courtroom, in fairly deciding "precisely when the disorder and constant readjustment, which is to be expected . . . became so extreme, so debilitating and so unreasonable as to constitute a breach of contract," underscores the extraordinary burden of construction field personnel on the firing line in the heat of the construction process in making correct determinations of contract breach and its materiality under pressures imposed by obscured availability of facts, limited time to decide, frequent conflicting perspectives, and the risk of being second guessed in future litigation.

§ 18:3 Consequences of wrong assessment of materiality of breach upon termination for cause

The most highly leveraged decision in construction, bar none, is the decision to declare the contract terminated due to a material breach by the other party.[1] An owner's wrong decision to terminate the contract discharges both the contractor and its performance bond surety from all performance obligations,[2] and exposes the owner to liability to the contractor for lost profits and

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their initial conclusions and then, because their determinations are not binding, to have the issues raised again in this litigation. Here, a single judge—not a panel of experts in the subject of tunnel construction—is asked to resolve the issues because the parties themselves refuse to accept the decisions of their contractually assembled team of experts.

[Section 18:3]

[1]See Walker & Co. v. Harrison, 347 Mich. 630, 81 N.W.2d 352, 355 (1957) (the decision to terminate a contract "is fraught with peril, for should such determination, as viewed by a later court in the calm of its contemplation, be unwarranted, the repudiator himself will have been guilty of material breach and himself have become the aggressor, not an innocent victim").

[2]See St. Paul Fire & Marine Ins. Co. v. City of Green River, Wyo., 93 F. Supp. 2d 1170 (D. Wyo. 2000), aff'd, 6 Fed. Appx. 828 (10th Cir. 2001) (obligee's wrongful termination of surety discharged performance bond obligations); U.S. ex rel. Virginia Beach Mechanical Services, Inc. v. SAMCO Const. Co., 39 F. Supp. 2d 661 (E.D. Va. 1999) (obligee's material breach of subcontract by wrongfully withholding payment discharged both the subcontractor and surety of their obligations under the bonded subcontract). Depending upon the language of the subcontract termination clauses, the termination of the prime contract also may result in termination of subcontracts. See Carolina Cas. Ins. Co. v. Ragan Mechanical Contractors, Inc., 262 Ga. App. 6, 584 S.E.2d 646 (2003) (holding that a subcontract was terminated by virtue of an owner's termination of a prime contract for default, and that the subcontractor had no obligation to continue performance of the subcontract under the prime contractor's take over of surety). When termination of the prime contract results in termination of subcontracts, subcontractors who are authorized to continue working after termination may recover under implied contract theory. See Encore Const. Corp. v. SC Bodner Const., Inc., 765 N.E.2d 223 (Ind. Ct. App. 2002).

other damages due to wrongful breach[3] and even for extracontractual damages where the termination decision is found not only to have been wrongful but made in bad faith.[4] An owner's wrong decision not to terminate, whether reached in trepidation of the consequences of a wrongful termination or in confusion over the occurrence of a material breach, can leave the owner with a project untimely completed or of unsatisfactory quality or both, and with recourse limited to the contractor and not to the performance bond surety.[5] A contractor's wrong decision to abandon the work results in liability to the owner for completion costs and

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[3]See Franklin Pavkov Const. Co. v. Ultra Roof, Inc., 51 F. Supp. 2d 204, 5 Wage & Hour Cas. 2d (BNA) 846, 139 Lab. Cas. (CCH) ¶ 33939 (N.D. N.Y. 1999) (wrongful failure to pay was a material breach that discharged the subcontractor and imposed liability upon the contractor for the subcontractor's lost profits and other costs). See also Denny Const., Inc. v. City and County of Denver ex rel. Bd. of Water Com'rs, 199 P.3d 742 (Colo. 2009) (awarding lost profit damages to a contractor due to the owner's wrongful contract termination). See also Stewart Brothers Independent Contractors, L.L.C. v. Renata Lakes Apartments, L.P., 2013 WL 4049000 (E.D. La. 2013) (holding that an owner wrongfully terminated a contract for the contractor's alleged lack of progress, where the evidence showed that most of the difficult work had been performed and the contractor could have completed all work on schedule).

[4]See Cuddy Mountain Concrete Inc. v. Citadel Const., Inc., 121 Idaho 220, 824 P.2d 151 (Ct. App. 1992) (contractor's heavy-handed wrongful termination of subcontractor justified jury award of punitive damages). See also Miller v. Mills Const., Inc., 352 F.3d 1166 (8th Cir. 2003) ("under South Dakota law, a material breach is one that would defeat the very object of the contract"); McCoy v. Gibson, 863 So. 2d 978 (Miss. Ct. App. 2003) ("material breach is a failure to perform a substantial part of the contract or one or more of its essential terms or conditions, or if there is such a breach as substantially defeats its purpose").

[5]The longer that an owner allows unsatisfactory performance to continue under a bonded contract without amply withholding, the more likely it is that the performance bond surety, when finally called upon to complete, either may be deemed discharged to the extent of overpayments or may have recourse to recover its losses. See Ohio Cas. Ins. Co. v. U.S., 12 Cl. Ct. 590, 34 Cont. Cas. Fed. (CCH) ¶ 75333 (1987) (holding that the government's untimely termination of the contract damaged the surety). When the unterminated contract reaches substantial completion, the owner ordinarily loses the right to terminate the contract and call upon the surety to complete. See Restatement Second, Contracts § 237 cmt. d ("if there has been substantial although not full performance, the building contractor has a claim for the unpaid balance and the owner has a claim only for damages"); Huguet v. Musso Partnership, 509 So. 2d 91, 92 (La. Ct. App. 1st Cir. 1987), writ denied, 512 So. 2d 462 (La. 1987) ("[t]he law is clear that a building contract may not be resolved after substantial performance has been rendered"). When the owner no longer can terminate the contract because of substantial completion, the surety's performance obligation ordinarily is deemed discharged unless the bond obligation is otherwise interpreted. See Federal Ins. Co. v. Southwest Florida Retirement Center, Inc., 707 So. 2d 1119 (Fla. 1998) (performance bond construed to cover latent defects after substantial completion).

other foreseeable damages resulting from delayed project completion,[6] and frequently also results in loss of client relationships, intangible damage to reputation,[7] and exposure to possible bad faith extracontractual damages.

What makes the termination decision so highly leveraged for both parties is that a wrongful termination of a contract is itself the paramount material breach.[8] The economic risk that a termination decision subsequently may be judged wrongful is

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[6]See Cates Construction, Inc. v. Talbot Partners, 21 Cal. 4th 28, 86 Cal. Rptr. 2d 855, 980 P.2d 407 (1999) (holding that liability for the contractor's material breach of a building contract included not only the cost of completion incurred by the owner and its lender but damages caused to the owner as a result of delayed project completion). See also Fru-Con/Fluor Daniel Joint Venture v. Corrigan Brothers, Inc., 154 S.W.3d 330 (Mo. Ct. App. E.D. 2004) (subcontractor materially breached the contract by walking off the project after the subcontractor and the contractor were unable to reach agreement on change order pricing); Barnett v. Coppell North Texas Court, Ltd., 123 S.W.3d 804 (Tex. App. Dallas 2003) (contractor's abandonment of the work due to nonpayment was a material breach, because the owner was justified in withholding payment due to the contractor's delayed performance). See also Poulin, Abandoning the Construction Project, 28 Constr. Law. 48 (Summer 2008).

[7]A contractor's wrongful abandonment leading to termination for default frequently is considered by owners (1) in determining whether the contractor should be qualified as a "responsible" contractor for the award of future contracts, and (2) in evaluating possible termination of other contracts. See Miami-Dade County v. Church & Tower, Inc., 715 So. 2d 1084 (Fla. 3d DCA 1998) (upholding county determination of nonresponsibility of bidder with whom the county was embroiled in a pending lawsuit involving defective work, improper billing, and fraud on a prior contract); Decker & Co. v. West, 76 F.3d 1573, 1581-1582, 40 Cont. Cas. Fed. (CCH) P 76887 (Fed. Cir. 1996) (the contractor's performance history could be taken into account because past lack of progress "indicate[s] a pattern of nonperformance and delay which should not be ignored. Although not justifications for default in themselves, they provide a context for understanding and evaluating [the contractor's] continued problems.") The Federal Acquisition Regulations expressly authorize consideration of performance on prior contracts in determining bidder responsibility to receive future contract awards. See F.A.R. § 9.104-3(b), 48 C.F.R. § 9.104-3(b) ("A prospective contractor that is or recently has been seriously deficient in contract performance shall be presumed to be nonresponsible, unless the contracting officer determines that the circumstances were properly beyond the contractor's control, or that the contractor has taken proper corrective action . . . .").

[8]See Carter v. Krueger, 916 S.W.2d 932 (Tenn. Ct. App. 1995) (holding that an owner's wrongful termination overrode the contractor's prior uncured material breach because the termination prevented the contractor from taking steps to cure its breach); Walker & Co. v. Harrison, 347 Mich. 630, 81 N.W.2d 352, 355 (1957) (the decision to terminate a contract "is fraught with peril for should such determination, as viewed by a later court in the calm of its contemplation, be unwarranted, the repudiator himself will have been guilty of material breach and himself have become the aggressor, not an innocent victim"). See also

magnified considerably by the (1) subjective unilateral "self help" nature of the remedy;[9] (2) lack of a clear legal standard for determining whether a construction contract breach is material or immaterial; (3) factual complexity of the construction process resulting in an increased likelihood that both parties may be found guilty of some kind of breach of contract; (4) need to determine which party is guilty of the first uncured material breach;[10] (5) judicial disfavor of termination as a draconian and drastic remedy,[11] constituting a species of forfeiture[12] warranting

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Fru-Con/Fluor Daniel Joint Venture v. Corrigan Brothers, Inc., 154 S.W.3d 330 (Mo. Ct. App. E.D. 2004) (subcontractor materially breached the contract by walking off the project after the subcontractor and contractor were unable to reach agreement on change order pricing); Barnett v. Coppell North Texas Court, Ltd., 123 S.W.3d 804 (Tex. App. Dallas 2003) (contractor's abandonment of the work due to nonpayment was a material breach, because the owner was justified in withholding payment due to the contractor's delayed performance).

See also Bast Hatfield, Inc. v. Joseph R. Wunderlich, Inc., 78 A.D.3d 1270, 910 N.Y.S.2d 256 (3d Dep't 2010) (holding invalid a contractor's termination of a subcontract for cause, after finding that the subcontractor's delays in performance were caused by the contractor or others outside the subcontractor's control, and that the contractor had waived its right to terminate the contractor where items listed in its notice of termination were incorrect or had been cured by the subcontractor before the termination became effective); Cellar Dwellers, Inc. v. D'Alessio, 2010 ME 32, 993 A.2d 1 (Me. 2010) (holding invalid an owner's termination of a contract for cause, where the contractor's delayed performance was due to the owner's wrongful withholding of funds and interference with the contractor's work); Eastern Elec. Corp. of New Jersey v. Shoemaker Const. Co., 657 F. Supp. 2d 545 (E.D. Pa. 2009) (citing treatise, and opining: "A party who has materially breached . . . may not object if the other party refuses to perform its obligations under the contract and may not insist upon such performance. If a breach constitutes a material failure of performance, as refusal to pay amounts due does, the non-breaching party is discharged from liability under the contracts that have been breached.").

[9]See Andersen, A New Look at Material Breach in the Law of Contracts, 21 U.C. Davis L. Rev. 1073, 1114 (1988);

> By its nature, cancellation is a self-help remedy. The victim need not seek prior judicial approval of the decision to bring the contract to an end, but typically commits to that course of action prior to litigation. Indeed, litigation undoubtedly never occurs in the vast majority of contract cancellations. When the matter does come before a court, it is to sort out the precise amount of damages owed and, more importantly, to decide whether the decision to cancel was correctly made. If it was not correct, that is, either no breach or no material breach occurred, then the victim wrongfully repudiated the contract and has committed the first material breach. The decision to cancel thus is a hazardous one.

[10]See § 18:15. See also Oak Ridge Const. Co. v. Tolley, 351 Pa. Super. 32, 504 A.2d 1343, 1348 (1985) (holding that the contractor's work stoppage, rather than the owner's refusal to pay disputed charges, constituted the "first material breach.").

[11]See J. D. Hedin Const. Co. v. U. S., 187 Ct. Cl. 45, 408 F.2d 424, 431

strict judicial construction and enforcement[13] of the breaching party's pretermination rights to notice and an opportunity to cure breaches deemed sufficiently material to warrant contract termination by the nonbreaching party; (6) differing judicial views of the evidentiary proof of material breach; (7) likelihood that the multitude of interdependent subcontractors and suppliers will be damaged by the wrongful termination decision, thus compounding the economic impact of the risk;[14] and (8) stark reality that

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(1969) (termination described as a drastic remedy).

[12]See Decker & Co. v. West, 76 F.3d 1573, 1580, 40 Cont. Cas. Fed. (CCH) P 76887 (Fed. Cir. 1996) ("a default termination—a species of forfeiture—is a remedy to which the Government should not lightly resort"); DeVito v. U. S., 188 Ct. Cl. 979, 413 F.2d 1147, 1153 (1969) (same); J. D. Hedin Const. Co. v. U. S., 187 Ct. Cl. 45, 408 F.2d 424 (1969) ("[d]efault termination is a drastic sanction which should be imposed (or sustained) only for good grounds and on solid evidence").

[13]See Clay Bernard Systems Intern., Ltd. v. U.S., 22 Cl. Ct. 804, 810, 37 Cont. Cas. Fed. (CCH) ¶ 76067, 1991 WL 50606 (1991) ("termination for default . . . is a drastic adjustment of the contractual relationship and the Government is held to strict accountability in using this sanction"); Kisco Co., Inc. v. U. S., 221 Ct. Cl. 806, 610 F.2d 742, 26 Cont. Cas. Fed. (CCH) ¶ 83432 (1979); White v. Mitchell, 30 Ind. App. 342, 65 N.E. 1061 (1903).

See also Mike Building & Contracting, Inc. v. Just Homes, LLC, 27 Misc. 3d 833, 901 N.Y.S.2d 458 (Sup 2010) (holding invalid a contract termination for cause, where a developer failed to strictly comply with conditions precedent to termination by failing to give the contractor adequate notice of and opportunity to cure its allegedly inadequate performance, and by failing to obtain a certificate from the architect that "just cause" existed to support the termination); New Image Const., Inc. v. TDR Enterprises Inc., 74 A.D.3d 680, 905 N.Y.S.2d 56 (1st Dep't 2010) (holding invalid a contract termination for cause, where an owner failed to give the contractor a 14-day cure notice before terminating the contract).

[14]See Siegfried Constr., Inc. v. Gulf Ins. Co., 203 F.3d 822 (4th Cir. 2000) ("The actual termination of a subcontractor is disruptive to the entire construction process because it adds to delays and expenses as new subcontractors must be found and retained, often at higher rates because of the premium paid for availability."). For insight into the perspective of subcontractors and suppliers, see Rubin and Wordes, Life at the Bottom of the Heap: Default Termination from the Subcontractors' and Suppliers' Perspective, 17 Const. Law 29 (April 1997). See also Strouth v. Pools By Murphy and Sons, Inc., 79 Conn. App. 55, 829 A.2d 102 (2003), in which the Appellate Court of Connecticut upheld an owner's termination of a contractor for material breach of contract, where the contractor began to construct a "peanut shaped pool" instead of a "kidney shaped pool" as requested by the owner. Reciting Restatement Second, Contracts § 241, the court observed that the trial court "did not specifically apply the standards of materiality enunciated in § 241," but nevertheless decided that the "standards of materiality are to be applied in the light of the facts of each case" and that "it would appear that the [trial]court, essentially, focused on the criteria set forth in § 241(a) and (b) to reach its conclusion that the construction of a kidney

rarely can a wrong decision be reversed and only infrequently can judicial second-guessing in subsequent proceedings be avoided.[15]

Given the extraordinary risks and conseqences of a wrongful termination, typical advice is "don't do it—without being sure you're right." The burden of proof is upon the party who terminates, even if denominated a defendant in subsequent litigation.[16] Once the terminating party proves that termination

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shaped pool constituted a material breach of the parties' contract."

[15]See Andersen, A New Look at Material Breach In the Law of Contracts, 21 U.C. Davis L. Rev. 1073, 1114-1115 (1988):

> While the party canceling a contract should be held to account if cancellation was not justified, the risks of the decision should not be made greater by holding the victim responsible for information that becomes known with certainty or clarity only with the benefit of hindsight. Knowledge about the costs that cancellation imposes on the breaching party often are in that category. If the victim paid for little or none of the performance rendered prior to the breach, of course, it may be possible to surmise that the other party stands to lose a great deal if the contract is canceled. But the extent of that loss will depend on a number of factors, none of which may be within the victim's knowledge. For example, to determine the costs of cancellation, an owner injured by a contractor's breach would have to know, among other things, the extent of the builder's investment in preparations for performance that had not yet been incorporated into the job. One asks too much if the victim of a breach is held responsible for knowing the risk of forfeiture to the other side and, though self-interested, must balance harm to self against harm to another. Yet, the balancing approach requires nothing less. (Footnotes omitted.).

Compare John A. Russell Corp. v. Fine Line Drywall, Inc., 2008 WL 501273 (D. Vt. 2008) (holding that a contract is repudiated not at the time the contractor walks off the job but at the time weeks later when it becomes apparent that the contractor does not intend to return), and Oak Ridge Const. Co. v. Tolley, 351 Pa. Super. 32, 504 A.2d 1343, 1348 (1985) (the contractor's work stoppage rather than the owner's suspension of the work pending resolution of disputed charges constituted the first material breach).

See also Burke and Dockery, Living in a Material World: *Kiewit-Turner*, Material Breach, and Implications for Breaching and Nonbreaching Parties, 35 Constr. Law. 18 (Spring 2015) ("The *Kiewit-Turner* decision serves to remind both owners and contractors of the perilous fact-intensive nature of determining if a material breach of contract has occurred. In light of the fact-intensive analysis required to determine whether a given breach was material or not, contractors and owners should be cautious about stopping work or terminating a contract for breach absent egregious circumstances.").

[16]See Lisbon Contractors, Inc. v. U.S., 828 F.2d 759, 34 Cont. Cas. Fed. (CCH) ¶ 75358 (Fed. Cir. 1987) (the burden of proof is on the government even if designated as defendant in litigation). See also In re Trinity Installers, Inc., A.G.B.C.A. No. 2004-139-1, 05-1 B.C.A. (CCH) ¶ 32868, 2005 WL 310792 (Dep't Agric. B.C.A. 2005) (ruling that the burden of proving the propriety of its termination for default is on the Government, and that the Government failed to carry its burden in that case).

See also Collins/Snoops Associates, Inc. v. CJF, LLC, 190 Md. App. 146, 988 A.2d 49 (2010) (where both parties to a terminated contract argued that the

was justified and properly consummated, the burden of proof shifts to the terminated party to prove that its material breach was excused.[17] As a self-help remedy, termination does not require a due process hearing of any kind prior to being invoked.[18]

A classic illustration of wrongful termination is *CJP Contractors, Inc. v. U.S.*,[19] in which the United States Court of Federal Claims overturned a decision of a government contracting officer that terminated a contract for default. The terminated $632,000 contract had called for the contractor to replace an oil-based heating system with a new gas-fired industrial furnace system in six buildings at a government storage depot in Springfield, Virginia. The work sequence required the contractor to install new gas piping, demolish and dispose of the existing oil-based furnaces, install new gas-fired furnaces, and then remove the existing oil lines and storage tanks.

From the commencement of work, the personal relationships between the contractor's president and the government's on-site representatives were strained. The government's representatives complained that the contractor did not have the right crew, right equipment, and right attitude for the job, and that the contractor's work was sub-par and behind schedule. The contractor, in turn, contended that the government had interfered with its performance by (1) failing to provide essential design details such as pipe location and type of pipe brackets, (2) failing timely to review and return shop drawings detailing the new furnaces, (3) failing to judge quality of welds by proper welding standards during inspection of the new gas pipeline, (4) failure to extend the contract completion date adequately to compensate for government delays, and (5) wrongfully suspending the work when the contractor was perceived to be behind schedule. Based on cursory government estimates that the heating systems would not be

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other party materially breached the contract, each party has the burden of proving that the other party materially breached the contract and committed the first material uncured breach that excused performance by the other party).

See also Quality Flooring v. B.F. Const. Co., Inc., 56 So. 3d 395 (La. Ct. App. 4th Cir. 2011) (rejecting proofs offered by the terminating party in justification of a contract termination for cause, and ruling that the termination was wrongful).

[17]See CJP Contractors, Inc. v. U.S., 45 Fed. Cl. 343 (1999).

[18]See Riblet Tramway Co., Inc. v. Stickney, 129 N.H. 140, 523 A.2d 107, 113 (1987) (holding that a public owner was not required to hold a formal administrative hearing prior to termination, because notice of default and opportunity to cure provided sufficient opportunity to the contractor "to present its side of the story informally prior to the termination of the contract").

[19]CJP Contractors, Inc. v. U.S., 45 Fed. Cl. 343 (1999).

completed by winter, which the contractor repeatedly disputed, the contracting officer decided to terminate the contract for default. The government then awarded a contract for completion of the remaining work to another contractor on a negotiated basis for $701,000. The completion contract's scope of work included repairing a substantial number of welds, accelerating completion so that all work would be finished prior to winter, and installing additional materials not clearly required by the terminated contract. The completion contract price included a markup for overhead and profit of 30.5%.

As might be expected, the contractor commenced suit in the United States Court of Federal Claims, challenging the government's termination for default and the assessment of reprocurement costs. The court defined the burden of proof:

> It is well-settled that "default-termination is a 'drastic sanction,' which should be imposed (or sustained) only for good grounds and on 'solid evidence.' " The government is charged with the burden of proving whether a default termination is justified. Once the government has satisfied this burden, the contractor is charged with showing that its failure was excusable.[20]

The court then addressed the government's contention that the contractor's failure to make adequate progress justified the contractor's termination for default. After a detailed analysis of the contract schedules, the court concurred with the government that the contractor could not have completed the work by winter, but also concurred with the contractor that its lack of progress was caused by excusable delays for which the contractor should have been granted time extensions. The court also accepted the contractor's contention that the government had waived the phased scheduling requirements of the contract by disregarding them during contract performance.

After making its own detailed analysis of the construction schedule, the court found that the contractor was entitled to 47 days of excusable delay, that the government had done an inadequate job of analyzing the contractor's right to extended time prior to terminating the contract for default, and that the termination was unjustified:

> [The government contracting officer] testified that [the contractor's] failure to man the site adequately and meet its commitments led her to 'lose faith' in [the contractor's] ability to get the job done. The court does not doubt the sincerity of [the contracting officer's]

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[20]CJP Contractors, Inc. v. U.S., 45 Fed. Cl. 343, 371 (1999) (citations omitted).

> beliefs. However, a review of the facts reveals the absence of data to support her beliefs. [The contracting officer] terminated [the contractor] without ever examining a time-schedule or manpower assessment. She terminated [the contractor] without any clear understanding of what needed to be done and how long it would reasonably take. Her decision was based on incomplete information at best and mistaken information at worst. As such, it cannot be sustained. . . .
>
> Finally, contrary to established precedent, [the contracting officer] never examined the impact of her decisions on [the contractor]. She never considered whether [the contractor] would be entitled to more time due to the stop-work orders, or what impact her order had on getting the job completed. She simply assumed that her stop-work orders were reasonable and that [the contractor] was not entitled to anymore time. The court finds that [the contractor] would have been able to substantially complete the contract had [the government] granted [the contractor] the 47 days [the contractor] was entitled to receive. Accordingly, the court finds that [the government] has failed to sustain its burden on its decision to terminate [the contractor] for default based on a failure to make progress.[21]

The court also ruled that the welding standards imposed by the government were more stringent than those actually required by the contract, and the government thus had not proven that the contractor breached the contract welding requirements. With respect to the reprocurement price, the court concluded that the "price was not reasonable" and that the contractor should not be required to reimburse the government.

Based upon its carefully documented findings, the court conluded that the government had wrongfully terminated the contract for default. As a result of the government's wrongful termination, the government (1) was required to pay the contractor $585,000 under the termination for convenience clause for its cost of performance prior to termination, and (2) was denied recovery of the completion contract price of $701,000 paid to the completing contractor. The government's wrongful termination decision thus caused it to pay for the work more than twice the original contract amount of $632,000. Such is the high leverage of a wrongful termination decision.

§ 18:4 Amorphous legal standard of material breach

Although the materiality of breach is the paramount issue in every contract termination dispute, there surprisingly is no adequate common law legal standard by which "material breach"

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[21]CJP Contractors, Inc. v. U.S., 45 Fed. Cl. 343, 378-79 (1999) (citations omitted).