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Construction Contract Termination: Risks and Risk Mitigation Associated with this Powerful Contractual and Common Law Tool

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- **Damian Santomauro, Esq. - Gibbons P.C.**
- **Peter Torcicollo, Esq. - Gibbons P.C.**

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5255 North Federal Highway, Suite 100, Boca Raton, FL 33487
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Construction Contract Termination: Risks and Risk Mitigation Associated with this Powerful Contractual and Common Law Tool

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**Presented by: Damian Santomauro, Esq.
Peter Torcicollo, Esq.**

Introduction

- Termination Concepts
- Types of termination
- Constructive termination and termination conversion clauses
- Surety issues
- Risks with termination
- Questions

Termination Concepts

- The end of the contractual relationship on a construction project
- Often thought of as method of last resort:
 - For a distressed Project
 - When things go bad between the parties
- But there can be many reasons to terminate a contractual relationship – many of them may have nothing to do with whether the parties are getting along or whether the Project is distressed
- Types:
 - Common law – “material breach”
 - Termination for cause (i.e. default) contract provision
 - Termination for convenience contract provision

Termination Concepts

- Termination can be a prudent or even necessary step to take on a construction project, but it is important that:
 - It is done correctly (i.e. comply with legal or contractual requirements)
 - All aspects of termination and post-termination are properly documented
 - All relevant parties are in the loop (e.g. bank, surety)

Common Law Termination

- A party may terminate a construction contract under the common law where there is a material breach by the other party (a material breach is often said to “excuse” the non-breaching party from further performance)
- Material breach is essentially a common law right to terminate for cause
- Material breach v. Nonmaterial breach *See Miller v. Mills Const., Inc.*, 352 F.3d 1166 (8th Cir. 2003)
 - All breaches may entitle the non-breaching party to recover damages against the breaching party
 - A material breach allows the aggrieved party to terminate the contract as well

Common Law Termination

- Two step inquiry for common law right to terminate:
 - Is there a breach?
 - Is the breach material?
- What makes a breach of contract a “material breach”?
 - Courts in different jurisdictions use different descriptions
 - “Goes to the heart of the contract” *Gulick v. A. Robert Strawn & Associates, Inc.*, 477 P.2d 489 (Colo. App. 1970)
 - “So gross that the very object of the contract is defeated” *Wells Benz, Inc. v. U.S. for Use of Mercury Elec. Co.*, 333 F.2d 89 (9th Cir. 1964)
 - “Failure to perform a substantial portion of the contract or one or more of its essential terms or conditions, or if there is such a breach as substantially defeats its purpose” *McCoy v. Gibson*, 863 So. 2d 978 (Miss. Ct. App. 2003)

Common Law Termination

- “If it affects the purpose of the contract in an important or vital way” *Jay Dee/Mole Joint Venture v. Mayor and City Council of Baltimore*, 725 F. Supp. 2d 513 (D. Md. 2010)
- “Substantially defeats the purpose of an agreement in such a fundamental way as to defeat the object of the parties making the contract . . . it must go to the root of the agreement between the parties” *In re Buffalo Schools Renovation Program*, 50 N.Y.S.3d 24 (N.Y. Sup 2016)

Common Law Termination

- Some courts will look to the Restatement Second, Contracts § 241 (Circumstances significant in determining whether a failure is material) to determine if the breach of a construction contract is “material”
 - The extent to which the injured party be deprived of the benefit which he reasonably expected;
 - The extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
 - The extent to which the party failing to perform or to offer to perform will suffer forfeiture;
 - The likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances, including any reasonable assurances; and
 - The extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Common Law Termination

- Whether a breach is considered material can be a very fact-specific inquiry and different courts can reach different conclusions – important to look to the law in your jurisdiction
- Examples of things that **may** be material breaches under the common law
 - Failure to timely pay
 - See *Franklin Pavkov Constr. Co. v. Ultra Roof, Inc.*, 51 F. Supp. 2d 204 (N.D.N.Y. 1999) (failure to make weekly payments to subcontractor as required by subcontract was a material breach)
 - *But see Stewart v. C & C Excavating & Const. Co.*, 877 F.2d 711 (8th Cir. 1989) (holding that a subcontractor was not justified in abandoning a job over a payment dispute involving a mere \$2,386)

Common Law Termination

- Failure to follow required safety policy (failure to ground bucket trucks) even for one day See *M & M Elec. Contr., Inc. v. Cumberland Elec. Mbrshp. Corp.*, 529 S.W.3d 413 (Tenn. Ct. App. 2016)
- Delays
 - See *Quintin Vespa Co. v. Construction Service Co.*, 179 N.E.2d 895 (Mass. 1962) (failure by contractor to provide site to subcontractor for 2 weeks a material breach)
 - See *Morton Bldgs., Inc. v. Correct Custom Drywall, Inc.*, 2007 Ohio App. LEXIS 2540 (Oh. Ct. App. June, 2007) (failure to perform within a reasonable time amounts to a material breach)
 - *But see Clairborne Hauling, LLC v. Wisteria Park, LLC*, 2010 Tenn. App. LEXIS 519, (Tenn. Ct. App. July 10, 2010) (developer improperly terminated contractor for untimely performance because failure to complete a construction project by a specified date will not constitute a material breach absent a provision making time of the essence)

Common Law Termination

- Failing to install specific product as called for by the contract See *Michael James Co., LLC v. Naugatuck Hous. Auth.*, 2011 Conn. Super. LEXIS 3218 (Conn. Sup. Ct. Dec. 16, 2011)
- Other issues
 - “Terminate” is not the only term that may be used under the common law – courts may also use “rescind,” “cancel,” “discharge,” “annul,” “abandon,” and “repudiate” to describe the non-breaching party’s right when there has been a material breach
 - Even if parties are not permitted to terminate under a contract’s termination provision, they may still be permitted to terminate for material breach under the common law See *Ingrassia Const. Co., Inc. v. Vernon Tp. Bd. of Educ.*, 345 N.J. Super. 130 (App. Div. 2001)

Common Law Termination

- Election of Remedies
 - When party has a right to terminate for material breach, but elects to continue performance (or modify contract and continue performance) it may be deemed to have waived its right to subsequently terminate for that material breach See *Madden Phillips Constr. v. GGAT Dev. Corp.*, 315 S.W.3d 800 (Tenn. Ct. App. 2009)
 - A subsequent material breach can establish new grounds to terminate
 - Party who fails to elect to terminate can then be at risk for termination if it subsequently commits a material breach See *Cities Serv. Helix, Inc. v. United States*, 543 F.2d 1306 (Cl. Ct 1976)
 - Some courts may permit the non-breaching party to terminate and sue for contract damages and rescission remedies in the alternative, but at some point that party must elect what remedy it will proceed upon See *Harris v. Desisto*, 932 S.W.2d 435 (Mo. Ct. App. 1996)

Termination For Cause

- Termination for cause provisions:
 - Arose out of government contracts, but are now routinely part of many private construction projects
 - Typically outline:
 - The process for termination and what non-breaching party gets
 - If, when and for what the breaching party is entitled to any payment
 - Many will also identify what constitutes “cause”
 - Goal of termination for cause clauses:
 - Orderly progression of termination to avoid disruptions
 - Eliminate the ambiguity and potential uncertainty under the common law as to whether a breach is a “material breach”
 - Create more certainty regarding payment and damages

Termination For Cause

- General rules
 - The issues permitting a termination for cause are typically significant and material
 - Small or inconsequential errors or mistakes will not typically result in a termination for cause
 - A one-time issue may not be sufficient to terminate for cause – repeated failures are what normally give rise to a termination for cause (the quantity of breaches may make inconsequential errors sufficiently significant and material to permit termination for cause)
 - Termination for cause provisions often permit a partial termination for cause

Termination For Cause

- Common contractual grounds for terminating for cause
 - Poor workmanship/defective work
 - Consistent failure to perform according to schedule
 - Failure to pay subcontractors, suppliers, or laborers
 - Use of materials or equipment inferior to contract specifications
 - Understaffing the project
 - Failure to comply with legal requirements
 - Failure to comply with safety requirements
 - Many termination for cause provisions include a “catch-all” intended to cover other types of breaches of the contract that could be deemed material

Termination For Cause

- Procedure for termination for cause
 - Termination for cause clauses typically require notice of default
 - Providing notice that the contractor is in default of its contract is typically a prerequisite before a party can terminate
 - Notice must typically be provided to surety (if applicable)
 - There may be timing requirements for the notice
 - Notice must be provided within a certain period of time when the owner becomes aware of the default
 - Notice must be provided within a certain period of time in advance of when owner can exercise right to terminate
 - There may be requirement of written notice
 - In some provisions, once notice is provided the party in default must be provided an opportunity to cure within a certain period of time

Termination For Cause

- Termination for cause provisions will typically define what happens upon termination for cause
 - What happens to subcontractors
 - What happens to material and equipment on site
 - What happens to outstanding payment applications
 - What are the owner's options to complete the work
 - Complete the work itself
 - Retain another contractor to complete the work
 - Use surety (if applicable) to complete the work
- Termination for cause provisions will typically outline the potential damages (often the cost to complete the remaining work and costs associated with termination), although often the owner retains other rights and remedies

Termination For Cause

- Other points
 - Failure to comply with procedural requirements of termination for cause provision can invalidate the termination under the contract (although termination for material breach may still be permissible under the common law)
 - See *Town of Plainfield v. Paden Engineering Co., Inc.*, 943 N.E.2d 904 (Ind. Ct. App. 2011) (failure to obtain the certificate rendered the termination invalid)
 - See *MCK Bldg. Assocs. v. St. Lawrence Univ.*, 301 A.D.2d 726 (N.Y. App. Div. 3rd Dept. 2003) (termination was wrongful where letter stated that it was immediate because termination did not comply with contract requirement to provide 10 days' notice of termination)
 - See *Cuddy Mountain Concrete v. Citadel Construction*, 121 Idaho 220 (1992) (general contractor breached its contract with subcontractor by failing to give seven-day written notice of termination)

Termination For Cause

- Federal contracting termination for cause clause See 48 C.F.R. 52-249.10 (Fixed price construction)
 - Specifies the grounds for terminating for cause (referred to as default)
 - The contractor refuses or fails to prosecute the work to ensure timely completion
 - The contractor fails to complete work within the required time
 - Provides the government with discretion to terminate the contract or a portion of the work
 - Provides grounds for the contractor to avoid termination for default
 - Delay is from unforeseeable causes outside contractor's control; and
 - Contractor has provided notice of the delay within 10 days of it beginning

Termination For Cause

- Describes the recoverable damages from contractor and surety – any damages, including any increased costs to complete work
- States that rights and remedies of the government are in addition to any other rights and remedies provided by law
- The procedures the government must follow for terminating for default are set forth in 49 C.F.R. 49-402-3
- The procedures the government must follow in lieu of termination are set forth in 49 C.F.R. 49-402-4

Termination For Cause

- American Institute of Architects (“AIA”) A-201™ 2017 General Conditions of the Contract for Construction Article 14.2
 - Specifies the grounds for terminating contractor for cause
 - The contractor repeatedly refuses or fails to supply enough properly skilled workers or proper materials
 - The contractor fails to make payments to subcontractors or suppliers in accordance with the respective agreements between the contractor and the subcontractors or suppliers
 - The contractor repeatedly disregards applicable laws, statutes, ordinances, codes, rules and regulations, or lawful orders of a public authority
 - The contractor is otherwise guilty of substantial breach of a provision of the contract documents

Termination For Cause

- Specifies the procedure for terminating contractor for cause
 - Architect must provide certification
 - Owner must provide 7 days notice to the contractor and the contractor's surety
 - Owner can
 - Exclude the contractor from the site and take possession of materials, equipment, tools, etc.
 - Accept assignment of subcontracts
 - Finish the work by whatever reasonable means the owner deems expedient
- States that the contractor is not entitled to any further payment until the work is finished (if any is even left after work is completed)
- States that the owner retains all other rights and remedies

Termination For Cause

- Contracts may also include provisions entitling the contractor to terminate for cause
 - Contracts with public owners often are less likely to provide a contractor with a right to terminate a contract for cause
 - Contracts with private owners often given the contractor the right to terminate a contract for cause – but, not surprisingly, the grounds for a termination for cause tend to be much more limited than for an owner to terminate a contractor

Termination For Cause

- AIA A-201™ 2017 General Conditions of the Contract for Construction Article 14.1
 - Specifies the grounds for terminating owner for cause
 - Order from court or other public authority requiring that all work be stopped
 - Act of government that requires all work be stopped
 - The owner has not made timely payment or the architect has not issued a certificate for payment and has not notified the contractor of the reasons for withholding the certification
 - The owner has failed to furnish reasonable evidence that the owner has made financial arrangements to fulfill its obligations under the contract
 - Repeated suspensions, delays, or interruptions of the entire project that total more than 100% of total schedule or 120 days in a 365 day period (or work is stopped for 60 consecutive days)

Termination For Cause

- No “catch all” category that would cover other material breaches
- Specifies a limited procedure for terminating owner for cause
 - Contractor must provide 7 days notice to the owner and the architect surety
- Does not address payment to contractor when it terminates for cause

Termination For Convenience

- Termination for convenience provisions
 - Arose out of government contracts, but are now more increasingly part of many private construction contracts
 - A clause in a construction contract that allows the owner to terminate the contract without a specific reason for doing so (no default by terminated party required)
 - Termination for convenience is not due to poor performance
 - Termination for convenience is not because one party breached the agreement
 - Partial termination for convenience is often permitted

Termination For Convenience

- Damages
 - Often includes payment for work performed prior to termination and costs of termination (including costs associated with winding down any subcontracts impacted by termination)
 - May include lost profits
 - May also include a liquidated damage amount
- Contractors generally do not have a contractual right to terminate owners for convenience

Termination For Convenience

- Termination for convenience clauses provide virtually unfettered discretion for an owner to terminate for almost any reason
 - Defective plans and specifications that raise concerns about claims
 - Estimating errors that warrant rebidding
 - Substantial deterioration in the working relationship of the parties
 - Public procurement irregularities (termination and potentially rebidding is to protect the integrity of the competitive bidding system)
 - Compliance with legislative mandate or judicial ruling
 - Impossibility of performance

Termination For Convenience

- The only limitation on an owner's exercise of a termination for convenience provision is that the owner cannot terminate for convenience in bad faith. See *Krygoski Constr. Co. v. United States*, 94 F.3d 1537 (Fed. Cir. 1996)
- This is a high burden that is difficult to overcome – even terminating for convenience to obtain a better price has been held not to constitute bad faith by some courts. See *Vila & Son Landscaping Corp. v. Posen Const., Inc.*, 99 So. 3d 563 (Fla. 2d DCA 2012)
- Some courts have held that a showing of bad faith requires proof by clear and convincing evidence when the government is involved. See *NCLN20, Inc. v. United States*, 99 Fed. Cl. 734 (2011)

Termination For Convenience

- Federal contracting termination for cause clause See 48 C.F.R. 52-249.2 (Fixed price – includes additional language for construction)
- Specifies that government terminate contract in whole or in part if the contracting officer determines that a termination is in the government's interests
- Specifies the process for termination for convenience
 - Contracting officer delivers notice specifying the extent of the termination and the effective date
 - Sets forth obligations on contractor (e.g., stop work, terminate subcontracts and assign them to government, place no further orders with subcontractors/suppliers, work to settle any claims by subcontractors)
 - Submit settlement proposal to government for termination for convenience

Termination For Convenience

- Specifies how the contractor's damages are calculated if the parties cannot reach a settlement for the termination, which include
 - Payment for work already performed
 - Costs for terminated work (such as initial costs and preparatory work)
 - Costs of settling with subcontractors who would have performed terminated work
 - Fair and reasonable profit lost as a result of termination
 - Reasonable costs of settlement of terminated work (such as accounting, legal, storage, and transportation fees)

Termination For Convenience

- AIA A-201TM 2017 General Conditions of the Contract for Construction Article 14.4
 - Specifies that the owner may terminate the contract for the owner's convenience and without cause at any time
 - Specifies the contractor's obligations upon termination for convenience
 - Stop work as directed by the owner in the notice
 - Take actions necessary (or directed by the owner) for the protection and preservation of the work
 - Terminate all existing subcontracts (and enter into no new ones) except to the extent there is work to be performed prior to the effective date
 - States that the contractor is entitled to payment for work performed and for the costs incurred in the termination

Termination For Convenience

- Advantages to the owner with termination for convenience clauses
 - Allows for owner to end a project without it being a breach of contract
 - Pre-determined wrap-up of the contractual relationship
 - Easier and cleaner break than a termination for default (no need to document the contractor's failures)
 - Less likely to result in disputes/litigation
- Why would contractor agree to a termination for convenience clause?
 - Often the contractor does not have a choice (particularly in construction contracts with a public entity)
 - Contractor receives a remedy that is intended to provide contractor with better result than termination for cause

Converting Cause To Convenience

- Constructive termination for convenience
 - Developed in federal common in public contracts to allow the government to retroactively justify a wrongful termination for cause as a termination for convenience
 - Courts essentially convert an improper termination for cause to a termination for convenience based on the rationale that the government could have exercised the contractual right to terminate the contractor for convenience at any time *See Kalvar Corp. v. United States*, 543 F.2d 1298, 1306 (Ct. Cl. 1976)
 - Typically applied in the context of a government's termination, it has been applied to a termination between two private parties (although this seems a much rarer occurrence) *See Morrison Knudsen Corp. v. Ground Improvement Techniques, Inc.*, 2006 U.S. Dist. LEXIS 24405 (D. Colo. Mar. 20, 2006)

Converting Cause To Convenience

- Termination conversion clauses
 - Arose out of government contracts, but are now appearing in more and more private construction projects
 - Contract clauses that state that if the owner terminates for cause and it is subsequently determined that grounds for terminating for cause did not exist, the termination will be treated as a termination for convenience
- Federal contracting termination for cause clause contains a termination conversion clause See 48 C.F.R. 52-249.10(c) (Fixed price construction)

“If, after termination of the Contractor’s right to proceed, it is determined that the Contractor was not in default, or that the delay was excusable, the rights and obligations of the parties will be the same as if the termination had been issued for the convenience of the Government.

Converting Cause To Convenience

- Termination conversion clauses are enforceable See *Stony Brook Constr. Co. v. College of N.J.*, 2008 N.J. Super. Unpub. LEXIS 799 (App. Div. June. 16, 2008)
- Fairness issues with constructive termination for convenience and termination conversion clauses
 - Not always a bargained for result
 - Constructive termination for convenience is a judicially made remedy
 - Termination conversion clauses in public contracts are “take it or leave it”
 - Caps the owner’s liability, but does not allow for contractor to seek full redress for a wrongful termination
 - Allows owner to assert a termination for cause without much risk (i.e. knowing that if it is wrong it will be a termination for convenience)

Surety Issues

- Termination for cause will implicate a surety where the project is covered by a performance bond
- Performance bonds
 - Common on public construction projects, but may also be present on private projects
 - Intended to ensure that the contractor fulfills all of its obligations under the contract with the owner – the surety is guaranteeing satisfactory completion of the contractor's performance in accordance with the terms of the contract between the contractor and the owner
 - The surety has obligations when the contractor defaults on the project
 - Because the surety steps into the shoes of the contractor upon a default by the contractor, the performance bond almost always requires notice of the contractor's default be provided to the surety

Surety Issues

- Surety's obligations when a contractor is terminated for cause
 - Surety can pay either the amount of the bond or the cost of completion of the work
 - Surety and the owner can work together to finish the contract performance with the owner selecting a replacement contractor and the surety paying for that replacement contractor
 - Surety finds and pays for a replacement contractor to complete the remaining work
 - Because the surety is standing in the shoes of the contractor and retains the defenses the contractor had to the default, the surety can reject that the termination is proper and that it has any obligations under the performance bond

Termination Risks/Mitigation

- Termination for cause poses significant risks because:
 - Courts consider it a “drastic remedy” and impose a “heavy burden” on the party asserting right to terminate for default See *Composite Laminates v. United States*, 27 Fed. Cl. 310 (1992)
 - It is the ultimate sanction to the contractual relationship See *Clay Bernard Systems Int'l, Ltd. v. United States*, 22 Cl. Ct. 804 (Cl. Ct. 1993)
 - Whether a party is entitled to terminate for a material breach under the common law or for cause under a contract is not easily predicted and can be governed by amorphous standards
 - What is “essential” to the contractual relationship can be fact-specific
 - How many times constitutes “repeated” under contractual provisions
 - Reasonable minds can differ

Termination Risks/Mitigation

- Most importantly, an improper termination can be considered a material breach of the contract
 - Courts recognize that an improper termination for cause can be a material breach of contract See *Greenbridge Constr., Inc. v. Glasgow Investigative Solutions, Inc.*, 2021 U.S. Dist. LEXIS 51225 (D. Md. March 18, 2021)
 - This can turn into a battle of what is the first uncured material breach See *United States ex rel. Taylor & Polk Constr. v. Mill Valley Constr.*, 29 F.3d 154 (4th Cir. 1994) (contractor wrongfully terminated subcontractor where subcontractor nonperformance was caused by contractor's failure to pay subcontractor)

Termination Risks/Mitigation

- If there is no termination conversion clause, improperly terminating can:
 - Excuse the other party's continued performance
 - Subject the party who improperly terminated to all of the adverse consequences associated with terminating without the benefits
 - Subject the party who terminated to significant damages for improperly terminating
 - Owner – could be responsible for contract price less cost of remaining work and potentially consequential damages
 - Contractor – could be responsible for owner's damages to complete and delay damages

Termination Risks/Mitigation

- Owner terminates contractor/contractor terminates subcontractor
 - Risks
 - Potential dispute/litigation and fights with surety (if applicable)
 - Cost and schedule impacts with replacement contractor/surety
 - Project status (i.e. Is it the beginning or the end of the project? Are there risks to untimely completion?)
 - Devoting additional resources to termination process and post-termination tracking of costs
 - Impact on warranties by using a replacement contractor
 - Impacts on financing
 - Wrongful termination may itself be a material breach of contract

Termination Risks/Mitigation

- Potential mitigation measures (important to consider what may be permitted/precluded by contract)
 - Discuss issue with contractor in an effort to get them to change – may help in keeping the project on track and to avoid bigger issues
 - Partial termination – reduce the contractor’s scope of work/supplement the contractor’s forces
 - Pay subcontractors and suppliers with joint check (if payment is issue)
 - Use potential termination as leverage to get better performance (although this may result in waiver of termination)
 - Loss of work and its contribution to overhead/opportunity make a profit
 - Terminated contractor may be required to pay the owner the costs to complete the remaining work
 - Damage to reputation (impact on ability to get future work)
 - Involvement of surety (potential personal guarantees)

Termination Risks/Mitigation

- Contractor terminates owner/subcontractor terminates subcontractor
 - Risks
 - Lost work (impact to business if there is not other work in the pipeline)
 - Damage to reputation (impact on ability to get future work)
 - Subcontractors and suppliers may not be in favor of termination
 - Surety will need to be involved
 - Wrongful termination may itself be a material breach of contract
 - Potential mitigation measures
 - Statutory protections (e.g. construction liens, prompt payment acts)
 - Put owner's financing on notice (lender consents often require this)
 - Use leverage of termination to renegotiate key terms (e.g. extension of time, additional compensation)

Questions

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Converting Improper Termination for Cause Into Termination for Convenience

There are benefits to converting an improper termination for cause to a termination for convenience, particularly for an owner. But is this increasingly common approach fair to contractors?

By **Damian V. Santomauro** | October 22, 2020



suphakit73

At the beginning of every construction project, the parties' preference is obviously to have the job completed on time and within budget, and for everyone working on the project to be paid in full. However, circumstances such as performance issues, delay, changes in the owner's financing or plans for the project, insolvency, market changes, and government intervention can arise that create an untenable situation and cause an owner to terminate the contract (and, in some cases, the project). Over time, and following principles in federal contracting, parties to public and private construction contracts have developed contractual provisions to address these circumstances and provide an off-ramp for the contractual relationship through a termination for cause (i.e., default) or convenience.

Under the common law, a party can terminate a construction contract if the other party materially breaches the contract. *See Zulla Steel v. A&M Gregos*, 174 N.J. Super. 124, 131-32 (App. Div. 1980) (holding that subcontractor could terminate for prolonged non-payment). Termination for cause provisions contractually define the specific circumstances in which a party may terminate for fault. *See, e.g., American Institute of Architects ("AIA") A201™-2017 (General Conditions of the Contract for Construction)*, Art. 14.2.1; *Titan Stone, Tile & Masonry v. Hunt Construction Group*, 2010 U.S. App. LEXIS 19495, *37-39 (3d Cir. Sept. 20, 2010). Conversely, termination for convenience is not fault-based and provides an owner with broad discretion to terminate the contractual relationship at any time and for any reason, provided the termination is not made in bad faith. *See, e.g., AIA A201™-2017*, Art. 14.4.1, *Interstate Indus. Corp. v. State*, 2008 N.J. Super. Unpub. LEXIS 1495, *36-41 (App. Div. July 28, 2008).

Although the parameters of termination provisions will be governed by the specific terms of the contract, there are typically some key distinctions between a termination for cause and termination for convenience. These distinctions include: (1) the role of fault; (2) while both an owner and contractor can typically terminate for cause (although the grounds for a contractor to do so are generally more limited), only the owner can terminate for convenience; (3) a termination for cause often requires additional procedural steps (e.g., a specific determination of default made by a third party or the individual administering the contract); and (4) a termination for cause permits an owner to withhold payment to the contractor until the work is finished (assuming there is any unpaid balance remaining after the contractor completes the project), whereas a termination for convenience typically entitles the contractor to an immediate payment.

An interesting issue arises when the owner's termination for cause is improper (either for failure to follow the required termination procedure or because the contractual grounds for such a termination did not exist). Logic seemingly dictates that an owner's improper termination for cause is itself a breach of contract, entitling the contractor to sue for breach, and courts have held that a contractor can seek to recover damages for wrongful termination under such circumstances. *See Ingrassia Const. Co. v. Vernon Tp. Bd. of Educ.*, 345 N.J. Super. 130, 136-37 (App. Div. 2001) (noting that when an owner failed to follow the procedural requirements for a termination for cause, "the parties are left to their common-law causes of action for breach of contract"). However, the doctrine of constructive termination for convenience and contractual provisions incorporating this doctrine may bar such claims by a contractor improperly terminated for cause.

Constructive termination for convenience is a creature of federal common law, whereby courts essentially convert an improper termination for cause to a termination for convenience, limiting the contractor to redress under the contract's termination for convenience provision. The underlying rationale is that the government could have exercised the contractual right to terminate the contractor for convenience at any time and, as such, it is not unfair to apply the termination for convenience clause when the owner improperly terminates. *See, e.g., Kalvar Corp. v. United States*, 543 F.2d 1298, 1306 (Ct. Cl. 1976). In *Linan-Faye Constr. Co. v. Housing Auth.*, the Court of Appeals for the Third Circuit applied the constructive termination for convenience doctrine, predicting that New Jersey courts would recognize the doctrine. 49 F.3d 915, 926 (3d Cir. 1995).

Some construction contracts contain "termination conversion" clauses, which expressly incorporate the constructive termination for convenience doctrine. Specifically, these clauses mandate that if the owner improperly terminates a contractor for cause, the termination will be treated as a termination for convenience. Such clauses are routine in public construction contracts, *see, e.g., New Jersey Department of Transportation, Standard Specifications for Road and Bridge Construction (2019)*, Spec. 108.14 ("[i]f, after declaration of default, the Department determines for any reason that the Contractor was not in default or that the delay was excusable ... [or] a court determines for any reason that the Department's default of the Contract was legally improper, the rights and obligations of the parties are the same as if the Department had issued an order of termination for convenience"), but are also becoming more prevalent in contracts for private projects, *see, e.g., Cnj Constr. Corp. v. Autobuilders Gen. Contr. Servs.*, 2020 N.J. Super. Unpub. LEXIS 223, *1-3 (App. Div. Jan. 31, 2020) (termination conversion clause present in subcontract relating to

construction of a car dealership). Significantly, New Jersey courts have enforced such provisions in the absence of bad faith by the owner. *See, e.g., Stony Brook Constr. Co. v. College of N.J.*, 2008 N.J. Super. Unpub. LEXIS 799, *20 (App. Div. June. 16, 2008) (enforcing “a clear express provision by which the parties agreed to apply the [constructive termination for convenience] doctrine to their contractual undertaking”).

There are benefits to converting an improper termination for cause to a termination for convenience, particularly for an owner. A termination for convenience provides a process for winding up the contractual relationship and, absent potential bad faith allegations against the terminating party, should help to end any dispute between the parties. Moreover, the costs the owner must pay to the contractor under a termination for convenience are typically defined and likely far less than if the contractor were to assert a breach of contract claim for wrongful termination—a savings that ultimately inures to the benefit of taxpayers on a public project. Nevertheless, conversion to a termination for convenience, whether constructive or contractual, implicates questions of fairness for contractors who are wrongfully terminated for default.

First, converting to a termination for convenience is not always a bargained-for outcome. In the case of a constructive termination for convenience, it is based on a judicially made doctrine rather than any explicit contract requirement. Further, public contracts are typically “take it or leave it,” and, as such, contractors cannot negotiate away contractual termination conversion clauses.

Second, an owner is protected from a wrongful decision to default a contractor because the owner’s downside risk is limited to the termination for convenience provisions. Indeed, while terminating for cause can have drastic consequences for the contractor, owners can essentially avoid adverse claims for this decision because it is extremely difficult for a contractor to show bad faith. *See Interstate Indus.*, 2008 N.J. Super. Unpub. LEXIS 1495, at *38 (“government officials are presumed to act in good faith and, as a result, the contractor has a very heavy burden of proof”).

Third, the contractor is unable to seek full redress for the wrongful termination. While the contractor would ordinarily be entitled to greater (and quicker) recovery than in the case of a proper termination for cause, the contractor’s recovery under a termination for convenience provision may not approximate the actual damage the contractor suffers from the termination for convenience. *See, e.g., Capital Safety v. State, Div. of Bldgs. and Const.*, 369 N.J. Super. 295, 303 (App. Div. 2004) (contractor limited to liquidated damages for each work day up to the date of issuance of a notice to proceed or order of termination for convenience). Moreover, when a termination for cause is converted to a termination for convenience, it is a different scenario than an ordinary termination for convenience—the contractor has been forced to address a wrongful termination for default. In addition to incurring injury to its reputation, an improperly terminated contractor often expends significant resources and money disputing and overturning the default, responding to claims by its subcontractors, and addressing issues with its surety if there is a performance bond. Such adverse impacts might be recoverable in a breach of contract action for wrongful termination. However, converting to a termination for convenience likely forecloses the contractor’s opportunity to be made whole because its recoverable costs will be limited to those authorized by the contract’s termination for convenience clause. *See City of Perth Amboy v. Interstate Indus. Corp.*, 2017 N.J. Super. Unpub. LEXIS 1209, *34-35 (App. Div. May 17, 2017) (contractor terminated for convenience limited to “all reasonable shutdown costs as agreed to by both parties” in the contract, stating the contractor failed “to explain how, having been properly terminated for convenience, it can nonetheless recover any kind of damages beyond those permitted by the contract”).

There is not a lot of New Jersey case law concerning contractual termination conversion clauses, and even less regarding constructive termination. Nevertheless, it seems likely such contractual provisions will be enforced by New Jersey courts in the absence of bad faith, and the *Linan-Faye Constr.* case suggests New Jersey courts would apply the constructive termination for convenience doctrine (at least in public contracts). Thus, when a proposed contract contains a termination conversion clause (or a termination for convenience provision), a contractor should note the potential risk that, if it is improperly terminated for default, it may be

prohibited from asserting a breach of contract claim and left only with its rights under the contract's termination for convenience provision. A contractor contracting with a public entity likely must accept the risk if it wants the work, but contractors on private projects should consider negotiating to eliminate such provisions and/or to increase the contractually compensable costs for a termination for convenience.

Damian V. Santomauro *is a Director in the Commercial & Criminal Litigation Department of Gibbons P.C. in Newark.*

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