

# Termination for Convenience—Pre-Nup in the Construction Context

By Brian G. Lustbader

Construction contracts between project owners and contractors are a lot like marriages. Both parties enter hoping for a successful long-term relationship, but as issues arise, some end up dissolving. When they do, it is important that the parties have mechanisms in place to disengage in a straightforward manner so they can move on with their lives.

## The Basic Termination Mechanisms

When a relationship with a contractor or construction manager has turned sour, a construction project owner has two termination options:

1. For cause, which is based on a contract breach or default, and often leads to litigation or arbitration; or
2. Without cause—“termination for convenience”—where there is no such claim of breach/default.

## Reasons for Terminating for Convenience Rather Than for Cause

Similar to a pre-nuptial agreement, “termination for convenience” is when no court action (or arbitration) takes place—the parties simply agree to dissolve their relationship based on previously agreed-upon financial terms and then part ways. Owners typically go this route when the project has become unworkable, i.e., project abandonment, which can occur for a number of reasons, such as a loss of financing or failure to obtain necessary public authority approvals.

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Despite having valid reasons to terminate for cause, an owner may want to terminate for convenience to avoid the time and effort—and expense—of a protracted dispute and possible litigation or arbitration. It is a more cost-effective way to deal with such a situation—a clean break, akin to a no-fault divorce. The way to make this

possible is to include the termination for convenience option in the construction agreement at the start of the project.

## Crafting the Termination for Convenience

A key component of this option is determining how much to pay the terminated-for-convenience contractor or construction manager. Under the standard AIA contract provision, the owner terminating for convenience is required to pay the contractor or construction manager for the work performed to the date of termination, plus reasonable overhead and profit on the work not performed.<sup>1</sup> This means the owner agrees to pay what the contractor lost as a result of not being able to finish the project. In establishing “reasonable overhead and profit on work not performed,” contractors usually request that owners pay the contractors’ entire overhead and profit for the project as if it had been fully completed. They may also add on home office overhead, lost opportunity costs, and related items. Construction managers typically request the analogous as-yet-unearned fee for the project.

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To avoid such a large payout, or the time and effort of negotiating which items to pay, it is best to have the agreement spell out precisely what damages will and will not be paid. For example, it may be useful to eliminate any reference to paying profit or fee, or even overhead to the contractor or construction manager. What would be appropriate to pay is the contractor’s or construction manager’s actual cost of the work performed up to the termination date, plus retainage attributable to that work. Demobilization costs should also be paid. Whether anything else should be included, such as a portion of lost profits or unearned fee, is subject to negotiation between the parties. It is critically important to set forth in the agreement which categories of items are not going to be paid, such as extended home office overhead, lost opportunity costs, etc. This is the way to establish clarity as to what is and what is not to be paid.

## Litigating Termination for Convenience Issues

Because the New York courts have addressed many issues arising out of termination for convenience issues scenarios, those decisions should inform the ways the attorneys should craft the termination for convenience provisions in construction contracts.

## No Owner Claims for Default Damages

As noted above, owners will often invoke the termination for convenience mechanism even when grounds for termination for cause exist. There is no turning back, however. If the agreement has been terminated for convenience, the owner may not thereafter try to claim damages arising out of the contractor's pre-termination work, including costs to remediate work improperly performed by the contractor, or to complete the contractor's incomplete work. This is true even if the contractor independently initiates an action against the owner seeking additional damages. Several Appellate Division decisions, have confirmed this rule, notably the Appellate Division decisions in *Paragon Restoration v. Cambridge Square Condominiums* and *Tishman Constr. Corp v. City of New York*.<sup>2</sup>

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*"Less than a year later, with several months left on the contract, IBM terminated the agreement with American Vending, after which the latter sued IBM for fraud in the inducement, breach of contract and unjust enrichment."*

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This rule is in contrast to the rule that permits the owner in a construction agreement to convert a termination for cause to a termination for convenience. In fact, many owners provide in their agreements that such a conversion will be automatic in the event a termination for cause is challenged, the purpose undoubtedly being to avoid a contractor's claim for damages for improper termination for cause.<sup>3</sup>

## Owner's Motives Irrelevant

In the context of a termination for cause, the owner must have a valid basis for terminating the contractor/construction manager. Those bases are set forth in the standard form agreements, e.g., AIA A101/201, A107, or ConsensusDOCS, and many owners' attorneys add additional bases for termination for cause.

Where the termination is for convenience, however, the owner need not have any reason, or even a bad faith reason for terminating. That is, a court will not overturn this type of termination.<sup>4</sup>

## Fraud in Inducement Claim Difficult to Maintain

In order to avoid the last-stated proposition regarding terminating party's motive, another, somewhat related argument terminated parties have attempted to use to avoid losing their ability to claim additional damages on a termination for convenience is the contention that the terminating party has engaged in fraudulent conduct, or that it fraudulently induced the terminated contractor to enter into the agreement in the first place. This argument, typically based on assurances of agreement continuation emanating from the terminating party, usually fails in the absence of an actual showing of outright fraud.

For example, in *American Food & Vending Corp. v. International Business Machines Corp.*,<sup>5</sup> the plaintiff, American Food & Vending Corp.'s predecessor, ARA Services, Inc., had an agreement with IBM to supply food vending services over a two-year period, with an ability on IBM's part to terminate for convenience on 90 days' notice. Thereafter, ARA expended some \$100,000 to comply with an expanded scope of work requested by IBM for food vending services. Shortly thereafter, American Food purchased ARA's assets, including the \$100,000 in machinery. Before going through with the purchase, American Vending sought, and obtained, IBM's assurance that American Food "had nothing to worry about" with respect to perpetuation of ARA's existing vending agreement with IBM.<sup>6</sup> IBM then wrote to American Vending consenting to ARA's assignment of the contract to American Vending, with a 60-day termination for convenience proviso. Less than a year later, with several months left on the contract, IBM terminated the agreement with American Vending, after which the latter sued IBM for fraud in the inducement, breach of contract and unjust enrichment. Despite the alleged fraud on the part of terminating party inducing non-terminating party to remain in contract, fraud and breach of contract causes of action were dismissed where the terminating party showed it had terminated pursuant to termination for convenience provision.

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*"The court permitted the conversion and ruled that surety would be obligated if compensable damages were proved, but then found that no such damages had been shown, and so granted the surety's motion to dismiss."*

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A similar result obtained in *Abacus, v. Datagence, Inc.*,<sup>7</sup> where the appellate court affirmed a non-jury verdict dismissing a fraud in the inducement counterclaim on the ground that "no evidence that plaintiff entered into the contract with the intention not to perform," and "both parties had unfettered right to terminate the contract pursuant to a 'termination of convenience clause.'"<sup>8</sup>

## Surety Considerations

Very often, contractors obtain performance and payment bonds assuring that they will fully perform their work and pay their subcontractors and suppliers. In that way, if the contractor fails to complete its work or pay its subcontractors, the owner will be entitled to terminate the agreement for cause, and seek from the surety that issued the bonds full completion of the project and/or payment of subcontractors who did not receive payment. Termination for convenience, however, would not permit any claim against the surety because, by definition, the owner is not claiming a contract breach, i.e., is not claiming that the termination was “for cause.”

Nevertheless, sureties have been involved in cases where a termination for convenience occurred. In one such case, on a performance bond, the owner originally terminated for convenience, but then converted that termination to one for cause (which is the reverse of the usual direction of such conversions), and called upon the surety to meet the contractor’s obligations on account of the “for cause” termination.<sup>9</sup> The court permitted the conversion and ruled that surety would be obligated if compensable damages were proved, but then found that no such damages had been shown, and so granted the surety’s motion to dismiss. In another case, on a payment bond, the surety was able to dismiss a subcontractor’s action on a payment bond because the two-year statute of limitations in the surety bond had run, even though the surety had agreed to negotiate with the subcontractor beyond that two-year period.<sup>10</sup>

## Conclusion

If properly drafted, the termination for convenience provision in a construction contract can help the “divorcing” parties dissolve a relationship on carefully prescribed financial terms, just as a pre-nuptial agreement does in a marriage, allowing both parties to move forward on terms each one can live with.

## Endnotes

1. The provision referenced in the text is to the American Institute of Architects (AIA) Document A201-2007 “General Conditions of the Contract for Construction,” which general conditions are applicable to most AIA form agreements, The AIA has just issued (effective April 30, 2017) new form agreements, including a new A201-2017. That form changes the termination for convenience provisions in certain respects by, among other

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things, deleting the reference to the Owner paying “reasonable overhead and profit on the Work not executed” and inserting instead the following: “including costs attributable to termination of Subcontracts; and the termination fee, if any, set forth in the Agreement.” While those changes are important to be aware of, they do not alter the necessity of including the provisions outlined in this article.

2. *Paragon Restoration Grp., Inc. v. Cambridge Sq. Condos.*, 42 A.D.3d 905, 839 N.Y.S.2d 658 (4th Dep’t 2007); *Tishman Constr. Corp. v. City of N.Y.*, 228 A.D.2d 292, 293, 643 N.Y.S.2d 589 (1st Dep’t 1996).
3. *Minelli Constr. Co., Inc. v. WDF Inc.*, 134 A.D.3d 508, 20 N.Y.S.3d 530 (1st Dep’t 2015).
4. *Louis Food Serv. Corp. v. Dep’t of Educ. of City of N.Y.*, 76 A.D.3d 956, 908 N.Y.S.2d 235, 260 (2d Dep’t 2010) (termination for convenience may be exercised “without inquiry”); *Watermelons Plus, Inc. v. N.Y.C. Dep’t Of Educ.*, 76 A.D.3d 973, 908 N.Y.S.2d 80 (2d Dep’t 2010) (termination for convenience sustained even though not raised until eve of trial); *A.J. Temple Marble & Tile v. Long Island R.R.*, 256 A.D.2d 526, 682 N.Y.S.2d 422 (2d Dep’t 1998) (“a party has an absolute, unqualified right to terminate a contract on notice pursuant to an unconditional termination clause without court inquiry into whether the termination was activated by an ulterior motive”, quoting *Big Apple Car v. City of N.Y.*, 204 A.D.2d 109, 111, 611 N.Y.S.2d 533 (1st Dep’t 1994)); *L & M Bus Corp. v. N.Y.C. Dep’t of Educ.*, 2008 NY Slip Op. 33633(U) (Sup. Ct. N.Y. County 2008) (the termination for convenience clause is valid, without any provision requiring good faith), *but see affirmance in part; L & M Bus Corp. v. N.Y.C. Dep’t of Educ.*, 71 A.D.3d 127, 892 N.Y.S.2d 60 (1st Dep’t 2009) (“where an agency has the right to terminate an agreement without cause, the decision to terminate may not be made in bad faith and is subject to review under CPLR article 78”); *G & R Elec. Contractors, Inc. v. State*, 130 Misc. 2d 661, 496 N.Y.S.2d 898 (Ct. Cl. 1985) (upholding New York State’s termination for convenience even though the State admitted it had committed errors in its preparation of specifications).
5. *Am. Food & Vending Corp. v. IBM*, 245 A.D.2d 1089, 667 N.Y.S.2d 545 (4th Dep’t 1997).
6. *Id.* at 1090, 667 N.Y.S.2d at 545.
7. *Abacus v. Datagence, Inc.*, 66 A.D.3d 552, 553, 887 N.Y.S.2d 94, 95 (1st Dep’t 2009).
8. *Id.*
9. *400 15th St., LLC v. Promo-Pro Ltd.*, 28 Misc 3d 1233(A), 960 N.Y.S.2d 341 (Sup. Ct. Kings County 2010).
10. *A.J. McNulty & Co. v. P.J. Carlin Const. Co.*, 247 A.D.2d 254, 669 N.Y.S.2d 29 (1st Dep’t 1998).

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