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UNDER CONSTRUCTION

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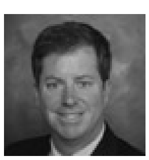

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A Letter From the Editor

By James J. Sienicki

Welcome to our summer 2011 issue. In keeping with the weather theme, Under Construction is pleased to provide some timely articles hot off the press that we hope you will find informative. We start with a series of articles that examine some of the many differences and similarities in prompt payment laws from both a federal and state perspective in our regional practice area. We then switch gears to look at how a recent Arizona appellate court dealt with how much compliance is necessary with respect to mechanics' lien statutes. The case provides insightful analysis regarding many Arizona mechanics' lien issues. Our next article addresses the "Nevada Jobs First" Act that is designed to increase the number of Nevada residents employed on Nevada public works projects. We examine the potential ramifications of the Act for Nevada general contractors on a number of levels. We wrap up this issue with a look at the increase in union "bannering" and demonstration activities against owners and developers.

If you have questions or comments about any of these articles, you can e-mail the attorney who authored the article, the editor or your regular Snell & Wilmer contact. If you have any suggestions for future articles, please feel free to e-mail them to me.

Sincerely,
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The Federal Prompt Payment Act Provides Interest Penalties for Agencies and Contractors in Supplies or Services Contracts

By Daniel P. Wierzba

Under the federal Prompt Payment Act, 31 U.S.C. § 3901 *et seq.* (the "PPA"), the head of a federal government agency must pay an "interest penalty" to a business concern when the agency acquires "property or service" from the business, and the agency fails to pay for each "complete delivered item of property or service" before the required payment date. The interest penalty "shall be paid for the period beginning on the day after the required payment date and ending on the date on which payment is made." The interest penalty must be paid regardless of whether the business has requested it.

The Federal Acquisition Regulations ("FAR") have incorporated the PPA provisions into federal government contracts through FAR Subpart 32.9 and contract clauses. Under the FAR, an agency must pay an interest penalty if: (1) the agency billing office received a proper invoice; (2) the agency authorized payment and there was no dispute over quantity, quality, compliance or amount of the work and invoice submitted by the contractor; and (3) in the case of final payment, the amount is not subject to "further contract settlement actions" between the agency and the contractor. Under FAR 52.232-25, the due date for an agency to make payment is 30 days after the agency receives a proper invoice or accepts supplies or services, whichever is later.

The FAR regulations define "proper invoice" as including:

1. Name and address of the contractor;
2. Invoice number and date;
3. Contract number or purchase order number and delivery order number or task order or contract line item number;
4. Description, unit prices and extended price of supplies delivered or services rendered (exactly as written on the purchase order);
5. Quantities, shipping terms and payment terms (followed as written on the PO and clearly stated on the invoice);

6. Name and address of the agency contracting official;
7. Contractor's contact person to notify if the invoice is deemed defective;
8. The contractor's taxpayer identification number;
9. The contractor's electronic funds transfer information; and
10. Other information as required in the contract, i.e., evidence of shipment, statement of work, standard of performance, or contract data requirements.

The interest the agency must pay to a contractor ends either (a) one year after the required payment date or (b) on the earlier date when a claim is filed under the Contract Disputes Act. However, the agency is not required to pay interest if the agency disputes the amount the contractor is owed or there are issues related to contract compliance.

Further, the PPA only applies to *contracts* that the government issues related to services and supplies. The Federal Circuit Court of Appeals has held that a contractor cannot receive PPA interest for contracts that are not related to services or supplies. The U.S. Court of Federal Claims recently held that a settlement agreement between an agency and contractor is not entitled to PPA interest, while an earlier Federal Claims case held a settlement agreement between a contractor and agency was sufficiently related to a supplies and services contract to warrant PPA interest for the contractor.

Similarly, contractors are required under FAR 52.232-27 to flow this provision down to their subcontractors and lower-tier suppliers. Under the flow-down provision, the contractor must pay its subcontractors and lower-tier supplier within seven days after receiving payment from the agency. If the contractor fails to pay its subcontractors and lower-tier suppliers within the specified time, the contractor is then liable to the subcontractors and suppliers for an interest penalty, just as the agency would be for paying the contractor late. The contractor can withhold amounts due to subcontractors or suppliers for deficiencies in contract performance, but it must do the following: provide notice of the withholding to the subcontractor and the contracting officer; reduce the progress payment by the amount being withheld, but not more; and the contractor must pay the withheld amount within seven days after the deficiency is corrected or within seven days after the deficiency is corrected or the contractor receives payment from the agency (if the agency withheld funds based on the subcontractor's deficiency). In addition, the contractor will be obligated to pay the agency interest penalties on the withheld payments until the subcontractor deficiency is corrected.

The federal PPA provides interest penalties in favor of contractors if the contracting agency fails to make timely payment. However, interest is only available for proper invoices submitted on contracts involving goods or services provided to the agency, and a contractor is not entitled to interest if there is a dispute about the amounts owed. The contractor must be aware that it too may be liable for interest if it fails to timely pay its lower-tier subcontractors and suppliers. Contractors should take great care to submit proper invoices to the agency, and also to quickly and timely pay subcontractors and suppliers when receiving payment from the agency.

Summary of Arizona's Prompt Payment Law Regarding Private Payments

By Jason Ebe

Arizona's prompt pay laws, A.R.S. §§ 32-1129 to 32-1129.07, govern payment of general contractors and subcontractors on private construction projects in Arizona. The statutes establish time frames and procedures for the periodic payment of contractors, alter the time frame for the periodic payment of subcontractors and permit work stoppage for failure of a contractor or subcontractors to receive timely payment. Contractors, subcontractors, owners and design professionals must be familiar with the rights and obligations of each participant in the construction process under this law.

I. APPLICABILITY OF THE PROMPT PAYMENT LAW

The law applies to all private construction projects in the state of Arizona. Separate legislation provides for similar, but not as comprehensive, prompt payment requirements on public projects. The 2010 amendments described in this article apply to any private construction contract in Arizona where the initial distribution or dissemination of plans, including bid plans and construction plans, specifications or contract documents by an owner to a contractor or subcontractor occurred on or after January 1, 2011.

Prior projects follow the 2000 law. The 2010 amendments apply to all private construction contracts in Arizona entered into on or after January 1, 2012 regardless of when plans are distributed.

With limited exceptions, you cannot contract around these provisions. The law may arguably also apply to any projects outside the state in which the construction contract has an Arizona choice of law provision.

II. PAYMENT TIMELINE UNDER THE PROMPT PAYMENT LAW

A. Time Period for Owner to Review and Certify or Object to Pay Application.
On all construction projects longer than 60 days, the law requires the owner to make progress payments. Progress payments are made on the basis of a duly certified and approved billing or estimate of the work performed and the materials supplied during the preceding 30-day billing cycle.

When a pay application has been submitted, *the owner or its agent has 14 days to certify the payment or issue a written statement detailing those items that are not approved and certified, or the statement is deemed certified and approved.* Grounds for declining to approve the pay application may include:

- Unsatisfactory job progress;
- Defective construction work or materials not remedied;
- Disputed work or materials;
- Failure to comply with other material provisions of the construction 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; or
- Reasonable evidence that the construction contract cannot be completed for the unpaid balance of the construction contract sum or a reasonable amount for retention.

The owner may withhold from payment an amount sufficient to pay the direct expenses the owner expects to incur to correct any items set forth in the written statement, but issuance of the statement is critical. *If the owner fails to issue such a statement within 14 days, the pay application shall be deemed certified and approved.* The 2010 amendments revise the language with respect to withholding to allow an owner to withhold from future payments amounts necessary to protect the owner from *prior* billed defective work.

B. Opt Out of Fourteen Day Approval Period

The owner may opt out of the 14-day approval period by (1) specifically identifying the extended approval period in a clear and conspicuous manner in the construction contract and (2) identifying in a clear and conspicuous font on *each* page of the plans, including bid plans and construction plans, the following provision:

> NOTICE OF EXTENDED CERTIFICATION AND APPROVAL PERIOD PROVISION. This contract allows the owner to certify and approve billings and estimates for progress payments within ____ days after the billings and estimates are received from the contractor, for release of retention within ____ days after the billings and estimates are received from the contractor and for final payment within ____ days after the billings and estimates are received from the contractor.

C. Opt Out of Thirty Day Billing Cycle

The owner may also opt out of the statutorily mandated 30-day billing cycle by (1) specifically identifying the new billing cycle in a clear and conspicuous manner in the construction contract and (2) identifying in a clear and conspicuous font on *each* page of the plans, including bid plans and construction plans, either one of the following provisions depending on the owner’s preference:

> NOTICE OF ALTERNATIVE BILLING CYCLE. This contract allows the owner to require the submission of billings or estimates in billing cycles other than 30 days. Billings or estimates for this contract shall be submitted as follows: ______________.

> NOTICE OF ALTERNATIVE BILLING CYCLE. This contract allows the owner to require the submission of billings or estimates in

billing cycles other than 30 days. A written description of such other billing cycle applicable to the project is available from the owner or the owner's designated agent at (telephone number of address, or both), and the owner or its designated agent shall provide this written description on request.

D. Opt Out of Seven Day Period for Owner to Pay Contractor

Once the invoice is approved, partially approved or deemed approved, the owner is required to pay the contractor *within seven days*.

To opt out of the seven day payment period, the owner must (1) identify the extended payment period in a clear and conspicuous manner in the construction contract and (2) identify in a clear and conspicuous type on each page of the plans, including bid plans and construction plans, the following provision:

> NOTICE OF EXTENDED PAYMENT PROVISION. This contract allows the owner to make payment within ___ days after certification and approval of billings and estimates for progress payments, within ____ days after certification and approval of billings and estimates for release of retention and within ____ days after certification and approval of billings and estimates for final payment.

E. Substantial Completion, Retention, Final Payment and Opt Out

Under the 2010 amendments, the contractor is required to submit a billing for release of retention upon substantial completion of the work. The billing for release of retention is deemed certified and approved 14 days after submission unless the owner declines to certify and approve the billing in writing and for reasons allowed under the statute. Retention must be paid within seven days after certification and approval of the billing.

The 2010 amendments further provide that the owner is limited in its withholding an amount not to exceed one hundred and fifty percent of the direct costs and expenses the owner reasonably expects to incur to protect the owner from loss for which the contractor is responsible.

The 2010 amendments also include a new notice legend to allow the owner to opt out of the statutory provisions regarding substantial completion, the release of retention and the making of final payment. That notice legend states:

> NOTICE OF ALTERNATE ARRANGEMENTS FOR RELEASE OF RETENTION AND FINAL PAYMENT. This contract allows the owner to make alternate arrangements for the occurrence of substantial completion, the release of retention and making of final payment. Such alternate arrangements are disclosed on sheet no. _____ of these plans.

F. Design Professionals and Owners Should Coordinate Regarding Opt Out

Design professionals should be careful to consult with their owner clients to determine whether the owner wishes to opt out of any or all of these above provisions. If so, the design professionals and owners should include the necessary opt-out notice legends on all pages of their plans, including bid plans and construction plans, and in the contract with the general contractors.

G. Time Period for Contractor to Pay Subcontractors

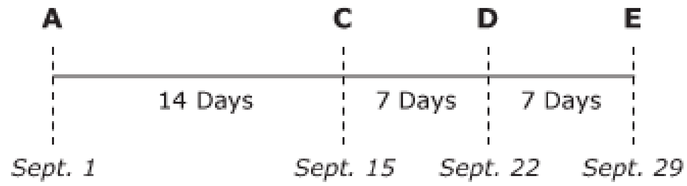
Once the owner pays the contractor, the contractor is required to pay its subcontractors within seven days.

Unlike the owner-contractor time periods set forth above, this seven-day payment period *cannot* be changed. Under the 2010 amendments, if the owner withholds payment for defective work or materials not remedied and if the contractor as a result does not receive sufficient funds to pay subcontractors and suppliers whose work was *not* the basis of the owner's withholding for defective work or materials not remedied, the contractor must nevertheless pay such subcontractors and material suppliers within 21 days.

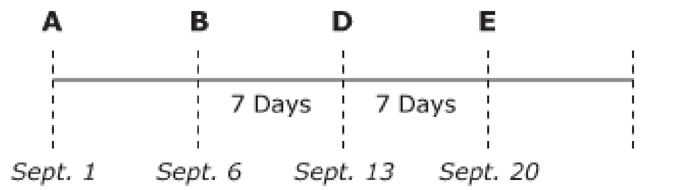
H. Timeline

A = Invoice Received by Owner
B = Date Invoice Approved by Owner
C = Invoice Deemed Approved
D = Payment Due to Contractor
E = Payment Due to Subcontractor

Standard Timeline:



Timeline When Owner Approves Invoice Early:



I. Special Requirement for Home Builders

The 2010 amendments impose an additional requirement on construction projects involving owner-occupied dwellings. The law now requires the contractor to include the required notice legend in clear and conspicuous font on the *front* page of *each* billing or estimate from the contractor to the owner-occupant. If the contractor does not include the proper notice legend on its billings to the owner-occupant, the prompt pay requirements will not apply.

III. RIGHTS OF CONTRACTOR AND SUBCONTRACTORS FOR PROMPT PAY VIOLATIONS

The law provides that the monthly interest rate is one and a half percent per month on late payments and allows for the recovery of attorneys' fees in any lawsuit or arbitration brought to collect amounts due under the prompt payment law.

In addition, a contractor may suspend performance or terminate the construction contract for late payments by giving the owner written notice at least seven calendar days before the contractor's intended suspension or termination.

A subcontractor may suspend or terminate the construction construct under the following circumstances:

1. The owner fails to make timely payments to the contractor and the contractor does not pay the subcontractor for certified or approved work. In this situation, the subcontractor must give the

contractor and owner at least three days written notice before the subcontractor's intended suspension or termination.

2. The owner makes timely payments to the contractor but the contractor does not pay the subcontractor for certified and approved work. In this situation, the subcontractor must give the contractor and owner at least seven days written notice before the subcontractor's intended suspension or termination.
3. The owner declines to approve and certify portions of the contractor's billing for the subcontractor's work but the reasons for the owner's failure to approve and certify the billing are not the fault of or directly related to the subcontractor's work. In this situation, the subcontractor must give the contractor and owner at least seven days written notice before the subcontractor's intended suspension or termination.

The law provides that the construction contract may provide for *shorter*, but not *longer*, notice periods before a contractor's or subcontractor's intended suspension or termination of work. The law also provides that a contractor or subcontractor that suspends work, as authorized by the statute, will not be deemed to be in breach of the contract for doing so, and any provision in a construction contract that prohibits a party from suspending performance or terminating the contract if prompt payments are not made is void. Finally, the law provides that a contractor or subcontractor that has suspended work is not required to furnish further labor, materials or services until the contractor or subcontractor is paid the amount that was certified and approved, together with any costs incurred for mobilization, that results from the shutdown and start up of the project.

IV. CONCLUSION

As contractors and owners begin new private construction projects in Arizona in 2011, now is the time for them to update their contracts to ensure compliance with the Arizona prompt pay laws.

California Prompt Payment Requirements And Key Exceptions

By Stuart J. Einbinder

California has various prompt payment statutes governing the timing of payments on construction projects. The requirements vary, but generally an owner must pay retention within 45 or 60 days after completion of a project, and the prime contractor must pay retention to subcontractors within seven or 10 days of receipt of payment. With respect to progress payments, an owner is typically required to pay the prime contractor within 30 days after receipt of a proper payment request, and the prime contractor must pay its subcontractors within 10 days of receipt of payment. Failure to comply will subject the non-paying party to a penalty, which is typically two percent per month of the amount due (lesser amounts apply to public entities in certain instances), and the prevailing party in a lawsuit to recover wrongfully withheld funds is usually entitled to recover its attorney's fees and costs.

There are various exceptions, however, which a non-paying party can rely upon to avoid prompt payment penalties.

One important exception is that in most instances the existence of a good faith or bona fide dispute permits the non-paying party to withhold up to one hundred and fifty percent of the disputed amount—*even if the withheld funds are ultimately found to be owing*. This brings up the question, however, as to whether an objective or subjective standard should be applied. There are conflicting appellate court decisions on this issue. In *Alpha Mechanical, Heating & Air Conditioning, Inc. v. Travelers Casualty & Surety Co. Of America*, the court concluded a good faith dispute exists where a party "subjectively" believes it does not owe the requested payment. By contrast, in *FEI Enterprises, Inc. v. Kee Man Yoon*, the court applied a more stringent, objective standard, stating: "[A] party who has no reasonable, objective justification for withholding payment under a construction contract, but 'believes,' by reason of delusion, ignorance, negligence of legal counsel or otherwise, that the money is not owed should not be able to avoid penalty on such ground."

A related issue is whether the "dispute" must relate to, or be an offset against, the funds being withheld by the non-paying party. In *Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.*, the court concluded that any good faith dispute is sufficient. This case involved a prime contractor who withheld undisputed retention funds owed to a subcontractor due to a dispute over the subcontractor's change order due to a dispute over the subcontractor's change order claims for additional payment. Even though the claims in dispute could only *increase* the amount owed by the prime contractor, the court held the prime contractor was entitled to withhold one hundred and fifty percent of the disputed amount, thereby barring the imposition of prompt payment penalties. The court noted there is nothing in the statutory language that "evinces a legislative intent to limit the types of honest disputes that will justify the withholding of retention."

The court in *Martin Brothers* also addressed another important exception. Business and Professions Code section 7108.5 mandates that prime contractors and subcontractors on most projects pay progress payments to all tiers of subcontractors "not later than 10 days of receipt of each progress payment, *unless otherwise agreed to in writing*." In this case, the written subcontract included language stating that payments were not due until the subcontractor submitted various required documentation (including lien waivers), and the subcontractor failed to provide the required documentation with its payment requests. The court held the subcontract language "alter[ed] the timing of payment" and was a valid "waiver of the [prompt] payment requirements." Accordingly, the court concluded that the subcontractor's failure to submit the required documentation barred the imposition of prompt payment penalties.

Finally, there is an apparent exception to the prompt payment requirements concerning the "final" payment to a contractor or subcontractor. The prompt payment statutes in California focus on "progress payments" and "retention." Two recent court of appeals decisions – *Murray's Iron Works, Inc. v. Boyce* and *Yassin v. Solis* – concluded that a "final" payment which is due after completion of performance and does not include retention withheld from prior payments is neither a "progress payment" nor "retention." Therefore, according to these decisions, a final payment of this type is not even subject to the prompt payment requirements. Rather, the remedy "for the failure to pay a last installment payment upon completion of the services is simply damages for a breach of contract."

The purpose of California's prompt payment statutes is to encourage prompt payments in the construction industry, and the failure to comply can result in severe penalties. A non-paying party may rely upon various exceptions to withhold payment, but the law is evolving and there is a lack of clarity as to how the exceptions will be applied. Given the consequences of exceptions will be applied. Given the consequences of a violation, good business practices seem to dictate taking a conservative approach in the face of this uncertainty.

Colorado General Assembly Expands Prompt Payment Rights in Public Contracts

By Scott C. Sandberg

While Colorado provides no statutory prompt pay rights for private construction projects, Colorado's Public Works Prompt Pay Statute provides such rights on public entity projects—*i.e.* projects for the State and its political subdivisions—exceeding $150,000.

First, the public entity must pay contractors all amounts due under the contract, except statutorily-mandated retention, at the end of each calendar month, or as soon thereafter as practicable, if the contractor is satisfactorily performing the contract. Second, within seven calendar days of receiving such payments from a public entity, contractors must pay their subcontractors all subcontract amounts which were included in the contractor's request for payment to the public entity, provided the subcontractor is satisfactorily performing the subcontract. A contractor's failure to comply with this subcontractor payment requirement is subject to interest penalties of the lesser of fifteen percent per annum or the interest provided by the contract.

On May 26, 2011, Colorado's Governor signed an amendment by the General Assembly to the Public Works Prompt Pay Statute. The amendment noted that the "construction industry is a significant component of the state's economy" and that "cash flow is vital to the stability of the construction industry." Specifically, the General Assembly decreased the statutorily-mandated retention from ten to five percent of the value of completed work. Any retention provided by contract may still be withheld. The amendment also permits public entities to release retention for a specific phase of the project, rather than requiring all phases to be complete. And the amendment requires public entities to make a final settlement of all payments within 60 days after the project is completed and accepted by the public entity.

Nevada Prompt Payment Act

By Leon F. Mead II

One of the most important concepts affecting Nevada construction law is the Nevada Prompt Payment Act, NRS 624.606, et seq. The Nevada Prompt Payment Act ("PPA") affects virtually every *private* works construction contract executed in the state of Nevada. The PPA will *not* apply to two areas of contracts between the general contractor and the owner: 1) public works and 2) residential projects which are being built under a contract between the general contractor and a person who will own or occupy the home. However, because of the statutory placement of the excepting provisions, there is some question as to whether the PPA only exempts the contract between the general contractor and the owner in these situations. The excepting provisions are only found in NRS 624.622, which is applicable to general contracts, and governs the transactions between the owner and the general contractor. Similar exempting language is not found in NRS 624.624 to 624.628, which govern relations between "higher-tiered contractors" and "lower-tiered contractors."

The effect of the PPA is to mandate compliance with contractual terms, or impose more “reasonable” ones, regarding payments and change orders than might exist in certain contracts. In general and with limited exceptions, the PPA requires an owner or higher tiered contractor to pay its lower tiered contractors within certain time limits. While these time limits may be specified in a written contract, the act can supersede the time frames contractually agreed to and impose stricter terms. The PPA will also supersede contract terms dealing with change orders and imposes strict time tables for execution or rejection of change orders which, if not complied with, eviscerate the contractual change order clause and force submitted change orders to become part of the contractor’s scope and time by operation of law. Failure to abide by the requirements of the PPA allows the contractor to stop all work and demobilize until the owner or higher-tiered contractor complies with the PPA requirements. Should demobilization not cure the payment or change order issue, the lower tiered contractor is in certain circumstances allowed to terminate the contract and sue the higher-tiered contractor or owner for breach of contract. In dealing with both payment situations as well as change orders, the burden is shifted to the higher-tiered contractor to take some action relative to a lower-tiered contractor’s request; otherwise the law steps in to enforce the lower-tiered contractor's request, regardless of its merit. Only by undertaking the statutorily proscribed procedures can the owner or higher-tiered contractor protect itself and preserve its higher tiered contractor protect itself and preserve its legal rights.

The PPA starts by inserting some terms governing when payments are due, if those terms have not been already negotiated between the parties. While the parties (owners, prime contractors and lower-tiered subcontractors) are free to establish payment schedules as they might, failure to define when payment is specifically due in the contract will result in the statutory terms being implemented. In this situation, the owner is required to either make payment or to inform its prime contractors that payment will not be forthcoming and provide the reasons why. The PPA, however, does not define a "schedule for payments." Typically, a construction contract will schedule payment in one of two ways: a set interval based on a percentage of completion determined in a formulaic fashion, or in lump sum amounts based on a time table of events. Webster's defines "schedule" as "an ordered list of times at which things are planned to occur." The former payment method sets a time during the month when progress will be measured and then the progress payment will be calculated. Once calculated, there is a period of time to deliver the requested payment. However, errors or disputes over the calculation can impact the "date that payment is due" under such formulas, which raises a question as to whether an "ordered list of times at which things are planned to occur" has been established.

Regardless, if a schedule of payments exists, then the PPA requires that payment be made on or before the date that the schedule indicates payment is due. Otherwise, the owner is obligated to pay the prime contractor within 21 days of receipt of the prime contractor's invoice for payment; while a higher-tiered contractor is obligated to pay its lower-tiered subcontractors within 30 days of invoice. While this may seem reasonable in the abstract, it is often the case that the owner disputes the amount the prime contractor claims is due in that invoice. This is certainly the case when payments are based on a percentage of acceptable work in place, and the calculation is subject to the interpretation of the parties involved. In this situation, the owner is obligated to inform the prime contractor of the dispute and any intention to withhold all or any part of the amount that is due to be paid to the prime contractor, whether demonstrated by invoice or by calculated formula.

The PPA allows withholding from a prime contractor for three basic reasons: 1) retention, 2) improperly billed work (unperformed or deficiently performed), and 3) because the prime contractor has failed to pay wages or fringe benefit obligations to its employees. Each of these categories, however, has its own conditions which must be satisfied in calculating the amount to be withheld. The provisions of the PPA likewise allow the owner to condition payment to the prime contractor on the provision of progress payment releases. Nevada has set forth specific forms for progress and final payment releases in its mechanics lien statutes at NRS 108.2457(5). However, the PPA only allows conditioning payment on receipt of the specific *conditional* waiver and release on progress payment form (NRS 108.2457(5)(a)) or the *conditional* waiver and release on final payment form (NRS 108.2457(5)(c)). Refusing payment based on a failure to submit unconditional waiver and releases is not authorized by the PPA and could be a legitimate cause of the prime contractor to stop work.

Additionally, the specific form language of NRS 108.2457(5) must be used, and should not be substantially altered or the limited legal utility of the form could be lost. The statutory effect of any Nevada progress or final payment release is limited and conditional regardless of its language. Even unconditional releases are subject to the condition that the payment given in exchange for them actually clears the bank. NRS 108.2457(5)(e). Thus, the owner in Nevada is somewhat constantly at risk of mechanics liens or payment claims, even when he has received unconditional waivers and releases on progress or final payments. Nevertheless, the owner should use and obtain progress and final payment releases from the prime contractor and his sub-tier subcontractors and suppliers, and issue joint checks according to the owner's best practices.

While the owner's payment to the prime contractor may be conditioned on receipt of conditional payment releases, the owner may not withhold payment on this ground unless the owner notifies the prime contractor in writing of its failure to meet this requirement of NRS 624.609(3). However, nothing in the PPA requires any calculation of the amount that can be withheld on the basis of missing release forms. Withholding on the unmet condition of providing conditional releases falls outside the amount calculation provisions which are only required by NRS 624.609(2)(a). Therefore, the failure to provide one conditional release from a single failure to provide one conditional release from a single supplier or subcontractor could probably suffice as justification to withhold the entire payment from the prime contractor.

Uniquely, the PPA also makes a significant impact on the methods for dealing with change order requests between the owner and prime contractor, and a slightly different impact on how a higher-tiered contractor deals with change order requests from lower-tiered subcontractors. In practical application, the PPA's change order requirements only work correctly when there are only a few tiers of contractors. These provisions cause significant dilemmas for larger construction projects where many tiers of subcontractors exist and communication of change order requests and the necessary back up and support for them is not quickly exchanged between all tiers involved. In these cases, serious contractual disputes can, and traps for the unwary do, exist which can result in large lawsuits.

As between owners and prime contractors, the submission of a change order request to the owner begins a 30-day clock running for response to the change order. NRS 624.610(1)(d), while seeming to acknowledge two acceptable responses, actually sets out three: 1) issue the change order according to the terms of the request; 2) issue a written objection to the change order request that it is unreasonable and the reasons therefor or 3) issue a written notice to the prime contractor that additional time and/or information is needed to process the change order. If the owner fails to take any of these steps, the prime contractor may stop work, by following the statutory procedures for doing so. But failing to act according to NRS 624.610(1)(d) likewise carries with it an additional penalty: making the change order request valid and enforceable by operation of law.

Under NRS 624.610(3), failing to respond in writing to a change order request within 30 days causes the prime contract to be altered by the written change order as submitted by the prime contractor. The contract price is increased and the time for performance is extended by the change order requests terms. The prime contractor is thereafter authorized to bill against the change order request and the owner must pay the request for payment against the change order in the next draw request. It is fair to say that this provision in the law would be disallowed under most standard construction contracts. As the PPA voids any contractual provision which conflicts with its voids any contractual provision which conflicts with its mandates, however, there is little that may be contractually used to avoid the harsh results of this provision. Short of a successful constitutionality challenge to the PPA, the only protection for an owner is to ensure that every change order is responded to in writing within 30 days of its receipt.

As affecting change order requests between higher-tiered contractors and lower-tiered subcontractors, the PPA allows a higher-tiered contractor only two ways to respond to a lower-tiered subcontractor's change order requests: 1) issue the change order request according to its terms; or 2) reject the change order request as unreasonable, providing written notice of the reasons why the change order request is considered unreasonable by the higher-tiered contractor. There is no discussion in the legislative history of the PPA of any reason that the higher-tiered contractor is not allowed to inform the lower-tiered subcontractor that additional time or information will be necessary to process the change order request, as the owner is authorized to do. Therefore, the PPA poses a trap for the unwary general or higher-tiered contractor who is faced with change order requests that are submitted by lower-tiered subcontractors but must be approved by the owner or other prime contractor before the subcontract may be altered. The general or higher-tiered contractor must take steps to deal with the lower-tiered subcontractor's change order request while the owner is processing it, or risk the situation where the owner rejects the change order request but the PPA has operated to make the change order request enforceable against the general or higher tiered contractor.

In summary, the Nevada PPA is a maelstrom of unique and sometimes counter-intuitive measures for owners and contractors not familiar with its precepts. A lack of understanding of this critical law can significantly impact the rights and liabilities of owners and contractors. A qualified Nevada construction attorney can help ensure that the contract and project procedures comply with the PPA.

Utah Prompt Payment Act

By Stewart Peay

The Utah Prompt Pay Act, Utah Code Ann. §15-6-1 through -6 (“Act”) was enacted in 1983. Unlike other states’ prompt payment acts, the Act *only* applies to contractors working on *state* projects. It does not apply to state projects funded with federal funds and does not apply to private projects. The Utah licensing code, however, does place requirements on contractors paying subcontractors and suppliers on private projects. The various statutory payment requirements and potential ways to deal with them are discussed below.

The Act establishes deadlines by which a state agency must pay its contractors for services and property provided, and the deadlines by which those contractors must pay their subcontractors and suppliers. Failure to comply with these deadlines, by either a state agency or its contractor may result in punitive penalties for a violator. The Act does allow general contractors to include terms in their subcontracts and supplier contracts limiting the effect of the Act's punitive provisions. General contractors may want to include such limiting language if they deem it appropriate

Payments from the state agency to its contractor
The provisions of the Act require a state agency "which acquires property or services [including by rental contract] pursuant to a contract with a business" to make payments for completed services or delivered property on the date required by the contract or 60 days after receipt of the invoice. Utah Code Ann. § 15-6-2. Should the agency fail to make the payment according to the applicable deadline, interest shall accrue at two percent above the rate the IRS pays on refund claims, which is currently four percent ("Penalty Rate"). Utah Code Ann. §15-6-3. The Penalty Rate is calculated on a quarterly basis and will accrue on a per annum basis. Penalty Rate interest ceases to accrue on the day that payment is made. Accrued Penalty Rate interest will be added to the outstanding principal of the contract and interest will accrue thereon. An agency that fails to comply with the Act is not allowed to obtain additional appropriations to pay Penalty Rate interest. Utah Code Ann. §15-6-3.

The Act does *not* apply in two significant situations: (1) when there is a dispute about "the amount due or compliance with the contract;" and (2) when the state agency is disbursing federal funds to pay for all or part of the work under the contract. Utah Code Ann. § 15-6-4 and 15-6-6. The dispute exception should be read broadly to include any dispute that includes "a fraud investigation; numerous exit conferences, hearings and other negotiations; and ultimately a 'compromise' and other negotiations, and ultimately a "compromise" settlement." *Vali Convalescent and Care Institutions v. Utah*, *797 P.2d 438, 444 (Utah Ct. App. 1990)*. As a result, a contractor who is working on a contract that does not include federal funds and is in compliance with the contract, should be able to use the Act to ensure that the agency pays it in a timely manner.

Payments from the agency's contractors to its subcontractors and suppliers

The Act also applies to all payments from the state agency's contractor to the contractor's subcontractors and suppliers. The exceptions for disputes and federal funds mentioned above do *not* apply to these payments. The Act, however, allows an agency's contractor to include language that limits the Act's punitive language with respect to payments made by the contractor to its subcontractors and suppliers. Utah Code Ann. §15-6-5. The agency's contractor, especially in the current economic climate, may want to limit these punitive provisions if they deem it appropriate. These provisions require that the subcontractor or supplier be paid within 30 days of when the contractor receives payment. Utah Code Ann. §15-6-5. On the 31st day, interest at the rate of fifteen and one half percent per annum begins to accumulate. There is a 15-day grace period, thereafter, but if payment is not made to the subcontractor or supplier within 45 days of payment by the state agency to the contractor, then the fifteen and one half percent per annum interest accumulates from day 30.

Another code requirement on payments to subcontractors

Although the Act has limited application, all contractors should be aware that the Utah licensing code requires contractors on any project in the state (including private projects) to make payments to subcontractors within 30 days of receiving funds from the owner or another contractor or from the date of the subcontractor's billing, whichever is later. Utah Code Ann. § 58-55-603. Should the contractor fail to pay within those time frames, it will be required to pay a one percent per month penalty, plus reasonable costs and attorneys' fees to the subcontractor or supplier. Again, the contractor may limit these terms through pre-contract negotiations.

Contractors should be aware of the Act, benefit from its beneficial provisions and deal with its potential punitive aspects before signing agreements. Contractors who provide property and services to state agencies should be able to ensure they are paid on agencies should be able to ensure they are paid on time. Furthermore, state agency's contractors should ensure that their subcontractors and suppliers are paid in accordance with the operative contracts or the Act to avoid the Act's punitive penalties. Likewise, on private projects, contractors should abide by the terms of the licensing code and their contracts when paying their subcontractors and suppliers.

Perfecting a Mechanics' Lien: The Arizona Court of Appeals Holds that Contractors Need Only Substantially Comply with the Mechanics' Lien Statutes

By Eric Spencer

When the economy began to deteriorate in 2008, and a flood of payment lawsuits from unpaid contractors, subcontractors and material suppliers ensued, owners and developers not unexpectedly argued that mechanic's liens affecting their property were invalid for failure to comply with Arizona's lien statutes. Contractors have made these arguments on occasion as well. However, the defenses to enforcement have increasingly focused on alleged "defects" in mechanics' liens. In light of this increased scrutiny, contractors, owners and developers were in need of clarification about many mechanics' lien issues. The Arizona Court of Appeals recently provided this much needed guidance.

Background

In *Fagerlie v. Markham Contracting Co., Inc.*, No. 1 CA-CV 10-0051 (App. Div. 1 May 31, 2011), the Arizona Court of Appeals' decision noted that Markham supplied labor and materials for a residential development in Peoria, Arizona. The developer who hired Markham, Estates at Happy Valley, LLC ("EHV"), had divided the parcel into 28 lots and began selling them as site-improved lots.

The court further noted that Markham served EHV with a preliminary 20-day notice based on information from a recorded final plat. The notice named EHV as the "owner or reputed owner" and included a legal description. When the 20-day notice was served, many of the lots had been sold and EHV only owned some of the remaining lots. Markham did not have knowledge of any particular sale and EHV did not correct the 20-day notice. EHV later sold the remaining lots.

The court's opinion discusses that Markham recorded a mechanic's lien after EHV failed to pay it nearly $600,000. Markham included a proper legal description with its lien in accordance with A.R.S. § 33-993(A) (albeit a different description than what was attached to its 20-day notice), but failed to include the 20-day notice's proof of mailing with the lien. Markham later modified its description of labor, and mailed the amended lien and original lien (collectively "the lien") to each of the lot owners. The lot owners argued the lien was invalid and demanded that Markham release it. In response, Markham recorded a "notice of correction of replacement," attaching a re-typed version of the original legal description along with the correct proof of mailing for the 20-day notice. Markham served the lot owners once again with the corrected lien.

Fagerlie, a lot owner, filed a wrongful lien claim against Markham pursuant to A.R.S. § 33-420 (permitting a minimum $5,000 fine for knowingly recording an invalid document and a $1,000 fine if the person willfully refuses to correct the document after notice). The trial court agreed, finding Markham's lien documents invalid on five different bases and awarding $6,000 in punitive damages to each lot owner. Markham appealed. The Court of Appeals reversed in favor of Markham, determining that each of the lot owners' objections were without merit. In doing so, the Court addressed some recurring issues in Arizona lien law that will be of keen interest to all in the construction industry.

Work Furnished at the Instance of the Owner or Agent

The lot owners argued that Markham's work was not done at their instance because EHV was not the lot owners' agent. A.R.S. § 33-981(A) provides that a lien is valid if "the work was done or the articles were furnished at the instance of the owner…or his agent."

This argument was dispensed with easily by the Court. A.R.S. § 33-983(B), which applies to lots within an incorporated city, defines "agent" as "every… subdivider or other person having charge or control of the improvement or work on any such lot…." Since EHV was the subdivider in charge of the work, not to mention the fact that its sales contracts with the lot owners *required* it to create "site-improved" lots, EHV was the lot owners' agent for lien purposes.

Service of the Preliminary 20-day Notice

The lot owners argued that Markham could not serve

The lot owners argued that Markham could not serve EHV with the 20-day notice because EHV was neither the owner nor reputed owner when the notice was served. Again, the Court disagreed.

A lien claimant may name the *reputed* owner as long as it makes a reasonable effort to ascertain the ownership status of the property. Here, Markham checked the final plat which named EHV as the “owner/developer,” which corroborated Markham's claim that it served EHV according to information from the public record. Furthermore, the Subdivision Public Report on file with the State specifically listed EHV as holding title to the subdivision—which had an effective date after the 20-day notice was sent. Markham also introduced testimony that it had no actual knowledge that any lots had been sold at the time it issued the notice.

The Court further noted that even if EHV was not the proper party to receive notice, its failure to inform Markham of this fact prevented the lot owners from arguing otherwise pursuant to A.R.S. § 33-992.01(I)(2). The statute’s reach includes “interested parties” such as EHV (a party “who has a recognizable stake… in a matter”), so it was reasonable for Markham to rely on EHV to respond to its 20-day notice with the names and addresses of the lot owners if EHV was not the owner.

Timeliness of the Lien

The lot owners claimed the lien was not recorded timely in accordance with A.R.S. § 33-993(A) because more than 120 days had passed since “completion” of the “improvement.” In this case, since a building permit was issued but no final acceptance was granted, the relevant benchmark for “completion” was the cessation of labor for more than 60 consecutive days under A.R.S. § 33-993(C)(2). Citing the absence of employee time sheets for long gaps, the lot owners argued the project could be considered “complete” on at least two occasions.

However, the lot owners bore the burden of proof—it was their affirmative defense and their motion for summary judgment. Markham rebutted the owners’ claim by presenting evidence that during the gaps 1) its salaried employees and its subcontractors’ employees performed work, 2) it continuously re-marked utilities for blue staking, and 3) it continued to rent and maintain barricades while it waited for APS to move power lines before Markham could widen and stripe the road. The Court sent this issue back to the stripe the road. The court sent this issue back to the trial court.

No Original Legal Description or Proof of Mailing

The lot owners argued that Markham's lien could not be amended or corrected to include the original legal description and proof of 20-day notice mailing. The Court disagreed. Although a lien claimant must strictly comply with the steps to perfect a lien, it need only *substantially* comply with any particular step. Past Arizona cases, for example, have excused a claimant for failing to attach a copy of its contract when the general terms of that contract were otherwise provided. Additionally, nothing prevents a claimant from correcting its lien within the time permitted for perfecting that lien. Since Markham did so within 120 days of completion, its Notice of Correction was timely recorded.

Lis Pendens Not Notarized

Pursuant to A.R.S. § 12-1191(A), a notice of lis pendens must be recorded within five days of foreclosing on any mechanic's lien. The lot owners argued that Markham's signed (but un-notarized) lis pendens was invalid. The purpose of a lis pendens, however, is to provide constructive notice to interested parties that litigation may affect title to the property. Since the lack of notarization did not prevent the lis pendens from serving that purpose, the Court held that Markham's lis pendens need not be notarized.

Summary

While the Court of Appeals provided much needed guidance regarding mechanics' liens, it did not address one of the reasons why Markham appealed this case: the trial court's assessment of A.R.S. § 33-420 wrongful lien damages over *each lot* ($6,000 x 28 lots) rather an aggregate $6,000 penalty for a single wrongful lien. Since Markham prevailed on its lien claims on appeal, the wrongful lien issues were moot. That subject will be left for another day.

Nonetheless, *Markham* is important because it reinforces that lien claimants need only substantially comply with each step in perfecting their mechanic's lien. After *Markham*, contractors should feel a little better that their liens will be found enforceable if they substantially comply with each step. Nevertheless, that may not lead to payment in this down economy. In any event, this case does provide some valuable guidance to everyone in the construction industry.

"Nevada Jobs First" Act Alters Nevada Preference Requirements on Public Works Contracts to the Detriment of Nevada General Contractors

By Leon F. Mead II

With little fanfare earlier this year, the Nevada Legislature passed and Governor Brian Sandoval signed into law Assembly Bill 144, which is designed to increase the number of Nevada residents employed on Nevada public works projects. The “Nevada Jobs First” Act, which it is commonly called, seeks to accomplish this by adding more requirements to obtain a bidder’s preference for such works. Effective upon its approval date of April 27, 2011, AB 144 affects every public work construction project bid after that date. Whether AB 144 will achieve its purpose—or become a huge bureaucratic nightmare for contractors—remains to be seen.

Nevada’s public works preference law has historically merely required that a contractor demonstrate that he has paid sales and use tax and/or government services taxes of $5,000 or more for each consecutive 12-month period, for the last 60 months immediately preceding the application for a preference. Once demonstrated, the preferred contractor would be allowed a five-percent “cushion” to his public work bids against other non-preferred contractors bidding on the same projects. As such, even if the preferred contractor’s bid was higher than the non-preferred, so long as it was not more than five percent higher, the preferred contractor’s bid would be considered the “best” bid and entitled to the contract award. NRS 338.1389(2). AB 144 now adds the component of using Nevada workers and suppliers to this preferential requirement, by mandating that to receive the five-percent bidder’s credit, the contractor must sign an affidavit agreeing to comply with the provisions of AB 144.

In sum, AB 144 seeks to drive public works contracts towards Nevada-based contractors by requiring any contractor seeking to obtain the five-percent preference, to execute an affidavit upon award of the public works contract, agreeing that it will ensure:

- That fifty percent of its workforce, as well as that of all subcontractors, will hold Nevada-issued driver’s licenses or identification cards
- All vehicles used on the public work will be

registered in Nevada, or registered and partially apportioned in Nevada (as applicable)

- At least fifty percent of the design professionals used on the public work will have Nevada-issued driver's licenses or identification cards
- That it will purchase at least twenty five percent of the materials used for the public work from suppliers located in Nevada
- That it will maintain payroll and other records to prove such compliance during the project's duration

The penalty for breach of these obligations is the imposition of a ten percent gross contract price liquidated damage assessment against the contractor, or the voiding of its bid, as well as the prohibition of bidding again on a public work for one year and the prohibition of being issued a preference certificate for five years. All contract documents must reflect these requirements and liquidated damage provisions as elements of the contractor's work scope and conditions of the contract.

Obviously, a contractor's affidavit making these assurances, with the penalty of ten percent gross contract value loss, the loss of the ability to bid public works at all for a full year, and the loss of a preference for five years, constitutes a significant impact to a contractor. The ability of the contractor to achieve these stated requirements for himself may be difficult enough, but to potentially suffer these penalties for the failure of its subcontractors or third-party design professionals raises large legal issues. But the contractor's ability to shift liability for breach also has its limitations. Subsection 6 of Section 2 of the act mandates that any indemnification contract language be apportioned to the percentage of relative fault for the breach and resulting liquidated damages. Nothing is mentioned about the loss of bidding and preference rights.

Compliance with AB 144 is checked through the certified payroll system already in place. Contractors and their subcontractors are required to keep an accurate record of the name, position, wages and benefits paid to each worker on the project. Under AB 144, these certified payroll records must also include records of the employee driver's license or identification card numbers and the jurisdiction that issued the driver's license or identification card. These records must be maintained for inspection by the public body issuing the contract, and the contractor must ensure that a copy of her report and a report for each subcontractor is delivered to the public body no later than 15 days after the end of each month. While these records are to be open to the public, the driver's license / ID card information is not and needs to be kept confidential by the public body. A concern is raised here that the contractor may be subject to penalties under NRS 338.060 as a result of a subcontractor's failure to provide the proper certified payroll reports, however, current provisions on NRS 338.070(6) allowing for withholding of penalties for recalcitrant subcontractors are not altered by AB 144.

The legislative history of AB 144 suggests that legislators were concerned with the ability of the public bodies to use AB 144 and the penalties thereunder as leverage against retention. For this reason, the liquidated damages and loss of bid penalties cannot be extracted unless a court determines that the contractor has breached the obligations of the contract regarding AB 144. This is not true of the loss of preference penalty. There is also the indication that a series of forms were created to assist the Department of Labor and the Public Bodies to streamline and unify the compliance reports and other mandates. These forms, however, did not make it into the final legislative language, and could be issued as administrative code regulations or as addenda to the public work bid specifications.

Of the biggest concerns created by this legislation is the impact on general contractors. On its face, the legislation places the entire burden of compliance, as well as the penalties for breach, upon the general contractor, even where the general contractor has little or no control over the offending party. As a practical matter, it will be nearly impossible for the general contractor to control where a subcontractor buys materials, where a design professional under contract with the public body directly has its design work performed, where a sub-subcontractor hires its workers or how any of these parties maintain their payroll and employment records. Yet under the plain language of Section 2 of AB 144, this burden is placed solely on the general contractor. No provisions encompass the potential defenses of the general contractor that any breach was caused by such third parties over whom the general contractor has little control. Subcontractors, design professionals and material suppliers are not required to execute similar affidavits.

affidavits.

While there is lip service paid to allowing a general contractor to push liability for liquidated damages down to subcontractors in proportion to the subcontractor's fault, there is no corresponding ability for the general contractor to apportion the loss of its ability to bid for one year on future public works projects under Section 3, nor the loss of its ability to obtain a preference for five years upon finding of a breach under AB 144's section 9's amendments to NRS 338.1389(9). Moreover, this latter penalty is imposed by action of the Nevada State Contractor's Board, *not* a district court. As we have seen historically in the Contractor's Board's "money owing" enforcement actions, the Board's findings are not always based on any particular Court's findings of fact or the judicial process. The potential for abuse of this law is substantial.

Beyond the difficulties in dealing with damages and penalties for potential breach, the effect of AB 144 is already being felt. There are reports that Nevada-based contractors have been unable to bid with preferences on local paving projects because of the particular public body's experience and performance qualification requirements for a given application. Nevada-based contractors with qualified and experienced work crews based in other jurisdictions were denied preference in their bid because their Nevada based crews did not have the requisite experience. Further, no effort has been made by the legislators to deal with large material-based contracts, when such materials are sole sourced or only available from distributors without locations in the State of Nevada. While the burden should be on the public bodies to specify materials which are available locally, or to ensure that systems are specified on which Nevada based workers have experience to install, there is no such burden offered under AB 144. The law of unintended consequences may weigh heavily on the very people that AB 144 was intended to assist.

Union Bannering and Demonstrations at XYZ Company Officials' Homes

By Jerry Morales

Without notice, a large banner with the "Shame On You" logo and the name of Joe Smith, XYZ Company President, written in large bold letters was placed in front of Mr. Smith's residence one Monday morning. The individuals holding the banner also distributed handbills which read "Shame on Joe Smith. XYZ

Company refuses to help American workers achieve a just and fair standard of living." The Union's name also appeared in the handbill.

Several of Mr. Smith's family members asked the individuals holding the banner the reason for the bannering and handbilling. They were told to call the Union. After calling the Union, Smith was finally able to determine that the general contractor that XYZ Company had contracted for the construction of an office building in another city was using a subcontractor that had a dispute with the Union. Smith explained to the Union officials that XYZ Company did not select the subcontractors for that or for any jobsite and such selection was solely at the discretion of the general contractor. The response was that the bannering and handbilling would continue at Smith's residence so long as the subcontractor remained at the jobsite.

Owners and developers are confronting this scenario with greater frequency. Construction trade unions believe that, in light of recent legal developments, the above-described conduct would result in the exclusion from jobsites of companies that decline to comply with unions' demands for a union contract. Several points should be kept in mind:

- Stationery Bannering is Lawful[1]. A Union is free to approach neutral employers to "persuade" them to engage in a boycott against non-union employers—so long as the Union refrains from "coercion"
- In order to find "coercion" there must be either (1) "picketing" or (2) conduct that is otherwise directly disruptive of the neutral employers' operation.
- Picketing is "patrolling" with a message. Bannering is not picketing because there is no "patrolling"

Examples of conduct that has been held to be "directly disruptive" of neutral employees' operations include:

- Driving vehicles with signs up and down the street in front of neutral's facilities
- Use of inflatable balloons – rats, etc., in front of neutral's facilities
- Creating a "gauntlet" that forces pedestrians and employees to walk through in order to enter or leave neutral's facilities[2]
- Use of megaphones and video cameras for chanting

and filming at job site gates or store fronts[3]

- Trespass[4]
- "Insufficient Relationship" between employee being bannered and primary-second-tier neutral? (*See, Point Ruston LLC v. Carpenters,* 189 LRRM 2202 (W.D. Wash. 9/8/10))

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Notes:

[1] *Eliason and Knuth*, 335 NLRB No. 159 (Aug. 27, 2010) [back]

[2] *LaFarge North America, Inc.* ADV. MEMO, September 15, 2006 [back]

[3] *South Ban Construction* ADV. MEMO, October 23, 2008 [back]

[4] *Staffmade, Inc.* ADV. MEMO, February 14, 2003 [back]

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