

# **ARIZONA CONSTRUCTION TRADES**

## **HOW TO GET PAID FOR YOUR WORK AND HOW TO AVOID DEADLY CONTRACT CLAUSES**

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### **INTRODUCTION:**

Arizona law provides a number of tools to assist you in getting paid for your work on construction projects. This seminar will cover the most common and effective ways of getting paid for your work:

#### **A. Collecting your money**

- 1) Mechanic's and Materialman's Liens**
- 2) City of Tucson Construction Fairness Ordinance**
- 3) Registrar of Contractors Complaints**
- 4) Arizona Prompt Pay Statutes**

#### **B. More Deadly Contract Clauses**

- 1) Pay-When-Paid Clauses**
- 2) Audit of Financials**
- 3) Contractor's Right to Take Over Work**
- 4) Overtime Work**
- 5) Written Change Orders**

**Many of these payment tools can be used at the same time, for example: filing a lien foreclosure and breach of contract action in the same lawsuit, plus filing a claim under the City of Tucson Construction Ordinance.**

## **A. COLLECTING YOUR MONEY**

### **1. MECHANIC'S AND MATERIALMAN'S LIENS**

Liens are still one of the most reliable methods of securing payment for your labor, equipment and materials. Recent changes in the Arizona lien statutes have simplified the process for filing liens. Unlike claims for breach of contract, lien claims attach to the property and provide you with security for collecting a judgment. The following are some of the important dates to remember for filing liens:

- A. All contractors and suppliers must serve a Preliminary Twenty Day Notice within twenty days of providing services. You can serve the notice later, but it will only cover the twenty days before the notice was served.**
- B. If the labor, materials and/or equipment you are providing increases by more than 20% over the amount stated in your Preliminary Twenty Day Notice, you must file a new notice to cover the additional amounts.**
- C. Your Mechanic's and Materialman's Lien must be filed within 120 days after completion of the project (or within 60 days of recording a Notice of Completion). Completion is defined as the earliest of either:
  - 1) Thirty days after final inspection and written final acceptance by the responsible governmental agency;**
  - 2) Cessation of labor for sixty consecutive days unless due to strike, shortage of materials or act of God.****

**If no final inspection or acceptance is issued, then completion is on last day any labor, materials, fixtures or tools were provided to the property.**

- D. A lawsuit to foreclose on a lien must be filed in superior court within six months of the filing of the lien.**
- E. For residential work a contractor must have a signed, written agreement with the homeowner in order to have lien rights.**

**One important thing to keep in mind under the lien statutes is that the court may award attorney fees to the prevailing party. In other words, the court has discretion on whether to award attorney fees.**

## **2. CITY OF TUCSON CONSTRUCTION FAIRNESS ORDINANCE**

The purpose of the CFO is to assist contractors, subcontractors and suppliers in collecting on accounts where payments should not have been delayed. The CFO does not apply to good faith disputes over the work performed and timing of payment. Instead, it is to punish bad faith failures to pay for work or materials when there are no legitimate defenses to payment.

### **A. Processing the Claim**

1) The claim period begins to run when the owner, general contractor or subcontractor fails to pay for labor or materials within 14 days of completion of work (or as provided by contract) and after delivery of an initial written request for payment. The initial written request must be accompanied by an affidavit of service or return receipt of certified mail.

This means that when the work is complete or the materials have been delivered and payment is due, an initial written request for payment must be made on the owner, general contractor or subcontractor with proof of delivery.

2) Two weeks after the initial written request, a second written request must be delivered and two weeks after the second written request a third written request must be delivered. The additional written requests do not have to be served or sent by certified mail.

3) After two weeks have passed since the third written request for payment, application can be made to the City of Tucson for prosecution of the claim under the CFO.

4) The claimant will need to testify that payment in full has not been made and that there is no reasonable basis to delay payment.

5) A hearing before the Construction Special Magistrate will be held not more than 60 days after the complaint has been answered.

### **B. Defenses to the Claim**

1) If a valid pay-when-paid clause exists in a contract, the City of Tucson will not file a complaint if the defense of non-payment has been raised by the owner,

general or subcontractor.

However, this defense may not be valid unless the party asserting non-payment files a lawsuit, makes a demand for arbitration or asserts a claim under the CFO against the non-paying party (unless these acts would be futile, such as the filing of bankruptcy by the owner).\_\_\_

2) The existence of a legal or equitable dispute over the work completed, labor performed or materials provided is a defense to non-payment.

3) Non-payment based on poor quality of work can be raised but only if a written complaint has been filed with the Registrar of Contractors or appropriate agency.

### **C. Time limits**

A complaint with the City of Tucson must be filed within one year after the violation accrues, which is the date of delivery of the last request for payment.

## **3. REGISTRAR OF CONTRACTORS COMPLAINTS**

While most complaints that are filed with the Registrar of Contractors deal with workmanship issues and corrective work, the ROC will hear complaints arising from non-payment by a licensed contractor.

The ROC has the authority to order a licensed contractor to pay its subcontractors and suppliers, and can order a subcontractor to pay its sub-subcontractors and suppliers. Failure of a contractor to comply with the ROC's order of payment can result in suspension or revocation of the contractor's license and/or a monetary penalty. The ROC also has the authority to discipline a general contractor for failure to comply with the Arizona Prompt Pay Statutes.

One advantage of the ROC process is that it is generally quicker than going through the court system. Typically you can get to a hearing before the Office of Administrative Hearings (the branch of the State that hears complaints filed with the Registrar of Contractors) within six to nine months of filing your complaint. In superior court it can take up to 18 months. Another advantage is that even though you may get a money judgment in court, collecting on that judgment might take some time. With the ROC, a suspension or revocation of license is immediate and can force the contractor to pay quickly.

One of the drawbacks to filing a complaint with the ROC is that no attorney fees can be awarded. Also, discovery of testimony or documents from the other side is difficult to get at the ROC level. And the ROC will sometimes decline to decide cases that involve contract disputes (such as interpretation of contract clauses, who was responsible for what work) and refer the parties to superior court.

#### **4. ARIZONA PROMPT PAY ACT**

In 2000 the Arizona Legislature made significant changes to the laws dealing with contracts on private construction projects in the State of Arizona. The new laws govern timing of payment from the owner to the general contractor; from the general to the subcontractors; and from subcontractors to suppliers. The Prompt Pay Act (A.R.S. §32-1129 et seq.) also gives contractors and subcontractors the right to suspend or terminate work for non-payment. Some of the highlights of the Act are set out below.

##### **A. Owner payments**

An owner must pay the contractor within seven calendar days after the contractor's billing or estimate is certified and approved.

A billing or estimate is deemed approved and certified 14 days after the owner receives the billing or estimate, unless before that time the owner or owner's agent issues a written statement detailing those items that are not approved or certified.

##### **B. Payments by Contractor and Subcontractor**

A contractor must pay its subcontractors and material suppliers within seven days after receipt of payment from the owner.

Subcontractors must pay their sub-subcontractors and suppliers within seven days after receipt of payment from the general contractor. However, the Prompt Pay Statutes state that payment shall be made for the full amount received for such subcontractor's work and materials supplied based on work completed or materials supplied under the contract.

**C. The contract can change the timing of payments**

An owner may make progress payments later than seven days after the date the billing or estimate is certified and approved if the contract clearly states this and the contract contains a "Notice of extended payment provision" stating when such payments will be made.

The contract can also extend the time for the owner to approve and certify billings and estimates.

If payments from the owner to the general contractor are delayed, then payments from the general to the subcontractors and suppliers will be delayed. The same is true for the timing to approve and certify billings or estimates.

**D. When payment can be withheld**

The owner or general contractor may withhold payment to a subcontractor or supplier for:

- \* **Unsatisfactory Job Progress**
- \* **Defective Construction Work or Materials Not Remedied**
- \* **Disputed Work or Materials**
- \* **Failure to Comply With Other Material Provisions Of the Contract**
- \* **Third Party Claims Filed or Reasonable Evidence That A Claim Will Be Filed**
- \* **Failure of the Contractor or a Subcontractor to Make Timely Payments for Labor, Equipment and Materials**
- \* **Damage to the Owner**
- \* **Reasonable Evidence that the Construction Contract Cannot be Completed for the Unpaid Balance of the Construction Contract Sum or a Reasonable Amount for Retention**

**E. Disciplinary action for failure to timely pay**

**Failure of a general contractor or subcontractor to make prompt payment is grounds for suspension or revocation of license by the Registrar of Contractors.**

**F. Right to Stop Work - General Contractor**

**The Prompt Pay Act provide that a contractor may suspend work on a construction contract or terminate the contract if the owner doesn't make timely payment of the amount certified and approved.**

**A contractor shall provide written notice to the owner at least seven calendar days before the contractor's intended suspension or termination.**

**A contractor shall not be in breach of contract for suspending performance or terminating the contract for non-payment.**

**G. Right to Stop Work - Subcontractor**

**1. Failure of Owner and Contractor to Timely Pay**

**A subcontractor may suspend performance or terminate a contract if the owner fails to make timely payment of amounts certified and approved for the subcontractor's work and the contractor fails to pay the subcontractor for the certified and approved work.**

**A subcontractor shall provide written notice to the contractor and owner at least three calendar days before the subcontractor's intended suspension or termination.**

**2. Failure of Contractor to Timely Pay**

**A subcontractor may suspend performance or terminate a contract if the owner makes timely payment but the contractor fails to pay the subcontractor for the certified and approved work.**

**A subcontractor shall provide written notice to the contractor and owner at least seven calendar days before the subcontractor' intended suspension or termination.**

### **3. Failure of Owner to Approve and Certify Work**

A subcontractor may suspend performance or terminate a contract if the owner declines to approve and certify portions of the contractor's billing or estimate for that subcontractor's work, but the reasons for the failure of the owner to approve and certify are not the fault of or directly related to subcontractor's work.

A subcontractor shall not be in breach of contract for suspending performance or terminating the contract for non-payment.

### **4. No Further Work Required Until Payment Made**

A contractor or subcontractor that suspends performance is not required to do any further work until it has been paid the amount certified and approved.

A contractor and subcontractor is also entitled to any costs incurred for mobilization resulting from shutdown or start-up of a project.

### **H. Written Notice Under Prompt Pay Statute**

Written notice can either be delivered in person to the person for whom it is intended or must be delivered or sent by any means that provides written, third party verification of delivery to the last business address known to the party giving notice.

### **J. Arizona Laws and Jurisdiction Apply**

No construction contract can require a contractor or subcontractor to be subject to the laws or jurisdiction of another state.

## **B. MORE DEADLY CONTRACT CLAUSES**

### **1. PAY-WHEN-PAID-CLAUSES**

Pay-when-paid clauses govern the timing of payments from a general contractor to a subcontractor.

A pay-when-paid clause delays the general contractor's obligation to pay a

subcontractor for a reasonable time until payment is received by the general contractor from the owner.

**Prompt Pay Statute protection:** Except where a contract expressly states to the contrary, a contractor must pay a subcontractor within a reasonable time after completion of its work, even though the contractor has not been paid by the owner.

a. **Pay-When-Paid Clause**

The contractor looks to the solvency of the owner; the subcontractor looks only to the solvency of the contractor:

In order to transfer this normal credit risk incurred by the general contractor from the general contractor to the subcontractor, *the contract* between the general contractor and subcontractor *should contain an express condition clearly showing that to be the intention of the parties.*

b. **Pay-If-Paid Clause**

Pay-if-paid clauses are another way of saying "Pay-when-paid". They make payment by an owner to a general contractor a "condition precedent" to the general contractor's obligation to pay its subcontractor.

Under a Pay-if-paid clause, the general contractor has no obligation to pay the subcontractor if the general contractor does not receive payment from the owner.

c. **Pay-When-Paid Clause, What Does Work**

Where the agreement specifies a certain method of payment and that such method is to be the only method of payment, then that is specific enough to uphold the pay-when-paid clause.

**Example:**

As an express condition precedent, payment of any approved portion of Subcontractor's application for payment shall be conditioned upon receipt by the Contractor of payment from the Owner. All payments to the Subcontractor shall be made by the Contractor solely out of funds received from the Owner, and from no other source.

d. **Pay-When-Paid Clause, What Doesn't Work**

**THE CONTRACTOR AGREES AS FOLLOWS:** To pay the Subcontractor, promptly upon receipt thereof from the Owner, the amount received by the Contractor on account of the Sub-Contractor's work to the extent of the Subcontractor's interest therein.

At all times subcontractor shall be paid to the extent that the contractor has been paid on his account.

2. **AUDIT OF FINANCIALS**

Many contracts include this clause in their Subcontract Agreements:

In the event of a claim or disputed change order, or as otherwise deemed necessary by Contractor or Owner, Subcontractor's financial records shall be available to Contractor or Owner for audit or review.

The Contractor and Owner have no right to audit or review your books. This is nothing more than an opportunity for the Contractor to make you spend your time and money by making your books available to the Contractor.

3. **CONTRACTOR'S RIGHT TO TAKE OVER WORK**

Many subcontract agreements contain this clause:

In the event of default by Subcontractor, Contractor reserves the right to take over the work of Subcontractor and may take possession of all materials, tools and equipment of the Subcontractor at the site.

While the Contractor is entitled to take over your work if you are in default, you should not agree to have the Contractor take your materials, tools and equipment. If the materials have been paid for by the Contractor, then he can make an argument that he is entitled to the materials. But tools and equipment are yours.

4. **OVERTIME WORK**

A contract may include a provision that requires a Subcontractor to perform overtime work for the actual additional premium wage paid plus taxes. This excludes the Subcontractor's overhead and profit. An example of this is:

The Subcontractor agrees to perform work to the extent directed by the Contractor. The Subcontractor shall be entitled to additional payment only for overtime premium costs of labor plus required payroll taxes and employee benefits on the premium portion of labor.

To protect your rights for overtime work, use this clause:

The Subcontractor does not agree in advance to perform any of its work on overtime. Any overtime work shall be payable at rates jointly agreed upon by the parties at the time such overtime is authorized by the Contractor. These overtime billing rates or adjustments for increased labor hours shall include a loss of efficiency factor related to the extent and duration of the overtime.

## 5. WRITTEN CHANGE ORDERS

Almost all contracts contain a statement that change orders must be in writing and signed by the parties before the work starts. One contractor even included the following language:

Contractor will not pay Subcontractor for any extra work that is not approved in writing prior to the work being done, even if Contractor's project manager has requested the extra work.

We all know that during the course of your contract you will be directed by the Contractor's project manager on job superintendent to do extra work which has to be done right now, and you will be told "Don't worry, we sign the change order later."

Don't take the Contractor's word for change orders. Have your employees keep change order forms in their trucks so they can write in the terms of the change order and have it signed before they start the work. Otherwise, you risk not getting paid for the extra work.