

Structuring Construction Contracts: Termination for Convenience vs. Termination for Cause

Providing Notice, Calculating Damages, Pros and Cons of Various Termination Provisions

WEDNESDAY, MAY 25, 2022

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Construction Contracts: Termination for Convenience vs. Termination for Cause

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May 25, 2022

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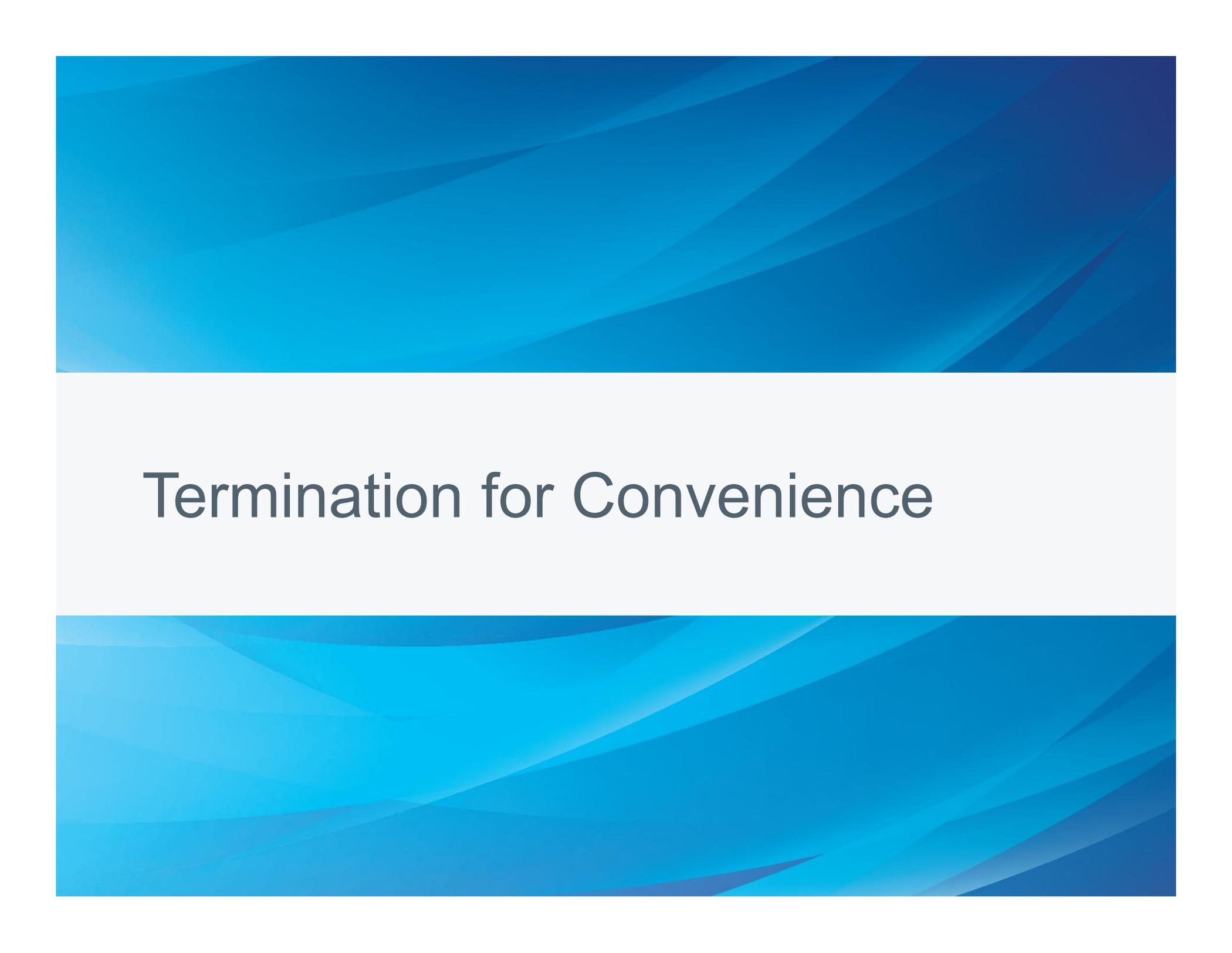
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Termination for Convenience



Jason L. Richey

Jason Richey concentrates his legal practice in the areas of dispute resolution with an emphasis on construction and engineering industry, complex commercial disputes, energy disputes and state and local bid protests.

LAX DISPUTE – AIRPORT LIGHTING



LAX DISPUTE – AIRPORT LIGHTING

- LAX Airport Authority Terminated Contractor for its Convenience.
- Contractor did nothing wrong – yet terminated
- Only entitled to reasonable cost incurred at time of termination
 - No anticipatory profit
- How is this possible?
- How much in damages can be claimed?

Termination for Convenience Clause

What is a Termination for Convenience Clause

- Sample Clause
 - Jason Richey may terminate this Agreement at any time for his own convenience.
- American Heritage Dictionary
 - Convenience
 1. The quality of being convenient, suitability or handiness
 2. Personal comfort; material advantage
 3. Something that increases comfort or makes work less difficult

Termination for Convenience Clause

Termination for Convenience Clause gives terminating party unilateral power to demand performance while still reserving the right to terminate that performance if contract proves undesirable.

- Where is the Consideration?
- Where is the Mutuality of Contract?
- Are there any limitations to when a party can utilize a termination for convenience clause?



Termination for Convenience Clause

The Termination for Convenience Clause: A Powerful Weapon in Contractual Disputes

by Jason L. Richey

Imagine a contractor who has done an outstanding job of building a magnificent skyscraper in the heart of one of the world's largest cities. The skyscraper is 65% complete, expected to be finished on time and within budget. The contractor has not defaulted, and proudly touts that this construction project will be the centerpiece of the company's accomplishments. Suddenly, the owner of the project notifies the contractor that it has been terminated from the job for the owner's convenience. To complete the skyscraper, the owner replaces the contractor with one of its competitors. Can the owner unilaterally terminate the contractor even though the contractor was not in default? If so, what compensation is the contractor entitled to recover? The answer to these questions lies within the termination for convenience provision which has become increasingly common in private construction contracts.

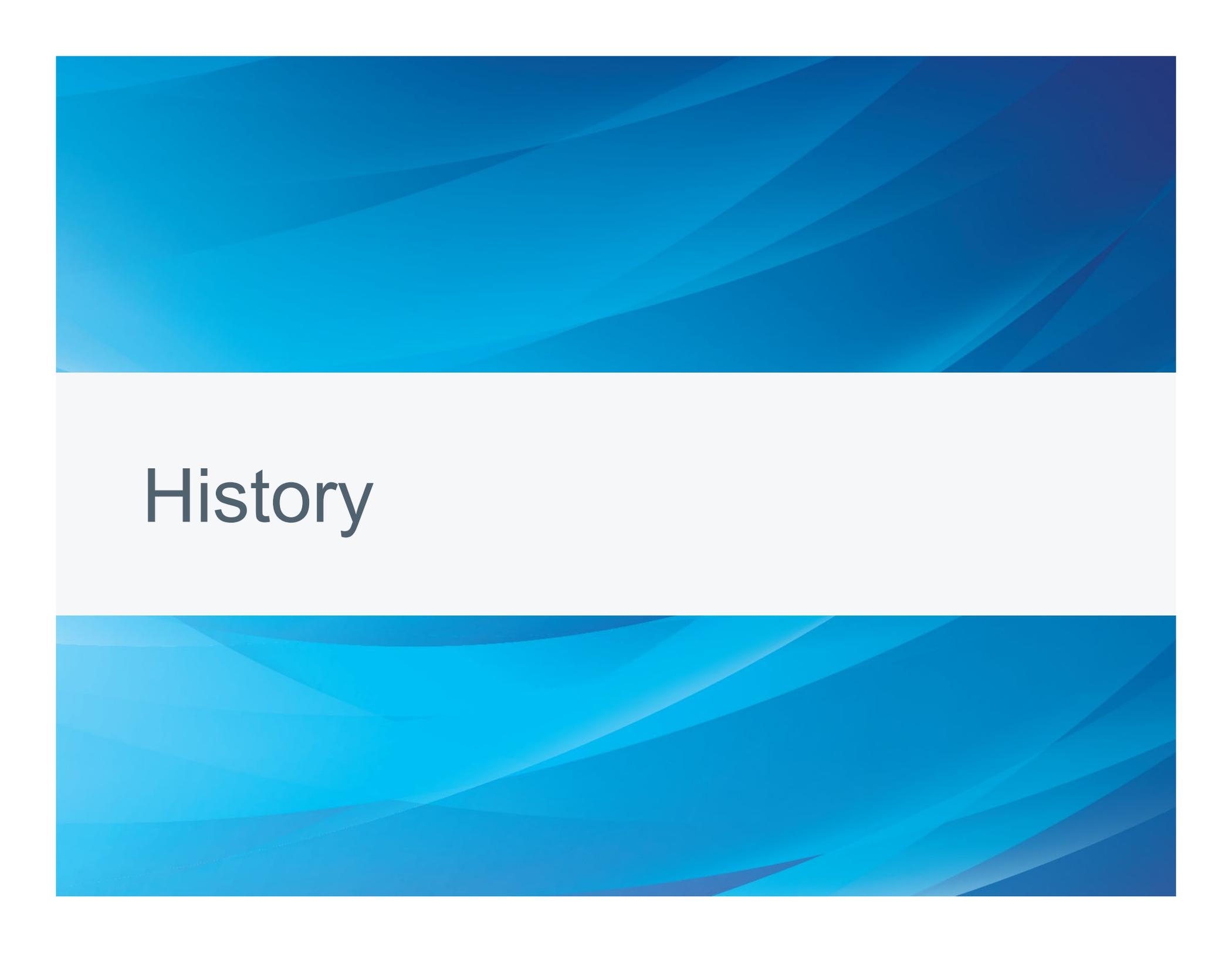
The termination for convenience provision is one of the most unique provisions in construction contracts. It allows an owner to unilaterally terminate the contract with or without cause, or even if the owner itself is in default, without incurring a breach of the contract. Webster's Collegiate Dictionary defines "convenience" as "something conducive to...ease." This definition is consistent with the holdings of many courts that 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 ulterior motive."¹

Such unilateral power defies the fundamental legal principle of "mutuality of contract." Nevertheless, courts throughout the United States are frequently enforcing these provisions despite the consequences.

¹ A.J. Temple Marble & Tile, Inc. v. Long Island R.R., 682 N.Y.S.2d 422 (N.Y. App. Div. 1998).

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- Not much law on termination for convenience
- Not much in secondary sources
- Law that exists is mostly from Federal Claims Courts

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History

History

Who invented these termination for convenience clauses?

- As early as 1863, Rule 1179 of the Army Regulations provided that military contracts “shall expressly provide for their termination at such time as the Commissary-General may direct.”
- Without this, government would be in breach and supplier entitled to anticipatory profits on long term supply contracts.



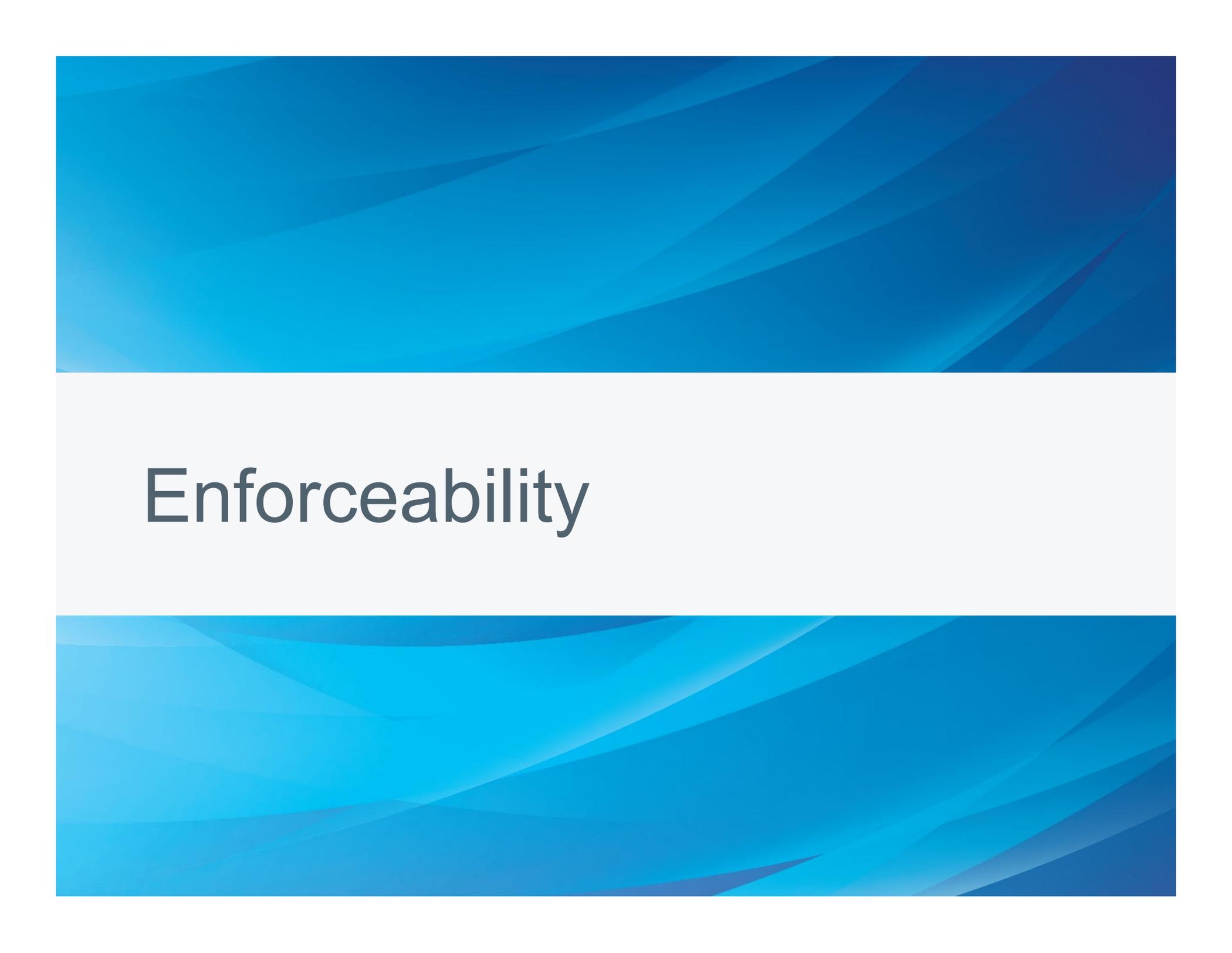
History

Supreme Court recognized government's special right to terminate for convenience

- United States v. Corliss Steam-Eng Co., 91 U.S. 321, 323 (1876)

Clause remained limited to Military – WWI, WW2

- In 1964, the first edition of the Federal Procurement Regulations contained optional termination for convenience clauses for use **“whenever an agency considered it necessary or desirable.”**
- Becomes a Staple of Government Contracts
- Not used in private contracts until the last 30 years or so
- As such, most of the law that exists out there is from government contracts, not private contracts.

The image features a central white horizontal band with the word "Enforceability" written in a dark grey, sans-serif font. The top and bottom portions of the image are filled with a blue abstract pattern of overlapping, semi-transparent geometric shapes, creating a sense of depth and movement.

Enforceability

Enforceability

How are these clauses enforceable?

- Especially in dealing with private contracts – don't forget about challenging the enforceability.

Vola & Son Landscaping Corp. v. Posen Construction, 99 So.3d 563 (Fla. App. 2012)

- Rejects Good Faith Requirement
- Notice (not even advance notice) is enough for Consideration – So Not Illusory
- Perfectly fine to terminate one Contract to get a better price in another
- Other courts have found that notice plus reimbursement of reasonable cost of termination party is enough. See, e.g., EdoCorp v. Beech Aircraft Corp., 911 F.2d 1447, 1453 (10th Cir. 1990)

Enforceability

REMEMBER – Most jurisdictions have not ruled on enforceability in private contracts, like Florida did!!

- Illusory nature of this clause

Federal Courts in government contracts have struggled with consideration and initially imposed “bad faith” requirement to provide the consideration.

Then standard changed in a case called Torncello v. United States, 681 F.2d 756 (Fed. Cir. 1982)

- Case required to utilize a termination for convenience clause terminating party must prove “a change in circumstances” between the time contracting and the termination.
 - Necessary to avoid creating an illusory contract in which government had no obligation to contractor.

Enforceability

Torncello change in circumstance test limited & criticized over time

- Courts went back to bad faith
- Government never intended to move forward with contract
- Government terminated due to national origin of company
- Government intended to injure contractor, including making false statements

Many State Courts, like Florida & New York simply treat contract as terminable at will in dealing with private contracts.

Default Versus Convenience

Be Specific in Notice of Termination

The Rules of the Game when Notice Ambiguous

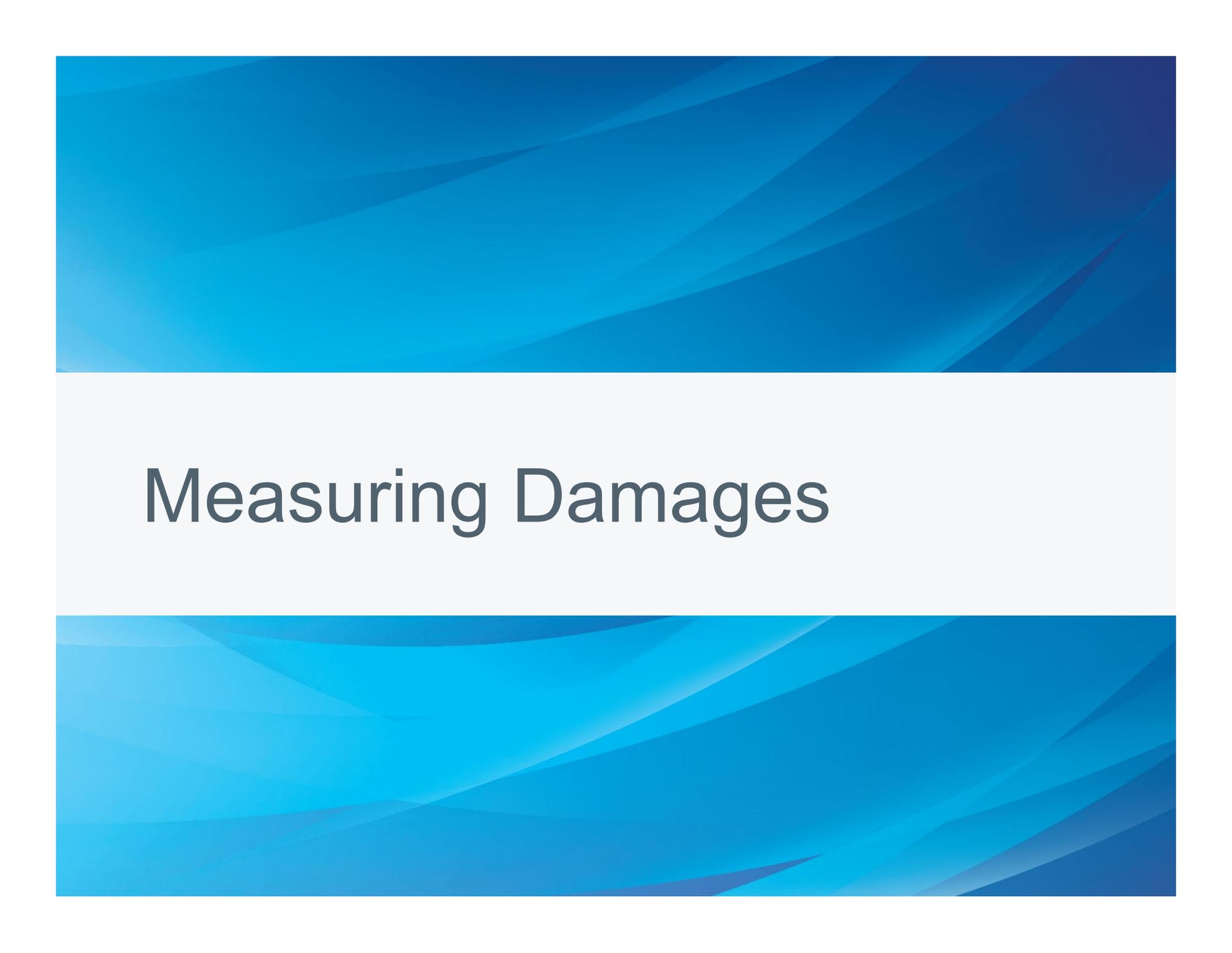
- Terminating party meant convenience, then convenience
- Terminating party meant default, then default
- If terminating party did not know what it wanted, then likely treated as convenience

Default Versus Convenience

Once convenience is elected, party cannot later switch to default

- Careful consideration should be given when picking
 - Impacts type of damages you can claim
 - Impact proof you need at trial

Once default is elected, you can switch to convenience with doctrine of constructive termination which will be discussed later

The image features a central white rectangular area containing the text "Measuring Damages". This central area is flanked by two horizontal bands of a blue abstract pattern, consisting of overlapping, semi-transparent geometric shapes in various shades of blue, creating a dynamic, layered effect.

Measuring Damages



Talor I. Bearman

Talor Bearman concentrates his legal practice on complex commercial litigation matters and construction disputes.



‘[T]ermination for convenience’ clauses permit one party to terminate a contract, even in the absence of fault or breach by the other party, without suffering the usual financial consequences of breach of contract.

- Harris Corp. v. Giesting & Assoc., Inc., 297 F.3d 1270 (11th Cir. 2002)



AIA A201 Damages for Cause

§ 14.2.2 When any of the above reasons exist, the Owner may without prejudice to any other rights or remedies of the Owner and after giving the Contractor and the Contractor's surety, if any, seven days' written notice, terminate employment of the Contractor and may, subject to any prior rights of the surety:

- .1 Exclude the Contractor from the site and take possession of all materials, equipment, tools, and construction equipment and machinery thereon owned by the Contractor;
- .2 Accept assignment of subcontracts pursuant to Section 5.4; and
- .3 Finish the Work by whatever reasonable method the Owner may deem expedient. Upon written request of the Contractor, the Owner shall furnish to the Contractor a detailed accounting of the costs incurred by the Owner in finishing the Work.

§ 14.2.3 When the Owner terminates the Agreement for one of the reasons stated in Section 14.2.1, the Contractor shall not be entitled to receive further payment until the Work is finished.

§ 14.2.4 If the unpaid balance of the Contract Sum exceeds costs of finishing the Work, including damages incurred by the Owner and not expressly waived, such excess shall be paid to the Contractor. If such costs and damages exceed the unpaid balance, the Contractor shall pay the difference to the Owner. The amount to be paid to the Contractor or Owner, as the case may be, shall be certified by the Initial Decision Maker, upon application, and this obligation for payment shall survive termination of the Contract.

AIA A201 Damages for Convenience

§ 14.4.3 In case of such termination for the Owner's convenience, the Owner shall pay the Contractor for Work, properly executed; costs incurred by reason of the termination, including costs attributable to termination of Subcontracts; and the termination fee, if any, set forth in the Agreement.

Government Contract Damages





Where the government terminates a private contractor pursuant to a termination for convenience clause in a contract, instead of receiving full expectation damages *the contractor's recovery is defined by the termination for convenience clause.*

- Linan-Faye Const. Co., Inc. v. Housing Auth. of City of Camden, 49 F.3d 915 (3d Cir. 1995)



F.A.R. Damages for Cause – 48 CFR § 52.212-4(m)

Termination for cause. The Government may terminate this contract, or any part hereof, for cause in the event of any default by the Contractor, or if the Contractor fails to comply with any contract terms and conditions, or fails to provide the Government, upon request, with adequate assurances of future performance. In the event of termination for cause, the **Government shall not be liable to the Contractor for any amount for supplies or services not accepted**, and the Contractor shall be liable to the Government for any and all rights and remedies provided by law. If it is determined that the Government improperly terminated this contract for default, such termination shall be deemed a termination for convenience.

F.A.R. Damages for Convenience – 48 CFR § 52.212(I)

Termination for the Government's convenience. The Government reserves the right to terminate this contract, or any part hereof, for its sole convenience. In the event of such termination, the Contractor shall immediately stop all work hereunder and shall immediately cause any and all of its suppliers and subcontractors to cease work. Subject to the terms of this contract, the ***Contractor shall be paid a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination, plus reasonable charges*** the Contractor can demonstrate to the satisfaction of the Government using its standard record keeping system, have resulted from the termination. The Contractor shall not be required to comply with the cost accounting standards or contract cost principles for this purpose. This paragraph does not give the Government any right to audit the Contractor's records. The Contractor shall not be paid for any work performed or costs incurred which reasonably could have been avoided.

Government TFC Damages

Termination Settlement

- Percentage Completion
 - Determine % completion
 - Multiply by the contract price for that item
- Reasonable Charges
 - Expenses to prepare Settlement Claim
 - Storage costs, demobilization costs, administrative expenses, attorneys' fees for preparing settlement, etc.

Failure to Agree

- Contract price for completed work
- Costs incurred for the work
- Profit on costs incurred determined by Contracting Officer
- Settlement costs
- All costs calculated in accordance with F.A.R. part 31

Reasonable Costs Under F.A.R. 31.205-42 – Termination Costs

- Common Items – NOT ALLOWED
- Costs After Termination
- Initial Costs
- Loss of Useful Value
- Rental Under Unexpired Lease
- Alterations of Leased Property
- Settlement Expenses
- Subcontractor Claims

Liquidated Damages



Old Colony Const., LLC v. Town of Southington, 113 A.3d 406 (Conn. 2015)

In the present case, the town's pursuit of liquidated damages does not deprive Old Colony of any rights that it would have been afforded had it been terminated for cause. Similarly, it does not expose Old Colony to the costs of completing the project, as would be the case had it been terminated for cause. We disagree, therefore, with Old Colony that permitting liquidated damages in the present case renders the distinction between terminating for convenience and for cause illusory.

Accordingly, we conclude that the trial court properly determined that, in light of the express terms of the parties' contract, the town's election to terminate the contract for convenience did not preclude it from recovering liquidated damages.

TFC in Subcontracts



SAK & Assocs., Inc. v. Ferguson Const., Inc., 357 P.3d 671 (Wash. Ct. App. 2015)

Private construction contract between contractor and subcontractor.

- Subcontractor completed 24% of the Work prior to TFC
 - Argued that contract lacked consideration because it could be terminated at Contractor's convenience

- Court held that partial performance validated the TFC clause
 - Found covenants of good faith and fair dealing do not trump express terms or unambiguous rights in a contract

Damage Factors for Method of Termination



Cost Considerations for the Owner

Convenience

- No recovery for Defective Work
- Decrease litigation costs
- Higher costs of completion
- Equitable Adjustment
- Subcontractor liens

Cause

- Cure period
- Consequential Damages
- Potential surety involvement
- Increased cost of litigation
- Potential for conversion



Constructive Termination for Convenience



William D. Wickard

Mr. Wickard concentrates his legal practice on construction and commercial litigation along with negotiating and drafting construction contracts.

Constructive Termination for Convenience

When, despite existence of termination for convenience clause, Owner terminates contractor for default, which Court determines to be improper.

If the Owner could have invoked the termination for convenience clause instead of terminating, rescinding, or repudiating on some other invalid basis, the court may constructively invoke the clause to retroactively justify the government's actions avoid a breach, and limit liability.

Constructive Termination for Convenience

Even when the basis upon which a contract was actually terminated is legally inadequate to justify the action or taken or the government wrongfully terminates the contract, courts are reluctant to award damages for breach of contract.

Instead, courts typically will only award damages under the convenience termination provision.

In other words, the principle of Constructive Termination for Convenience may limit recovery even if the government wrongfully terminated a contract.

Bottom line: This has the effect of broadening the Termination for Convenience Clause.

The Government's Constructive Termination for Convenience

Government regulations have adopted this concept:

F.A.R. 52.249-8(g):

...if, after termination, it is determined that the Contractor was not in default or the default was excusable, the rights and obligations of the parties shall be the same as if the termination had been issued for the convenience of the Government....

Linan-Faye Construction Co. v. Housing Authority of the City of Camden, 49 F.3d 915 (3rd Cir. 1995).

- The leading case on Constructive Termination for Convenience
- Government invokes constructive termination for convenience as a **shield** when contractor sues for costs from improper termination.
- Housing Authority awards a contract to the low bidder, Linan-Faye, to fix up 244 public housing units.
- Linan-Faye starts pre-construction activities but never begins physical construction.

Linan-Faye Construction

- Disputes break out between Housing Authority and contractor about the project and specifications, plumbing, availability of areas for work, etc.
- Contractor refuses to start work until it gets a price increase
- Housing authority terminates the contract with a letter that does not mention “breach” or “default.”
- Contractor sues for breach, seeking all types of damages.
- Housing Authority files for summary judgment claiming the termination for convenience clause limited Contractor’s damages and since Contractor never began construction it could not recover any damages.

Linan-Faye Construction

- Trial Court agreed with Housing Authority.
- Third Circuit Affirms the Trial Court and provides a treatise on constructive termination for convenience.
- “Constructive termination for convenience, an outgrowth of termination for convenience, is a judge-made doctrine that allows an actual breach to be retroactively justified.”

Linan-Faye Construction

- “Termination for convenience, and its expansion into the constructive termination for convenience doctrine, however, does not confer upon the government a discretion that it is unbounded. In granting the government the privilege of constructive termination for convenience, courts brush up against the problem of allowing the government to create an illusory contract.”
- In order to invoke constructive termination for convenience, there must be “some kind of change from the circumstances of the bargain or in the expectations of the parties.”

Linan-Faye Construction

- There also cannot be bad faith....but the court is required to presume public officials always act in good faith.
- Third Circuit finds there is constructive termination for convenience because:
 - Contractor produces insufficient evidence of bad faith to overcome the presumption of good faith
 - The government was not terminating to get a lower price because this was the low bidder
 - And the deterioration of the contractor/owner relationship was sufficiently changed circumstances
- The result is that it is irrelevant whether the contractor breached by refusing to begin work.

Judge Becker issues a concurring and dissenting opinion that dissents from what he calls the “harsh construction by the majority” of the Termination for Convenience Clause:



The majority holds that a deterioration in business relations, demonstrated in not insignificant part by a dispute over specifications, constitutes such a change in circumstances. In my view, such a rule would largely eviscerate the limitation. As lawyers who have dealt with construction disputes know, these contracts almost always generate some dispute over specifications, and any construction dispute rancorous enough to spawn litigation will almost certainly have led to the requisite deterioration in business relations. The facts of this case illustrate how circular a deterioration-of-business-relations test can be, for HACC did not even attempt to invoke the clause until litigation began.



Conway Construction Company v. City of Puyallup, 197 Wash.2d 825 (Wash. 2021)

- An example of where the contractor invokes constructive termination for convenience as a sword.
- City hires contractor to build a road – the nation’s first arterial roadway with pervious concrete
- There are a number of problems – the City suspends the contractor and identifies contract violations
- The Contractor disputes the violations, but attempts to remedy them and requests to meet to discuss
- The City’s engineer refuses; “I don’t see a need for a meeting”

Conway Construction Company

- City terminates contractor for default, and does not pay the contractor any further payments
- Contractor sues and claims the termination for default was improper and should be converted to a termination for convenience.
- Trial court agrees, awarded the Contractor damages including attorneys fees.

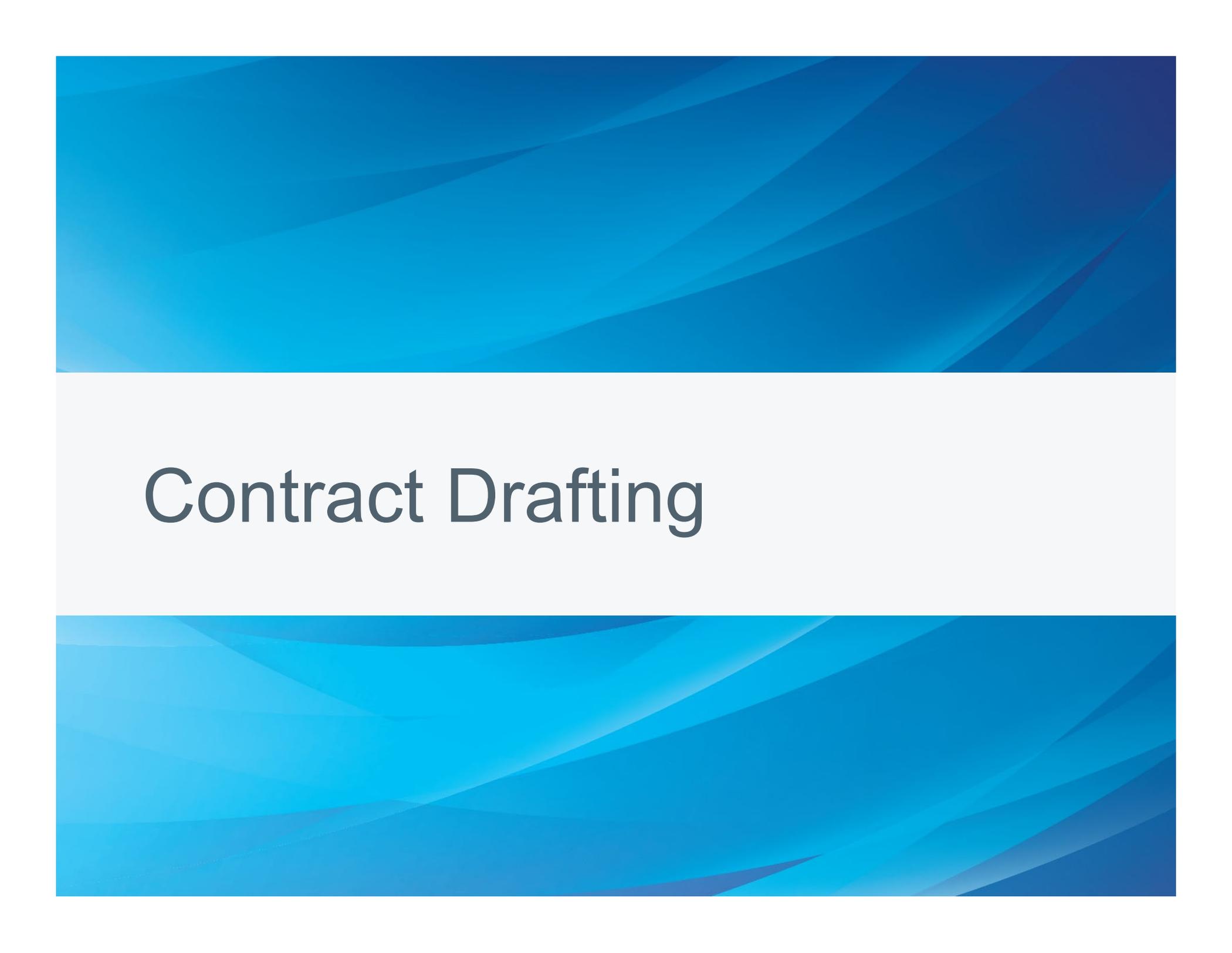
Conway Construction Company

Washington Supreme Court upholds decision:



The City's termination of the contract was not properly for default and therefore will be converted to a termination for convenience. The contract language specifies that a default based on defective work is proper only if the contractor neglected or refused to correct the defective work, which Conway did not. While the City had the right to be satisfied with the proposed remedy, it did not have the right to unreasonably withhold satisfaction. Finally, the City failed to demonstrate that Conway was in default at the time of termination. Conway made significant efforts to address the nine issues in the notice of suspension, and repeatedly asked for a meeting to discuss these efforts. We affirm the trial court that the termination was for the City's convenience.



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Contract Drafting

Contract Drafting

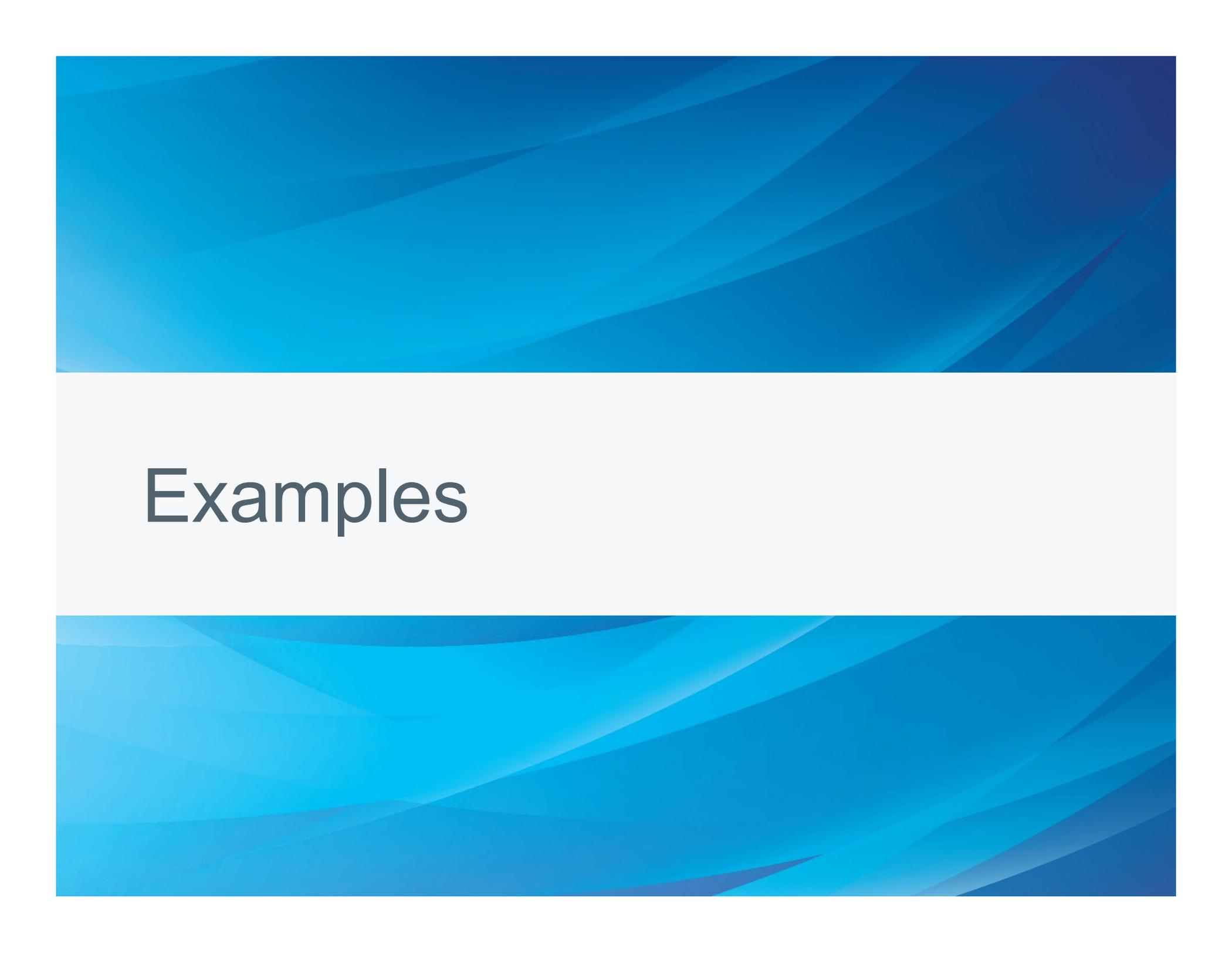
From Owner perspective

- Clause is inherently owner friendly; always try to get one
- Would want to exclude any future costs, profits and only pay the cost of work performed
- Would want to exclude consequential damages from contractor's recovery

Contract Drafting

Contractor Perspective

- Exclude termination for convenience clause altogether
- Negotiate a clause where Owner would have to pay a favorable set fee that is so large that Owner would never want to terminate for convenience – fee may be on a sliding scale depending upon the stage of construction
- Negotiate a clause where Owner has to pay profit it would have obtained on unperformed work.
- Negotiate a termination for convenience clause contractor gets to exercise – nearly unheard of

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Examples

Examples

Modifying the AIA A201 – General Conditions

Original Version

§ 14.4.3 In case of such termination for the Owner's convenience, the Owner shall pay the Contractor for Work, properly executed; costs incurred by reason of the termination, including costs attributable to termination of Subcontracts; and the termination fee, if any, set forth in the Agreement.

Modified Version

§ 14.4.3 In case of such termination for the Owner's convenience, ***the Contractor shall be entitled to receive payment for Work properly executed, and direct costs incurred by reason of such termination, along with reasonable overhead and profit on the Work not executed.***
Contractor is ***not entitled to recover any consequential damages.***

Examples

Owner may at any time and for any reason terminate Contractor's services and work at Owner's convenience. Upon receipt of such notice, Contractor shall, unless the notice directs otherwise, immediately discontinue the work and placing of orders for materials, facilities and supplies in connection with the performance of this Agreement.

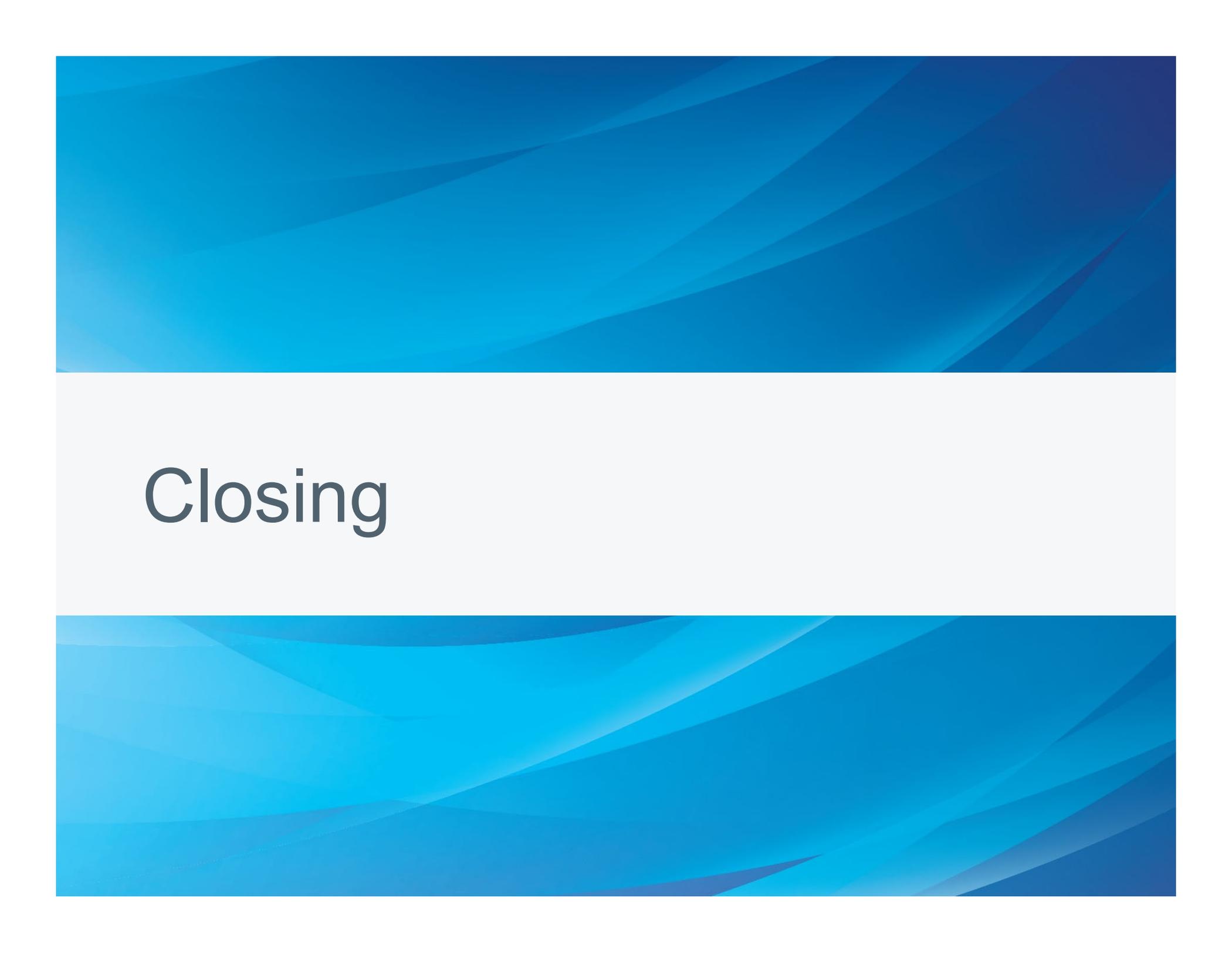
Upon such termination, Contractor shall be entitled to payment only as follows: (1) the actual cost of the work completed in conformity with this Agreement; plus, (2) such other costs actually incurred by Contractor as are permitted by the prime contract and approved by Owner; (3) plus ten percent (10%) of the cost of the work referred to in subparagraph (1) above for overhead and profit. There shall be deducted from such sums as provided in this subparagraph the amount of any payments made to Contractor prior to the date of the termination of this Agreement. Contractor shall not be entitled to any claim or claim of lien against Owner for any additional compensation or damages in the event of such termination and payment.

Examples

Contractor shall have the right at any time by written notice to Subcontractor, to terminate this Subcontract without cause and require Subcontractor to cease work hereunder, in which case, provided Subcontractor is not then in default, 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 the termination, including overhead and profit thereon at the rates provided for in the Contract Documents, and for items properly and timely fabricated off Project site, delivered and stored in accordance with Contractor's instructions.

Examples

Termination for Convenience. Owner shall have the right at any time by written notice to the Contractor, to terminate this Agreement and require the Contractor to cease work hereunder, in which case, provided the Contractor be not then in default, the Contractor shall be entitled to 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, as well as all costs associated with non-cancelable material orders provided said materials are delivered to the Owner. The compensation provided herein shall be the full and final payment of all amounts due to the Contractor and the Contractor's sole and exclusive remedy for Owner's termination for convenience. In no event shall Contractor be entitled to any other amounts, payments or damages, including, without limitation, overhead or profit on unexecuted Work, anticipated profits, consequential damages or damages concerning any other project. The Owner shall be credited for (i) payments previously made to the Contractor for the terminated portion of the Work, (ii) claims that the Owner has against the Contractor under the Agreement, and (iii) the value of the materials, supplies, equipment, or other items that are to be disposed of by the Contractor that are part of the Contract Price. In the event the termination results in an overpayment to Contractor, then Contractor shall return such overpayment amount to Owner.

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Closing

Closing

What did we learn?

- Termination for Convenience originated in military context
- Courts enforce these provisions in government contracts, and have generally found them enforceable in private contracts
- Contractors tend to challenge the provision on the grounds that a contract that can be terminated at any time for any reason is “illusory” and lacks consideration
- Courts have struggled to define the proper test for consideration
- Unless the terms of the contract state otherwise, the measure of damages is the contractor’s costs plus the costs associated with termination
- Constructive Termination for Convenience clauses have been enforced and serve to limit an owner’s damages

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