Termination For Convenience Clauses: Not All Are Alike, So the Terms Do Matter

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Introduction

Inevitably, time marches on – from the moment a project is first contemplated to the day that project is completed. During that march, however, the factors that previously made the project worthy, financially or otherwise, can change. Changes in the availability and cost of credit for construction loans and permanent financing, changes in the wherewithal and stability of contractors and trade contractors, scarcity of skilled labor, materials and equipment, turnover in private ownership and public demand can turn a previously worthy project into a losing proposition. As we have all seen over the past year, projects once contemplated are being postponed, and projects started are being suspended or terminated.

When circumstances change so that the once worthy project, contract or subcontract is no longer so, do you have the right to terminate without being in breach; and if there is a termination without fault or for convenience, was it done in accordance with the contract clause? To be sure, not all contracts, subcontracts or purchase orders allow for termination for convenience without fault, and when those contracts do, termination for convenience or without cause clauses are not all alike.

Some Issues To Consider

- **The Right to Terminate for Convenience or Without Fault**

As a starting point, the right to terminate for convenience or without fault (sometimes also called without cause) generally does not exist outside of your contract. If there is such a right, it exists because of contract terms or a contract clause; without such terms or clause, (and barring a legal excuse or exception) a party terminating a contract without cause is at significant risk of being in breach of the contract. This is in contrast to the right to terminate or to cease performance for material breach of the contract; also sometimes referred to as “for cause”. Consequently, before contracting, whether you will be acting as project owner, general contractor, subcontractor or supplier, consider whether you want to include a termination for convenience or without fault clause in your contract, and if so, with what terms? As but one example, while most standard form contract documents between owner and general contractor include a termination for convenience clause, (e.g., AIA A201, 2007 ed.) it is the owner with the sole right to terminate for convenience and then under varying terms and obligations to the contractor terminated without fault.

- **Terminating For Convenience Or Without Fault**

When a contract is to be terminated for convenience or without fault, the terminating party must generally take certain action(s) such as notice and give direction(s) if and as specified in the
contract clause. For example, to initiate the termination for convenience, the terminating party to the contract, in this example the project owner, generally must give notice to its contractor. Herein the differences in clauses start to become evident. The AIA A201 allows the project owner to terminate for convenience “at any time,” and does not require that a specific amount of notice be provided. Similarly, ConsensusDocs 200 simply requires that the owner provide written notice, without specifying a length of time for such notice. In contrast to these form agreements, EJCDC C-700 mandates that the owner provide the contractor with seven days written notice before terminating the contract for convenience. It is important to be aware of such differing requirements when negotiating or thereafter initiating a termination for convenience of your contract.

After the contractor receives the requisite notice, the contractor generally must cease operations within the time period required by the contract, which may range from “immediately” (ConsensusDocs 200), to “as directed by the owner” (AIA A201). In addition to ceasing the ongoing work, the contractor may be obligated to perform certain “wrap-up” actions. For example, pursuant to the ConsensusDocs 200 form agreement, the contractor must take all actions necessary to vest in the owner the contractor’s rights to all materials, supplies and equipment, and to assign to the owner all of its subcontracts, orders and commitments. Additionally, ConsensusDocs 200 states that the contractor shall “sell at prices approved by the Owner any materials, supplies and equipment as the Owner directs, with all proceeds paid or credited to the Owner.” The AIA A201 agreement has similar requirements, although that form agreement specifically directs the contractor to cancel all existing subcontracts and purchase orders, with no provision for assignment of those agreements to the owner. Again, when negotiating your contract or later undertaking the termination for convenience process, consider the terms you may want or have accepted in the event of a termination without fault.

- **Costs The Contractor Terminated For Convenience May Recover**

The form contract documents differ as to the costs a contractor may recover upon being terminated for convenience. The terms of the contract should specify exactly what costs can be recovered in the event of a termination without cause and the parties should review such provisions carefully before contracting. After contracting it is likely too late to restrict or expand on the allowable recovery for a termination for convenience. Two examples of the possibly allowable types of costs recoverable in the event of a termination for convenience are discussed below.

  - **Subcontractor Termination Costs**

In the event a project owner terminates its general contractor for convenience, that contractor will typically cancel, or in some cases, depending on the contract clause, assign its subcontracts and purchase orders to the owner. The costs that can result from this action, e.g., cancellation charges, prepaid materials or minimum term rental agreements, often identified as “subcontractor termination costs” are regarded as a direct result of the owner’s decision to terminate the contract, and the contractor is typically allowed to recover these costs. For example, the EJCDC C-700 form agreement allows the contractor to recover “all claims, costs, losses and damages…incurred in settlement of terminated contracts with Subcontractors, Suppliers and
others.” In some instances, these costs have included charges of engineers, architects, attorneys and other professionals, including court or other dispute resolution costs.

In contrast, the AIA A201 form agreement includes a more restrictive provision as to the contractor’s right to recover subcontractor termination costs. For example, Section 14.4.3 of the A201 allows the contractor to receive payment only for “the costs incurred by reason of such termination.” This provision does not explicitly allow the contractor to recover professional or attorneys fees in canceling its subcontracts and purchase orders as may be required by the termination. Similarly, ConsensusDocs 200 does not directly define the recoverable subcontractor termination costs, noting only that the contractor shall be paid “for all demobilization costs and costs incurred as a result of the termination….” As a practice pointer, during contract negotiations, the parties should identify with specificity whether, and to what extent, subcontractor termination costs will be recoverable upon a termination for convenience.

- Anticipated Profits and Overhead

When a contract is terminated for convenience, there is typically work remaining to be performed. Because the contractor will not complete this work, the contractor will not be compensated for the unperformed work nor for the profit and overhead recovery that would have been earned on the now unperformed work. Contracts vary in their treatment of a contractor’s right to recover profit and overhead on unperformed work at the time of a termination for convenience. For example, AIA A201, Section 14.4.3, entitles the contractor to payment of “reasonable overhead and profit on the Work not executed.” In contrast, the ConsensusDocs 200, Section 11.4.2.2 expressly disallows anticipated profits and overhead on work not yet performed as of the date of the termination. These two extremes demonstrate how the language of a contract’s termination for convenience provision can affect the outcome of a decision to terminate the contract and the payment due the terminated party.

As an example of a more complex treatment of this issue, the EJCDC C-700 distinguishes between the contractor’s recovery of profit and overhead on uncompleted work (allowed) versus unperformed work (not allowed). Specifically, a contractor shall be paid for fair and reasonable overhead and profit on expenses sustained prior to the termination for convenience “in performing services and furnishing labor, materials, or equipment as required by the Contract Documents in connection with uncompleted Work.” EJCDC, Section 15.03.A.2. By the same Article, a contractor cannot recover anticipated profits [for unperformed work] arising from the termination. EJCDC, Section 15.03.B.

**Conclusion**

Termination for convenience provisions come in all shapes and sizes, and parties must be careful to understand their obligations, as well as their rights, under these provisions. Although this article discusses the language used by certain form agreements, owners and contractors should be aware of how different termination for convenience provisions can be despite the similarity in name. What do your termination for convenience clauses say?