

## **ARIZONA PROMPT PAY STATUTE**

### **1. Introduction**

- The Arizona Prompt Pay Statute creates a standard statutory payment billing cycle for all private Arizona construction contracts. This law sets out guidelines for the payment of general contractors and subcontractors working on private Arizona construction contracts.
- The entire Arizona Prompt Pay Statute can be found at A.R.S. §§ 32-1129 et. seq. (2006).

### **2. The Basic Idea of the Prompt Pay Statute**

- The Prompt Pay Statute was enacted to ensure that owners pay contractors and subcontractors periodically over the course of a construction project for work that has been satisfactorily completed.

### **3. Key Terms and Their Definitions for Understanding Who and What the Prompt Pay Statute Covers**

- “Construction contract” is broadly defined in the statute to mean “a written or oral agreement relating to the construction, alteration, repair, maintenance, moving or demolition of any building, structure or improvement or relating to the excavation of or other development or improvement to land.” A.R.S. § 32-1129(1) (2006).
- “Contractor” is defined as “any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that has a direct contract with an owner to perform work under a construction contract.” A.R.S. § 32-1129(2) (2006).
- “Owner” is defined as “any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that causes a building, structure or improvement to be constructed, altered, repaired, maintained, moved or demolished or that causes land to be excavated or otherwise developed or improved, whether the interest or estate of the person is in fee, as vendee under a contract to purchase, as lessee or another interest or estate less than fee.” A.R.S. § 32-1129(3) (2006).
- “Subcontractor” is defined as “any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that has a direct contract with a contractor or another subcontractor to perform a portion of the work under a construction contract.” A.R.S. § 32-1129(4) (2006).

#### 4. The Contracts that are Covered by the Prompt Pay Statute

- The Prompt Pay Statute applies to all private Arizona construction contracts for projects that require 60 days or longer to complete.
- It is presumed that the Prompt Pay Statute applies to construction contracts with an Arizona choice of law provision. This means if a construction contract for a project located in California contains an Arizona choice of law provision, then the Prompt Pay Statute will probably apply unless the contract specifically states otherwise.
- This information can be found at A.R.S. § 32-1129.01(A) (2006).

#### 5. How the Prompt Pay Statute Works

##### *a. Step One – Submit Invoice*

- For all construction contracts covered by the Prompt Pay statute, the **contractor submits payment applications every 30 days**. A.R.S. §32-1129.01(D), (I) (2006).
- The owner is **deemed** to have received the pay request invoice when the invoice is submitted to any person designated by the owner as a person authorized to receive, review, or approve invoices. A.R.S. §32-1129.01(D), (I) (2006).

##### *b. Step Two – Certification and Approval of the Invoice*

- Once the general contractor submits an invoice to the owner, the owner has 14 days to issue a written statement detailing those specific items that are not approved and certified. **If the owner fails to issue a written objection within 14 days, the invoice is automatically deemed certified and approved as a matter of law.** An owner may decline to approve the invoice in full or in part for any of the following reasons:
  - 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. A.R.S. § 32-1129.01(D) (2006).
- **If** one of these reasons exists, an owner may **only** withhold an amount from the invoice that is “sufficient to pay the direct expense the owner reasonably expects to incur” from the unapproved items or invoices. A.R.S. § 32-1129.01(D) (2006).

*c. **Step Three – Owner’s Payment to the General Contractor***

- Once the invoice is certified and approved, partially approved, or deemed approved by operation of law, the **owner is required to pay** the general contractor **within 7 days**. A.R.S. § 32-1129.01(H) (2006).
- **If** the owner makes a late payment to the general contractor, interest can be **charged**. The statute requires the owner to pay the general contractor interest for each day that payment is late at **1.5% per month** or at a higher rate agreed to by the parties. A.R.S. § 32-1129.01(K) (2006).

*d. **Step Four – General Contractor’s Payment to the Subcontractor***

- The **general contractor is required to pay the subcontractors within 7 days** after payment is received from the owner. A.R.S. §32-1129.02(b) (2006).
- **If** the owner and the general contractor are a single entity, then the owner has **14 days to pay** the subcontractors or material suppliers after the invoice is approved, partially approved, or deemed approved. A.R.S. § 32-1129.01 (N) (2006).

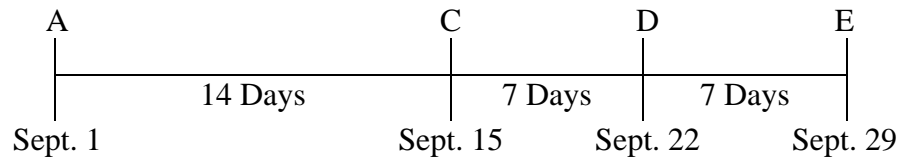
*e. **Step Five– Final Payment***

- The **owner must make the final payment within 7 days** after the general contractor completes the work and the owner certifies and approves the work. A.R.S. § 32-1129.01(H) (2006).

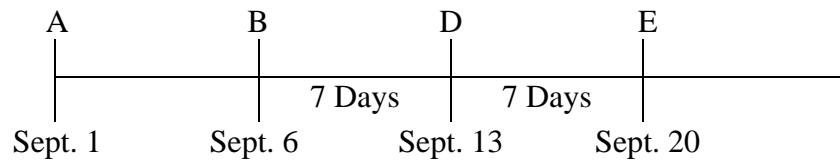
## 6. Timeline:

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

- Standard Timeline When Owner Does Not Certify Payment Application:



- Timeline When Owner Approves Invoice Early:



## 7. General Contractor's Suspension and Termination Rights Under the Prompt Pay Statute

- A general contractor may suspend performance or terminate the construction contract for late payments by giving the owner written notice at least 7 calendar days before the contractor's intended suspension or termination. A.R.S. § 32-1129.04 (A) (2006).
  - The statute allows a construction contract to shorten, but not lengthen, this 7-day notice period.
  - The statute is unclear as to whether the general contractor may terminate the construction contract for late payments if the owner makes the payments before the end of the 7-day notice period.
- A general contractor that suspends work is not required to furnish labor, materials, or services until the owner makes the payments, which may include additional costs

incurred for "mobilization" resulting from the shutdown and start-up. A.R.S. § 32-1129.04(E) (2006).

## **8. Subcontractor's Suspension and Termination Rights Under the Prompt Pay Statute**

- A subcontractor may suspend performance or terminate the construction contract under the following circumstances:
  - The owner fails to make timely payments to the general contractor and the general contractor does not pay the subcontractor for certified and approved work (the subcontractor must give the general contractor and the owner notice at least 3 calendar days before the subcontractor's intended suspension or termination). A.R.S. § 32-1129.04(B).
  - The owner makes timely payments to the general contractor but the general contractor does not pay the subcontractor for certified and approved work (the subcontractor must give the general contractor and the owner notice at least 7 calendar days before the subcontractor's intended suspension or termination). A.R.S. § 32-1129.04(C).
  - The owner declines to approve and certify portions of the general contractor's billing (see Numbers 5 and 6 above) 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" (the subcontractor must give the general contractor and the owner notice at least 7 calendar days before the subcontractor's intended suspension or termination). A.R.S. § 32-1129.04(D).
  - The statute allows a construction contract to shorten, but not lengthen, the referenced notice periods.
- A subcontractor that suspends work is not required to furnish labor, materials, or services until the required payments are made, which may include additional costs incurred for "mobilization" resulting from the shutdown and start-up. A.R.S. § 32-1129.04(E).
- The statute is unclear as to whether the subcontractor may terminate the construction contract for late payments if the payments are made before the end of the notice period.

## **9. When Written Notice is Deemed to Have Been Given to the Owner**

- Notice is deemed given to the Owner:

- When written notice is delivered in person to any individual, member or officer of the corporation for which it was intended, **or**
  - When written notice is delivered at or sent by any means that provides written, third party verification of delivery, to the last business address known to the party giving notice. A.R.S. § 32-1129.04(G) (2006).
- **Recommendation:** Because of the short notice periods associated with a contractor's or subcontractor's suspension or termination of performance (see Sections 6, 7, and 8), all construction contracts should clearly specify the individual who should receive notice and how and where notice should be given.

## 10. Provisions the Owner Can Alter in the Prompt Pay Statute

- Although most of the statute's provisions cannot be altered or waived by contract, the owner may extend (i) the 30-day billing cycle, (ii) the period for the general contractor's payment, and (iii) the owner's approval period.
- Billing Cycle:
  - To extend the billing cycle, the owner must (A) specifically identify the new billing cycle in a "clear and conspicuous manner" in the construction contract and (B) identify in a "clear and conspicuous" type on **each** page of the plans, including bid plans and construction plans, either one of the following provisions depending on owner's preference. For Example:

**"NOTICE OF ALTERNATE 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 ALTERNATE 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 or address, or both), and the owner or its designated agent shall provide this written description on request." A.R.S. § 32-1129.01(B) (2006).

- Extended Approval Period:
  - To extend the owner's approval period, the owner must (A) specifically identify the extended approval period in a "clear and conspicuous manner" in the

construction contract and (B) 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 CERTIFICATION AND APPROVAL PERIOD PROVISION. This contract allows the owner to certify and approve billings and estimates within \_\_\_\_\_ days after the billings and estimates are received from the contractor.” A.R.S. § 32-1129.01(F)–(G) (2006).**

- Extended Payment:
  - To extend the payment period, the owner must (A) specifically identify the extended payment period in a "clear and conspicuous manner" in the construction contract and (B) 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.” A.R.S. § 32-1129.01(C) (2006).**

## **11. The Prompt Pay Statute’s ‘Voiding’ Effect on Certain Provisions in construction contracts**

- The statute provides that the following contract clauses are void:
  - A contract clause that makes the contract subject to the laws of another state or that requires litigation or arbitration arising from the construction contract to take place in another state.
  - A contract clause that prohibits a party from suspending performance or terminating a contract if prompt payments are not made. A.R.S. § 32-1129.05(1)–(2) (2006).

## **INDEMNIFICATION**

### **1. What is Indemnity?**

- **Definitions of Key Terms**

- “Indemnity” generally means “To reimburse (another) for a loss suffered because of a third party’s act or default.”
- “Indemnification” is “The action of compensating for loss or damage sustained.”
- “Indemnity clause” is “A contractual provision in which one party agrees to answer for any specified or unspecified liability or harm that the other party might incur.”
- An “Indemnitee” is the person “who receives indemnity from another.”
- An “Indemnitor” is the person “who indemnifies another.”
- These definitions can be found in *Black’s Law Dictionary*, 7th Ed. (1999).

- **What Indemnity Means**

- An indemnification provision in a contract is designed to provide the indemnitee with protection against a risk of financial loss, damage, or liability to another person who is known as the indemnitor.
- Indemnity rights can arise from an express indemnification provision found in a construction contract, or they can also be implied under common law principles.

### **2. What is Contractual or Express Indemnity?**

- Contractual indemnity occurs when parties expressly include an indemnification provision in a contract stating the indemnitor will either repay, or hold the indemnitee harmless for all expenses incurred resulting from a claim.

### **3. Are There Any Specific Arizona Contractual or Express Indemnity Rules?**



- In Arizona, “contracts indemnifying a party against his own negligence do not violate public policy.” *Estes Co. v. Aztec Constr., Inc.*, 139 Ariz. App. 166, 677 P.2d 939 (Ariz. Ct. App. 1983); *Graver Tank & Mfg. Co. v. The Fluor Corp.*, 4 Ariz. App. 476, 478, 421 P.2d 909, 911 (1966); *Washington Elementary Sch. Dist. No. 8 v. Baglino Corp.*, 169 Ariz. 58, 61, 817 P.2d 3, 6 (1991).
- A general indemnity clause “does not specifically address what effect the indemnitee’s negligence [will] have on the indemnitor’s obligation to indemnify.” *Washington Elementary Sch. Dist. No. 8*, 169 Ariz. at 61, 817 P.2d at 6; *Pioneer Roofing Co. v. Mardian Constr. Co.*, 152 Ariz. 455, 474, 733 P.2d 652, 671 (Ariz. App. 1986)
- Arizona courts will strictly construe indemnity contracts and generally “will not protect an indemnitee against his own negligence unless the indemnitor’s obligation to do so is expressed **in clear and unequivocal terms**.” *Allison Steel Mfr. Co. v. Superior Court*, 22 Ariz. App. 76, 80, 523 P.2d 803, 807 (1974); *Pioneer Roofing*, 152 Ariz. at 474, 733 P.2d at 671 (Ariz. Ct. App. 1986); *Washington Elementary Sch. Dist. No. 8*, 169 Ariz. at 61, 817 P.2d at 6.
- General, non-specific, indemnity agreements entitle an indemnitee to indemnification for losses caused by an indemnitee’s **passive negligence, but not active negligence**. *Cunningham v. Goettl Air Conditioning, Inc.*, 194 Ariz. 236, 240, 980 P.2d 489, 493 (1999); *Estes Co.*, 139 Ariz. at 169, 677 P.2d at 942; *Pioneer Roofing*, 152 Ariz. at 474, 733 P.2d at 671; *Washington Elementary Sch. Dist. No. 8*, 169 Ariz. at 61, 817 P.2d at 6.
  - **Exception:** Arizona courts apply the active/passive distinction, but also look to what the contracting parties intended. Arizona courts will look at the “contract itself or the all-encompassing language of the indemnification clause in order to find an intent to indemnify the indemnitee for his own negligence.” *Washington Elementary Sch. Dist. No. 8*, 169 Ariz. at 61, 817 P.2d at 6.
  - **Active Negligence:** A finding of active negligence requires “some active participation in the wrong which was the immediate cause of the injury.” *Estes Co.*, 139 Ariz. App. At 169, 677 P.2d at 942.
    - Determining whether certain conduct is active or passive negligence depends upon the circumstances of a given case. *Busy Bee*; *Estes Co.*, 139 Ariz. App. At 169, 677 P.2d at 942.
- There is “no requirement that the term negligence actually be used [in an indemnity provision], or that specific reference be made to liability arising out of the indemnitee’s negligence.” *Washington Elementary Sch. Dist. No. 8*, 169 Ariz. at 61, 817 P.2d at 6.

#### 4. What Types of Things Can be Indemnified?

- Almost anything can be the source of an indemnity provision.
- Examples:
  - Losses
  - Expenses
  - Attorney Fees
  - Consultant Fees/Costs
  - Damages
  - Claims
  - Judgments etc.

## 5. Are All Indemnity Provisions Enforceable?

- Anti-Indemnification Statutes: Arizona has statutorily made certain indemnity provisions unenforceable and void as against public policy.
  - Indemnatee's "Sole Negligence:"
    - A.R.S. § 32-1159 (2006) applies to "all contracts entered into between private parties." This statute's purpose is to void any agreement seeking indemnification against an indemnatee's "sole negligence."
    - A.R.S. § 34-226 and A.R.S. § 41-2586 (2006) apply to Arizona public works projects. Under these statutes, any indemnity provision that attempts to indemnify the promise or indemnatee from the negligence of the promise are void and unenforceable.

## 6. What Type of Language Do Indemnity Provisions Contain?

- Examples:
  - It is the specific intentions of the parties that the Indemnatee(s) shall, in all instances, except for claims arising solely from the negligent or willful acts or omissions of the Indemnatee(s), be indemnified by Contractor/Subcontractor, from and against any and all claims...
  - Contractor will indemnify, defend, hold harmless, and insure Owner from...regardless of whether or not the indemnified matters are caused in part by Indemnatee(s).

- Contractor shall defend and indemnify Owner...and hold them harmless from and against all loss, cost, expense of any nature whatsoever...including when Owner, its agents or employees are jointly negligent with Contractor...”
- Subcontractor and Subcontractor’s subordinate and lower tier contractors agree...that its obligation and duty to defend, indemnify and hold harmless Indemnitee(s) is not dependent upon Subcontractor’s fault or negligence.
- Subcontractor and Subcontractor’s subordinate and lower tier contractors agree that its duties and obligations under this section are distinct from and independent from its insurance obligations.
- To the fullest extent permitted by law, the Subcontractor shall indemnify and hold harmless the Owner, Contractor, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Subcontractor's Work under this Subcontract, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself) including loss of use resulting therefrom, but only to the extent caused in whole or in part by negligent acts or omissions of the Subcontractor, the Subcontractor's Sub-subcontractors, anyone directly or indirectly employed by them or by anyone for whose acts they may be liable regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge, or otherwise reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Paragraph.
- To the extent permitted by law, Subcontractor will indemnify and hold harmless Contractor and Owner from the consequences of any negligent act or omission of Subcontractor, but only to the proportionate extent that any such liability is caused or contributed to by Subcontractor. Subcontractor shall not be required to indemnify or hold harmless the Contractor or Owner from the consequences of their independent negligence, whether in whole or in part.

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