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Termination for Convenience: Was it Done in Good Faith?

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Recently, the Court of Appeals of Maryland issued an opinion, which impacts the use of "termination for convenience" clauses in construction contracts between private parties. In *Questar Builders, Inc. v. CB Flooring, LLC*, Maryland's highest court determined that termination for convenience clauses may be enforceable between private parties but that such clauses are subject to the "implied limitation that they be exercised in good faith and in accordance with fair dealing." The upshot of the *Questar Builders* decision is that termination for convenience clauses do not provide a right to terminate for any reason whatsoever. Maryland courts will review whether the justification for termination comports with the obligation of good faith and fair dealing, which "requires a party exercising discretion to do so in accordance with the 'reasonable expectations' of the other party."

In order to reach this decision, the Court of Appeals reviewed a contract between a general contractor hired to construct an apartment and townhome complex and a flooring subcontractor, which had agreed to carpet the project. The contract contained two clauses, which when read together, governed the rights of the parties upon breach by the subcontractor or if the contract was terminated for convenience. The clause relating to breach by the subcontractor stated, among other things, that in the event of any breach the general contractor could terminate the contract and complete the work. In addition, the clause stated that if the subcontractor "is not in breach then such termination shall be deemed a termination for convenience" In turn, the "termination for convenience" clause provided that if the contract was terminated for convenience, the subcontractor was only entitled to be paid for the reasonable value of certain authorized materials, equipment and incidentals.

Issues arose before the flooring subcontractor performed any work. Approximately two months after the contract was executed, the interior designer issued drawings which changed the carpeting to be installed throughout the complex. The flooring subcontractor had not responded to the drawings when the general contractor contacted the next highest flooring bidder about installing carpet for the complex. The next highest bidder then submitted a proposal to complete the work for \$1,000 less than the original winning bid. However, the revised bid utilized the original carpet specifications and not the materials noted in the interior designer's drawings. When the

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original flooring subcontractor requested an upward adjustment due to the interior designer's change in carpeting, discussions between the parties ensued and within a month, the general contractor terminated the flooring contract. Shortly thereafter, the next highest bidder entered into a contract for the flooring work at the same price as the prior flooring subcontractor.

The original flooring subcontractor brought suit in state court and was awarded \$243,000 in damages upon a finding that it had not breached the contract, that the general contractor had "schemed" with the next highest bidder, and that the termination for convenience clause was inapplicable. The general contractor appealed the decision and argued that the termination for convenience clause allowed for termination for any reason whatsoever.

On appeal, the Court reviewed the history of termination for convenience clauses and their utility in governmental contracting. However, the Court distinguished its current decision from those involving governmental entities and declined to give private parties the "near *carte-blanche* power to terminate that courts have given the federal government . . ."

The Court then provided guidance as to the circumstances that would allow a general contractor to terminate for convenience. Noting that such clauses are risk-allocating tools, the general contractor could exercise its discretion to terminate, if continuing with the contract would "subject it potentially to a meaningful financial loss or some other difficulty in completing the project successfully." However, the Court also set out that good faith and fair dealing prohibit "a party from terminating its contract . . . to 'recapture' an opportunity that it lost upon entering into the contract." After entering into a contract, the parties "give up their opportunity to shop around for a better price."

The lesson for private parties involved in the termination of a contract for convenience is that a court in Maryland may one day review the justification for termination to determine whether it was done in good faith.

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