

# Legal Pipeline

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## Is breaking up hard to do?

*Understanding termination for convenience.*

**T**hink of a construction contract as a “prenuptial” agreement between parties. The termination provisions in a construction contract address the parties’ rights and responsibilities in the event their professional relationship comes to an end before the work is completed on a project.

Generally, there are two kinds of termination clauses: 1.) termination for default, also known as termination for cause and 2.) termination for convenience, also known as termination at will.

This article focuses only on the latter clause, which is included in all of the form construction contracts (AIA, ConsensusDOCS and EJCDC), as opposed to the former clause, which is typically triggered by an event that constitutes a breach of contract.

### Sample termination for convenience clause

Perhaps the best way to understand termination for convenience is to review the provisions found in Article 7.2 of AIA Form A401. This form is the AIA’s standard subcontractor agreement, and most likely to be encountered by plumbing subcontractors:

§7.2.2 If the Owner terminates the Prime Contract for the Owner’s convenience, the Contractor shall promptly deliver written notice to the Subcontractor.

§7.2.3 Upon receipt of written notice of termination, the Subcontractor shall .1 cease operations as directed by the Contractor in the notice; .2 take actions necessary, or that the Contractor may direct, for the protection and preservation of the Work; and .3 except for Work directed to be performed prior to the effective date of the termination stated in the notice, terminate all existing Subsubcontracts and purchase orders and enter into no further Subsubcontracts and purchase orders.

§7.2.4 In case of such termination for the Owner’s convenience, the Subcontractor shall be entitled to receive

payment for Work executed, and costs incurred by reason of such termination, along with reasonable overhead and profit on the Work not executed.

These provisions, like most of the ones found in the standard AIA forms, are subject to revision after negotiation between the contractor and the plumbing subcontractor. Very rarely are AIA forms utilized by contracting parties without modification.

Due to the technical and legal nature of these forms, it is strongly recommended that any modifications to AIA forms be reviewed by counsel. Oftentimes a contract involves multiple forms in an AIA form “family,” and it is important that any change to a single form be harmonized with any other forms that may be part of the overall contract documents.

### Terms subject to negotiation

Among the issues that parties negotiate in termination for convenience provisions are notice (time, place and manner), work by sub-subcontractors, payments and limitation of consequential damages. Of course in an ideal world, the plumbing subcontractor would delete these provisions in their entirety.

However, contractors — often constrained by their own agreements with owners — are not likely to be so benevolent in negotiations. Instead, contractors may be more inclined to agree to recovery of specific “termination costs” incurred by the subcontractor.

Regardless of what is agreed to by the parties, however, no subcontractor, absent some very special circumstances, likes to be terminated for convenience. And sometimes, despite lengthy negotiations and detailed contract provisions, the parties find themselves in a dispute over a termination for convenience and the following implications.

The recent case of *SAK & Associates Inc. v. Ferguson Construction Inc.*, 357 P.3d 671 (Wash. Ct. App. 2015), is instructive. SAK entered into a fixed price contract with Ferguson to provide concrete materials and paving services for the construction of airport hangars. After SAK worked on the project for over three months, it received a termination notice from Ferguson, which cited, “phasing restrictions, site logistics, and basic convenience.” The notice also referred to Section 7 of the parties’ subcontract, which permitted Ferguson to terminate the subcontract “for its own convenience and require [SAK] to immediately stop work.”

Upon termination, Ferguson paid SAK \$181,044.77 for work actually performed. Dissatisfied with this payment, SAK sued Ferguson for an additional \$226,000 in damages, alleging that Ferguson breached the subcontract due to its unilateral termination without cause. Ferguson moved for summary judgment, claiming that the termination for convenience clause in the parties’ agreement was

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enforceable. The trial court agreed, dismissing the action and awarding Ferguson over \$44,000 in attorneys' fees. SAK appealed to the Court of Appeals of Washington.

### Contract principles govern

In a fairly straightforward decision predicated on basic principles of contract law, the court of appeals affirmed the trial court's determination and rejected the two primary arguments advanced by SAK: 1.) the termination for convenience was "illusory;" and 2.) Ferguson failed to give proper notice of the termination.

Think of a construction contract as a "prenuptial" agreement between parties.

It is well settled that an enforceable agreement requires "consideration," or a bargained-for exchange. As the court of appeals stated, "If the provisions of an agreement leave the promisor's performance entirely within his discretion and control, the 'promise' is illusory. Where there is an absolute right not to perform at all, there is an absence of consideration." In other words, "if a promise is illusory, there is no consideration and no enforceable obligation."

Here, SAK argued that because the termination for convenience clause allows Ferguson to terminate the contract

at its sole discretion, it lacks consideration and is therefore illusory and an unenforceable obligation. The problem with this argument is that it ignores a fundamental precept of contract law: partial performance provides adequate consideration.

In this case, SAK performed nearly a quarter of its work on the project and was paid accordingly. As the court of appeals concluded, "This level of partial performance provides adequate consideration. Accordingly, SAK fails to establish the termination for convenience provision is illusory for lack of consideration."

Note: It would be a different story if SAK had just signed the subcontract and was terminated immediately thereafter by Ferguson.

As for SAK's argument that Ferguson did not give proper notice of termination, the court of appeals dispatched that contention without much explanation.

### The requisite notice

Section 7 of the parties' subcontract provides, "Contractor may, after providing Subcontractor with written notice, terminate (without prejudice to any right or remedy of Contractor) the Subcontract or any part of it, for its own convenience and require Contractor to immediately stop work."

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This clause requires written notice to SAK, but does not specify the content of the notice. SAK argued that the notice was deficient because its references to “phasing, site logistics and convenience” were false and pretextual; the real reason Ferguson wanted to terminate SAK was to

increase profits on the project. The court of appeals rejected this argument, finding that the notice Ferguson gave was valid since it only had to cite “convenience.” Under the parties’ subcontract, Ferguson did not have to provide any other reasons for the termination.

Finally, the court of appeals upheld the trial court’s award of attorneys’ fees to Ferguson, relying on the clause in the parties’ subcontract which awarded attorney fees to the “substantially prevailing party.” Since Ferguson won this case on summary judgment, there is no doubt that it substantially prevailed against SAK.

Cases like SAK are extremely rare — and not because they involve complicated legal concepts or uncommon facts. On the contrary, the legal principles involved are quite simple, and

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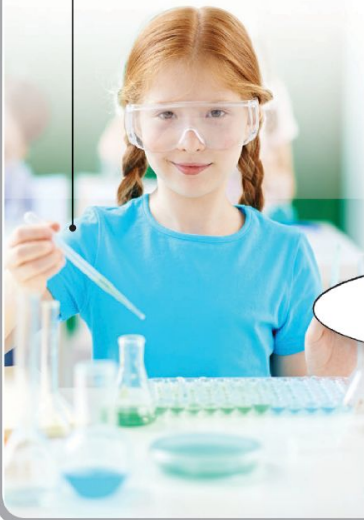
the facts are extremely common. It is for that reason that parties do not elect to litigate such disputes because if they do, like SAK, they may wind up not only having to pay their legal fees, but those of their adversary’s as well.

To avoid the plight of SAK, it is important to understand the termination for convenience clause in your subcontract and be prepared to accept the risks of such a termination. An attorney versed in construction law understands the ramifications of a termination for convenience and can help you negotiate its terms and understand its scope. ■

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