

Issues & Answers

SPECIAL CONSTRUCTION ALERT

Attention Builders, Contractors & Real Estate Developers...

By John E. Kofron

If you are involved in private commercial and/or residential construction and use contractors, subcontractors, sub-subcontractors and suppliers, or are a lender to anyone involved in private commercial or residential construction, you need to be aware of a new Arizona law effective July 18, 2000.

Prompt Payment Legislation

On April 12, 2000, Governor Hull signed legislation intended to enhance prompt pay to contractors, subcontractors, sub-subcontractors and suppliers. This legislation, Ch. 233, Laws 2000, applies to all private commercial and residential construction and becomes effective on July 18, 2000. The following is a summary of some of the key provisions of the law.

Owner's Progress Payments to Contractors

The new statute establishes the following general presumptions for progress payments to a prime contractor:

- **Progress Billing Cycle:** Contracts for projects expected to last 60 days or more must provide for progress payments based on a 30-day billing cycle. This cycle can only be extended by following a notice procedure specified by the new statute.
- **Time to Approve Progress Payment Applications:** The owner will have 14 days or less after receipt to approve and certify a billing that complies with the contract's requirements. This time can

only be extended by following a notice procedure specified by the new statute.

- **Disapproval of Progress Payment Applications:** A payment application is "deemed approved and certified" unless the owner issues a timely "written statement detailing those items in the billing or estimate that are not approved and certified." The owner can withhold amounts sufficient to pay "direct expenses" that the owner reasonably expects to incur to correct the disapproved items.
- **Time to Pay Approved Billings:** Owners must pay approved sums within seven days after the billing or estimate is "certified and approved" in accordance with the statute. This deadline can only be extended by following a notice procedure specified by the statute.

Final Payment: Final payment must be made within seven days after the "contractor completes and an owner approves and certifies all work under a construction contract."

Interest: Sums not paid timely will bear interest of at least 1 1/2% per month.

Attorneys' Fees: The successful party in any arbitration or litigation brought to collect payment or interest will be awarded costs and attorneys' fees in a reasonable amount.

Contracts May Not Alter Prompt

Payment Rights: "A construction contract shall not alter the rights of any contractor, subcontractor or material supplier to receive prompt and timely progress payments as provided under this article."

Suspension or Termination By The Contractor or the Subcontractor

Perhaps the most potent remedy of the contractor or subcontractor created by this legislation is the right to suspend work or terminate the contract for nonpayment, without breaching the agreement. Some of these provisions are:

- An owner's failure to make timely payment of the "certified and approved" amount permits the prime contractor to suspend work or terminate the contract on seven days notice.
- A prime contractor's failure to timely pay its subcontractor amounts for work "certified and approved" by the owner permits the subcontractor to suspend work or terminate its subcontract on three days notice. This casts doubt on the continued enforceability of "pay if paid" clauses.
- If an owner fails to timely approve and certify billings for a subcontractor's work but the reasons are not the fault of the subcontractor or directly related to the subcontractor's work, the subcontractor may suspend work or terminate the contract on seven days notice.
- If an owner makes a timely payment to the contractor but the contractor does not pay the subcontractor for the "certified and approved" work, the subcontractor may suspend work or terminate the contract on seven days notice to the contractor and owner.

- If a contractor or subcontractor suspends work, it need not resume work until it has been paid all sums due, including interest and remobilization costs.
- Contract clauses attempting to prohibit the new legislation's suspension and termination rights are not enforceable.

Arizona Law And Venue Required In All Contracts

Arizona law must govern construction contracts to be performed in Arizona, and any arbitration or trial arising from the contracts must be conducted in Arizona. Clauses to the contrary will not be enforceable.

Comments and Recommendations: This new statute raises a number of questions that we are still evaluating. The legislation appears to apply to any project for which bidding or other plans are first distributed on or after July 18, 2000 or if the parties sign a construction contract on or after

January 1, 2001. Our immediate action recommendations are as follows:

- *Undertake Immediate Contract Review:* Make sure legal counsel reviews and revises, as necessary, all private construction contracts (prime contracts, subcontracts, sub-subcontracts, and purchase orders) that will be impacted by this legislation.
- *Public Construction Subcontracts Should Also Be Reviewed:* Because the new legislation made numerous changes applicable to subcontracts, including those for work on public projects, review and modify, as necessary, all subcontracts and similar documents that may be used on state and local projects after July 18, 2000.
- *Coordinate With Construction Lenders:* Many construction lenders may not be prepared to approve and disburse construction draws consistent with the new

legislation's tight payment requirements. Given the potential for a construction loan default if a contractor suspends or terminates for nonpayment, borrowers should make sure lenders can process loan requests within the time frames required under the new legislation.

- *Emphasize Quality In Contractor and Subcontractor Selection:* Given the potential for its abuse, careful selection of your construction partners becomes more important than ever before. You should place a strong emphasis on hiring only strong, reputable, fair-minded contractors, subcontractors and suppliers.

Conclusion

We suggest a three-step strategy of contract modification, contractor selection and lender coordination as an effective strategy to minimize the adverse consequences of this new law. ■

Contacts

Michael V. Mulchay, *Chair* 602-916-5338
 Calvin H. Udall 602-916-5416
 Richard T. Coolidge (T) 520-879-6813
 Robert P. Robinson 602-916-5355
 Ronald L. Ballard 602-916-5312
 Stephen M. Savage 602-916-5324
 Roger T. Hargrove 602-916-5459
 William L. Kurtz 602-916-5372
 Mark A. Nesvig 602-916-5472
 George T. Cole 602-916-5308
 Charles M. King 602-916-5382
 Joseph Conn 602-916-5398
 Graeme Hancock 602-916-5448
 Don J. Miner 602-916-5373
 Norman D. James 602-916-5346

Andrew M. Federhar (P) 602-916-5301
 (T) 520-879-6802
 Kimberly A.
 Howard Arana (N) 520-761-4215
 Hector G. Arana (N) 520-761-4215
 Jay S. Kramer 602-916-5341
 Jim L. Wright 602-916-5441
 Bryan A. Albue 602-916-5311
 David E. Vieweg 602-916-5358
 Benjamin W. Bauer (T) 520-879-6809
 David K. Gray (T) 520-879-6852
 John Randall Jefferies 602-916-5313
 John J. Balitis Jr. 602-916-5316
 James J. Trimble 602-916-5305
 Robert J. Kramer 602-916-5464

John M. Pearce 602-916-5376
 Keith L. Hendricks 602-916-5430
 M. Virginia Perry 602-916-5348
 Elizabeth M. Behnke 602-916-5356
 Jeffrey S. Pitcher 602-916-5375
 Jay L. Shapiro 602-916-5366
 John E. Kofron (T) 520-879-6814
 Ruth Graham Kern 602-916-5335
 Stacey A. Kelly 602-916-5339
 Scott W. Hyder 602-916-5388
 John D. Bethea 602-916-5344
 Drew C. Flowers 602-916-5419
 David V. Fowler 602-916-5403
 Todd W. Roles 602-916-5368

FENNEMORE CRAIG

3003 North Central Avenue
 Suite 2600
 Phoenix, AZ 85012-2913

One South Church Avenue
 Suite 1000
 Tucson, AZ 85701-1627

1891 North Mastick Way
 Suite A
 Nogales, AZ 85621-1081