

Legal Perspective

TERMINATION FOR CONVENIENCE CLAUSES: AN INCONVENIENT TRUTH

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The concept of a "termination for convenience" of a contract developed in American law during the Civil War as a mechanism for the U.S. Government to avoid costly military procurements that became unnecessary as a result of changes in war-time technology or the end of conflict. In the famous Corliss case, decided in 1874, the United States Supreme Court upheld the Secretary of the Navy's termination of a contract for ships where the Navy no longer needed the ships due to the end of the Civil War. As a result, the shipbuilder did not receive the full value of the contract, as it sought, but was paid only for the ships it had built as of the time of the termination.

Relying on Corliss, the Federal government expanded on the use of termination for convenience clauses in procurement contracts during World Wars I and II in order to eliminate possible expectation damages to companies whose contracts might be prematurely terminated.

It was during World War II that the use of the term "convenience", in connection with such terminations, became common and accepted as the Government provided, in its fixed price supply contracts, the following clause:

Termination for the convenience of the Government. (a) the Government may, at any time, terminate this Contract, in whole or in part, by a notice in writing from the Contracting Officer to the Contractor that the Contract is terminated pursuant to this Article.

In the 1960's, the use of termination for convenience clauses began to be used in civilian, commercial contracts. Some forty years later, termination for convenience clauses are almost standard in construction contracts and subcontracts. Termination for convenience clauses are intended to provide the party with the superior bargaining power the option to terminate the contract, without need to prove a breach by the other party, and then also establish the amount of compensation to be paid. The standard clause, almost always, will exclude lost profits on the work yet to be performed at the time of the termination.

Here is an example of a termination for convenience clause:

The Contractor may, at any time, terminate the Subcontract in whole or in part for the Contractor's convenience and without cause. Termination by the Contractor under this paragraph shall be by a notice of termination delivered to the Subcontractor specifying the extent of termination and the effective date.

Upon receipt of the notice of termination for convenience, the Subcontractor shall immediately, in accordance with instructions from the Contractor, proceed with performance of the following duties regardless of delay in determining or adjusting amounts due under this paragraph:

- Cease operation as specified in the notice;
- Place no further orders and enter into no further subcontracts for materials, labor, services or facilities except as necessary to complete continued portions of the Subcontract;
- Terminate all subcontracts and orders to the extent they relate to the Work terminated;
- Proceed to complete the performance of Work not terminated; and
- Take actions that may be necessary or that the Contractor may direct, for the protection and preservation of the terminated Work.

Upon such termination, the Subcontractor shall recover as its sole remedy payment for work properly performed in connection with the terminated portion of the Work prior to the effective date of termination and for items properly and timely fabricated off the Project site, delivered and stored in accordance with the Contractor's instructions. The Subcontractor hereby waives and forfeits all other claims for payment and damages including, without limitation, anticipated profits on the incomplete part of the Work or otherwise.

The Contractor shall be credited for (1) payment(s) previously made to the Subcontractor for the terminated portion of the Work, (2) claims which the Contractor has against the Subcontractor under the Subcontract, and (3) the value of the materials, supplies, equipment or other items that are to be disposed of by the Subcontractor that are part of the Subcontract Sum.

In addition, termination for cause contract clauses will often provide that, if it is determined that the terminated party was not in breach, then the termination for cause

shall be deemed to be a termination for convenience. This can be a potent contract tool in that it may negate the risk of an unsupported termination for cause, and ensuing litigation over the issue, as an unsupported for cause termination is converted, by operation of contract, into one for convenience.

This all, of course, leads to the central question, can a private contract really be terminated by one party just for convenience sake as the title of the termination for convenience clause connotes? Although you will want to check the law of the state which governs the contract, the short, and safe, answer is: Most Probably Not.

The legal basis for the conclusion that one party may not have unfettered rights to terminate for convenience is that such a right would make the contract illusory because one party was obligated absolutely to perform, while the other was not, as it could terminate at will. Under such circumstances, one party was providing consideration for the contract to the other, but the other party actually was not as it could rescind its consideration, at will, by terminating the contract.


With this in mind, the better label for these clauses might be "termination without cause" as opposed to "termination for convenience," as a contract generally may not be terminated simply out of convenience to one party alone.

What then are valid grounds for the exercise of a termination for convenience clause? Courts reviewing convenience

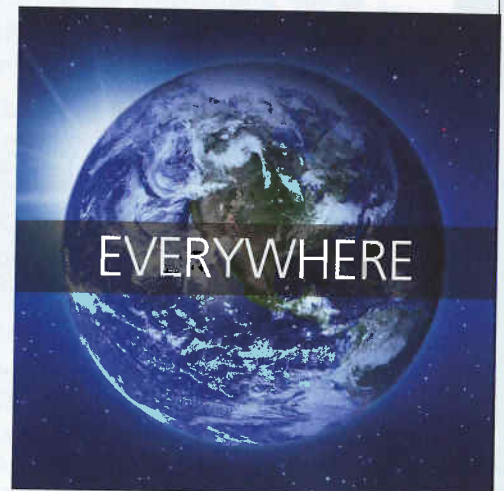
terminations generally focus on whether the grounds behind the termination for convenience were in bad faith or an abuse of discretion. Examples of upheld bases for a termination for convenience include changed circumstances, such as termination of an upstream contract for which the contract at issue was dependent. Importantly, courts have upheld terminations for convenience when one party determined that the other party would not perform and, as a result, would subject the exercising party potentially to a material loss or difficulty in fulfilling its obligations to others.

Examples of possible improper terminations for convenience would be to obtain a better price or to try to avoid an obligation to arbitrate an existing dispute.

The bottom line, thus, on termination for convenience clauses, is that they may serve as effective tools to protect one party from risk of loss from changed circumstances. They are not, however, absolute weapons that can be used by one party to arbitrarily terminate a contract. Such clauses, while they should be included in contracts, should only be exercised based on good faith reasons and under the appropriate circumstances, preferably with the advice of counsel who has consulted the case law of the forum to insure that the basis for the termination is well-founded at law.

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