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LEGAL



Default termination clauses: A lethal but potentially pricey weapon

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With mounting project delays, missed progress payments, growing tensions, funding concerns and growing stacks of mechanic's liens on projects these days, it should come as no surprise that many project owners and general contractors (even subcontractors with lower tier contractors) get the itch to terminate a "problem" contractor. Like ending a bad relationship, pulling the trigger on the default termination clause in their construction contract can be an appealing solution replete with instant gratification. Although the clause is an excellent risk transfer mechanism with, at times, a "feel good" component, a knee-jerk reaction to terminate can often lead to a host of unanticipated and potentially expensive ramifications.

The construction contract is the pivotal starting point for evaluating whether or not to draw the termination weapon. Many prime contracts especially those used on federal projects and some general contracts are drafted to assist the parties by defining what constitutes a default (or "cause") worthy of termination; however, many non-standard private contracts fail to do so. A well-drafted clause also expressly states the procedure for termination including, but not limited to, a description of the notice requirements including those to any surety,

the parameters of any opportunity to cure and the impact of a waiver of these rights all of which should be drafted in accordance with prevailing Texas or federal law. By negotiating the terms of this clause, all parties are better positioned to avoid a material default and minimize the risk associated with invalidly terminating the contract.

A default termination is often appealing to upper tier contractors because it is usually associated with a number of remedies. A termination clause may impart to the owner or general contractor

some or all of the following rights:

- Take possession of the site, tools, equipment and other materials
- Assume all subcontracts to force subcontractor compliance and/or resolve existing liens
- Need not pay the subcontractor until the work is finished
- May finish the work by whatever reasonable means is most expedient
- Ability to back-charge the defaulting contractor for costs in excess of the contract price

However, even if just cause exists for a termination, the practical realities of replacing a defaulting contractor may be enough to dissuade the wannabe terminator. Terminating a contractor often results in an increase in the time and price of the construction contract as well as litigation. Because of this likelihood, a careful analysis of the costs must be balanced against the potential liability of retaining the defaulting contractor. If the decision is made not to immediately terminate, written notification of that party's intent to preserve (and not waive) its right to terminate for default should be provided in the event that it is clear that termination is the most favorable solution at a later date.

For those who believe they are victims of a wrongful termination, they may, depending on the contract language, bring a breach of contract lawsuit against the terminating party to prove that "cause" did not exist for their termination.

In many instances, this type of claim is very fact driven and requires well-kept documentation and witnesses to prove the groundless basis for termination. Subcontractors may also wish to negotiate revisions to the default termination clause that require the upper tier contractor to provide notice of default and an opportunity to cure.

In order to avoid a wrongful termination claim or lawsuit, many owners and general contractors also include a termination for convenience clause which allows for a termination with or without cause and may even bar a claim for breach of contract on wrongful termination grounds. Although the termination for convenience clause does not provide as many remedies to an owner or general contractor as the default termination clause, it may eliminate many of the disputes that arise over whether or not "cause" existed for the termination.

The foregoing was provided for informational purposes only and is not intended to provide legal advice or to serve as an alternative to seeking legal counsel.

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