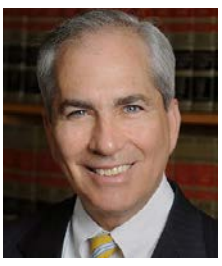
SUBCONTRACTOR SAVED BY CONTRACTOR'S FAILURE TO STRICTLY COMPLY WITH TERMINATION PROCEDURE



By Henry L. Goldberg, *Managing Partner, Goldberg & Connolly & STA Legal Counsel*

Termination for cause is an existential disaster for a construction firm, whether a general contractor or subcontractor. A default for cause impacts the company's bonding capacity, as well as its banking relationships. Certainly nothing pulls cash out of a construction company more precipitously than a default termination, and legal fees mount up, at just the wrong time, as a defaulted company must do battle on many fronts at once: against the owner or general contractor, and/or against its surety and/or against its subcontractors and suppliers. Defaults are also reported in Vendex. A "defaulted" job can create a classic "domino effect, " impacting all of the company's otherwise "good jobs". It is for this reason that a New York appellate case, just decided last week, caught my attention.

The subcontractor in this case was confronted with this very nightmare: a default termination. However, under Section 19 of the parties' subcontract, the general contractor was required to provide the subcontractor with ten days written notice before terminating the subcontract for cause. The general contractor failed to comply with this notice provision, claiming that another contract provision permitted its termination of the contract for cause without complying with Section 19, and, in any event, that oral notice was provided of its intent to terminate the contract.

As the court reasoned in its decision, most construction contracts provide for adequate notice of a claimed default, as well as adequate time "to cure" an alleged default. The issue in this case was whether the subcontractor was properly defaulted and whether the general contractor had maintained its right to assert such a harsh result.

It was successfully argued that the subcontractor's rights should be protected by virtue of long-held principles of contract interpretation. A contract must be read as a whole, giving effect and meaning to all of its terms in a way that reconciles the entirety of its provisions. Where a contract provides, such as the subcontract in this case, that a party must satisfy a specific condition precedent before terminating an agreement, the condition precedent should be enforced as written, and must be complied with by the appropriate party.

In this recent appellate case, the general contractor clearly disregarded the provision requiring ten days written notice in order to terminate the contract for cause. The general contractor's failure to adhere to the condition precedent of 10 days written notice triggered the application of a subsequent portion of Section 19, which stated that, if the general contractor "improperly" terminated the contract for cause, the termination was to be deemed "for convenience, " entitling the subcontractor to damages (typically reimbursement of direct costs, but not profit) resulting from the termination. Under these circumstances, the general contractor would be responsible for compensating the subcontractor under the termination for convenience provisions of the subcontract. (Although not an issue in this case, the procedure for "calling in" a performance bond where a surety's principal has been defaulted can also present critical conditions precedent that must be carefully followed.)

G&C Commentary

Keep in mind that subcontracts are essentially private sector agreements, even in the context of a public project. Unlike the prime contract on a public job, where not a single word in a typically 200-300 page contract can be negotiated or modified, a subcontract presents many opportunities to mitigate or modify contractual risk. However, in their anxiety "to get the work, " far too many contractors and subcontractors give up the ghost of any real attempt to negotiate a better deal. This can be a costly mistake.

One of our "first rules" to contractors and subcontractors, of course, is to "carefully read any proposed contracts or subcontracts... and, then to read them again. " Every aspect of a subcontract is potentially negotiable, except for those provisions which are required to be (and are properly) "flowed-down" from the prime contract. Perhaps the rule should be "negotiate, and then negotiate again. " One need only imagine where the subcontractor in this case would have been if it did not pay careful attention to the subcontract when it was first proposed, to assure that there was a fair default/termination clause? No doubt it was not hard to obtain at the outset of the project when no controversies existed.

Yes, it is difficult to talk about topics such as divorce (i. e., termination) during the honeymoon. But do not make any assumptions as to what may be possible in subcontract negotiations. Your company's needed skillset, and other unique reasons for its desirability to a particular general contractor for a particular job, can often give you a better bargaining position than you might imagine. Push the limits and put your company in a more profitable and less risk-ladened position. Get the best deal, understand it and follow its provisions meticulously. Invest in contract management (not just project management). It will pay, as in this case, huge dividends down the road.

Henry L. Goldberg, Esq. can be reached by email at hlgoldberg@goldbergconnolly.com or by telephone at (516) 764-2800.

Andreas Koudellou of Goldberg & Connolly assisted with the preparation of this article.