

# PUBLICATION

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## An Inconvenient Truth About Termination for Convenience Clauses in Private Construction Contracts [Ober|Kaler]

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Termination for convenience clauses are standard in public and private construction contracts and provide a means for one party to terminate a contract without breaching it. In the public sector, a government agency (whether federal, state, or local) typically may terminate a construction contract if the contracting officer determines that such action is in the "best interest" of the government. The termination process is set forth in the contract and is governed by applicable government regulations – such as the Federal Acquisition Regulations (FAR) for Federal Government contracts or the Code of Maryland Regulations (COMAR) for State of Maryland contracts.

In the private sector, the termination process is also set forth in the contract (often in a clause like section 14.4 of the AIA A201-2007) but is governed by principles of contract law, which do not provide the terminating party with the "near *carte-blanche* power to terminate" that government agencies have. Thus, while private parties do have freedom to contract, the freedom is not limitless. Instead, private parties must be mindful of contract law principles that can control whether a termination for convenience clause in a particular construction contract is enforceable and whether the actions taken by the terminating party pursuant to that clause are valid.

One such contract law principle in Maryland is the duty of good faith and fair dealing that is implied in all contracts. Under this principle, an owner may terminate a general contractor for convenience, or a general contractor may terminate a subcontractor for convenience, provided that the termination complies with the implied obligation of good faith and fair dealing.

There is no bright-line standard for what constitutes good faith and fair dealing; however, courts in Maryland have found that it "requires a party exercising discretion to do so in accordance with the 'reasonable expectations' of the other party." Courts in Maryland have also found that a party must "refrain from doing anything that will have the effect of frustrating the right of the other party to receive the fruits of the contract between them" and that a party is prohibited from "terminating its contract ... to 'recapture' an opportunity that it lost upon entering the contract" because parties to a contract "give up their opportunity to shop around for a better price."

Owners and general contractors, therefore, may not terminate private construction contracts purely at their convenience (*i.e.*, for any reason whatsoever), as a literal reading of some termination for convenience clauses may suggest. For example, section 14.4.1 of the AIA A201-2007 provides that the "Owner may, at any time, terminate the Contract for the Owner's convenience and without cause." An owner's discretion under this clause, while substantial, is nevertheless constrained by the good faith and fair dealing principles discussed above. Thus, in Maryland, an owner must have a good faith basis for invoking a termination for convenience clause, or it will risk having its decision challenged by a disgruntled contractor in court.

One such good faith basis, according to the Maryland courts, is if continuing to perform under the contract at issue "would subject [a party] potentially to a meaningful financial loss or some other difficulty in completing the project successfully." Keep in mind, though, that the terminating party must be able to document/establish its "meaningful financial loss" or "other difficulty" so that its decision to terminate the contract for convenience – if challenged – is found to be consistent with the reasonable expectations of the other party. Otherwise, the terminating party could face an inconvenient legal battle.