CONSTRUCTION SUBCONTRACTING

A Comprehensive Practical and Legal Guide

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CHAPTER 9

Terminations

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I. Introduction

This chapter discusses how either party to a construction subcontract may terminate that subcontract. As with many issues, the first place to look is the subcontract itself. Federal and state statutes and regulations may provide additional rights or impose additional restrictions on the ability to terminate. Finally, common law and equity may impact a party's ability to terminate.

Construction subcontracts typically include termination provisions. They almost always include a provision that permits the prime contractor (or higher-tier subcontractor) to terminate the subcontract for cause (also referred to as a "termination for default"). Many, especially on public projects, also provide that the prime may terminate without cause (also referred to as a "termination for convenience"). Some also provide for cancellation, which is typically a termination without cause early in the project or for some specific, anticipated possible event (e.g., a failure to obtain project funding).

The parties to subcontracts often use, or at least borrow from, termination provisions in the American Institute of Architects (AIA) form subcontract[1] and the ConsensusDocs (CD) form subcontracts.[2] The Federal Acquisition Regulation (FAR) standard termination clauses[3] are often flowed down to subcontracts on federal projects and, as the most detailed provisions commonly used, are sometimes borrowed for use on non-federal public and private projects as well.

Common law and equity will limit the enforceability of some termination provisions. For example, terminations for default are considered forfeitures, to

1. AIA A401-2007, Standard Form of Agreement Between Contractor and Subcontractor. Termination provisions are found at article 7.

2. CD 750, Standard Agreement Between Constructor and Subcontractor, and CD 752, Standard Subcontract Agreement for Use on Federal Construction Projects. Termination provisions in both are found at article 10.

3. FAR 52.249-10 (1984); FAR 52.249-2, Alternate I (2012).

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be avoided wherever possible.[4] Termination for convenience provisions may be considered illusory, especially in commercial construction contracts.[5] And equity will allow rescission under certain circumstances, regardless of what the subcontract provides.[6]

Termination of a subcontract is likely to be governed by applicable state law, either under applicable state choice of law rules or according to the subcontract itself.[7] When the work is performed on a federal project, a few courts have held that federal common law governs the interpretation of a subcontract, but most decisions have, without discussion, applied state law.[8] Due to courts' inconsistency in determining what law applies to subcontracts under government prime contracts, the parties will often include a choice of law clause in the subcontract designating federal contract law as the primary source, with a specified state law as backup in the absence of relevant federal law.[9]

II. When the Owner Terminates the Prime Contractor

A. Typical Subcontract Provisions

Most construction prime contracts give the owner the right to terminate for default, and many give it the right to terminate for convenience as well.[10] Some subcontracts provide that, when the prime contract is terminated, the prime has the right to terminate the subcontract as well,[11] though most do not limit the prime's right to terminate for default to instances in which the owner

4. Lisbon Contractors, Inc. v. United States, 828 F.2d 759, 765 (Fed. Cir. 1987); B.V. Constr., Inc., ASBCA Nos. 47766, et al., 2004-1 BCA ¶ 32,604, at 161,350.

5. *See, e.g.*, Questar Builders, Inc. v. CB Flooring, LLC, 978 A.2d 651 (Md. 2009).

6. *See, e.g.*, Tolboe Constr. Co. v. Staker Paving & Constr. Co., 682 P.2d 843, 847 (Utah 1984); Lakeside Pump & Equip., Inc. v. Austin Constr. Co., 576 P.2d 392, 396–97 (Wash. 1978).

7. Westinghouse Electric Corp. v. Garrett Corp., 437 F. Supp. 1301 (D. Md. 1977), *aff'd*, 601 F.2d 155 (4th Cir. 1979); Wallace Process Piping Co. v. Martin-Marietta Corp., 251 F. Supp. 411 (E.D. Va. 1965).

8. For further discussion of choice of law on public projects, see chapter 17.

9. *See, e.g.*, AMC Demolition Specialists, Inc. v. Bechtel Jacobs Co., No. 3:04-cv-466, 2006 U.S. Dist. LEXIS 32273 (E.D. Tenn. Sept. 26, 2006).

10. *See, e.g.*, AIA A101-2007, Standard Form of Agreement Between Owner and Contractor, § 7.1; AIA A201-2007, General Conditions of the Contract for Construction, §§ 14.14.2, 14.4; CD 200, Standard Agreement and General Conditions Between Owner and Constructor (lump-sum price), §§ 11.3, 11.4; FAR 52.249-10, 52.249-2, Alternate I, 52.249-3, 52.249-7 (standard termination for default and convenience clauses for most federal fixed-price contracts for construction, for dismantling and demolition, and for architect-engineer services).

11. *See, e.g.*, AIA A401-2007, § 7.2.2-.4; CD 750, § 10.4; CD 752, § 10.4; ABA's Guide to Fixed-Price Supply Subcontract Terms and Conditions 45, Clause C-50, ¶ (d) (4th. ed. 2005).

has terminated the prime contract,[12] and many do not limit the prime's right to terminate for convenience to such instances either.

Finally, some prime contracts require the prime contractor to assign all rights to its subcontracts to the owner if the owner terminates the prime contract and directs or accepts assignment by the prime.[13] As a result, many subcontracts give the prime the ability to make such an assignment.[14] Assignment of subcontracts allows the owner either to obtain continued performance by the subcontractor[15] or to negotiate a termination settlement directly with a subcontractor.[16]

B. Terminations for Default

1. Consequences to the Prime Contractor and Subcontractor

When a prime contract is terminated for default, the owner may be entitled to recover from the prime contractor a variety of damages resulting from the contractor's failure to perform its contractual obligations. These include re-procurement costs, delay damages, and unliquidated progress payments, among others. Moreover, the prime contractor may also incur poor performance evaluations and negative responsibility determinations that may affect the contractor's ability to obtain additional work in the future, not to mention litigation costs in defending against the owner's decision to terminate.

The two most commonly used form contracts between owners and prime contractors impose similar requirements and consequences on prime contractors terminated for default. Under both AIA A201 and CD 200, the owner may terminate a prime contract on seven days' written notice if the contractor (1) repeatedly refuses or fails to supply sufficient skilled workers or materials, (2) fails to pay its subcontractors, (3) violates applicable laws, or (4) substantially breaches the contract documents.[17] The owner may also exclude the prime contractor from the site; take possession of all materials, equipment, tools, and construction equipment and machinery owned by the contractor; accept assignment of any subcontracts that it desires to keep; and finish the work by whatever reasonable method it deems expedient.[18] The contractor may make a written request for a detailed accounting of the costs incurred to finish the work, but it is not entitled to receive further payment until the work is finished.[19] If the costs of finishing

12. *See, e.g.*, AIA A401-2007, § 7.2.1; CD 750, § 10.1; CD 752, § 10.1.
13. *See, e.g.*, AIA A201-2007, §§ 5.4.1, 14.2.2.2; CD 200, § 5.4.1; FAR 52.249-2(b)(4).
14. AIA A401-2007, § 7.4.1; CD 750, § 10.5; CD 752, § 10.5.
15. *See, e.g.*, AIA A401-2007, § 7.4.1; CD 750, § 10.5; CD 752, § 10.5.
16. *See, e.g.*, FAR 49.108-8.
17. AIA A201-2007, § 14.2.1; CD 200, § 11.2.
18. AIA A201-2007, § 14.2.2; CD 200, § 11.2.1.
19. AIA A201-2007, § 14.2.3-4; CD 200, § 11.3.1.

the work exceed the unpaid balance, then the contractor must pay the difference to the owner.[20]

Those terms are commonly incorporated by reference into subcontracts, such that the same conditions for termination apply to subcontractors.[21] If termination of the subcontractor is warranted under any of the conditions stated above, particularly if a prime contract's default occurs as a result, then the prime contractor may also default the subcontractor by written notice if the subcontractor fails to cure the default within the time prescribed by contract.[22]

2. The Prime Contractor Is Generally Responsible to the Owner for the Conduct of Its Subcontractors

A prime contractor is responsible for the performance of all its subcontractors, and the owner may choose to terminate a prime contractor for default even if the basis for the termination lies solely with a subcontractor.[23] In other words, the prime is also responsible for its subcontractor's performance.[24] As such, a prime is responsible for monitoring the actions of its subcontractors to ensure performance and avoid delay.[25] A subcontractor's financial difficulties, including bankruptcy, will not excuse the prime's obligation of timely performance.[26] Blaming nonperformance on a subcontractor will not result in the reversal of a default termination.[27]

Prime contractors are responsible not only for the performance of their subcontractors but also that of lower-tier subcontractors and suppliers.[28] For example, if a delay were caused by a second-tier subcontractor, the prime contractor would have to establish that the second-tier subcontractor's delay was itself excusable before the prime would be entitled to claim excusable delay.[29]

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20. AIA A201-2007, § 14.2.4; CD 200, § 11.3.1.

21. AIA A401-2007, § 1.2.

22. AIA A401-2007, § 7.2.1 (10 days); CD 750, § 10.1 (5 days).

23. *See* Gen. Injectables & Vaccines, Inc., ASBCA No. 54930, 2006-2 BCA ¶ 33,401 (sustaining the default termination of a contract for flu vaccine and finding that the contractor was responsible for the nonperformance of its subcontractor, even though the commercial item contract default clause does not specifically say so).

24. Harris Mfg., Inc., ASBCA No. 40434, 94-1 BCA ¶ 26,415; Halifax Engineering, Inc., ASBCA No. 34779, 88-1 BCA ¶ 20,227; Continental Mach. Tool Co. v. Aircraft Welding & Mfg. Co., No. CV 94-0462809S, 1996 Conn. Super. LEXIS 2015, at *9–*10 (Conn. Super. Ct. July 24, 1996); Hutton Contr. Co. v. City of Coffeyville, 487 F.3d 772, 779 (10th Cir. 2007).

25. Decker & Co. GmbH, ASBCA No. 41089, 94-2 BCA ¶ 26,759, *aff'd*, 76 F.3d 1573 (Fed. Cir. 1996); Excell Constr., Inc. v. Michigan State Univ. Bd. of Trs., No. 228310, 2003 Mich. App. LEXIS 59 (Jan. 14, 2003).

26. Aerospace Eng'g & Support, Inc., ASBCA No. 47520, 95-2 BCA ¶ 27,707, at 138,101 (citing J.J. Seifert Machine Co., ASBCA No. 41398, 91-2 BCA ¶ 23,705; N.S. Meyer, Inc., ASBCA No. 27144, 83-1 BCA ¶ 16,214).

27. V&W Constr. Servs. Co., AGBCA No. 2003-147-1, 2004-2 BCA ¶ 32,692.

28. Schweigert, Inc. v. United States, 388 F.2d 697 (Ct. Cl. 1967).

29. Atlas Mfg. Co., Inc., ASBCA No. 15177, 71-2 BCA ¶ 9026.

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Moreover, the mere fact that performance will result in a loss due to increased costs of using an alternate subcontractor does not excuse performance; the responsibility still remains with the prime.[30]

One possible exception is the owner-directed use of a particular subcontractor. A number of federal tribunals have adopted the view that when the government, as the owner, designates a particular subcontractor as a sole source, the government necessarily warrants the performance by that subcontractor.[31] If this view were followed, the contractor would be entitled not only to an excuse for a sole source subcontractor's nonperformance but also to recover any increased costs caused by the subcontractor's failures. As least one federal tribunal, the Armed Services Board of Contract Appeals, has chosen not to follow this view, finding that the government warrants only that the source exists and has the ability to produce the product, not that it will do so without defect.[32] Likewise, state courts have generally declined to shift responsibility for subcontractor performance from the prime contractor to the owner simply because the owner directed use of that particular subcontractor.[33]

3. The Prime Contractor's Decision Whether to Default Terminate a Subcontractor

a. What Does the Subcontract Allow or Require?

Terminating a subcontractor for default will often result in litigation between the prime and the subcontractor, negative relations between the parties, and other costs. As a result, a prime contractor may, in some instances, choose not to terminate a subcontractor for default even when it has a contractual right to do so.

Moreover, in some cases, a prime contractor may not be able to terminate a subcontractor for default at all, unless it complies with other requirements. For instance, prime contracts may contain provisions that require consent by the owner before a subcontractor may be replaced.[34] Similarly, state laws

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30. Baldt, Inc., ASBCA No. 37810, 90-1 BCA ¶ 22,596; Eppco Metals Corp., ASBCA No. 38305, 90-1 BCA ¶ 22,349; Pioneer Valve & Fitting Co., ASBCA No. 33355, 89-3 BCA ¶ 22,203; C&M Mach. Prods., Inc., ASBCA No. 43348, 93-2 BCA ¶ 25,748; New Era Contract Sales, Inc., ASBCA No. 56661, et al., 2011-1 BCA ¶ 34,738; *see also* Collins/Snoops Assocs. v. CJF, LLC, 988 A.2d 49, 51 (Md. App. 2010) (county terminated prime contractor even after replacing defaulted subcontractor).

31. Franklin E. Penney Co. v. United States, 524 F.2d 668 (Ct. Cl. 1975); Kaplan Contrs., Inc., GSBCA No. 2747, 70-2 BCA ¶ 8511; Electro-Nav, Inc., DCAB No. NOAA 1-74, 75-1 BCA ¶ 11,162 (1975); Engineered Sys., Inc., B-184098, 76-1 CPD ¶ 144.

32. Salisbury Special Tool Co., ASBCA No. 37530, 89-2 BCA ¶ 21,838.

33. *See, e.g.*, Barham Constr. v. City of Riverbank, Nos. F058692 & F059499, 2011 Cal. App. Unpub. LEXIS 5959, at *26–*28, *35–*39 (Aug. 8, 2011) (unpublished).

34. *See, e.g.*, AIA A201-2007, § 5.2.4 ("The contractor shall not substitute a Subcontractor, person or entity previously selected if the Owner or Architect makes reasonable objection to such substitution.").

governing subcontractors may impact how easily a subcontractor can be terminated or substituted. For example, many states have subcontractor listing laws limiting the prime contractor's ability on public construction projects to replace a subcontractor listed in its original bid.[35]

b. Options and Strategic Considerations

Even if a subcontractor is technically in default, a prime contractor should not necessarily proceed with a default termination. A default termination is rarely the best option. Generally, a prime contractor should default a subcontractor only in the most serious of situations in which the default actually facilitates contract performance.

Many practical concerns exist when determining whether to default a subcontractor. These concerns include the risk of litigation by the subcontractor, the difficulty in finding a replacement subcontractor that is able to complete the work at a reasonable price, the difficulty in finding a replacement contractor that will perform better than the existing subcontractor, the risk of delays and costs associated with bringing on a new subcontractor, whether any warranties will be impaired, and whether the subcontractor will file a mechanic's lien on the property.

Potential alternatives to defaulting a subcontractor include reassigning a portion of the subcontractor's scope of work, paying the subcontractor's suppliers directly, and hiring additional workforce (on the subcontractor's account) to assist the subcontractor.

The prime contractor's receipt of a cure notice based, at least in part, on alleged subcontractor performance deficiencies raises other concerns the prime must consider before proceeding with defaulting the subcontractor. In such a situation, abruptly defaulting the subcontractor may simply give the owner evidence that the prime is in default and may be terminated. Remember, the prime is responsible for its subcontractor's performance. Thus, before defaulting the subcontractor, the prime may wish to present a planned cure to the owner, both with and without the subcontractor's future involvement in the contract. If the subcontractor is in default and if terminating the subcontractor will stop the owner from defaulting the prime and otherwise facilitate contract performance, then the prime may consider defaulting the subcontractor. If the prime contract is terminated for the default of the subcontractor, it may be better for the prime to join forces with the subcontractor to challenge the validity of the default. At other times, the owner may want, and have a right, to have the prime contractor assign the subcontract to the owner,[36] in which case, terminating the subcontractor could cause additional friction with the owner.

35. For a more detailed discussion of these laws, see chapter 2.
36. AIA A201-2007, § 5.4.1.

While, generally, prime contractors will want to avoid terminating subcontractors, there may be times where a termination for default is more appropriate than its alternatives. If the subcontractor is consistently behind schedule or fails to perform, the relationship may be unsalvageable. Additionally, owners and prime contractors occasionally successfully use the threat of termination as a tool to compel their contractors' or subcontractors' performance, respectively, when it has not been satisfactory.

C. Terminations for Convenience

When the owner terminates the prime contract for convenience, the prime has several important obligations with regard to its subcontracts. The most important of these obligations is to notify all subcontractors that the owner has terminated the prime contract and to instruct the subcontractors to stop work, protect and preserve work in progress, terminate existing lower-tier subcontracts and supply orders, and not enter into any new subcontracts or orders for the project. These requirements are expressly stated in many subcontracts.[37]

A termination for convenience by the owner of the prime contract may be complete—that is, all remaining work as of the time of termination is eliminated—or partial—that is, only some of the remaining work is terminated.[38] Where it is partial, the first order of business for the prime is to determine which subcontracted work, if any, is affected. For affected subcontracted work, the prime must quickly identify whether all or some of the work remains and, for terminated work, notify the subcontractor, and determine the status of the work (including any pending supply orders, equipment rentals, and other ongoing expenses). If the subcontractor has work in progress that, if stopped immediately, may result in waste, it should promptly notify the prime, which, in turn, should promptly notify the owner. The owner or prime may opt to allow the subcontractor to complete that work in progress (and get paid per the subcontract), but the subcontractor should try to get this consent in writing before incurring post-termination costs to do so.[39]

The subcontractor, under a typical provision, will be entitled to some form of recovery if the owner terminates the prime contract and, as a result, the prime terminates the subcontract for convenience.[40]

Where the owner has terminated the prime contract and the prime has terminated the subcontract, both contracts will typically provide a deadline for the terminated parties to submit claims for reimbursement in accordance with the termination provisions. Ideally, the subcontract deadline will be

37. *See, e.g.*, AIA A401-2007, §§ 7.2.2, 7.2.3; CD 750, § 10.4; CD 752, § 10.4.

38. *See, e.g.*, FAR 52.249-2(a).

39. *See* FAR 31.205-42 (recognizing that federal government may allow some terminated work to continue to avoid waste).

40. For a more detailed discussion, see section III.C.5.

significantly earlier than the prime-contract deadline, so as to allow the prime enough time to review the claims of the subcontractor and those of any other terminated subcontractors and to include those claims in its overall termination claim to the owner.[41]

Typically, the subcontractor's termination claim will be provided to the prime contractor, which will review and incorporate that claim into the prime's termination claim to the owner. The prime must take reasonable steps to ensure that the subcontractor's claim is true and correct before including it in its own claim to the owner. This is especially true on public projects. For example, on federal projects, not only must the prime contractor and subcontractors certify their own settlement proposals but also the prime contractor must certify, among other things, that its subcontractors' charges are fair and reasonable, are allocable to the terminated portion of the contract, were negotiated in good faith, and are not more favorable to the immediate subcontractors because reimbursement by the government is involved.[42] On public projects for the federal government and in many states, if the subcontractor includes amounts in its termination settlement proposal to which it is not entitled, it may be liable under false claims laws, and, if the prime is not diligent in reviewing its subcontractor's false proposal before submitting it, the prime may be liable as well.[43]

Among the costs the prime contractor typically may recover under the convenience termination provision in its contract with the owner are the prime's settlement expenses, which typically will include its post-termination costs incurred in terminating its subcontracts.[44] These generally may include the prime's costs of settling subcontract termination claims, so long as they are made in good faith and are reasonable in amount,[45] and its costs of paying judgments on such claims.[46] The prime may also recover as settlement expenses its administrative costs relating to subcontract terminations and negotiation of settlements.

If the prime contractor has difficulty negotiating a termination settlement with a subcontractor, it may submit to the owner a "partial proposal," and, if

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41. *See, e.g.*, ABA's Guide to Fixed-Price Supply Subcontract Terms and Conditions, *supra* note 11, at 45, Clause C-50, ¶ (d); FAR 49.502(e)(1).

42. FAR 49.108-3.

43. *See* chapter 17.

44. AIA A101-2007, § 7.1; AIA A201-2007, § 14.4.3; CD 200, § 11.42; FAR 31.205-42(h).

45. *See, e.g.*, Murdock Mach. & Eng'g Co., ASBCA No. 42891, 93-1 BCA ¶ 25,329; Boeing Co., ASBCA No. 10524, 67-1 BCA ¶ 6350; General Electric Co., ASBCA No. 24111, 82-1 BCA ¶ 15,725, *reconsid. denied*, 83-1 BCA ¶ 16,207; Bos'n. Towing & Salvage Co., ASBCA No. 41357, 92-2 BCA ¶ 24,864; Joint Venture G.C.D.-E Lykiardopoulos & J. Lydakis & Asphaltiki, S.A., ASBCA No. 47285, 97-1 BCA ¶ 28,976.

46. *See, e.g.*, FAR 49.108-5; Teledyne Indus., ASBCA No. 18049, 73-2 BCA ¶ 10,088; Tom Shaw, Inc., ENG BCA Nos. 5540, et al., 93-2 BCA ¶ 25,742; *Boeing Co.*, 67-1 BCA ¶ 6350; R-D Mounts, Inc., ASBCA Nos. 17422, et al., 75-1 BCA ¶ 11,077.

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necessary, the owner and prime contractor may except the subcontractor's settlement proposal from their settlement.[47] With the consent of the prime contractor, the owner also may provide assistance in settling subcontractor claims.[48]

III. Prime Contractor's Right to Terminate the Subcontractor

A. Typical Subcontract Provisions

The prime contractor's right to terminate a subcontract will largely depend on the language in the subcontract itself. Most subcontracts provide that the prime contractor may terminate the subcontract for default, regardless of whether the owner has terminated the prime contract.[49] As discussed below, typical default termination language will allow the prime to terminate based on a material breach by the subcontractor and a failure to cure that breach within a specified time period after notice is given by the prime. Some subcontracts also allow termination for specific breaches, such as failures to acquire required insurance or bonds, or subcontractor bankruptcy.[50]

Many subcontracts also allow the prime contractor (or higher-tier subcontractor) to terminate for convenience, though some only if the owner has terminated the prime contract.[51] Convenience termination provisions are more variable and often depend on the owner and type of project. Prime contractors on public projects often must agree in their prime contracts to provisions giving the government broad rights to terminate without cause; they will typically flow these requirements down to their subcontractors. On commercial projects, the prime may not be subject to termination for convenience or, if it is, the owner's right to terminate without cause may be more limited than that of the government; in those circumstances, the prime often may not insist on a broad right to terminate for convenience and may forgo that right altogether.

A common subcontract limitation on the prime's ability to terminate for convenience is to allow such a termination only when the owner has terminated the prime contract.[52] Such a limitation will be enforced.[53] If a prime is agreeable to such a limitation, it should at least try to make it broad enough to include any action by the owner that eliminates or reduces the subcontractor's scope of work. This should include not only complete terminations but also

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47. *See, e.g.*, FAR 49.206-1(b); *see also* FAR 49.102(a), 49.109-5.
48. *See, e.g.*, FAR 49.108-6, -7.
49. *See, e.g.*, AIA A401-2007, § 7.2.1.; CD 750, § 10.1; CD 752, § 10.1; *see also* FAR 52.249-10.
50. *See, e.g.*, CD 750, §§ 9.3.3, 10.2; CD 752, §§ 9.2.5, 9.3.3, 10.2.
51. *See, e.g.*, AIA A401-2007, §§ 7.2.2–7.2.4; CD 750, §§ 10.1, 10.4; CD 752, §§ 10.1, 10.4.
52. *See, e.g.*, AIA A401-2007, § 7.2.2–7.2.4; CD 750, § 10.4; CD 752, § 10.4; ABA's Guide to Fixed-Price Supply Subcontract Terms and Conditions, *supra* note 11, at 44, Clause C-50, ¶ (a).
53. Experimental Eng'g, Inc. v. United Technologies Corp., 614 F.2d 1244 (9th Cir. 1980).

partial terminations, so long as they impact the subcontractor's work, as well as other owner actions, such as deductive change orders.

On federal projects, procurement regulations do not require that the default or convenience termination clauses in the prime contract be flowed down to subcontracts.[54] However, because the government has the right to terminate the prime contract for default or convenience, it is generally accepted practice to include them in subcontracts as well. Prime contractors also generally want to flow down these provisions because they provide more specificity as to the particular conditions that support a default finding and the remedies available to the prime contractor.[55] The regulations state that the prime contractor may find the standard termination clauses suitable for use in subcontracts, provided that the relationship between the prime and the subcontract is clearly indicated.[56] In flowing down the default provision, a prime contractor will not want to rely solely on incorporating by reference the termination clauses in the prime contract, as they may have differing requirements than what the prime and subcontractors intend (such as time limits for notification) or conflict with other provisions in the subcontract. The customary practice for prime contractors, therefore, is to incorporate the standard clauses with modifications to conform to the parties' intent.[57]

When the subcontract contains no termination clauses, the prime contractor will generally have to rely on other legal theories to deal with a defaulting subcontractor, such as material breach, and it is likely to have no right to terminate for convenience, even if its prime contract has been terminated. While courts have read termination provisions into federal prime contracts under the *Christian* doctrine, which states that "a mandatory contract clause that expresses a significant or deeply ingrained strand of public procurement policy is considered to be included in a contract by operation of law,"[58] this doctrine has not traditionally been applied to subcontracts. In addition, the FAR termination clauses are *not* mandatory flow-down provisions, despite being mandatory for contracts with the government, and so may not qualify under the *Christian* doctrine. Since this area of the law is very much in flux, prime contractors should not rely on the *Christian* doctrine if they wish to incorporate termination for default provisions in their subcontracts.[59]

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54. *See, e.g.*, FAR 52.249-2, Alternative I (no flow-down requirement).
55. *See* FAR 52.249-10(a); FAR 52.249-2, Alternative I.
56. FAR 49.502(e)(1).
57. For further discussion of flow-down provisions on public projects, see chapter 17.
58. S.J. Amoroso Constr. Co. v. United States, 12 F.3d 1072, 1075 (Fed. Cir. 1993) (citing G.L. Christian & Assocs. v. United States, 312 F.2d 418 (Ct. Cl. 1963)).
59. For a detailed discussion of the *Christian* doctrine, see chapter 17.

B. Terminations for Default

1. Material Breach Requirement

A material breach is generally required before the owner may terminate a contractor for default.[60] The types of actions that constitute material breaches that warrant a default termination are typically set forth in the default clause. Both AIA A401 and CD 750, for example, include as material breaches defective or nonconforming work, failure to pay subcontractors or suppliers, or violation of applicable law.[61] Similarly, the standard federal default clauses list the following material breaches that will justify a default termination: failure to deliver or perform on time, failure to meet specifications, failure to make progress, or failure to perform other contractual provisions.[62] Additional material breaches that commonly result in default terminations include anticipatory repudiation[63] and abandonment of the contract,[64] and state courts will typically look to the following five factors to determine whether a breach is material: (1) the amount of the benefit lost to the injured party, (2) the adequacy of compensation to the injured party, (3) the amount of forfeiture by the breaching party, (4) the likelihood that the breaching party will cure, and (5) the breaching party's good faith.[65]

2. Notice and Opportunity to Cure Requirement

In certain situations, as a condition to a default termination, the owner must provide the contractor (or the prime contractor must provide the subcontractor) with a cure notice. Under federal law, a cure notice is required prior to a default termination not only for failure to make progress but also for failure to perform other provisions of the contract.[66] However, a cure notice is not required for failure to meet specifications or meet the schedule deadline.[67] In contrast to the federal requirements, both commonly used commercial construction subcontract forms require a cure notice for all default terminations.[68]

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60. *See, e.g.*, Aptus Co. v. United States, 189 F. Appx. 946, 947 (Fed. Cir. 2006).

61. *See, e.g.*, AIA A401-2007 (termination for default allowed where subcontractor repeatedly fails or neglects to carry out the work in accordance with the subcontract documents or otherwise perform in accordance with the contract); CD 750 (same).

62. FAR 52.249-8(a)(1).

63. *See, e.g.*, United States v. Dekonty Corp., 922 F.2d 826 (Fed. Cir. 1991); Jewell, GSBCA No. 10348, 90-3 BCA ¶ 23,283; Altina Trucking, PSBCA No. 3341, 93-3 BCA ¶ 26,256; P Star, Inc., PSBCA No. 4839, 2004-1 BCA ¶ 32,514.

64. *See, e.g.*, Dep't of Ins. United States, 33 Fed. Cl. 188, 194 (1995); Twigg Corp., NASA BCA No. 62-0192, 93-1 BCA ¶ 25,318; Reddy-Buffaloes Pump, Inc., ENG BCA Nos. 6049, 6115, 96-1 BCA ¶ 28,111; Howell Tool & Fabricating, Inc., ASBCA No. 47939, 96-1 BCA ¶ 28,225; Beeston, Inc., ASBCA No. 38969, 91-3 BCA ¶ 24,241; Malone, PSBCA Nos. 6129, 6135, 2008-2 BCA ¶ 33,958.

65. *See, e.g.*, L.L. Lewis Constr., LLC v. Adrian, 142 S.W.3d 255, 260 (Mo. Ct. App. 2004).

66. Paine, ASBCA No. 41273, 95-2 BCA ¶ 27,896.

67. FAR 49.402-3(c).

68. AIA A401-2007, § 7.2.1; CD 750, § 10.1.1.

State courts will typically require strict compliance with such notice requirements.[69] Under both federal procurement law and AIA A401, the notice, where required, must be in writing and must provide the contractor 10 days in which to cure.[70] CD 750 provides a slightly different notice requirement: the contractor must first give written notice to commence and continue satisfactory correction of the default, and, if the subcontractor fails to do so, then the contractor must give a second notice.[71] Failure to provide notice and a cure period may itself be seen as a material breach by the prime contractor.[72] There are, however, rare exceptions to the waiting-period requirement.[73]

3. Challenges to Default Terminations

a. Standard to Justify

(1) Default as Forfeiture

A default involves very serious consequences for a subcontractor. For example, even if the default termination is on appeal, a subcontractor may be excluded from the competition for the re-procurement contract.[74] Additionally, terminations for default on prior similar contracts may be considered in assessing past performance or responsibility on future procurements.[75] Therefore, the courts have adhered to the principle that a default termination is a drastic sanction akin to a forfeiture, which imposes on the terminating party accountability for its actions.[76]

Due to the serious implications of a default termination, the owner in most instances has the burden of sustaining its contention that the prime contractor was not in compliance with the contract requirements.[77] There are exceptions to this general policy, such as the prime contractor's burden of showing

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69. *See, e.g.*, Allstate Contractors v. Marriott Corp., 652 N.E.2d 1113, 1119 (Ill. App. Ct. 1995).

70. FAR 49.402-3(d); Roberts Int'l Corp., ASBCA No. 10954, 68-2 BCA ¶ 7074.

71. CD 750, § 10.1.1.

72. McClain v. Kimbrough Constr. Co., 806 S.W.2d 194, 198–99 (Tenn. Ct. App. 1990).

73. Lee Maintenance Co., PSBCA No. 522, 79-2 BCA ¶ 14,067 (government's obligation to give a contractor a full 10-day cure period was "preempted" by the contractor's wrongful conduct in threatening physical harm).

74. Colonial Press Int'l, Inc., B-403632, 2010 CPD ¶ 247.

75. Brown Tank & Steel, ASBCA No. 23118, 79-2 BCA ¶ 14,041; Commissioning Solutions Global, LLC, B-403542, 2010 CPD ¶ 272; Bannum, Inc., B-404712, 2011 CPD ¶ 52; M. Erdal Kamisli Co. (ERKA Co.), B-403909.2, B-403909.4, 2011 CPD ¶ 63, at 6.

76. H.N. Bailey & Assocs. v. United States, 449 F.2d 387 (Ct. Cl. 1971); J.D. Hedin Constr. Co. v. United States, 408 F.2d 424 (Ct. Cl. 1969); Sun Cal, Inc. v. United States, 21 Cl. Ct. 31, 39 (1990); Mega Constr. Co. v. United States, 29 Fed. Cl. 396, 414 (1993).

77. *See, e.g.*, Iowa-Illinois Cleaning Corp. v. GSA, GSBCA No. 12030, 93-3 BCA ¶ 25,989; Lanzen Fabricating, Inc., ASBCA No. 40328, 93-3 BCA ¶ 26,079; Custom Prod. Mfg., Inc. v. GSA, GSBCA No. 10393, 92-1 BCA ¶ 24,688 (burden on the government to establish that termination was proper); Cantrill Dev. Corp., ASBCA Nos. 30160, et al., 89-2 BCA ¶ 21,635; Lisbon Contractors, Inc. v. United States, 828 F.2d 759 (Fed. Cir. 1987).

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that its untimely performance was attributable to excusable delay. It appears, however, that the same burden of proof does not apply to a prime contractor that terminates subcontractors. State courts will typically place the burden of proof on the party alleging a breach, which would typically be the defaulted subcontractor seeking recompense for its termination.[78] If a prime contractor counterclaims, only then would it bear the burden of proving that the subcontractor was at fault.[79] However, the general concept of a termination of default as a forfeiture is an important foundation in examining the rights of the subcontractor and the prime contractor with respect to termination for default.

(2) Bases for Default Under Federal Contracts

Most of the law on terminations for default is concerned with the federal government's termination of prime contractors. Because the default termination clause is usually flowed down to subcontractors, that authority is instructive and cited here. Where there are state law decisions that directly involve the termination of subcontractors by prime contractors, references to those decisions will be made as well.

- *Failure to Meet Schedule Deadline*. For federal contracts, if the government can show that the contractor failed to deliver or to perform services in the time specified, then it may terminate without issuing a 10-day cure notice or giving a contractor the opportunity to cure under the default clause.[80] Other contracts often contain similar provisions.[81]
- *Failure to Meet Specifications*. For federal contracts, absent unusual facts and circumstances, the government is entitled to insist on strict compliance with all contract provisions.[82] Failure to conform to required specifications is a basis for default, despite timely performance, on the grounds that it constitutes *nondelivery* under FAR 52.249-8(a)(1)(i).[83] Such provisions are rare in nonfederal contracts, especially for commercial projects.
- *Failure to Make Progress*. A contractor's failure to make progress is a separate basis for default and may occur when the contractor fails to progress satisfactorily toward the completion of performance, despite the fact that the final performance date has not yet arrived.[84] Cases involving failure to make progress generally fall into two categories:

78. *See, e.g.*, Collins/Snoops Assocs. v. CJF, LLC, 988 A.2d at 57–58.

79. *Id.*

80. FAR 52.249-8(a)(1)(i).

81. *See, e.g.*, Excell Constr., Inc. v. Michigan State Univ. Bd. of Trs., No. 228310, 2003 Mich. App. LEXIS 59.

82. Dimarco Corp., ASBCA No. 29870, 87-1 BCA ¶ 19,456; R.B. Wright Constr. Co. v. United States, 919 F.2d 1569 (Fed. Cir. 1990), *aff'g*, R.B. Wright Constr. Co., ASBCA Nos. 31967, et al., 90-1 BCA ¶ 22,364.

83. Kain Cattle Co., ASBCA No. 17124, 73-1 BCA ¶ 9999.

84. FAR 52.249-8(a)(1)(ii).

(1) the contractor is so far behind schedule that timely completion is unlikely or (2) a failure to make progress because of defective work.[85] When addressing an allegation of failure to make progress, the question has traditionally been whether or not the contractor's performance has progressed in such a way to permit the contractor to meet the end-item delivery date. Typically, a cure notice is required before termination is allowed.

- *Failure to Meet Other Contract Requirements*. Under federal law, in addition to providing for default for failure to make progress or failure to meet specifications, the default clause provides the government with the right to terminate the contract in whole or in part for the failure to perform any other provision of the contract that is not cured after due notice.[86] As with a termination for failure to make progress, a cure notice is required for a default termination based on failure to perform other provisions of the contract.[87] Such a provision is less common in nonfederal contracts.
- *Anticipatory Breach*. A termination for anticipatory breach or repudiation of the contract has traditionally been found to exist in two situations: (1) where it is evident from the circumstances that the contractor is unable to perform although willing to do so or (2) where a contractor makes a positive, definite, unconditional, and unequivocal statement, before contract performance is due, that it will not perform in accordance with the contract's terms.[88] An additional situation has been found for construction contracts in *Danzig v. AEC Corp.*,[89] which held that, if the government asks a contractor for reasonable assurances of contractor performance and the contractor fails to provide those assurances, the contractor has anticipatorily repudiated even without an unequivocal refusal to continue.
- *Abandonment*. Abandonment occurs when the contractor simply performs no further work on the contract, but does not state its reasons for doing so.[90] In cases of true abandonment, a default termination may be valid, even without a cure notice.[91] Whether there has been an abandonment of performance depends upon the totality of the contractor's conduct.

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85. Hannon Elec. Co. v. United States, 31 Fed. Cl. 135, 143 (1994).

86. FAR 52.249-8(a)(1)(iii).

87. Paine, ASBCA No. 41273, 95-2 BCA ¶ 27,896.

88. United States v. Dekonty Corp., 922 F.2d 826 (Fed. Cir. 1991); Mometal Structures, Inc. v. T.A. Ahern Contrs. Corp., No. 09-cv-2791, 2013 U.S. Dist. LEXIS 27797 (E.D.N.Y. Feb. 28, 2013) (applying New York law).

89. 224 F.3d 1333 (Fed. Cir. 2000).

90. *See, e.g.*, Brown Elec., ASBCA Nos. 11441, 11456, 68-1 BCA ¶ 6841; BloomSouth Flooring Corp. v. Boys' & Girls' Club of Taunton, 800 N.E.2d 1038 (Mass. 2003).

91. Johnson & Gordon Secur., Inc. v. GSA, 857 F.2d 1435, 1438 (Fed. Cir. 1988); NBJ Restoration, Inc. v. GSA, GSBCA No. 14487, 98-2 BCA ¶ 29,987.

b. Subcontractor Defenses

(1) Excusable Delay

When there is a default termination, the subcontractor may be able to assert the defense of "excusable delay." The FAR default clause[92] sets forth the general principle of excusable delay and provides several examples of recognized causes of excusable delay:

> (c) Except for defaults of subcontractors at any tier, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Contractor. Examples of such causes include (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance the failure to perform must be beyond the control and without the fault or negligence of the Contractor.

Another part of that clause makes clear that delay is excusable only if it is beyond the fault or control of both the contractor and its subcontractors, at any tier.[93] Thus, if a delay was caused by a second-tier subcontractor, the prime contractor would have to establish that the second-tier subcontractor's delay was itself excusable under the terms of the Default Clause before the prime would be entitled to claim excusable delay.[94] Moreover, the mere fact that performance will result in a loss due to increased costs of using an alternate subcontractor does not excuse performance; the responsibility remains with the prime.[95]

(2) Waiver of Schedule Deadline

Another defense to a default termination is that the owner elected to waive the delivery date, permitting a contractor to continue with performance despite the fact that the contractor would not be able to deliver on time. If subsequently terminated for default, the contractor may then raise such a waiver as a defense if it can demonstrate that it *relied* on the owner's election and

92. FAR 52.249-8(c).

93. FAR 52.249-8(d).

94. Atlas Mfg. Co., ASBCA No. 15177, 71-2 BCA ¶ 9026.

95. Baldt, Inc., ASBCA No. 37810, 90-1 BCA ¶ 22,596; Eppco Metals Corp., ASBCA No. 38305, 90-1 BCA ¶ 22,349; Pioneer Valve & Fitting Co., ASBCA No. 33355, 89-3 BCA ¶ 22,203; C&M Mach. Prods., Inc., ASBCA No. 43348, 93-2 BCA ¶ 25,748; New Era Contract Sales, Inc., ASBCA Nos. 56661, et al., 2011-1 BCA ¶ 34,738.

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actually continued to perform.[96] Once waived, the right of the owner to terminate for default can be revived only by establishing a new delivery schedule.[97]

(3) Impossibility

When the contract specifications are impossible to perform, the contractor has a right to stop work, in order not to do a useless thing.[98] A simple statement alluding to financial concerns or difficulty in performing will not suffice to show impossibility.[99] If the facts do not support an excusable impossibility, the work stoppage constitutes anticipatory breach.[100]

Once the contractor has pointed out a specification deficiency, the owner has the obligation to give the contractor proper direction and correct any deficiencies rather than terminate the contract.[101] When a contractor discovers a defective specification, however, it has the obligation to promptly give notice of the perceived defect in order to justify any suspension of work based on the defective specification.[102]

c. Substantial Completion

Contractors may also avoid default when they have substantially completed the required work.[103] To determine whether substantial completion has been reached, both (1) the quantity of work left to be done and (2) the extent to which the "unfinished" project is capable of serving its intended use will be examined. However, the substantial completion rule does not apply when the termination for default affects only uncompleted work.[104] In that case, the contractor will still receive at least the fair value of the work performed before the

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96. *See* W. Pettit, *Waiver of Delivery Date*, in Briefing Papers, Vol. No. 71-6 (Dec. 1971); B. Fagg, *Default Terminations for Failure to Make Progress*, 25 Pub. Cont. L.J. 113 (1995); G. Carberry & P. Johnstone, *Waiver of the Government's Right to Terminate for Default in Government Defense Contracts*, 17 Pub. Cont. L.J. 470 (1988).

97. Nucletronix, Inc., B-213559, 84-2 CPD ¶ 82; Technocratica, ASBCA Nos. 47992, et al., 2006-2 BCA ¶ 33,316; Envtl. Safety Consultants, ASBCA No. 51722, 2011-2 BCA ¶ 34,848.

98. Dynalectron Corp. v. United States, 518 F.2d 594 (Ct. Cl. 1975); R.M. Hollingshead Corp. v. United States, 111 F. Supp. 285 (Ct. Cl. 1953); American Power, Inc., GSBCA No. 8752, 90-2 BCA ¶ 22,811; Defense Sys. Corp., ASBCA Nos. 42939, et al., 95-2 BCA ¶ 27,721.

99. *See, e.g.*, Miller, PSBCA Nos. 5264, et al., 2009-2 BCA ¶ 34,282 (board refused to accept as an excuse for nonperformance the statement that "for personal financial reasons I decided to submit a bid . . . that would have made it possible to successfully operate the route").

100. Kennard, ASBCA No. 3630, 57-2 BCA ¶ 1428.

101. Robert Whalen Co., ASBCA No. 19720, 78-1 BCA ¶ 13,087.

102. Enviromental Devices, Inc., ASBCA Nos. 37430, et al., 93-3 BCA ¶ 26,138.

103. Good, ASBCA No. 10514, 66-1 BCA ¶ 5362; Cosmos Eng'rs, Inc., ASBCA No. 19780; 77-2 BCA ¶ 12,713; *see also* Norberto & Sons, Inc. v. County of Nassau, 16 A.D.3d 642, 643 (N.Y. App. Div. 2005) (finding a subcontractor had substantially performed when 95 percent of the work was completed).

104. Al Khudhairy Grp., ASBCA Nos. 56131, 56374, 2010-2 BCA ¶ 34,530 (substantial completion defense was unsuccessful though 95 percent of a road as measured by cost had been completed because termination for default applied to the remainder only).

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termination for default occurred, but the default termination for the remaining work will stand.[105]

In order to rely on a substantial completion defense, a contractor must first show that the work performed is near total completion. Although no fixed percentages can be relied on with confidence, substantial completion will not be found if large portions of work remain unfinished.[106] Even if a high percentage of the work has been accomplished, substantial completion will not be found if a project cannot be put to its intended use.[107]

Once found, substantial completion does not operate to discharge all subsequent obligations of the parties. If the contractor is ordered to complete or correct work that is practical to perform, and if it fails to do so, the government may terminate for default, assess costs of completion, or reduce the contract price through equitable adjustment.[108]

d. Effect of Successful Challenge

(1) When Will a Wrongful Default Termination Be Converted to a Convenience Termination?

In certain instances, the owner may convert a default termination into one for convenience.[109] This remedy may also be imposed by a court when it decides a contract has been improperly defaulted.[110] This issue, and the relief that results from a converted termination, is discussed in the termination for convenience section below.[111]

(2) When Will a Wrongful Default Termination Be a Breach? In Those Cases, What Damages Are Recoverable?

On occasion, the prime contractor may also be entitled to breach damages where the contract did not include a provision providing for conversion to a termination for convenience in the event of an improper default termination.[112] In

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105. *Id.*; PCL Constr. Servs., Inc. v. United States, 47 Fed. Cl. 745, 810–11 (Fed. Cl. 2000).

106. Sun Constr. Corp., IBCA No. 208, 61-1 BCA ¶ 2926; Electrical Enters, Inc., IBCA No. 972-9-72, 74-1 BCA ¶ 10,400; Firma Tiefbau Meier, ASBCA No. 46951, 95-1 BCA ¶ 27,593 (where costs of remedying roof defect were 15 percent of total contractual amount, deficiency was major).

107. Capitol City Constr. Co., DOT CAB No. 74-29, 75-l BCA ¶ 11,012.

108. Southland Constr. Co., Nos. VACBA-2217, 2543, 89-1 BCA ¶ 21,548 (failure to complete punch list items within reasonable time justified default termination); Chilstead Bldg. Co., ASBCA No. 49548, 2000-2 BCA ¶ 31,097 (termination for default upheld where contractor refused to replace roof trusses not in compliance with specifications).

109. FAR 52.249-10(c); *see also* Envtl. Safety Consultants, Inc., ASBCA No. 51722, 2011-2 BCA ¶ 34,848; Kostmayer Constr., LLC, ASBCA No. 55053, 2008-2 BCA ¶ 33,869.

110. *See, e.g.*, Contract Maint., Inc., ASBCA No. 19409, 19509, 75-1 BCA ¶ 11,207.

111. See section III.C.2.

112. Praoil, S.r.L., ASBCA Nos. 41499, 44369, 94-2 BCA ¶ 26,840; Metzger Towing, Inc., ENG BCA 5862, 94-2 BCA ¶ 26,651 (termination constituted material breach and contract did not indicate consequences of improper default termination).

the absence of such a clause, the terminating party will be liable for all damages resulting from the improper termination, including anticipatory profits. The same result would occur where a subcontract does not contain a conversion clause or a termination for convenience clause.

4. Consequences of Default Termination

If a default termination stands, then the prime contractor is typically allowed to terminate the subcontract and complete the work by whatever means it deems necessary.[113] If the expense and damages incurred by the prime exceed the unpaid balance of the subcontract sum, then the subcontractor will usually be required to pay the difference to the contractor.[114] Such costs and expenses may include reasonable overhead, profit, and attorneys' fees.[115] Other potential claims, such as damages for delay and/or incidental and consequential damages, may also be sought.

C. Terminations for Convenience

1. Limitations on Ability to Terminate for Convenience

Even under the broadest of convenience termination clauses, there are limitations on the prime contractor's ability to terminate without cause. Most jurisdictions prohibit convenience terminations made in bad faith.[116] This limitation is very narrow and difficult to prove, such that subcontractor challenges of convenience terminations are usually unsuccessful. For example, in *Vila & Son Landscaping Corp. v. Posen Constr., Inc.*, the court held that a contractor may terminate a subcontract for convenience in order to enter into another subcontract with a different subcontractor at a lower price, finding that such a termination does not constitute bad faith. The court rejected the subcontractor's argument that interpreting the prime's termination rights so broadly would render the subcontract illusory, holding that the prime provided valid consideration because it was bound by the termination for convenience provision's written notice requirement.[117]

On federal projects, the only limitation on the government's right to terminate for convenience in either the termination clause or the procurement regulation is that the contracting officer must determine it is in the government's

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113. AIA A401-2007, § 7.2.1; CD 750, § 10.1.1.

114. AIA A401-2007, § 7.2.1; CD 750, § 10.1.1.1.

115. CD 750, § 10.1.1.1.

116. *See, e.g.*, Questar Builders, Inc. v. CB Flooring, LLC, 978 A.2d 651 (Md. 2009); Capital Safety, Inc. v. State Div. of Bldgs. & Constr., 848 A.2d 863 (N.J. App. 2004); RAM Eng'g & Constr., Inc. v. Univ. of Louisville, 127 S.W.3d 579 (Ky. 2003); Harris Corp. v. Giesting & Assocs., Inc., 297 F.3d 1270, 1272–73 (11th Cir. 2002) (applying Florida law); A.J. Temple Marble & Tile, Inc. v. Long Island R.R., 659 N.Y.S.2d 412 (1997); EDO Corp. v. Beech Aircraft Corp., 911 F.2d 1447 (10th Cir. 1990) (applying Kansas law).

117. 99 So. 3d 563 (Fla. Dist. Ct. App. 2012).

interest to do so.[118] As a result, courts have generally given a broad interpretation to the powers of the government to terminate,[119] which allow the government to terminate for its convenience so long as it does not act in bad faith or abuse its discretion.[120] Some decisions apply the same narrow limitations to prime contractors on federal projects who terminate subcontracts with similarly broad convenience termination clauses.[121] In *T.I. Construction Co. v. Kiewit Eastern Co.*,[122] for example, the court held that the restrictions on the federal government's ability to terminate the prime contractor applied equally to the prime's ability to terminate its subcontractor. In that case, the court found that the business relationship between the parties had so deteriorated that it constituted a change in the circumstances and expectations of parties sufficient to justify the convenience termination and overcome the allegations of bad faith.

There is a recent movement in federal cases, however, for the courts to find suspect convenience terminations improper. For example, in *Sigal Constr. Corp. v. GSA*, a board found the government abused its discretion by terminating for convenience to get a better price.[123] In *TigerSwan, Inc. v. United States*, the court found that a contractor stated a claim for improper termination where it alleged that the Department of Defense entered into the contract with no intention of honoring it (because it preferred another contractor).[124] And in *Gulf Group Gen. Enters. Co., W.L.L. v. United States*, the court found a convenience termination improper where the government offered no reasonable basis for it.[125]

On nonfederal projects, some challenges of convenience terminations have also succeeded, even where a bad-faith standard is applied. For example, in *Questar Builders, Inc. v. CB Flooring, LLC*, a general contractor terminated its carpeting installer for convenience before it started work at the project based on changes to the interior design plans and the subcontractor's proposed change order increasing the contract price by an amount the prime considered excessive. The prime terminated and obtained the work from a substitute subcontractor at a lower price. The terminated subcontractor sued for wrongful termination, prevailed at trial, and was awarded its expectation damages. On appeal, the appellate court held that an implied obligation of good faith and fair dealing limits a terminating party's discretion to terminate for

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118. FAR 52.249-2(a).

119. *See, e.g.*, Krygoski Constr. Co. v. United States, 94 F.3d 1537 (Fed. Cir. 1996), *cert. denied*, 117 S. Ct. 1691 (1997); John Reiner & Co. v. United States, 325 F.2d 438 (Ct. Cl. 1963).

120. *Krygoski Constr.*, 94 F.3d 1537.

121. *See, e.g.*, T.I. Constr. Co. v. Kiewit E. Co., Civ. A No. 91-2638, 1992 U.S. Dist. LEXIS 19213 (E.D. Pa. Dec. 9, 1992).

122. *Id.*

123. CBCA No. 508, 2010-1 BCA ¶ 34,442.

124. 110 Fed. Cl. 336, 345 (2013).

125. Nos. 06-835C, 06-853C, 06-858C, 07-82C, 2013 U.S. Claims LEXIS 899 (July 2, 2013).

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convenience and affirmed the trial court's finding that the prime breached this obligation.[126]

Other courts have been more restrictive regarding the ability to terminate for convenience, requiring a change in circumstances to justify termination.[127] For example, in *RAM Eng'g and Constr., Inc. v. Univ. of Louisville*, a protester challenged award of the contract for site preparation for construction of a football stadium. The university and the protester entered into a stipulated dismissal of the protest that called for the project to be re-bid, and the contract was terminated for convenience. On re-bid, the awardee again won and sued for the difference between its original price and its revised lower price in the re-solicitation. The Kentucky Supreme Court held that, since a contract issued under the Kentucky Model Procurement Code was subject to the obligation of both parties to perform the contract in good faith, a convenience termination could be justified only by a change in circumstances and that the stipulated dismissal did not qualify as such a change.[128]

2. Terminations for Convenience by Operation of Law

In addition to terminations for convenience following formal written notice, a convenience termination may arise by operation of law in which a court converts an erroneous default termination. Subcontracts sometimes expressly provide that, if the prime contractor improperly terminates the subcontractor for default, that termination will be converted to one for convenience.[129] For example, the ConsensusDocs standard-form fixed-price subcontracts provide that if the prime "wrongfully" terminates for default, its liability to the subcontractor is the same as it would be had the prime terminated for convenience.[130] Such provisions will generally be enforced.[131]

Some courts have implied a termination conversion provision in subcontracts based on an express provision to that effect in the prime contract and on the prime's ability to terminate for convenience. For example, in *Lockheed Elec. Co. v. Keronix, Inc.*, which involved a subcontract on a federal project, the prime contract contained the default clause required under federal regulations, which provided that an erroneous termination for default would be converted to one of convenience.[132] The court held that the incorporation by reference of the termination clause into the subcontract had the effect of converting an

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126. Questar Builders, Inc. v. CB Flooring, LLC, 978 A.2d 651 (Md. 2009).

127. 127 S.W.3d 579 (Ky. 2003); Linan-Faye Constr. Co. v. Hous. Auth., 49 F.3d 915 (3d Cir. 1995); *see also* Smart, Inc. v. V.I. Hous. Auth., 320 F. Supp. 2d 332 (D.V.I. 2004) (constructive termination for convenience limited to changed circumstances).

128. *RAM Eng'g & Constr.*, 127 S.W.3d 579.

129. *See, e.g.*, CD 750, § 10.7; CD 752, § 10.7; R&J Constr. Corp. v. E.W. Howell Co., 239 N.Y.L.J. 123 (Sup. Ct. 2008).

130. CD 750, § 10.7; *compare id.* § 10.4; CD 752, § 10.7; *compare id.* § 10.4.

131. *See, e.g., R&J Constr. Corp.*, 239 N.Y.L.J. 123.

132. 114 Cal. App. 3d 304 (1981); FAR 52.249-8(g).

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improper termination for default into a termination for convenience, precluding the subcontractor from recovering anticipatory profits.[133] In *Rogerson Aircraft Corp. v. Fairchild Industries, Inc.,* however, the court held that, where the default clause contained in a subcontract did not provide for the automatic conversion of an improper default to a termination for convenience, the clause covers only a situation in which the subcontract was terminated for reasons other than a default, and, as a result, a subcontractor was entitled to breach of contract damages for an improper termination for default.[134]

3. Complete Versus Partial Terminations

Many convenience termination clauses provide for both complete and partial terminations. For example, the federal clause prescribed for prime contracts and often flowed down to subcontracts states that the government may terminate the contract "in whole or, from time to time, in part."[135] This language provides the prime contractor with the flexibility to terminate only those aspects of the subcontract that are not needed in those instances when some portion of the contract work is still required. Partial terminations present special problems with respect to the effect of the termination on the non-terminated portion of the work to reflect the more limited effort.

A prime contractor should clearly state in its termination notice what portion of the work is terminated and what portion, if any, is to be continued. The subcontractor will be obligated to continue performance of the non-terminated portion of its work. The subcontract may provide a basis for a price increase for this remaining work, based on the subcontractor's increased costs allocable to that portion of the work. For example, a subcontractor may have to allocate more of its fixed costs, such as trailer and equipment leases and home and field-office overhead, to its now reduced scope of work.

4. Termination Procedures

The subcontract may provide specific procedures for how and when the prime contractor may terminate for convenience. Most subcontract provisions for convenience terminations require the prime contractor to give some kind of notice to the subcontractor. Both the AIA and ConsensusDocs form subcontracts require that such notice be made in writing, the former "promptly" and the latter "within three business days"; neither provides any detail regarding what the notice must include.[136] On federal projects, the subcontract often will flow

133. *Id*.

134. 632 F. Supp. 1494 (C.D. Cal. 1986); *see also* Westinghouse Elec. Corp. v. Garrett Corp., 437 F. Supp. 1301 (D. Md. 1977); Coleman Eng'g Co. v. N. Am. Aviation, Inc., 65 Cal. 2d 396 (1966).

135. FAR 52.249-2(a).

136. AIA A401-2007, § 7.2.2; CD 750, § 10.4; CD 752, § 10.4.

down the same detailed notice requirements as the prime contract.[137] Where it does so, it will require the notice to state whether any portion of the contract is to be continued, provide the effective date of the termination, and instruct the subcontractor to (1) stop all work, (2) terminate subcontractors, and (3) place no further orders except those necessary to perform any un-terminated portion of the contract.[138]

5. Subcontractor Recovery from the Prime Contractor

Once the prime has effectively noticed the termination for convenience of the subcontract, the parties must determine the recovery to which the subcontractor is entitled, if any. If the subcontractor has not incurred costs pertaining to the terminated portion of the contract or agrees to waive its costs, and if no costs are due the prime contractor under the subcontract, then the parties may execute a no-cost settlement agreement.[139] This type of agreement may provide a basis for settlement of a dispute involving a termination for default.[140]

More commonly, a termination for convenience will entitle the subcontractor to a monetary recovery. The typical procedure for achieving this recovery is that the subcontractor will prepare and submit a termination settlement proposal to the prime contractor, and the parties will then attempt to negotiate a settlement. If successful, the parties will enter into a settlement agreement and close out the subcontract. If not, the prime contractor will pay the subcontractor what the prime determines to be due under the subcontract convenience termination provision, if anything, and the subcontractor will either accept that determination and payment or sue for breach of the subcontract.

Most subcontract clauses for termination for convenience provide that, in the event of such a termination, the subcontractor is entitled to the following: (1) costs incurred for work performed at termination, plus a reasonable profit (or loss), and (2) settlement expenses.[141] Some subcontracts also allow recovery of anticipated profits on the unexecuted—that is, terminated—work.[142] Since this recovery is not allowed under prime contracts on federal projects,[143] subcontracts for those projects will typically preclude such recovery as well or, at least, limit it to instances in which the government terminated the prime contract for default due to no fault of the subcontractor.[144]

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137. FAR 49.102.

138. *Id.*

139. *See, e.g.*, FAR 49.109-4; *see also* DCAA Contract Audit Manual, DCAAM 7640.1 ¶ 12-101(g) (Jan. 2003).

140. *See, e.g.*, All-Steel Fabricators Co., ASBCA No. 7541, 1963 BCA ¶ 3712.

141. AIA A401-2007, § 7.2.4; CD 750, § 10.4; CD 752, § 10.4; FAR 52.249-2, Alternative I ¶ (g).

142. AIA A401-2007, § 7.2.4; CD 750, § 10.4; CD 752, § 10.4.

143. FAR 49.207, 49.202; Okaw Indus., Inc., ASBCA Nos. 17863, 17864, 75-2 BCA ¶ 11,571.

144. CD 752, § 10.4.

The most complicated element of a subcontractor's recovery, and often the most significant, is its costs incurred for work performed at termination, plus a reasonable profit (or loss) on that work. On federal projects, regulations prescribe for termination settlement proposals for construction contracts that the contractor calculate its cost recovery using the "total cost" method.[145] Proposals submitted under this basis should include all costs incurred by the subcontractor up to the effective termination date, plus the costs of lower-tier subcontractor settlements and settlement expenses. The costs may, under certain circumstances, include performance costs incurred prior to the effective date of the subcontract[146] and should be augmented by profit or adjusted for loss.[147] All credits to the prime contractor, such as pre-termination progress payments and disposal credits, must be deducted. The prime also may be able to deduct costs it has incurred due to breaches by the subcontractor.[148]

The subcontractor also may incur post-termination costs to which the subcontractor necessarily committed itself but that, due to the termination, it is prevented from absorbing through payments under the subcontract. Examples include (1) costs continuing after termination, (2) loss of useful value of special equipment, and (3) rental cost under unexpired leases. Each of these costs arises out of commitments necessary to perform the subcontract. These costs generally will be recoverable under most convenience termination clauses and are specifically recoverable under federal regulations.[149]

An express or implied term of the subcontract convenience termination provision is that the subcontractor has a duty to mitigate these costs.[150] This requires the subcontractor to act quickly and diligently to, among other things, stop work, cancel orders, and terminate its own lower-tier subcontracts and equipment leases. It also requires the subcontractor to dispose of its "termination inventory," such as unused materials and equipment and work in progress, so as to minimize the costs it passes on to the prime contractor as part of its termination claim. If the subcontractor fails to meet any of these obligations, the prime will be entitled to reduce its settlement payment by deducting the claimed costs that it can prove the subcontractor would not have incurred had it done so.

Some subcontract clauses will cap or otherwise limit the subcontractor's recovery for a convenience termination. For example, on federal projects, regulatory requirements, when flowed down, provide that termination settlements—exclusive of settlement expenses—may not exceed the contract price.[151] Other subcontracts—for example, the AIA form fixed-price

145. FAR 49.602-2(b)(4).
146. FAR 31.205-32.
147. FAR 49.202, 49.203.
148. *See, e.g., Westinghouse Elec. Corp.*, 437 F. Supp. 1301.
149. FAR 31.205-42; *see also* AIA A401-2007, § 7.2.4; CD 750, § 10.4; CD 752, § 10.4.
150. *See, e.g.*, AIA A401-2007, § 7.2.3; CD 750, § 10.4; CD 752, § 10.4.
151. FAR 49.207; *Okaw Indus., Inc.*, 75-2 BCA ¶ 11,571.

subcontract—do not cap the subcontractor's recovery.[152] Many subcontracts, including the ConsensusDocs form subcontracts and subcontractors adopting FAR requirements, do not allow the subcontractor's termination recovery to include consequential damages.[153]

Some courts have refused to apply to subcontracts the recovery limitations in the prime contract based on general flow-down provisions; rather, they will do so only if the subcontract specifically incorporates those limitations. For example, *Encon Utah, LLC v. Fluor Ames Kraemer, LLC* involved a subcontract that incorporated prime contract terms "as applicable to the Scope of Work" of the subcontractor. The prime terminated the subcontractor for convenience and sought to limit the subcontractor's recovery to "the value of work performed" as provided in the prime contract terms. The court rejected the prime's argument, finding that the prime contract termination clause was not applicable to the subcontractor's scope of work, and holding that the subcontractor's recovery would be determined by the convenience termination clause in the subcontract. That clause did not limit recovery to the value of work performed; rather, it allowed the subcontractor to recover "the actual costs of all such Work satisfactorily executed to the date of termination, plus an allowance for reasonable overhead and profit on such costs incurred prior to termination (but not to exceed a pro rata portion of such Contract Price for such Work based on the percentage of Work properly completed to the date of termination), together with termination costs." The court interpreted this to apply the pro rata limitation only to overhead and profit and not to direct costs incurred.[154]

In another case involving a subcontractor's termination claim, *AMC Demolition Specialists, Inc. v. Bechtel Jacobs Co.*, the subcontractor AMC sued the prime Bechtel Jacobs Co. (BJC), alleging that language in the subcontract's convenience termination clause limiting recovery to the subcontract price meant that AMC could recover its total costs reasonably incurred, up to the total contract price, rather than be restricted to the subcontract prices of the individual line items for the portions of the work that AMC actually performed before the convenience termination. Based on the subcontract's choice of law provision, the court applied federal law and agreed with AMC's interpretation of the convenience termination clause.[155]

The subcontractor's Miller Act payment bond claim was not as successful in *United States ex rel. EPC Corp. v. Travelers Cas. & Sur. Co. of America*.[156] There, the court denied the subcontractor EPC's motion for partial summary judgment on its claim under the convenience termination clause in its contract with the prime contractor Beneco Enterprises on a federal project. The subcontract convenience

152. AIA A401-2007, § 7.2.4.
153. *See, e.g.*, CD 750, § 5.4.1; CD 752, § 5.4; FAR 49.202(a).
154. 210 P.3d 263 (Utah 2009).
155. No. 3:04-cv-466, 2006 U.S. Dist. LEXIS 32273 (E.D. Tenn. Sept. 26, 2006).
156. 423 F. Supp. 2d 1016 (D. Ariz. 2006).

termination clause provided that the terminated contractor would be entitled to recover for work performed "in an amount proportionate to the sum payable under [the] Agreement," subject to any backcharges for deficient work. After Beneco creditors had filed an involuntary Chapter 11 petition against it five months into the job, Beneco terminated EPC pursuant to the convenience termination clause. Applying Utah law to the subcontract, the court found that the subcontract's convenience termination clause did not permit EPC to recover its actual costs, plus reasonable profit (as would have been allowed under the standard FAR clause in the prime contract), but would be limited to payment of the subcontract price prorated based on the percentage of work performed.[157]

Finally, most subcontract termination for convenience provisions entitle the terminated subcontractor to recover its reasonable settlement expenses.[158] These may include the following: (1) accounting, legal, clerical, and similar costs reasonably necessary for preparation and presentation of settlement claims and the termination and settlement of subcontracts; (2) reasonable costs for the storage, transportation, protection, and disposition of termination inventory; and (3) indirect costs related to salary and wages incurred as settlement expenses.[159]

IV. Subcontractor's Right to Terminate the Subcontract

On rare occasions, subcontractors may also terminate the subcontract pursuant to the terms that they are able to negotiate. Typically, this would occur when a subcontractor is unconditionally owed payment, but has not been paid for a substantial period of time. For example, both the AIA and ConsensusDocs forms allow a subcontractor to terminate for nonpayment.[160]

Practically speaking, though, termination by a subcontractor is rarely, if ever, advised due to the extremely high risk involved if it is later found that the termination was not justified. This is a significant risk, as ceasing work for nonpayment may conflict with the subcontractor's obligation to continue contract performance through a dispute.[161] Upon affirmatively ceasing performance, the subcontractor risks being found to have either anticipatorily repudiated the subcontract or of abandoning it—setting up clear grounds for its own default.[162]

At least one state has set forth clear conditions under which unpaid subcontractors may suspend work, albeit under limited circumstances. Under Texas's Private Works Prompt Payment Act, if an owner fails to pay

157. 423 F. Supp. 2d 1016 (D. Ariz. 2006).

158. AIA A401-2007, § 7.2.4; CD 750, § 10.4; CD 752, § 10.4; FAR 31.205-42(g).

159. *See, e.g.*, FAR 31.205-42(g); Manis Drilling, IBCA No. 2658, 93-3 BCA ¶ 25,931.

160. AIA A401-2007, § 7.1; *see also* United States *ex rel.* E.C. Ernst, Inc. v. Curtis T. Bedwell & Sons, Inc., 506 F. Supp. 1324, 1327 (E.D. Pa. 1981); CD 750, § 10.8.

161. AIA A401-2007, § 1.2 (incorporating AIA A201-2007, § 5.1.3).

162. See discussion at section III.B.3.a.(2) on anticipatory repudiation and abandonment.

undisputed amounts to a prime contractor within 35 days and the prime contractor then fails to pay its subcontractors, then a subcontractor may notify the owner in writing that it has not received payment and intends to suspend performance.[163] If the subcontractor receives no response stating either that (a) payment has been made or (b) a good-faith dispute for payment exists, then it may suspend contractually required performance after 10 days have passed.[164] A similar statute exists for Texas's public projects.[165]

If the subcontractor opts not to terminate the subcontract, it may occasionally be able to rely on other contractual provisions for alternative remedies. For example, AIA A401-2007 allows the subcontractor to stop all work on its subcontract upon seven days' written notice after seven additional days of nonpayment through no fault of the subcontractor and provides that the payment be modified to reflect the subcontractor's reasonable costs of demobilization, delay, and remobilization.[166]

V. Conclusion

While the rules of the game vary by jurisdiction and by contract, there are two consistent themes in the termination of construction subcontracts. First, termination for default, as a forfeiture, is an extreme remedy, requiring substantial justification by the terminating party. Contractors considering default terminating their subcontractors beware—the contractor will have the burden of proving the termination was proper and failure to do so will subject it to breach damages. A subcontractor facing such a termination should nevertheless take it seriously and take all reasonable steps to cure its default, if any, and, if terminated, should evaluate the propriety of the termination and consider potential challenges to it. Second, termination for convenience, if the contractor is able to negotiate it into its subcontract, is an extremely broad remedy. Contractors considering a convenience termination should be sure there are no indicia of bad faith but may otherwise proceed with relative security. A subcontractor should consider challenging such a termination only in the most egregious of cases and should instead focus on maximizing its recovery.

163. Tex. Prop. Code § 28.009(a).
164. Tex. Prop. Code § 28.009(a), (c).
165. Tex. Gov't Code § 2251.001, *et seq.*
166. AIA A401-2007, § 4.7.