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Termination For Convenience: Is It The Right Move?

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Traditionally, the owner of a construction project could not terminate the general contractor, and the general contractor could not terminate a subcontractor, without cause. A termination without cause was treated as a breach of contract, sometimes subjecting the owner or general contractor to damages beyond what they anticipated paying under the contract. Many years ago, however, the federal government introduced the concept of "termination for convenience," under which the government could terminate a contract without cause so long as it acted in good faith. In that circumstance, the contractor was entitled to recover some lost profit but generally was not entitled to recover the full measure of damages for breach of contract.

More recently, the concept of termination for convenience has gained acceptance in private contracts. In fact, the concept of termination for convenience is becoming relatively commonplace, as demonstrated by the most recent version of the AIA form contracts. For example, the AIA A201-1997 form of general conditions, which governs most AIA form contracts and is probably the most common form of general conditions used in private construction, now includes paragraph 14.4.1, which provides that:

The owner may, at any time, terminate the contract for the owner's convenience and without cause.

Section 14.4.2 of the A201 form provides that upon termination for convenience, the contractor must cease operations as directed by the owner; take any actions necessary (or that the owner may direct) for the protection and preservation of the work; and, except for work directed to be performed prior to the effective date of termination, terminate all existing subcontracts and purchase orders and enter into no further subcontracts and purchase orders.

Thus, many owners (and general contractors) now have the option to terminate their contractors for convenience. But whether a termination for convenience makes sense depends on the circumstances. Many factors come into play. An owner or general contractor considering termination for convenience should consider at least some of the following questions:

1. Does termination make sense?
2. If so, to what extent does cause exist for a default termination?
3. Even if cause for a default termination arguably exists, will it result in an unnecessary, protracted and expensive legal battle over cause?
4. What are the costs of terminating for convenience as compared with the costs of terminating for cause?

I. THE TERMINATION DETERMINATION

Obviously, the paramount consideration in deciding whether to terminate either for

convenience or for cause is the question of termination itself. If a project has lost funding or otherwise is not going to move forward, termination for convenience almost always makes sense and in many cases cause for a default termination may not exist at all. More commonly, however, the owner or general contractor considers termination when the project, or some portion of it, is going badly. For example, the project schedule may have slipped, or the performance may be unsatisfactory.

Of course, a project that has gone bad can be turned around, but it is often the case that when serious problems begin to occur with regularity on a project, they often persist throughout the life of the project. On the other hand, terminating a project mid?course makes it difficult, if not impossible, to maintain the schedule and to preserve the original contract price. Such a termination can also result in liens or other claims by subcontractors which the owner may need to satisfy. Ultimately, the owner (or general contractor) must decide whether it is better off toughing it out and completing the project with the original contractor, albeit subject to delays and performance deficiencies and/or other problems, or whether the project is so far gone that it makes more sense to start afresh midstream.

These are not necessarily easy calls to make. They are essentially business decisions, not legal decisions. For the purposes of this article, we will assume that the owner (or general contractor) is dissatisfied with the contractor's performance and has decided that termination makes sense.

II. DOES CAUSE EXIST?

Once the decision to terminate is made, the owner (or general contractor) should carefully consider whether cause exists. Not every contract will define what constitutes cause. The AIA A201 general conditions provide some guidance and a good example of what may qualify as cause. Section 14.2 of the A201 spells out the standards for termination for cause:

The owner may terminate the contract if the contractor:

> 1. persistently or repeatedly refuses or fails to supply enough properly skilled workers or proper materials;
> 2. fails to make payment to contractors for materials or labor in accordance with the respective agreements between the contractor and the subcontractors;
> 3. persistently disregards laws ordinances, or rules, regulations or orders of a public authority having jurisdiction; or
> 4. otherwise is guilty of substantial breach of a provision of the contract documents.

These are fairly obvious categories. Failure to properly staff the job or failure to use the proper materials should constitute cause under any contract. Failure to make payments to subcontractors such that the job is subjected to lien or bond claims likewise should constitute cause, although that may be somewhat debatable if it is not spelled out specifically in the contract. Disregard for laws, ordinances or rules of public authorities should not be controversial, although it is perhaps somewhat nebulous. Committing a substantial breach of a provision of the contract documents is not particularly defined but presumably includes such things as substantial schedule slippage, failure to complete the work in a workmanlike manner and similar blatant breaches of contract.

At least under the AIA documents, the owner may not unilaterally declare cause

sufficient to terminate the contract. Rather, and presumably to prevent abuse by the owner, prior to terminating for cause the architect must certify that sufficient cause exists to justify termination. Sometimes the architect is reluctant to certify that sufficient cause exists to justify termination. Moreover, it is not always a clear-cut call. If it is a clear-cut call, it is probably advantageous to terminate for cause. For example, if the project has slipped into delays from which the contractor can make no reasonable recovery, and those delays significantly impact the project, cause probably exists and the architect should so certify.

There are multiple advantages to terminating for cause. For example, under the A201 general conditions, when an owner terminates for cause, the owner may take possession of the site and of all materials, equipment, tools and construction equipment and machinery owned by the contractor necessary to complete the project. Moreover, in a termination for cause the owner may assume the subcontracts and force the subcontractors to perform. And finally, in a termination for cause the owner need not pay the contractor anything more until the work is finished and the owner may finish the work by whatever reasonable method is expedient.

At the end of the day, if the costs and damages caused by a proper termination for cause exceed the unpaid balance on the original contract, the contractor must pay the difference to the owner. In other words, at least under the A201, in a termination for cause the owner is entitled to back charge in the amounts by which completion of the job exceeds the original contract amount. None of these favorable remedies exist in a termination for convenience. At the same time, owners (and general contractors) must recognize that contractors (and their sureties) rarely accept a termination for cause without a fight.

III. IS THE FIGHT OVER CAUSE WORTH IT?

The question of whether cause exists is largely factual in nature. Of course, there may be legal disputes as to whether certain conduct can constitute cause, but by and large the disputes revolve around factual issues such as whether the project truly is irreparably delayed, who is responsible for delays, whether work is genuinely faulty, whether faults with the project relate to defective design specifications and/or plans, and a whole host of similar issues.

Moreover, there is generally a cure period (often seven days) during which the contractor may take curative steps. This is another possible point of dispute. First, given a contractor's history on the job, the owner may be reluctant to allow the contractor to cure and continue. Second, there may be very legitimate questions as to whether the contractor can cure, or whether it has taken the necessary steps to cure.

The problem is that it is costly and consumes valuable management time to fight these disputes over cause. Again, in some circumstances, cause will be clear-cut, but more often than not it is not. In the typical construction dispute, there are a myriad of small and large issues that combine together from the perspective of the owner (or the general contractor) to constitute cause. Each of these individual issues provides fertile ground for dispute. Imagine, for example, a delay dispute involving 50 separate items, perhaps no one of which is substantial by itself, but which in combination add up to substantial delay. Each of the 50 items might be hotly disputed by the parties. Properly preparing for such a dispute may, in effect, require a virtual trial within a trial of each disputed item as part of the overall trial or arbitration. This takes substantial lawyering time (translation: cost) and substantial management time which may detract from the completion of the

project or subsequent projects.

Depending on the costs, it may be cost prohibitive to fight over all of those individual issues. The dispute also may raise risk factors to unacceptable levels. For example, what if the owner prevails on 50% of the issues - does that total add up to sufficient delay or other problems to constitute cause? Do the potential upsides outweigh the likely cost of the dispute, or is the risk of coming up empty to great in light of the likely costs?

These are fundamental issues to consider. The owner (or general contractor) must carefully consider these costs in determining whether to terminate for cause. Of course, these issues are largely non-existent in a termination for convenience, and sometimes it will be more cost effective for the owner (or general contractor) to cut its losses by doing a termination for convenience.

IV. THE COST OF TERMINATION FOR CONVENIENCE

Obviously, there are advantages, but also some substantial costs to a termination for cause. While a termination for convenience eliminates many of the disputes and therefore many of the costs associated with a termination for cause, termination for convenience carries its own costs which need to be factored into the analysis. While other contracts may differ from the A201 with respect to termination for convenience, the A201 represents the most common set of general conditions in private contracts and thus is a fair point for analysis.

First, under the A201, when an owner (or general contractor) terminates for convenience, it does not have the right to assume the subcontracts. This means that unpaid subcontractors may have lien rights to which the owner has little or no defense. In other words, the owner may be required to pay subcontractors even though it may not entirely be satisfied with their work (of course, there is room for dispute in this arena, but the owner typically occupies an unfavorable position when lien rights are asserted). Moreover, the owner is in no position to force the subcontractors to complete their work. More often than not this results in the subcontractor's charging more for their part of the work, resulting in higher project costs.

Second, under the A201's version of a termination for convenience, the owner is required to pay the contractor for work executed (obviously subject to offsets for work that was not properly performed), termination costs, and reasonable overhead and profit on the work not completed. While the owner may have some offsets to apply against the work yet to be completed, most often in a termination for convenience the owner will end up paying the contractor something on top of what must be paid for the work completed to date. Moreover, to the extent offsets are disputed, termination for convenience may result in the same sorts of disputes that arise under a termination for cause. Generally, however, these disputes are more limited in scope and less expensive to defend.

Third, unlike terminations for cause, if the project costs more to complete than the original contract amount, there is no right of back charge against the contractor.

These costs may lead one to legitimately question whether termination for convenience under the A201 is any better for the owner than breaching the contract was under the old rules that did not permit a termination except for cause. Of course, the answer is at least partly in the eyes of the beholder. Without question, there is convenience in avoiding the costs and distractions of a dispute over cause. And if the costs of the A201 termination for convenience seem too

high, the owner can always modify those terms to something more palatable before signing the contract.

V. ULTIMATELY, THIS IS A BUSINESS DECISION

Ultimately, the decision to terminate for convenience as opposed to terminate for cause is a business decision. Termination for convenience in large part allows the owner to avoid getting mired in costly and time-consuming disputes over issues of cause. Frequently, the owner (or general contractor) will be miles ahead in an economic sense by avoiding these disputes and their associated costs. On the other hand, an owner (or general contractor) must guard against developing a reputation as a pushover in disputes. When cause is clear-cut, it usually makes good business sense to terminate for cause. It is only when questions of cause are less obvious, as they very often are, that an owner should consider termination for convenience.

At the end of the day, the owner (or general contractor) must do something of a cost/benefit analysis comparing the upsides and downsides of termination for cause against termination for convenience, and make a business decision as to which course of action to pursue. In either event, a careful review of the contract provisions is required.

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