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Message from the Editor:

This quarter, we have a packed edition of the *Under Construction* newsletter! In our first article, Stuart Einbinder and Jeff Singletary discuss the new mandatory disclosure requirements for federal government contracts. In the next two articles, the newest attorney to Snell & Wilmer's construction group, Fidelis Garcia, focuses on recently enacted laws in Arizona affecting the construction industry and military personnel. Our fourth article by Marc Erpenbeck and Colleen Schiman is timely, interesting, and informative as it addresses the benefits of green building. The next two articles, one by Ben Mitsuda and another by Richard Siever discuss understanding the impact and enforceability of a limitation of liability clause in your construction contract and revisions to the Clean Water Act, respectively. In our final article, Rick Erickson and Michelle Keogh focus on some of the steps and risks of contract termination which can be important to understand in an uncertain economy.

These topics can serve as a reference to provide awareness of updates in the construction industry throughout our regional practice areas. *Under Construction* is provided as a service to highlight legal trends and issues commonly faced. Please contact us if you have any questions or suggestions on how we can improve this publication to provide added value to you.

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Mandatory Disclosure Rule Imposes New Burdens on Government Contractors

by Stuart Einbinder and Jeff Singletary

On December 12, 2008, a new rule issued by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council took effect imposing dramatic and potentially burdensome new requirements to the Federal Acquisition Regulation ("FAR"). 73 Fed. Reg. 67064. Significant new requirements include: (1) mandatory disclosure requirements for certain violations of federal criminal law and the False Claims Act; (2) requirements for contractors to establish and maintain specific internal controls to detect, prevent, and disclose improper conduct in connection with the award or performance of any government contract or subcontract; and (3) new causes for suspension and debarment. The final rule applies to all federal government contracts in amounts greater than $5 million and more than 120 days in duration.

A. Mandatory Disclosure of Misconduct.

The centerpiece of the new rule is a requirement that mandates the disclosure by contractors of "credible evidence" of violations of certain criminal laws and the civil False Claims Act. The rule requires a government contractor to make a timely disclosure to the agency Office of Inspector General, with a copy to the contracting officer, whenever, in connection with the award, performance, or closeout of a government contract or subcontract, the contractor has "credible evidence" of:

- a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violation found in Title 18, United States Code;
- a violation of the civil False Claims Act; or
- significant overpayments on the contract.

The term "credible evidence" is not defined in the rule, but it is a higher standard than the "reasonable grounds to believe" standard included in the proposed regulations. This change suggests that "the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the government." The rule also requires flow down of the provision to subcontracts which meet the same size and duration thresholds, but provides that subcontractor disclosures must be made directly to the government, instead of to the prime contractor. In addition, the obligation to disclose applies to contracts that include the new clause and extends until three years after contract completion, "using final payment as the event to mark contract completion."

Contractors may likely conclude that it is not clear how the credible evidence standard will be applied, and err on the side of caution. When in doubt, contractors should disclose.

B. Establishment of Internal Control Systems.

The newly-amended rule also requires contractors to establish, within 90 days of contract award: (1) business ethics awareness and compliance programs; and (2) internal control programs. Contractors are required to flow down the

substance of the clause to subcontracts exceeding $5 million and 120 days.

A contractor's business ethics awareness and compliance program must include "effective training programs" and the dissemination of information "appropriate to an individuals' respective roles and responsibilities." The training provided must be given to the "Contractor's principals and employees, and as appropriate, the Contractor's agents and subcontractors."

A contractor's internal control system must provide for compliance with the mandatory disclosure requirements discussed above. Under the new rule, a contractor's internal control system must provide, at a minimum, for the following: assignment of responsibility at a sufficiently high level in the organization and the commitment of adequate resources; reasonable efforts not to include an individual as a principal who is known to have engaged in conduct contrary to the contractor's code of business ethics and conduct; periodic reviews of business practices, procedures, policies and internal controls; internal reporting mechanism; disciplinary action for improper conduct; timely disclosure of wrongdoing; and full cooperation with government investigators and auditors.

For contractors who do not already have such internal controls in place, implementing these new mandatory elements is likely to increase the cost of doing business with the government.

C. New Grounds for Suspension and Debarment.

The new rule also expands the causes for debarment or suspension to include the knowing failure by a principal, within three years after final payment on any government contract, to timely disclose to the government credible evidence of: (1) a violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the U.S. Code; (2) a violation of the False Claims Act; or (3) significant overpayment(s) on the contract. The term "principal" is defined as "officers; directors; owners; partners; and, persons having primary management or supervisory responsibilities within a business entity (e.g., general manager; head of a subsidiary, division or business segment)," and compliance officers or directors of internal compliance programs. Unlike the mandatory disclosure obligation discussed above, this provision applies to all government contractors as of December 12, 2008 and even to ongoing contracts that pre-date the effective date of the rule.

Although the term "timely" is not defined, it is noted, as discussed above, that contractors "will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government." Thus, timely disclosure will be measured from the time that a principal concludes that evidence of wrongdoing is credible. The term "significant overpayment" is also not defined, but it is noted that it "implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount…it is within the discretion of the suspension and debarment official to determine whether an overpayment is significant and whether suspension and debarment would be the appropriate outcome for failure to report such overpayment." Therefore, whether a principal has failed to disclose a significant overpayment will be determined on a case-by-case basis.

D. Conclusion.

This new rule imposes significant new compliance obligations on contractors and makes it even more important for contractors to be ever-vigilant in ensuring that they promptly, carefully and

thoroughly review all reports or indications of potentially applicable misconduct. Non-disclosure decisions will need to be carefully documented. Agreements with subcontractors, agents and employees will need to be revised to accommodate the new requirements. The new rule leaves many issues unanswered. But the new rule's adoption should convey to contractors that the government is placing an increasing emphasis on compliance, and it has shifted significant self-oversight responsibility to contractors.

Regulator's Corner: New Arizona Registrar of Contractor Laws Take Effect

by Fidelis Garcia

While Arizona's budget deficit dominated the last legislative session, several bills relating to the construction industry were introduced by various legislators. Among the bills that ultimately became law, and effective on September 26, 2008, was Senate Bill 1417 (SB1417), which amended several provisions of Title 32, Chapter 10, relating to the Arizona Registrar of Contractors.

First, SB1417 also attempts to clarify the "owner builder" exemption found in A.R.S. 32-1121(A)(5) by incorporating the specific definition of "owner-occupant" found in A.R.S. 33-1002.

Next, by amending A.R.S. 32-1154(B), SB1417 intends to narrow who can file a complaint against a licensed contractor by deleting the word "person" and replacing it with "owner or contractor that is a party to a construction contract or a person who suffers a material loss or injury as a result of a contractor's failure to perform work in a professional and workmanlike manner or in accordance with any applicable building codes and professional industry standards," and by adding definitions of "construction contract" and "owner."

Because this language appears to cause the Registrar to make a "new and initial" factual determination of who can legally file a complaint, both contractors and complainants may find themselves before a judge arguing: 1.) whether or not the complainant had the right to file the complaint under the new law; and 2.) the Registrar's rejection or denial in accepting the complaint. At this time, it remains unknown whether the Registrar will adopt or change its current procedures to address the potential Due Process concerns arising from these arguments.

Third, SB1417 made two changes to A.R.S. 32-1155. The first change, in A.R.S. 32-1155(A), deleted language relating to the Registrar's ability to issue a citation "upon written request of the complainant" against a licensed contractor. While this change was meant to restrict a complainant's ability to request that the Registrar issue a complaint, this amendment falls short of substantially changing the previous permissive language allowing the Registrar to issue a complaint after an investigation. As such, this statutory change may have little or no practical affect on the current Registrar's policies.

By contrast, a new sub-section, A.R.S. 32-1155(C), adds two specific instances in which the Registrar cannot issue a citation against a licensed contractor for poor workmanship or failure to follow building codes and industry standards. They are: 1.) instances in which the contractor was "not provided an opportunity to inspect the work within fifteen days after receiving a written notice from the Registrar; and 2.) if the "contractor's work has been subject to neglect, modification or abnormal use." Due to the uncertainty of the law's new meaning, both

contractors and complainants may find themselves before a judge arguing these issues, and the Registrar's findings relating to the definitions of "neglect, modification or abnormal use."

Finally, SB1417 added a new Article 5 to Title 32, Chapter 10, relating to "General Remodeling and Repair Contractors." First, upon a finding by the Registrar that a General Remodeling and Repair Contractor does not have worker's compensation pursuant to Title 23, Chapter 6, Article 4, the new law mandates that the Registrar order a summary suspension of the contractor's license pending a proceeding for revocation or other action. Additionally, Article 5 prohibits a General Remodeling and Repair Contractor who has at least five "unresolved and substantiated abandonment complaints" in a 12- month period from accepting any new projects until the number of these abandonment complaints "relating to the contractor's work performance is below five in a twelve month period." Lastly, Article 5 expands the Registrar's summary suspension authority over General Remodeling and Repair Contractors for situations in which the Registrar determines "that the public health and safety requires immediate action." Although SB1417 intended to protect homeowners by adding stricter regulations to all residential remodeling and repair classifications, its specific statutory language appears to limit its enforcement to only the "B-3 General Remodeling and Repair" classification defined by the Registrar's Rules.

From my experience, the provisions of Senate Bill 1417 will most likely cause the Registrar to adopt new policies and procedures to protect the Due Process rights of both contractors and complainants. Both groups should budget and prepare for another layer of potential legal action in defining and defending the parameters of this newly enacted legislation.

New Arizona Law Offers Active Duty Military Personnel New Protections

On September 26, 2008, Senate Bill 1006 (SB1006) relating primarily to members of the United States armed force reserves and Arizona's national guard took effect as A.R.S. 32-4301. SB1006 provides safeguards for military personnel who hold a license, certificate, or registration pursuant to Title 32 of the Arizona Revised Statutes.

First, the law does not allow a license, certificate or registration issued by a licensing authority to expire while a member of the United States armed forces reserves or Arizona national guard are serving on "federal active duty." Next, upon the "members" return from active duty, military personnel receive an extension of 180 days to their license. Third, the law allows additional extensions for military personnel who "suffer an injury as a result of active service" that prevents them from performing the duties of their license, certificate or registration. Finally, the law does not allow the licensing authority to charge any late or delinquent fees upon renewal of a license.

In order to qualify for the benefits extended under A.R.S. 32-4301, reservists and guardsmen are required to notify the licensing authority of their active duty status as defined by the law. Additionally, persons licensed under Chapter 36 of Title 32 have a shorter extension period of 90 days, and regular United States armed forces personnel may qualify under certain other conditions. Lastly, license holders under the Registrar of Contractor's laws, may not qualify for the exemption if someone other than the "federal active duty" member has the authority to renew its contractor's license. If you are a military member, or legal representative of the member who is licensed, certified or registered

under Title 32, you should check with your licensing authority or your knowledgeable construction attorney for more specific information regarding this new law.

Green Building Makes a Lot of ₵ent$

by Marc Erpenbeck and Colleen Schiman

In a down economy, developers, business owners and operators, contractors, architects and other building industry professionals may find themselves frantically searching for the next lucrative opportunity. One way to distinguish yourself in this market is to focus on the benefits of green building. As a new administration takes office in January of 2009 and the global economy continues to focus on the environment, green building is no longer a futuristic abstract idea with a minor realization; green building is now.

Green building has benefited from federal, state, and local governments' growing interest in protecting the environment and the conservation of energy, as well as the continued focus of the general population on living "green" lifestyles. Further, programs such as the U.S. Green Building Council's (the "USGBC") Leadership in Energy and Environmental Design ("LEED") or the U.S. Environmental Protection Agency's and U.S. Department of Energy's Energy Star have helped the rapid expansion of green building even in a recession.

LEED is a third-party certification program clarifying that you have designed, constructed or own a sustainable building. The LEED certification program currently includes a four-level rating system (Certified, Silver, Gold, and Platinum) that incorporates design, construction, and operation of high performance green buildings. LEED certification is based on a point system, with the current system for new buildings in effect since January 1, 2006. As the USGBC recently has announced it will introduce a major revision to the LEED rating system in 2009, it is important to periodically check the USGBC website for any updates to the LEED certification program.

Energy Star is a program that offers energy-efficient approaches for both residential and commercial use. Energy Star began as a voluntary labeling program used to identify energy-efficient products. Today, Energy Star has expanded its label to over 50 product categories for the home and office. Energy Star also delivers information and techniques to homeowners and building managers in order to promote efficiency and costs savings.

There are many benefits to achieving certain LEED ratings or complying with other green building alternatives. LEED certification and green building generally have higher initial construction costs, which means more money for the architects, engineers, and contractors. Some building officials are also offering incentives such as priority permitting, permitting assistance, and reduced permitting fees. Green buildings give even greater advantages to building owners and tenants in that there are long-term benefits associated with green building including federal, state and local tax incentives; reductions in maintenance and energy costs; better health; enhanced public image; the reduction of greenhouse gases; premium rental rates; and increased marketability of the property. Utility companies are also adding incentive programs for residential and commercial buildings. Green building is a win-win for all involved by providing owners and operators a lifetime of benefits, while contractors

and design professionals receive the up-front benefit of higher rates for specialized knowledge and skill.

Green building is a fast-moving trend. According to the McGraw-Hill Construction, Green Outlook 2009: Trends Driving Change, released December 1, 2008, (the "Green Outlook") green building policies and legislation have grown rapidly throughout the country over the past three years. For instance, California has nearly doubled its number of green building policies, from 22 in 2005 to 41 in 2008; Arizona has increased from 2 to 7 over the same period.

States and cities across the U.S. continue to create new green building legislation, which results in benefits for all those involved in green building. For instance, in 2005 and 2007, Nevada's legislature provided for property tax abatement for buildings that meet certain LEED requirements. Initially, in 2005, buildings that met or exceeded certified LEED Silver could receive up to a 50% abatement of property taxes for that property. The enrollment in the programs greatly exceeded expectations. Therefore, in 2007, the Nevada legislature scaled back the amount, capping the property tax abatement at a maximum 35% (with lower caps for lower LEED ratings). In Salt Lake City, Utah, the mayor issued an Executive Order in 2005 mandating that all new and renovated public buildings be certified LEED Silver or higher. Scottsdale, Arizona implemented a similar mandate for new city buildings and major remodeling in 2005, except it requires buildings to be certified as LEED Gold or higher. On the residential side, Telluride, Colorado has green building requirements for all new residential construction, additions, and remodeling that includes categories such as energy efficiency and resource conservation. California municipalities simply have too many different legislations to summarize here.

Congress also has passed federal legislation extending tax credits (that had expired at the end of 2007) for consumers and home builders, and deductions for commercial buildings. The Emergency Economic Stabilization Act of 2008, signed into law on October 8, extended consumer provisions for a variety of energy-efficient home improvements and solar energy or small wind energy systems. For home builders, tax credits are available for building energy efficient homes. Tax deductions for commercial buildings are offered for owners or designers of buildings that save energy in the heating and cooling of the building.

The Green Outlook also forecasts that both nonresidential and residential green building will increase dramatically over the next five years. **McGraw-Hill expects commercial and institutional green building to grow to a $56–$70 billion marketplace (20% to 25% of new construction by value) and residential green building to grow to a $40–$70 billion marketplace (12% to 20% of new construction by value) by 2013.**

The LEED certification program also establishes a unique opportunity to stand out in the building industry and become a LEED Accredited Professional ("LEED AP"). LEED APs are building industry professionals who have specialized knowledge and skills to help achieve LEED ratings. Those who pass the LEED AP exam are designated as LEED APs.

Other opportunities are available to learn and expand business as well. For example, on March 13 and 14, 2009, the Phoenix Convention Center is hosting the Southwest Build-It-Green Expo and Conference in Arizona. On May 6 and 7, 2009, the Colorado Convention Center in Denver will hold Sustainability '09: The Colorado Facilities & Green Building Expo and Conference.

Presently, those involved in the private sector of green building can possibly reap the benefits of the many incentives that exist. With green building's

booming popularity and legislative mandates, these incentives may eventually become a higher expense than federal, state, and local governments can afford in today's economic climate. As the trend grows and the momentum shifts, the incentives may begin to disappear and instead, switch to mandates, as already seen in the public sector, and in certain jurisdictions through applicable codes. Companies should consider taking advantage of incentives while they are still readily available in preparation for the mandates of tomorrow.

Understand and Negotiate Your Contract - an Engineering Firm Successfully Limits Its Liability for Negligence to the Fees Received through a Limitation of Liability Clause

by Ben Mitsuda

Whether it was a cell phone agreement, a doctor's office consent form, or an AIA construction contract, many have signed a contract without reading or negotiating it. However, failing to know and understand the terms of a contract can have serious consequences.

The Arizona Supreme Court recently held that an engineer's contract effectively limited damages for an engineer's negligence to the amount of the fees it received. The Court determined that a provision limiting the engineer's liability did not violate public policy and was properly applied by the lower court. *See 1800 Ocotillo, LLC v. The WLB Group, Inc.*, 2008 WL 4763314 (Ariz. 2008).

In November 1998, a real estate developer, 1800 Ocotillo, sought the services of the WLB Group, an engineering firm, to survey boundary lines for a new development in Phoenix. WLB faxed Ocotillo its proposal and its standard conditions, which 1800 Ocotillo signed. WLB then completed its work surveying the property in an allegedly negligent manner. 1800 Ocotillo filed a lawsuit against WLB seeking more than $1 million in damages for WLB's negligence.

In response to 1800 Ocotillo's claims, WLB argued that, even if it was negligent, the standard conditions of the contract limited its liability to $14,242.00 (the total amount of fees it had received from 1800 Ocotillo). Specifically, WLB relied upon a limitation of liability provision in the standard conditions which stated:

> Client agrees that the liability of WLB, its agents and employees, in connection with services hereunder to the Client and to all persons having contractual relationships with them, resulting from any negligent acts, error and/or omissions of WLB, its agents and/or employees is limited to the total fees actually paid by the Client to WLB for services rendered by WLB hereunder.

It is unclear whether 1800 Ocotillo read the standard conditions before signing the proposal and 1800 Ocotillo later claimed that the faxed copy of the standard conditions it received was illegible. 1800 Ocotillo also attempted to invalidate the provision by arguing that it violated public policy and was contrary to A.R.S § 32-1159 (Arizona's anti-indemnity statute).

The Arizona Supreme Court held that the provision was not against public policy and that

the lower courts properly applied it. The Court restated the general rule that, "absent legislation specifying that a contractual term is unenforceable, courts should rely on public policy to displace the private ordering of relationships only when the term is contrary to an otherwise identifiable public policy that clearly outweighs any interests in the term's enforcement."

The Supreme Court's ruling primary focused on the fact that the contract merely limited WLB's liability for its negligence and did not attempt to completely eliminate it. The Court noted:

> Although it is possible that a limitation of liability provision could cap the potential recovery at a dollar amount so low as to effectively eliminate the incentive to take precautions, this is not the case here. Under the Ocotillo contract, WLB remains liable for the fees it earns. The fees undoubtedly were WLB's main reason for undertaking the work. Thus, WLB retains substantial interest in exercising due care because it stands to lose the very thing that induced it to enter into the contract in the first place.

Thus, 1800 Ocotillo stands for the rule that contractual limitations on liability are effective so long as they do not limit the potential recovery to an amount so low that it eliminates "the incentive to take precautions."

The Court also rejected 1800 Ocotillo's argument that the limitation of liability clause was an assumption of the risk requiring interpretation by a jury. As it did with the public policy claims, the Court focused on the fact that the limitation of liability clause did not abolish all liability for WLB. The Court determined that the case did not need a costly jury trial because Article 18, Section 5 of the constitution only refers to "defenses that effectively relieve the defendant from any duty."

1800 Ocotillo's Lessons

1. **Negotiate and Read Your Contract -** Absent specific legislation stating a contract term is unenforceable, boilerplate provisions in a commercial contract are generally enforceable – even if the provisions were not reviewed by one of the parties. You may want to include or strike a limitation of liability clause in your contract before the parties sign it.

2. **Limitation of Liability Clauses are Generally Effective –** A commercial contract may generally limit a party's liability for its negligent acts so long as the contract leaves open the opportunity to recover some amount of damages. However, restricting a party's liability to an amount so low that it eliminates "the incentive to take precautions" may be against public policy.

Federal Agencies Revise Clean Water Act Guidance with Few Changes

by Richard Siever

On December 2, 2008, the U.S. Environmental Protection Agency ("EPA") and the Army Corps of Engineers (the "Corps") issued a revised guidance memorandum regarding scope of enforcement under the Clean Water Act (the "CWA"). Despite an overwhelming request for clarification, several issues specific to arid regions in the Western United States remain unaddressed. One thing remains clear from the new guidance: EPA and the Corps seek to retain the broadest of CWA jurisdiction despite court rulings to the contrary.

Previous EPA and Corps Guidance.

The CWA prohibits discharge of pollutants, including dredged or fill material, into "navigable waters" except otherwise in compliance with the CWA, or permits issued under Section 402 or 404 of the CWA. "[D]ischarge of a pollutant" means "any addition of any pollutant to navigable waters from any point source." "[N]avigable waters" means "the waters of the United States, including the territorial seas."

The U.S. Supreme Court in 2006 reviewed the scope of CWA implementation and issued its interpretation of the regulations in *Rapanos v. United States* and *Carabell v. United States* ("*Rapanos*"). But the Supreme Court left many questions unsettled. A plurality of four justices in *Rapanos* determined that regulatory authority extends only to "relatively permanent, standing or continuously flowing bodies of water" connected to traditional navigable waters, and to "wetlands with a continuous surface connection" to such relatively permanent waters. A concurring justice identified a broader approach to defining wetlands, classifying them as significantly affecting "the chemical, physical, and biological integrity of other covered waters more readily understood as 'navigable.'" In other words, the criteria for defining navigable water remained fairly unclear after the Supreme Court's review.

Following the Supreme Court's decision in *Rapanos*, local EPA regions and Corps districts were particularly challenged to provide consistent enforcement of the CWA. The scope of agency jurisdiction remained uncertain. Developers continued to question how extensively the federal government may apply the CWA in restricting development on or near wetlands.

An initial memorandum issued by EPA and the Corps on June 5, 2007, sought to clarify requirements for CWA jurisdictional determinations and permitting actions. The initial guidance discussed the circumstances under which wetlands were jurisdictional after *Rapanos*, effectively adopting the concurring opinion's broader interpretation and confirming that CWA jurisdiction exists if either the "continuous surface connection" or a substantial nexus standard is satisfied. Ultimately, the guidance concluded that EPA and the Corps will assert jurisdiction on a case-by-case basis.

What Does the Revised Guidance Change, if Anything?

The December 2, 2008, guidance memorandum is available at http://www.epa.gov/wetlands/guidance/CWAwaters.html.

Despite extensive public comment and criticism, the agencies' revisions are relatively minor. The revised guidance likely leaves open many of the same questions as to breadth and depth of CWA jurisdiction.

EPA and Corps Summary of Key Points After Revised Guidance.

The agencies will assert jurisdiction over the following waters:

- Traditional navigable waters
- Wetlands adjacent to traditional navigable waters
- Non-navigable tributaries of traditional navigable waters that are relatively permanent where the tributaries typically flow year-round or have continuous flow at least seasonally (e.g., typically three months)
- Wetlands that directly abut such tributaries

The agencies will decide jurisdiction on a case-by-case basis to determine whether they have a "significant nexus" with traditional navigable water for the following waters:

- Non-navigable tributaries that are not relatively permanent
- Wetlands adjacent to non-navigable tributaries that are not relatively permanent
- Wetlands adjacent to but that do not directly abut a relatively permanent non-navigable tributary

The agencies generally will not assert jurisdiction over the following:

- Swales or erosional features (e.g., gullies, small washes characterized by low volume, infrequent, or short duration flow)
- Ditches (including roadside ditches) excavated wholly in and draining only uplands and that do not carry a relatively permanent flow of water

Lingering Issues and Implications for the Arid Southwest.

Although the agencies appear to have taken steps toward more consistent regulation, the agencies declined to address much of the criticism they received during the comment period. Many urged changes to the agencies' analysis of significant nexus or the definition of relatively permanent waters. Other comments raised procedural concerns, including processing delays in obtaining jurisdictional delineations. The guidance clarified, however, that project proponents may request a preliminary jurisdictional determination, essentially agreeing to presumptive jurisdiction of their site, to expedite the process and proceed with permitting.

Individuals in arid states like Arizona also face unique challenges with respect to current CWA enforcement, most of which are not specifically addressed in the revised guidance. For example, the guidance implies different standards may be used to evaluate applications to arid regions, but fails to elaborate. *See* Comments of Western Coalition of Arid States (2008). Others suggest that the current guidance does not take into account the unpredictable rainfall in arid regions. *Id.*

In light of the apparent broad scope of CWA jurisdiction, site owners and developers should consider whether a preliminary jurisdictional determination makes sense to avoid the potential delay of an approved jurisdictional determination and to expedite the permitting process. Preliminary jurisdictional determinations are not legally binding as to CWA jurisdiction; rather, they establish only a presumption. Preliminary determinations may be worthwhile to avoid delays in determining whether or not CWA jurisdiction exists. Project proponents can stipulate to jurisdiction to avoid the delay and proceed directly to the permitting process. In exploring whether to seek a jurisdictional determination, project proponents can work with neighboring property owners and consider previous determinations rendered by the agencies for projects on adjacent or nearby sites. Parties requesting a finding of no jurisdiction should be fully prepared to meet Corps documentation requirements with sound science and a defensible record.

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Contract Termination in an Uncertain Economy

by Rick Erickson and Michelle Keogh

In these tough economic times, it goes without saying that developers and contractors alike want financially stable construction projects. It also goes without saying that no one in this economic climate can afford to go unpaid for their work. Banking takeovers and bankruptcies translate into losses for everyone on the project, especially for the general contractor and the subcontractors who can no longer depend on timely payment. What do you do then, if you are financing a project or duly performing your work, and the money dries up?

Contract termination may be an appealing option for some owners, contractors, and subcontractors who cannot afford to wait for the money to start coming in again. Yet, terminating a construction contract hastily and without proper legal advice can lead to bigger problems than the money you have already lost by not being paid. Below we have identified some basic information that owners, general contractors, and subcontractors should be aware of when deciding whether to terminate an existing contract. Wrongfully terminating a construction contract can have substantial negative consequences, including liability for wrongful termination and lost profits. Given the recent downturn in our economy, no one wants to incur these extra costs, so use the information below as a guide. Get legal advice whenever you are considering contract termination.

First and foremost, when considering termination, read your contract. Most contracts contain termination provisions that identify your rights and obligations regarding termination, including specifying when termination is available, what procedures must be followed to terminate the contract, and whether other remedies are available for breaches of the contract. Failure to comply with the terms of the contract can invalidate a termination, so you need to know and understand the language of your contract, especially regarding notice and procedural requirements.

Two types of termination provisions are common in construction contracts: termination for convenience and termination for default. Termination for convenience provisions are now widely used in the private sector, although they originated in government contracts. Termination for convenience allows an owner to terminate the contract in its discretion, as long as the owner does so in good faith and pays for the work in accordance with the termination for convenience clause. These provisions allow an owner who has lost funding on a project to end the project without breaching its contracts with the contractor and the subcontractors.

Termination for default provisions specify the conditions under which default gives rise to termination. The default provisions in the owner-contractor contract usually allow for termination by the owner if a contractor repeatedly fails to provide enough skilled labor to timely complete the work, fails to pay its subcontractors, or disregards safety laws. Subcontracts also usually contain default termination provisions that require contractors to give subcontractors notice of the default and an opportunity to cure before termination.

The construction contract is not the only governing source of rights and obligations imposed on parties considering termination. For example, state statutes may control. In fact, in Arizona, the Prompt Pay Act contains specific provisions regarding contract termination for failure to pay. A.R.S. § 32-1129.04 identifies detailed notice requirements that apply to each party seeking termination. For the purposes the Prompt Pay Act, written notice must either: 1) be delivered in person to the individual or member of an entity or to an officer of the corporation for which it was intended; or 2) be delivered or sent by any means that provides written, third party verification of delivery to the last business address known by the person giving notice.

Most importantly, the language of the Prompt Pay Act expressly states that a construction contact can shorten the time for notice but CANNOT extend the time period for a contractor or subcontractor to terminate a construction contract. That means, while reading your contract should always be your first step, you should also be aware of the statutory requirements.

Section 32-1129.04(A) of the Prompt Pay Act provides contractors with the right to suspend performance or terminate the contract upon the owner's failure to make timely payments that have been certified by the project architect. The contractor must provide at least seven (7) calendar days written notice to the owner before terminating, unless the contract specifies a shorter time. Section 32-1129.04(B) allows a subcontractor to suspend performance or terminate the subcontract if the owner fails to timely pay the contractor *and* the contractor fails to pay the subcontractor for certified work. Under this provision, the subcontractor must provide written notice to the contractor and the owner at least three (3) calendar days before suspending performance or terminating the contract. Section 32-1129.04(C) allows a subcontractor to suspend performance or terminate the subcontract if the owner pays the contractor for the subcontractor's certified work, but the contractor fails to pay the subcontractor. Here, the subcontractor must give written notice to the owner and contractor at least seven (7) days before suspending or terminating performance. Finally, section 32-1129.04(D) allows a subcontractor to suspend performance or terminate the subcontract if the owner fails to certify the subcontractor's work through no fault of the subcontractor. The subcontractor must give the owner and contractor written notice at least seven (7) days before suspending performance or terminating the contract.

In addition to the contractual and statutory termination rights discussed above, a party's ability to successfully terminate a construction contract may also be impacted by the common law governing contracts. Common law allows for contract termination when one party has materially breached the contract and also provides several defenses to termination, including frustration or purpose, commercial impracticability, and impossibility. There is no single definition of material breach and whether nonpayment constitutes a material breach is heavily dependent on the circumstances surrounding nonpayment, including the value of the overall contract, the amount owed, and how late is the payment. Determining whether your circumstances constitute a material breach or whether you meet the requirements of a common law defense to terminate requires a detailed factual analysis that should not be undertaken without the advice of a seasoned construction law attorney.

If our economy continues in its downward spiral, money will continue to become scarce, and nonpayment on construction contracts

will probably be an ever-present risk. Though contract termination is often a last resort, knowing your rights and obligations allows you to assess whether it is the right choice for you and your business. Your contract, state statutes, and the common law of contracts impose a myriad of requirements on owners, contractors, and subcontractors to properly terminate a contract. To avoid substantial penalties for wrongful termination, be familiar with your contract and state statutes and consult an experienced construction law attorney.

Note: Ron Messerly recently completed his second book, this time on Arizona Construction Law. Last year, Ron, working with Thomson/West Publishing, completed a two-volume treatise on Arizona Real Estate Law, which he will update on an annual basis. Both books are part of the Thomson/West "Arizona Practice Series" and are compilations of all relevant statutes and regulations on their respective topics combined with historical developments and modifications to the statutes and case law annotations.

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