann. § 27-1-15 provides that:

> "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."

See South Carolina Code Ann. § 27-1-15. Accordingly, under *South Carolina Code Ann*. § 27-1-15, a party can only be liable for attorneys' fees if it "fails to make a fair investigation" or

"otherwise unreasonably refuses to pay the claim or proper portion" within forty-five (45) days of the mailing of the demand. *Id*. The party seeking an award of attorney's fees and interest under the statute has the initial burden of presenting prima facie evidence that the opposing party did not make a fair and reasonable investigation. *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).

In the matter at hand, J&H's demand letter was dated March 2, 2018 and Clayton investigated and replied by March 9, 2018, clearly within the forty-five (45) statutory requirement. (R. pp. 151, 153). Further, Clayton's denial that any monies were due and owing was based on the agreed upon provisions of the Subcontract, the prevailing South Carolina case law under *Elk & Jacobs Drywall v. Town Contractors, Inc.* and the fact that Herlong had not paid Clayton for J&H's work. *See e.g. Elk & Jacobs Drywall v. Town Contractors, Inc.,* 267 S.C. 412, 229 S.E.2d 260 (1976).

The fact that Clayton relied on and accurately followed the prevailing South Carolina case law, as discussed below, is determinative that Clayton's investigation was fair and reasonable and the Court's finding otherwise was patently erroneous.

II. THE COURT WAS ERRONEOUS IN FINDING THAT "PAY WHEN PAID" PROVISIONS CREATE CONDITIONS PRECENDENT TO PAYMENT

The law of South Carolina is clear that "pay when paid" provisions do not create conditions precedent. *See e.g. Elk & Jacobs Drywall v. Town Contractors, Inc.,* 267 S.C. 412, 229 S.E.2d 260 (1976). In *Elk*, the provision in question was: "The retainage will be paid sixty (60) days after the later of the following events: … (iv) Full and final payment to the Contractor of all funds due him for this project…" *Id.* at 261. In looking at this provision, the South Carolina Supreme Court, stated "[w]e do not think subparagraph (iv) created a condition precedent but rather only postponed

payment by [the general contractor] for a reasonable time so as to afford [the general contractor] an opportunity to obtain funds from the owner." *Id.* Further, the rationale that "pay when paid" provisions do not create conditions precedent is even cited from numerous other jurisdictions in the Order itself. *See Galloway Corp. v. S.B. Ballard Const. Co.*, 250 Va. 493, 506, 464 S.E.2d 349, 357 (1995) (*holding that the default interpretation of "pay when paid" clauses is that they require payment within a reasonable time*); *In re Davidson Lumber Sales, Inc.,* 66 F.3d 1560, 1565 n.4 (10th Cir. 1995) (*"Moreover, with respect to construction contracts, the general rule is that such pay-when-paid provisions do not operate as conditions precedent under which the duty to pay is contingent upon receipt of funds from a third party ... To the contrary, these provisions are viewed as only postponing payment for a reasonable time and merely establishing a convenient time for payment."*); *Paul Morrell, Inc. v. Kellogg Brown & Root, Inc.*, 682 F. Supp. 2d 606, 630-631, 2010 U.S. Dist. LEXIS 7532, 64-65 (*"Under most circumstances, pay-when-paid provisions are not "suspensive conditions" but rather terms for payment that only delay a contractor's obligations to make payment, and then only for a limited time"*).

The Court's holding, in finding that "pay when paid" provisions were unenforceable, that "it is not that pay-when-paid clauses 'are not conditions precedent,' it is that payment by the owner may not be used as a condition precedent" cannot be reconciled with the standing precedent from the Supreme Court that it didn't think the "pay when paid" provision created a condition precedent. *See e.g. Elk.* Accordingly, the Court's finding of unenforceability was erroneous. The Court also erroneously states Clayton's interpretation of *Elk* in stating that "[Clayton]'s interpretation of *Elk* would require a subcontractor to work on a project indefinitely without payment" when that flies in the face of the entire holding of *Elk* and Clayton's position that the general contract, under a

"pay when paid" provision, could only withhold payment for a reasonable time so as to afford it an opportunity to obtain funds from the owner. *See e.g. Elk.*

III. THE COURT WAS ERRONEOUS IN FINDING THAT "PAY WHEN PAID" PROVISIONS ARE ENFORCEABLE UNDER THE SOUTH CAROLINA SUBCONTRACTORS' AND SUPPLIERS' PAYMENT PROTECTION ACT

As discussed in Section II, *supra*, "pay when paid" provisions do not create conditions precedent, such contractual provisions are not unenforceable under *South Carolina Code Ann.* § 29-6-210 et. seq., the South Carolina Subcontractors' and Suppliers' Payment Protection Act (the "SSPPA"). *South Carolina Code Ann.* § 29-6-230 states 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. 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.

South Carolina Code Ann. § 29-6-230. Pursuant to *South Carolina Code Ann.* § 29-6-230, therefore, if an agreement between a general contractor and a subcontractor has a condition precedent for payment as one of its terms, like a "pay if paid" provision, it is not enforceable. *Id*. Conversely, it follows that if an agreement between a general contractor and a subcontractor does not have a condition precedent for payment as one of its terms, it is not in violation of *South Carolina Code Ann.* § 29-6-230 for violating the prohibition against having a condition precedent for payment. *Id*.

Pursuant to the South Carolina Supreme Court's precedent in *Elk,* discussed above, contracts with "pay when paid" provisions, such as the one at issue, do not have a condition precedent and accordingly, are not in violation of *South Carolina Code Ann.* § 29-6-230 for violating the prohibition against having a condition precedent for payment. *See Id. and See e.g. Elk.* The Court's finding that "pay when paid" provisions create conditions precedent for payment

and are, therefore, unenforceable pursuant to the SSPPA is against the stated holding of the South Carolina Supreme Court and erroneous on its face. Furthermore, the Court's finding that "pay when paid" provisions violate the plain language of the SSPPA is also erroneous.

IV. THE COURT WAS ERRONEOUS IN FINDING THAT ANY DELAY IN PAYMENT BEYOND NINETY DAYS IS UNREASONABLE

a. The Supreme Court's articulated standard is a "reasonable time so as to afford it an opportunity to obtain funds from the owner"

The Supreme Court's holding in *Elk* mandates that a general contractor be given a reasonable time so as to afford it an opportunity to obtain funds from the owner before being required to pay its subcontractor when there is a "pay when paid" provision in the agreement between the parties. *See e.g. Elk.* Ninety (90) days from the subcontractor's last day of work on the project does not provide a general contractor a reasonable time to afford it a real opportunity to obtain funds from an owner even when the general contractor has pursued its rights in the most expeditious fashion and for the Court to find that payment after ninety (90) days was *per se* unreasonable is an abuse of its discretion.

b. The Court's rationale for establishing ninety (90) days as *per se* unreasonable was flawed

The Court based its finding that delaying payment to the a subcontractor longer than ninety (90) days was *per se* unreasonable on the premise that the subcontractor, under the mechanics' lien statute, would have to initiate proceedings and incur legal expenses to protect its rights within (90) days of its last date of work. *See e.g. South Carolina Code Ann.* § 29-5-10, et seq. This premise is erroneous.

Under the mechanics' lien statute, *South Carolina Code Ann.* § 29-5-10, et seq., all owners have a payment defense and "in no event can the total aggregate amount of liens on the improvement exceed the amount due by the owner". *See South Carolina Code Ann*. § 29-5-20(B).

Thus, with an owner's payment defense, if a general contractor has already filed a mechanics' lien which includes the amounts owed to its subcontractors, a subcontractor has no additional rights it can protect by filing its own mechanics' lien as its claim against the project is contingent on the general contractor prevailing. Accordingly, in instances where the general contractor has already filed a mechanics' lien which includes the amounts owed to its subcontractors, the subcontractor's pursuit of filing of a mechanics' lien is wholly unnecessary and a voluntary undertaking of incurring legal expenses.

In the matter at hand, Clayton's mechanics' lien was already filed when J&H filed its lien and all the rights J&H could have against the project were already protected.

c. The Court erroneously considered events that transpired after March 9, 2018 in determining Clayton's reasonableness under *South Carolina Code Ann.* § 27-1-15

South Carolina Code Ann. § 27-1-15 requires that the upstream contractor make reasonable and fair investigation of the merits of downstream contractor's 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. *See South Carolina Code Ann.* § 27-1-15. Importantly, *South Carolina Code Ann.* § 27-1-15 does not require any obligations after the upstream contractor makes its investigation of the downstream contractor's claim and pays it, or whatever portion of it is determined as valid. *Id.*

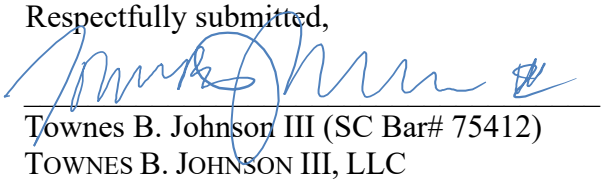
In the matter at hand, J&H mailed its demand pursuant to *South Carolina Code Ann.* § 27-1-15 on March 2, 2018 and Clayton promptly investigated and replied on March 9, 2018 stating that no amounts were due and owing under the contract between the parties at that time. (R. pp. 151, 153). J&H did not make any further demands under *South Carolina Code Ann.* § 27-1-15. Accordingly, the only appropriate analyses are: 1) Are "pay when paid" provisions enforceable; and 2) if so, was it reasonable to rely on that provision on March 9, 2018 when Clayton replied.

Instead, the Court's erroneously posited the red herring that the "unreasonable delay [("two years before J&H was finally paid")] occurred despite the facts that there was no dispute that J&H satisfactorily completed their work, the Certificate of Occupancy was issued prior to J&H even submitted the final pay application, and the amount owed J&H was undisputed. Presumably Clayton would have the Court believe that a time period exceeding two years is a reasonable amount of time to delay payment to a subcontractor" and that "[t]he Court can not reconcile this argument with the interests of justice". The Court additionally erroneously notes that it was not the Clayton who paid J&H for its work when the settlement agreement specifically states that the payment, though direct from the owner, is a payment to J&H under its subcontract with Clayton. (R. p. 48).

CONCLUSION

For the foregoing reasons, Clayton Construction Co., Inc. respectfully asks that this Court reverse the findings of the lower Court, find that Clayton Construction Co., Inc.'s investigation was fair and reasonable under *South Carolina Code Ann.* § 27-1-15 and remand the matter back for the entry of an Order consistent with this Court's findings.

Respectfully submitted,



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CERTIFICATE OF COUNSEL

The undersigned hereby certifies that the Final Brief of Appellant complies with Rule 211(b), SCACR.

Respectfully submitted,

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