

It is likely that a huge number of the many different individuals involved in the many different and quite varied aspects of the construction industry have been associated with, or impacted by, a contractor termination some time during their time in the industry. It is equally likely that, of those that have been exposed to a contractor termination, most will say their recollections of the experience are not particularly fond memories. Clearly, whether a party is the terminator or is being terminated, the matter is a quite serious one which is or can be significantly complex, and is laden with potential high risk to either/both parties.

Most contracts contain provisions addressing an Owner's right to terminate the contractor for miscellaneous or certain contractor breaches or actions/inactions. This type of termination is commonly referred to in the industry as a Termination for Default, with the reference often shortened to "T for D," or even "T4D." Some contracts also contain provisions addressing a right often retained by the Owner to terminate the contract merely at the Owner's wish and for the Owner's convenience. This is commonly known in the industry as a Termination for Convenience, and referred to in the shortened sense as "T for C" or "T4C."

Because the circumstances leading up to, and the consequences stemming from, a termination for default (adversarial atmosphere by nature) are so significantly different from those of a termination for convenience (generally cooperative atmosphere), this narrative addresses both scenarios separately as follows, even though there are many common threads.

## TERMINATION FOR OWNER'S CONVENIENCE

Since there are a number of factors that pertain to a construction project from inception to completion, and since there are equally numerous influences that do or can affect a construction project once construction contracts are executed and the project is underway, Owners often retain a contractual right to bring the contract/project to a partial or complete end merely because they so wish. Possible Owner reasons may include the end of a need for the end product, or due to technological obsolescence or a myriad of economic influences. Contracts containing an Owner right to terminate

for the Owner's convenience often have provisions addressing matters such as:

- Option to terminate in part or in whole;
- Protection of materials and completed operations/ work;
- Specific flow down of rights/provisions to subcontractors; and,
- Pricing options.

Because a T4C is primarily at the sole option of the Owner, there can be significant exposure to the Owner due to retaining this right. Stated another way, due to the principal of equity, the contractor is not to be left "damaged" in exchange for the Owner's retention of a sole right to decide to terminate, if for no other reason than just because it wants to. Contracts often contain T4C provisions designed to ensure the contractor is left "whole" and recoups certain costs that arise as a direct result of the Owner exercising a convenience termination contractual right. Costs such as:

- Non-recurring, indirect start-up costs that would only normally be fully recovered over the entire life of a project; and,
- Direct costs of completed services/goods that are not necessarily proportionate to the volume of completed services/goods.

Because of this general concept that the Owner's unilateral right to terminate for its convenience is balanced by the principal of equity and that the contractor will not suffer should the owner exercise this unilateral right, it is far better if contracts clearly spell out the particulars of a convenience termination. For example, a contract should address such matters as:

- What costs or types of costs are recoverable by the contractor;
- Whether values are based upon certain "costs" or "prices."
- Whether mark-ups are specified at certain values, and how calculated;
- What level of proof is required regarding certain costs and/or mark-ups; and,
- Whether costs related to the pricing, negotiations, and settlement of matters pertaining to the termination are recoverable.

When faced with or considering a termination for convenience, Owners should always consider other options that may be available, such as:

- If terminating only a portion of the remaining work would satisfy the Owner's needs, rather than a full termination;
- Issuing a deductive change order, either bilaterally (with contractor's concurrence) or unilaterally if right afforded by contract; and,
- Pay the contractor to calculate what the probable Owner-responsible costs of a partial or full termination would be prior to the Owner making the decision to terminate.

In summary regarding terminations for convenience, it is recommended that Owners include such provisions in their contracts simply due to the possibility that the owner may wish or need to terminate for a variety of reasons. In addition to addressing whether or not certain general or specific costs are either allowable or not allowable, these contract provisions should include factors addressing detailed costs of termination pricing/costing methodologies and limitations. When faced with opportunities to either terminate or not, Owners should fully identify and carefully evaluate the benefits and detriments relative to either option, as well as fully consider all options that may be available other than partial or full termination.

#### TERMINATION FOR DEFAULT

Being adversarial by nature, terminations for default often evolve into very contentious, protracted affairs. At a minimum, contracts containing provisions addressing terminating a contractor for defaulting on its performance should be detailed and well-defined, should include an opportunity and measurable criteria for the contractor to cure the breach/default issue. Another factor that can have bearing on the Owner's actions is whether or not a surety is involved via the issuance of a bond guaranteeing the contractor's performance. The contract should additionally address matters regarding:

- What damages to the Owner are or may be recoverable;
- What is status of ownership of completed work and stored materials; and,
- What actions are to be implemented by the contractor regarding its subcontractors and suppliers.

Potential reasons for an Owner's termination of a contractor for default include, but are not necessarily limited to, the following:

- Real or anticipated failure to deliver contract-compliant product/services;
- Absolute or anticipatory progress failure; and,
- Contractor refusal or failure to comply with "other" contract provisions.

Regarding real or anticipatory failure to deliver contract-compliant product/services, the failure must be of a "material" aspect, i.e., must significantly impair the value of the contract/work. However, under the "perfect tender" rule of the Uniform Commercial Code, the buyer has certain rights to insist on strict compliance and is not obligated to accept anything less than what it bargained to fully receive. In the alternative, the contractor may successfully argue that the Owner is only entitled to the value difference between substantial performance and complete performance.

Regarding absolute or anticipatory progress failure, a measure of progress commonly used involves comparing percent of completed work to percent of time consumed. Application of this measure should only be used in a cautious measure since there are situations where there is no connection between the measure of completed work in comparison to the measure of time consumed. The likelihood of a default based upon this type of measure being upheld is increased only if a contractor is far behind schedule and is essentially "incapable" of timely completion. It can be additionally beneficial to the Owner if the Owner's decision to terminate is based upon its belief that timely performance is highly improbable based upon facts that establish inadequate current performance, and the contractor's refusal/failure to cure noted deficiencies and provide reasonable assurances of timely performance of remaining work. Under certain situations, expiration of the contract time can occasionally be considered justifiable reason to terminate, except for the doctrine of substantial completion. Extenuating circumstances causing delay need to be carefully considered as well, e.g., acts of God and Owner-responsible issues.

Regarding a contractor's refusal or failure to comply with certain "other" contract provisions,

examples might include:

- Prompt payment violations;
- Bonds, permits, licenses, insurance;
- Safety violations (repeated, excessive, serious); or,
- Other “material” failure/breach.

Before deciding to terminate a contractor, and Owner is well advised to carefully evaluate certain influencing factors and projected outcomes. The typical prerequisites would include:

- Failure or breach of a material nature;
- Contract-compliant, or at least proper, notification;
- Copy surety, if existing;
- Opportunity to cure or remedy failure/breach, or otherwise show cause why termination is not justified; and,
- Ensure alternate way to complete work is available/reasonable.

In the event an Owner is justifiable in implementing a contractor termination, and depending upon what permissions and limitations which may be expressed in the contract documents, an Owner may be entitled to be compensated for certain costs arising directly and indirectly out the contractor's failure/breach and termination. Such costs may include:

- Excess costs needed to complete the work;
- Certain Owner internal costs;
- Lost profits;
- Outside professional services; and,
- Interest costs.

Rather than terminating a contractor, other avenues of relief may be available to an Owner. Potential other actions that may be implemented include:

- Issuing a unilateral deductive change order;
- Waiving Liquidated Damages in exchange for certain contractor consideration;

- Exercise a Termination for Convenience right instead; or
- Assess Liquidated Damages instead if appropriate.

An owner's decision and subsequent action to terminate a contractor has attendant exposure to the Owner. The contractor may vigorously fight/litigate the termination, and the surety, if involved, may treat matters similarly. Additionally, the project completion date becomes an unknown, at least for a while. Other Owner exposure, depending on the timing and other circumstances, could arise if the project may reasonably be considered to be “substantially complete” or is being used in some fashion in part or in whole.

In summary regarding Terminations for Default, it is always best if the contract documents expressly address the right to terminate and circumstances surrounding a termination. Prerequisites of termination actions include insuring the contractor has been granted all price and time adjustments to which it is entitled, and clear and unambiguous failure/breach of a material nature. Owners must identify and fully evaluate all options other than a T4D, weigh all benefits and detriments of a default termination, and perform all this in an expedient manner so as to not further impact the project due to indecision and inaction.

#### CONCLUSION

The top tips for contractor terminations, whether for default or for Owner's convenience are:

- Contract documents should provided for both;
- Spell out entitlement, process, time-frames, and costs/damages in detail;
- Grant contractor price and time adjustments in a timely manner;
- Examine all benefits & detriments, in conjunction with all alternatives;
- Act in good faith; and,
- Do not be afraid to exercise your contractual rights.

#### ABOUT THE AUTHOR-

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