Scribbles Squibs[1] #76 (December 6, 2021):

MINIMIZE WRONGFUL TERMINATION LITIGATION THROUGH THE USE OF A TERMINATION FOR CONVENIENCE CLAUSE AND A RIGHT TO SUPPLEMENT CLAUSE IN YOUR DOWNSTREAM CONSTRUCTION CONTRACTS

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I. INTRODUCTION.

For my largest client, a general contractor, I manage all of their litigation.[2] And, the number of cases we have currently pending is a total of zero. While litigation does have its uses in certain circumstances, it can run up costs for a contractor almost as quickly as Joe Biden can find new multi-trillion dollar programs to add to our national debt. And, the people I need for the litigation of wrongful termination cases are likely to be your estimators, your supers and your PMs – all of the people you rely on most to create profitability. And, this kind of litigation can take up boatloads of their time, which is probably a greater actual cost to your business than what you have to pay your attorney.

A common construction-related litigation issue is claims for wrongful termination. For, a termination of a contract might actually turn out to be a material breach of contract on the part of the terminating party, entitling the terminated party to seek and collect breach of contract damages.

The focus of this Squib will be a discussion of how this kind of litigation can be minimized by including two specific contract clauses in the contracts you draft.

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[1] A 'squib' is defined as 'a short humorous or satiric writing or speech'. Wiktionary defines a 'squib' as: "a short article, often published in journals, that introduces empirical data problematic to linguistic theory or discusses an overlooked theoretical problem. In contrast to a typical linguistic article, a squib need not answer the questions that it poses."

[2] This representation takes only ten hours out of my sixty hour work week, leaving me plenty of time to use my forty-five years of experience to help others with their construction-related problems.

II. BOTH PARTIES TO A CONTRACT HAVE EXCLUSIVE CONTRACT RIGHTS AS TO THE CONTRACT.

What does that mean?

For a certain project, let's assume that an electrical subcontractor has a one million dollar subcontract.

One of the three requisite elements for there to be a contract is 'consideration'.[3] 'Consideration' is what benefit each party to a contract receives from performing the contract. The subcontractor performs a certain amount of work and gets paid one million dollars. The general contractor by paying that one million dollars will get a certain amount of electrical work performed. One million dollars and a certain amount of electrical work to be performed are the two 'considerations' which are at the heart of this subcontract.

Each party's entitlement to the consideration it will receive through the performance of the contract is a contract right. The subcontractor has the exclusive right to perform the electrical work (and get paid the one million dollars) and the general contractor has the exclusive right of having this work performed for it through its payment of one million dollars.

Particularly when I speak with homeowners, they are surprised to learn that they just can't give the work to someone else if they are unhappy with the progress of their job or the quality of the work. There is no inherent right for one party to a contract to simply 'fire' the other party without having a good and substantial reason. Doing so can expose the party doing this to damage claims from the other party. A wrongful termination of contract can itself be a material breach of contract, potentially entitling the terminated party to damages.

And, absent some kind of mutually agreed upon settlement between the contracting parties to end the contract upon whatever terms, before a terminating party can properly move on to hiring another contractor, it has to first terminate the existing contractor.[4]

And, whether the contract requires it or not, giving the party about to be terminated a brief 'cure' period – an opportunity to correct the complained of behavior - before actually terminating the contractor often works better for the terminating party in court. Judges like to see people act reasonably. They seem to feel that to terminate a party without first giving it some form of prior notice – and some opportunity to correct its behavior - lacks fundamental fairness. I've seen 'cure periods' in contracts as short as two days (probably not long enough to be

[3] The other two elements necessary to create a contract are an offer and an acceptance.

[4] I recall in studying family law in law school that it is usually a good idea to first divorce a present spouse before getting a new one. For a time, Utah was an exception.

'reasonable') or as long as seven days. My sense would be five days would be a commonly-used number.

If the contractor can't cure the defects within that period of time, then the complaining party is in a better position to move on to termination.

III. THE ISSUE OF CONTRACT TERMINATION.

The issue underlying any termination – other than a termination for convenience – is fault. *Somebody* has got to be at fault. And, the fault has to be as to some basic, material term of the contract.

To be clear, any party to any contract can terminate the right to proceed of the other party to the contract.[5] This is especially true downstream: owners terminate general contractors; general contractors terminate subcontractors; subcontractors terminate sub-subcontractors. Sufficient grounds for termination include, without limitation, things such as an abandonment of the project, a failure to properly pay material suppliers and subcontractors, initiating any form of debt protection (such as the filing of bankruptcy), performance of unsatisfactory work and a failure to man the job on a continuous basis. And, upon termination, the terminated party must cease construction and leave the job-site.

But, this doesn't mean that the terminated party is left with no legal recourse. If it feels strongly enough about it, it can challenge the termination in court by claiming that the claimed ground for fault was insufficient to justify termination. The grounds proved and contested must be material, something going to the heart of the contract. So, a subcontractor's not manning the job on isolated days is probably not a material breach of contract. And, a subcontractor might successfully claim that its not paying its material suppliers and subcontractors was justified because the general contractor wrongfully withheld payment from the subcontractor.

If the trier of fact (an arbitrator, judge or jury) determines that the termination was justified, this could entitle the terminating party to damages (e.g. increased costs of completion; costs of correction of defective work; having to pay a subcontractor's material suppliers and subcontractors; and, costs relating to delay.)

Conversely, if the trier of fact finds that the termination was wrongful, damages could be awarded to the terminated party for the fair and reasonable value of work performed for which it was not paid and for lost profits on work the contractor was not allowed to perform.

[5] That is what a termination of contract actually means: terminating the right of the other party to proceed with the performance of the contract. Other than by mutual agreement, contracts otherwise last for an indefinite period of time, subject to applicable statutes of limitation, which limit the ability of one party to make claim against the other party for a claimed breach of contract.

Termination cases are time-consuming and can take longer to try, as there is generally more than one ground underlying the termination. And, for that matter, there will likely be a counterclaim by the terminated party against the terminating party.

IV. TERMINATION FOR CONVENIENCE.

A great deal of our construction law, practices and procedures - particularly within the public arena - originate from federal construction. One reason for this is that there is simply so much of it.

A need for a 'termination for convenience' clause may arise due to the prolonged periods of time required for the obtaining of funding, design and then ultimate procurement. At this point, a public entity might determine that it may no longer need the building or, at least, the building as designed.[6]

What to do? One way of handling this was to allow a contract to be 'terminated for convenience' with clearly-specified and limited recoverable items of expense that a terminated party might be entitled to. Public contracts at the federal level by regulation have a very extensive list of what things monies can be recovered by the terminated party, which list is substantially longer than what might be found anywhere else.[7]

When one has a termination for convenience clause, one can terminate one's contracting party for any reason or for *no* reason. It is an absolute right. Practically speaking, this is a way for an owner to get rid of a general contractor or for a general contractor to get rid of a subcontractor who is not sufficiently producing, who is contentious, who is excessively change order happy or for any other reason.

This type of termination is much less likely to lead to litigation than a termination for fault. This is because, in part, since no allegation of fault is required for such a termination, there is no need to have litigation to establish liability (i.e. the correctness of the termination). And, the terminated party has a fairly clear itemization in advance of termination of what its potential recoverable items will be in the event of termination for convenience.

`A sample clause:

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[6] One example of this frequently occurred when the use of computers first became widespread. Buildings were designed with increased air conditioning because cooler computers worked better than computers subject to too much heat. This need was significantly changed by a movement away from main-frame computers to personal computers.

[7] For those interested in further information as to allowable costs, or who practice literary masochism (death by one thousand commas) or who want to try the most effective sleeping aid that has *ever* been conjured by man, one can look at 52.249-2 Termination for Convenience of the Government (Fixed-Price), to be found in the Federal Acquisition Regulations.

"Roadrunner General Construction shall have the right in its sole judgment to terminate for convenience Wily Coyote Subcontractor's further performance under this Subcontract for any or no reason. In the event this occurs, Wily Coyote Subcontractor shall be entitled to be paid for all of its labor, materials, equipment and work incorporated into Project as is approved for payment by the Architect (or by Roadrunner General Construction, if there is no Architect) as of the effective date of the termination for convenience. Such payment to Wily Coyote Subcontractor is subject to any claims of Roadrunner General Construction against Wily Coyote Subcontractor as to this Subcontract. Should it be determined through any legal process that a termination for cause or fault issued by Roadrunner General Construction to Wily Coyote Subcontractor was not justified or warranted, then such termination for cause shall automatically be converted into a termination for convenience. Wily Coyote Subcontractor will not be entitled to any claims for lost overhead and profit as to the omitted work."

With such a clause, potential subjects for litigation are generally significantly reduced.

V. SUPPLEMENTATION OF PERFORMANCE.

This type of clause can be useful in assisting a general contractor in getting an existing subcontractor's work performed without terminating the subcontractor. That is not to say that the subcontractor might not challenge in court whether or not it needed supplementation. And, certainly, the subcontractor could challenge the costs assessed.

But, even if either of those two things happens, the litigation should be greatly reduced in scope as compared with all of the liability and damage issues associated with a termination for fault.

A sample clause:

"Further, Roadrunner General Construction shall have the right, but not the obligation, to supplement Wily Coyote Subcontractor's forces in the performance of the Subcontract work if Roadrunner General Construction determines, in its sole judgment, that such is necessary to keep up with the schedule. In the event Roadrunner General Construction supplements Wily Coyote Subcontractor's performance, Roadrunner General Construction will be entitled to be forthwith reimbursed by Wily Coyote Subcontractor for any increased costs and expenses incurred by Roadrunner General Construction in providing such supplementation including, without limitation, for any labor, material or equipment it employs in its supplementation of Wily Coyote Subcontractor's work, including all reasonable supervision and project management costs incurred during such supplementation along with a 15% mark-up on its direct costs for overhead and profit plus any reasonable attorneys' fees incurred in facilitating such supplementation."

Supplementation often makes more sense than an outright termination. This is less likely to upset the schedule as compared with the time that will be necessary to find a new subcontractor and for the new subcontractor to achieve the learning curve the existing subcontractor already has. The general contractor gets the benefit of the original dollar figure for the subcontract, not the increased number the general contractor will often have to pay when it replaces a subcontractor. This also tends to better maintain a subcontractor's warranty obligations. It just may generally be a less expensive method of completing the work of a troubled subcontractor.

VI. CONCLUSION.

Having practiced construction law for more than 45 years, several truisms have proved themselves to me time after time. And, these might seem surprising coming from a contract lawyer and from a trial lawyer.

In the drafting of contracts, the shorter the document, the better the document. For one of my general contractor clients, I have created a subcontract with all of the goodies in it and it is only four pages in length. My experience has been that most of the time subcontractors will not have a lawyer review a contract before it is signed. And, one of the criteria a subcontractor seems to use in making such a decision is how long the contract is. If it isn't too long, it can't be *that* bad.[8] But, particularly for the drafting party, it is important that the contract have the right provisions in it.

And, participating in as few litigations as possible seems to work better for most contractors over the long run.

Using these two clauses in your downstream contracts might help you better achieve both goals: a better contract and less time and expense involved with unnecessary litigation.

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[8] As learned by participants in my last group of seminars, a document labelled as a 'partial lien waiver' might actually be a complete release, which is a far more serious and troubling kettle of fish.

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