

# Prompt Payment Act's Arbitration Requirement Cannot Be Avoided by Subcontract Terms

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The New York Prompt Payment Act, codified in N.Y. General Business Law § 756 et seq., was enacted to expedite payment of monies owed to those that actually perform contracting services pursuant to construction contracts. Among other things, the statute requires that upon delivery of a proper invoice and all contractually required documentation, a contractor (or subcontractor) must approve or disapprove all or a portion of such invoice within twelve business days. Importantly, the statute provides that a contractor's approval shall not be unreasonably withheld, nor may a contractor in bad faith disapprove all or a portion of the invoice. Under the statute, if the parties are unable to reach a mutually agreeable resolution, the aggrieved party may refer the matter to the American Arbitration Association for an expedited arbitration.

In a recent case, the court was asked to determine whether the dispute resolution clause in a subcontract providing the option to litigate the dispute with a subcontractor and avoid arbitration, could supplant the statutory mandate of expedited arbitration in the Prompt Payment Act.

After a dispute ensued between a construction manager and subcontractor regarding certain alleged subcontractor defaults and the construction manager's failure to make payments on base contract and change order work, the construction manager commenced an action against the subcontractor for breach of contract. In the answer, the subcontractor asserted counterclaims for, among other things, breach of contract and violation of the Prompt Payment Act. Shortly after the action was commenced, the subcontractor filed a demand for arbitration and appropriately notified the construction manager.

The construction manager filed a motion to stay arbitration arguing, among other things, that the Prompt Payment Act's arbitration provision did not apply to the subcontractor's claims and that the subcontract's dispute resolution provisions did not require the construction manager to arbitrate the dispute. That same day, the subcontractor filed a motion to stay the court action and compel arbitration.

The court first looked to the statutory text of the Prompt Payment for payment requirements and arbitration remedies available. The court noted that the purpose of the statute was to expedite payment to those performing construction services by setting up a process for the submission, review and payment for work/services performed. In the event of a dispute, the parties are required to meet and try to resolve the dispute. Any unresolved dispute can thereafter be referred to expedited arbitration. The court further noted that the statutorily-derived arbitration remedy was intended to promote speedier resolutions and lessen the time and funds wasted in litigation.

After analyzing the statutory purpose, the court addressed whether the subcontract provided the construction manager with the option of avoiding the Prompt Payment Act's arbitration requirements. The construction manager argued that the dispute resolution process in the subcontract provided the construction manager with the option to reject arbitration and to commence litigation, at its choosing. The subcontract also provided the construction manager with the option of accepting or rejecting any demand for arbitration of "all claims, disputes and other matters in question... arising out of or related to the [s]ubcontract."

The court held that the Prompt Payment Act makes it void and unenforceable for a "provision, covenant, clause or understanding in, collateral to or affecting a construction contract stating that expedited arbitration as expressly provided... is unavailable to one or both parties." Here, the court found that because the subcontract empowered the construction manager with the sole authority to elect whether to proceed with arbitration or litigation, the subcontract's dispute resolution clause was void and unenforceable. Therefore, arbitration was available to the subcontractor.

The next issue the court was required to determine was the scope of the arbitration. In reviewing the statute, the court held that the plain language of the Prompt Payment Act revealed that the arbitration provision was broadly drafted in favor of arbitration. The court held that so long as the prerequisites of the statute had been satisfied, the question of whether there has been a violation of the Prompt Payment Act is an issue for the arbitrator to determine. The court further held that the statute is clear, that the dispute resolution provisions of the Prompt Payment Act are triggered by the mere allegation that the contractor has violated the statute and, whether it has actually done so is a question for the arbitrator.

The court noted that the construction manager is free to assert affirmative defenses in the arbitration and present evidence that the invoiced amount was subject to various deductions for back charges, incorrect invoicing and/or improper performance of the work. Indeed, the court further held that whether the subcontractor's proposed change order(s) constituted proper invoices under the Prompt Payment Act is a merit based question critical to whether there has been a violation of the statutes and it is an issue to be determined by the arbitrator.

In granting the subcontractor's motion to compel arbitration, the court noted that only those claims that allege violation of the Prompt Payment Act are subject to arbitration. To the extent that the subcontractor has claims not subject to arbitration those claims must proceed in the litigation along with the construction manager's claim. The court ultimately stayed the litigation so that the alleged Prompt Payment Act violation claim can be first resolved in arbitration.

### Commentary

The Prompt Payment Act is an under utilized sword that a contractor/subcontractor can utilize to obtain expedited resolution to payment disputes. The statute contemplates that

arbitration is a quicker and cheaper method to resolution than litigation.

The important lesson from this case is that the Prompt Payment Act will override any contract term that makes expedited arbitration unavailable to one or both parties. Compliance with the Prompt Payment Act's prerequisites are, however, mandatory and the failure to comply may result in a payment claim not being arbitrated. Here, the subcontractor complied with all requirements and the court properly referred the case to arbitration.

Feel free to call me to discuss the Prompt Payment Act.