

**O**ften, contractors face a situation where they believe they may have a right to abandon a job, but are not completely convinced of the merits of their position. Or contractors may realize they have the right to abandon, but see long-term benefits in staying on the project—perhaps because the project may still turn out to be profitable, they may recover on claims or, there is a shortage of other work.

Under these circumstances, the contractor wants to get the owner's attention in a serious way, but without completely abandoning the project. Therefore, either by actions (for example, cutting back on his labor force) or by notice, the contractor will signal the owner he is (a) entitled to abandon the job, (b) seriously considering abandonment of the job and is about to do so, but (c) has not yet taken the final step that would amount to abandonment.

The contractor who embarks upon this course of action must proceed with extreme caution. If he sends the wrong signal, the other side may interpret his intent as an abandonment when, in fact, the contractor did not intend to abandon the project. Then, the other side may terminate the contract, and the contractor finds his "warning" turns into the abandonment he was not prepared to undertake.

A contractor considering this form of quasi-abandonment should proceed very carefully in signalling their intent to the other side. Often this is done by way of a carefully drafted notice letter that attempts to 'straddle the fence' and prevent an unwilling abandonment, or an acquiescence to the problem and waiver of any remedies.

Consider the following example of such a notice letter:

*In light of the developments that have occurred on this project and your inability to deliver to the site to us, it is our view that there has been a material failure of performance on your part which operates to discharge our duty to perform. The duty which we undertook in our subcontract with you to install duct work was subject to certain conditions, the most important of which was the condition that the site would be available for such installation. The performance of our duty, subject to those conditions, does not become due unless the*

## To Walk or Not To Walk

*That is the question, when contractors are wronged but still think there's money to be made.*

conditions occurred, or unless their non-occurrence was excused.

The facts which we have related above and with which you are familiar, make it clear that the necessary conditions have not occurred and that their non-occurrence is not excusable. Therefore, we have no alternative, if we are to proceed under the new circumstances affecting this project, but to obtain relief for those costs if we are to perform our installation. After you have had an opportunity to review the situation, we will appreciate your contacting us.

In this case, the contractor had concluded that, while he probably had a legitimate reason to abandon the job, he still could make money and wanted to keep his labor force busy during a slow construction period.

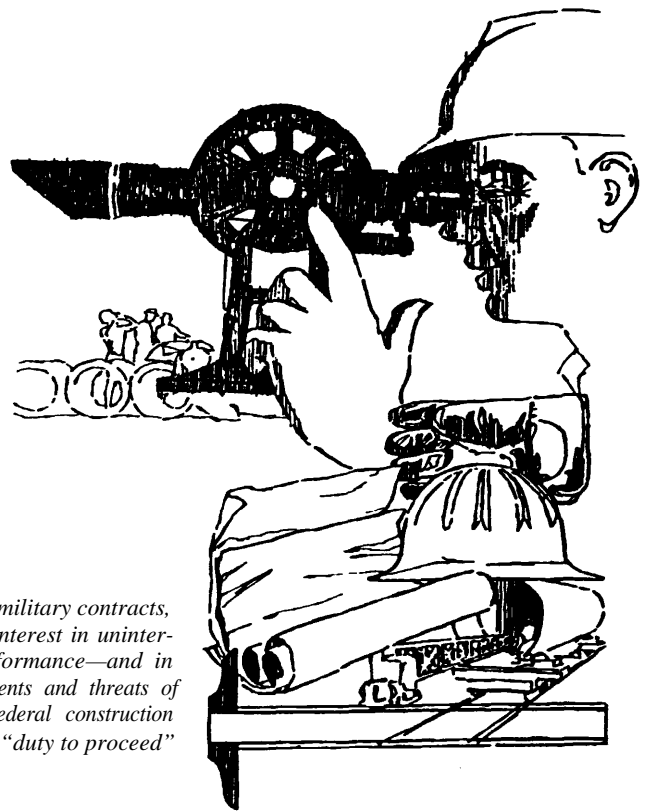
Therefore, while he felt it necessary to clearly signal the other side of his right to abandon, he did not want to go that far. So the letter had to be carefully drafted to ensure the recipient would not read it as an abandonment, but rather as a serious warning.

Such a warning may often be accompanied by a reduction in work force down to the bare minimum to maintain visibility on the project. If such action is contemplated, it is advisable to notify the other side that to minimize damages for which it will be responsible, the contractor has voluntarily reduced his work force until the other side corrects the problem.

Obviously, there is considerable "brinkmanship" in this area, and contractors who want to straddle the fence before making the final decision to abandon a project must proceed extremely cautiously.

However, ultimately forgiving another's material breach can sometimes carry a high cost, also. For example, a party's duty to render certain kinds of performance (like prompt payment) may be excused if the other party manifests an intention to forego a benefit. This manifestation is made through an intentional act or omission with knowledge of the party foregoing the benefit.

Such waivers need not be express, but may be implied from the circumstances. Moreover, if the other party makes a substantial change in his



*Especially in the area of military contracts, the government has an interest in uninterrupted and prompt performance—and in avoiding indefinite arguments and threats of abandonment. Thus all federal construction operates under a unique "duty to proceed" doctrine.*

## **Contractors performing work on government projects may exercise their right to abandon work if the government has materially breached the contract.**

position in expectation that the condition is permanently excused, the contractor may not be able to reinstate the waived benefit.

Acceptance of a late payment waives a contractor's right to assert breach as regards that payment, but not for future installments if clear notice of a requirement for future promptness is made. Once one party falls passively into a pattern of forgiveness, then it must clearly break the pattern to assert a future breach on the particular recurring activity.

These principles are illustrated in one court case, where a contractor terminated a subcontractor because equipment did not conform to specifications, liens were allowed to be placed on the equipment, and the schedule for work was not maintained. But the contractor was prevented by the court from us-

ing these grounds as material breaches to justify termination because:

- No protest was made against these occurrences at the time they became known.
- The subcontractor was allowed to continue its performance.

These lessons apply with equal force in the abandonment context, where a contractor may lose his right to assert a material breach, if he waits until after termination to assert it. Even if the contractor does not want to "walk," he will still want to assert damages for the material breach later.

If performance is continued despite a breach that could later justify abandonment, the contractor should file protests and claims immediately that liquidate his damages or identify problems that will to future costs of a presently indeterminable amount.

## Examine Your Contract

Contracts may restrictively define material breach in certain instances, or

through such devices as “no damages for delay” clauses, time extension

Is there compensation for delay? Is the stated compensation so clearly set

clusive remedy? Are there owner or contractor rights to suspend the —within what limits?

Contract language often provides guidance as to what specific acts on the part of the other side will entitle him to abandon. Set forth below are contract clauses, drawn from several of the Standard Form AIA Contract Documents, that define various acts which justify abandonment (provided the contractor gives the required notice):

## When a contractor unjustifiably walks, sometimes a breaching party may still recover, but the circumstances are fairly rare.

*A107, Article 20.1. If the Architect fails to issue a Certificate for Payment for a period of thirty days through no fault of the Contractor, or if the Owner fails to make payment thereon for a period of thirty days, the Contractor may, upon seven additional days' written notice to the Owner and the Architect, terminate the Contract and recover from the Owner payment for*

*all Work executed for any proven loss sustained upon any materials, equipment, tools, and construction equipment and machinery, including reasonable profit and damages applicable to the Project.*

*A201, Article 14.1.1. If the Work is stopped for a period of thirty days under an order of any court or other public authority having jurisdiction, or as a result of an act of government, such as a declaration of a national emergency making materials unavailable, through no act or fault of the Contractor or a Subcontractor or their agents or employees or any other persons performing any of the Work under a contract with the Contractor, or if the Work should be stopped for a period of thirty days by the Contractor because the Architect has not issued a Certificate for a Payment as provided in Paragraph 9.7 or because the Owner*

has not made payment thereon as provided in Paragraph 9.7, then the Contractor may, upon seven additional days' written notice to the Owner and the Architect, terminate the Contract and recover from the Owner payment for all Work executed for any proven loss sustained upon any materials, equipment, tools, construction equipment and machinery, including reasonable profit and damages.

*A401, Article 14.1.1. If the Work is stopped for a period of thirty days through no fault of the Subcontractor because the Contractor has not made payments thereon as provided in this Agreement, then the Subcontractor may without prejudice to any other remedy he may have, upon seven additional days, written notice to the Contractor, terminate this Subcontract and recover from the Contractor payment for all Work executed and for any proven loss resulting from the stoppage of the Work, including reasonable overhead, profit and damage.*

## **The contractor must carefully follow the procedures for giving proper notice.**

Note the preconditions for contractor's termination in AIA standard forms. Provisions like those quoted above amount to an agreement on the part of the parties as to what acts will constitute the basis for abandonment or termination of the project. However, the contractor must ensure he follows carefully the procedures for giving proper notice so as not to lose the right to terminate.

Termination of a contract, by either side, is often viewed by the courts as a forfeiture-and it is a fundamental policy of the law to avoid forfeitures. Therefore, the party seeking to oppose an abandonment or termination will argue that a precondition such as notice was not fulfilled, and therefore

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the termination is invalid.

Contractors performing work on government projects, particularly federal projects, may exercise their common-law right to abandon or terminate work if the government has materially breached the contract.

However, the "Disputes" clause contained in the standard form government

contract (Standard Form 23-A), has substantially reduced the type of government actions that justify abandonment. Instead, the Disputes Clause requires the contractor to *proceed with the work under protest* where a disagreement between the parties has developed.

The new disputes clause issued under

*Except as the parties may otherwise agree, pending final resolution of a claim by the contractor arising under the contract, the contractor shall proceed diligently with the performance of the contract in accordance with the contracting officer's decision.*

Many states and municipalities include disputes clauses in their contracts that limit contractors' rights to abandon jobs notwithstanding a material breach.

The Federal government has a particular interest in avoiding an interruption of performance in the area of military contracts, where uninterrupted and prompt performance is essential—and would be harmed by indefinite disputes and threats of abandonment. As the Armed Services Board of Contract Appeals said in *Detroit Designing & Engineering Company*, a 1964 case:

*Regardless of the merits of a dispute, the plain provisions of the contract and the public interest do not for a moment permit us to countenance possible hampering of operations which might involve the lives of servicemen or the political position of the country in its myriad worldwide commitments and responsibilities. Yet, this might be the precise effect of prolonged suspension of contract performance even in connection with the most commonplace item of supply.*

Thus, in the area of federal construction, there has arisen the doctrine of the "duty to proceed." One commentator has defined the theoretical basis of the duty to proceed in this fashion: "In exchange for the contractor's giving up his right to stop performance and seek redress in the courts, the government agrees to the administrative procedure for settling disputes."

Even under a disputes clause, contractors are entitled to an indication from the contracting officer that the government expects continued performance. Such an indication obviously is given where the contracting officer has issued an appealable final decision concerning the matter in dispute.

Where disputes have not risen to the level of an appealable final decision, contractors are still under a duty to proceed in accordance with the *direction*

## **Contractors may have a right to abandon, but see benefits in staying on the project.**

of the contracting office which later may become his final decision. Even though contractors may believe the government's actions to be wrong, refusal to proceed risks termination.

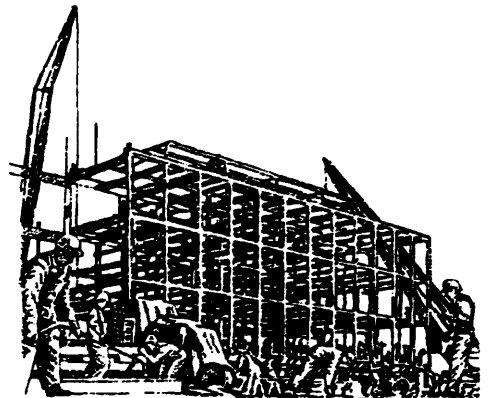
While the duty to proceed under a government contract is rather broad, there are certain acts on the part of the government that may constitute a material breach. The most obvious example is failure to make payments that are clearly due. As the Court of Claims noted in one case, mere *delay* would not be a material breach, but there is a clear distinction between mere delay and a total failure to pay over many months.

In one instance, the contractor's right to stop performance was upheld where payments were four months behind and admittedly due. In other cases, both the Agricultural and the Armed Services Department boards of contract appeals held that one month's delay in progress payments constituted a material breach by the government.

Other types of material breach the government may commit are "cardinal changes," and failure to follow procedures required by the Disputes Clause. Additionally, unreasonable and untimely government inspections may justify abandonment by the contractor.

Contractors on federal projects must be especially cautious about exercising their right to abandon the job. Where their contracts contain a Disputes Clause, they are under a duty to proceed unless the government has committed a material breach (which will be much more narrowly defined by the courts than a material breach in the private sector).

A general contractor's duty to proceed on a government project does not necessarily extend to his subcontractors. As the Fourth Circuit Court of Appeals held in *United States v. Cleveland Electric Co. of South Carolina*, 373 F.2d 585 (1967), a subcontractor is not automatically a party to the general contractor's government contract. Therefore, subcontractors are not required to pursue the Disputes Clause remedy contained in the prime contract.



In *Cleveland Electric*, suit was filed under the Miller Act by a subcontractor against the prime contractor in connection with work performed on a Polaris Missile Assembly Base in Charleston, South Carolina. The Miller Act plaintiff had installed an earthen cover over a building that the Navy resident officer in charge of construction determined did not meet contract specifications.

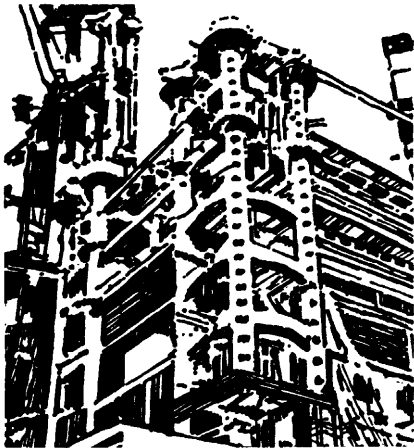
The government ordered the prime contractor to remove the earth cover and replace it with other material. The prime contractor, in turn, demanded the subcontractor perform the work.

The subcontractor refused, saying the material used to cover the building—which the Navy was now claiming defective—had been approved by an earlier Navy officer.

The subcontractor informed the prime contractor that neither of them were obligated to perform, since the job had been completed and accepted. But the subcontractor was instead informed by the prime contractor that the work would be done by others, and the subcontractor would be backcharged.

The prime contractor performed the work, and then filed a claim for an equitable adjustment under the “Changes” clause of the contract. Ultimately, the prime contractor recovered on its claim against the Navy.

The prime contractor backcharged the subcontractor for the expense of prosecuting the claim, plus a sum equal to interest on the amount allowed for the period during which the money was withheld while the claim was being prosecuted.



At the trial court level, the court found the subcontractor was justified in refusing to return to the site and comply with the Navy’s order. On appeal, the Fourth Circuit upheld the trial court, and noted the basic error of the prime contractor was his contention the subcontractor was bound to the prime exactly as the prime contractor was bound by the terms of the prime contract.

While the subcontract incorporated the terms of the prime contract, the court found such language did not require the subcontractor to pursue the administrative remedies given the prime contractor in the Disputes Clause.

The court cited a number of cases,

noting the government does not recognize or deal with subcontractors and owes them no obligation for the work they perform. The court found that, to the extent the subcontractor was bound to the prime contract, it was only to cover the quality and manner of performance of the subcontractor’s work—and not the rights and remedies between the subcontractor and the prime contractor.

Therefore, the subcontractor had no obligation to pursue and exhaust the administrative remedies provided in the Disputes Clause of the prime contract. Since the subcontractor was under no obligation to perform the extra work, he could not be backcharged for the expenses incurred by the prime contractor in pursuing its administrative remedies under the contract.

As this case made clear, the court

was not willing to conclude that general language was sufficient to hold the subcontractor to the Disputes Clause. However, had the general contractor's subcontract been carefully drafted, the subcontractor would have been bound to the Disputes Clause and liable for the backcharge.

When a contractor justifiably walks, he can initiate suit and does not have to raise his claims on the defense. Suit can be filed to recover cost and profit (expectation interest), or to recover the value of the benefit conferred on the owner before abandonment.

For example; suppose a contractor was in a financial loss position on a project, or had supplied labor and materials in excess of the contract price. Then, suing for "value conferred" would provide a better recovery, since no profit could have been realized and the contract price would not equal cost.

Remember, however, contracts may create exclusive remedies for certain

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## Written warnings may often be accompanied by a reduction in workforce.




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forms of breach. Courts will respect such remedies as a matter of proper consensual allocation of risk.

When a contractor unjustifiably walks, sometimes a breaching party may still recover, but the circumstances are fairly rare. Generally, abandonment

will be a material breach against the contractor if the act is not justified.

If the benefits conferred on the owner, however, exceed the value of lost expectations caused by the abandoning contractor's breach, there is a possible action for restitution. This action would be to recover any benefit the owner might have received that puts him in a better position than his bargain provided initially. A willful breach will preclude this type of recovery.

Rarely will abandonment of a construction contract provide opportunity for large recoveries because monthly progress payments usually prevent owners from accumulating great advance benefits. 

**About the Author . . .** Gerald Katz, Esq., is a partner in the law firm of Katz & Stone, Vienna, VA, and specializes in construction disputes. He lectures frequently before contractor groups.