

ABANDONING THE JOB: WHEN TO TAKE THE RISK

Gerald I. Katz, Esquire
KATZ & STONE, L.L.P.
8230 Leesburg Pike
Suite 600
Vienna, VA 22182
(703) 761-3000

(703) 761-6179 - fax

ABANDONING THE JOB: WHEN TO TAKE THE RISK

INTRODUCTION

Contractors have usually taken one of two “traditional” approaches to the question of abandonment of a construction project. Neither approach is safe, and a way must be found to steer a clear course between the great risks involved in each alternative.

By far the majority rule among contractors is the approach of never abandoning the job. However, this approach involves a number of risks which include the following:

1. The contractor may merely get further into trouble as a result of the problem he has encountered, for example, the owner may fall further behind in making progress payments and thus get deeper into the contractor's pocket. The deeper the owner gets, the harder it may be to withdraw from the job at a later date.
2. The contractor who absolutely refuses to consider abandonment may do further damage to his position when the job ends. For example, the contractor who fails to walk when he is entitled to may find, at the end of the job, that he is accused of failing to reduce his damages or waiving the breach by the other party which would have justified his abandonment had he done so earlier.
3. Taking the position of never walking a project will avoid the early confrontation which, sometimes, is helpful in clearing the air and disposing of a particular problem so that the remainder of the project proceeds smoothly.

The other traditional approach to the question of abandonment is that of the contractor who is willing, almost eager, often for reasons of principle, to take the risk of abandoning the job when, in fact, he is not in a position to do so. The risks associated with this approach to the problem include the following:

1. The contractor who is quick to abandon will find that his reputation among owners, bonding companies and subcontractors will suffer if he is viewed as being prone to walk a job.
2. The contractor who too eagerly walks a job may find that he has unjustifiably abandoned the work and has exposed himself to a lawsuit for the costs incurred to complete the job. In such cases, the contractor who is brought in to finish the job tends to “gold plate” it at the expense of the original contractor.
3. This contractor often will provoke a confrontation where none is necessary and where he is not in a good position to win the confrontation that arises.
4. The greatest risk is that an improper abandonment will be a material breach of contract thus justifying termination of the contract by the other party.

The problem, therefore, is clearly how to steer a safe, steady course between the two perils described above. To chart such a course we will review a number of factors that the contractor should consider in making a decision as to whether or not to abandon the job. However, it should be emphasized that the decision should come only after a careful analysis of the problem both from a business and legal perspective. In particular, it is an error to walk the job merely because the contractor's attorney concludes, often in the passion of the moment, that abandonment is legally justified. The decision should always reflect the contractor's sound business judgment, even if it is contrary to the advice he receives from his attorney.

I. EVALUATING THE PROBLEM: WHAT QUESTIONS SHOULD THE CONTRACTOR ASK HIMSELF AND HIS ATTORNEY?

A. Purpose of Presentation

1. When does the contractor have the right to abandon the job?
2. Does the contractor want to exercise this right?
3. If so, how can the contractor leave the job safely and avoid a lawsuit?

B. No Single Factor Determines the Right to Abandon

1. Every contract and project creates some of its own special rules and conditions.

2. The facts to be applied to these rules are unique to every project and always involve questions of judgment about which people may differ.
3. However, there are some general rules that do give helpful guidance to the contractor faced with this difficult problem.

C. Suggested: A Multi-Step Approach

1. Do you have a factual basis to support a claim that there has been a material breach of your contract?
2. Do you have a legal basis to support a claim that there has been a material breach of your contract?
3. Does your contract or your course of conduct reveal anything that can undermine the factual and legal basis of your claim?
 - a. Your contract may address the question of abandonment and create limitations on your right to walk off the job.
 - b. Your contract may require you to do certain things before you abandon, for example, give notice (See, e.g., AIA General Conditions, A-201).
 - c. Your actual conduct may undermine your legal right to abandon or send a confusing signal to the other side that results in a misinterpretation of your position.
4. Do you have good evidence and proof?
5. Have you given proper notice of all problems and kept good records?
6. If you abandon, what is your exposure?

D. An Illustration of the Suggested Approach

1. *Vermont Marble Co. v. Baltimore Contractors, Inc.*, 520 F. Supp. 922 (1981).

This case illustrates the approach suggested above. Vermont Marble Company was a subcontractor to the general contractor hired by the Architect of the Capitol to construct an extension to the Everett Dirksen Senate Office Building in Washington, D.C. The subcontractor was required to do the stonework facing on the building. Approximately 20 months after signing the subcontract, the subcontractor abandoned the project asserting a right

to rescind the contract by virtue of undue delays in the preparation of the site for the performance of its stonework. The subcontract originally included provisions requiring the subcontractor to prosecute the work promptly; a “no damages for delay” clause; and language referring to certain “milestones” established in the prime contract as guidelines by which the prime contractor was to schedule the work. Ultimately, the “no damages for delay” clause was deleted during negotiations of the subcontract and other language was included which preserved the subcontractor's right to make claims against the prime contractor for any “unreasonable length of delay of subcontractor's work within Contractor's control or caused by the Owner.” As a result of delays, the subcontractor was prevented from commencing its stone installation at the time originally anticipated (November 1979) and the building only became ready for stonework in April or May of 1980.

As the anticipated commencement date for the subcontractor's work drew near, the subcontractor's attorney advised the prime contractor that there had been unreasonable delays in making the site ready for commencement of the stonework. The subcontractor stated that it would perform the stonework if the delay was not the fault of the prime contractor; but if the delay was the responsibility of the prime contractor, the subcontractor intended to rescind the contract. It asked for documentation from the prime contractor as to the causes of and responsibility for delays. Additionally, the subcontractor advised the prime contractor that it intended to mitigate its damages by removing workers from the site whose services were not then required.

When the prime contractor failed to provide the documentation and assurances requested by the subcontractor, the subcontractor filed suit seeking a judicial determination of its right to abandon the job. One week later, the subcontractor withdrew its forces from the site claiming that this was being done in an effort to mitigate its damages, though it contended that this was not abandonment of the project. However, by mid-December, 1979, the subcontractor advised the prime contractor that it considered the subcontract as rescinded and that it was entitled to abandon the project.

At trial, the prime contractor contended that the subcontractor had all along planned to abandon the job and merely had postponed the decision until it had no further excuse for not abandoning the project. The subcontractor responded that as a result of the delay to the project, its subcontract had been materially breached, thus giving the subcontractor a common law right to terminate the contract or perform and sue for damages.

The court concluded that the subcontractor had wrongfully rescinded its contract and, therefore, was unjustified in abandoning the project. In reaching this decision, the court paid respect to the situation that all contractors encounter on a complex construction project by observing the following:

Except in the middle of a battlefield, nowhere must men coordinate the movement of other men and all materials in the midst of such chaos and with such limited certainty of present facts and future occurrences as in a huge construction project Even the most painstaking planning frequently turns out to be mere conjecture and accommodation to changes must necessarily be of the rough, quick, and ad hoc sort, analogous to ever-changing commands on the battlefield.

The court concluded that a clause of the contract, which the prime contractor and subcontractor had negotiated during lengthy sessions preceding execution of the subcontract, reflected the parties' attempt to provide for their respective rights and obligations under the type of circumstances that might arise during the course of performance, the details of which, like the details of a battle, obviously were quite unforeseeable. Therefore, the court placed greater reliance upon this clause which required the subcontractor to proceed under protest, in concluding that the subcontractor had improperly abandoned the job. The court dismissed the subcontractor's argument that merely because a provision of the contract stated "time is of the essence," the delays which the subcontractor had incurred justified its abandonment. The court concluded that the carefully-drafted paragraph dealing with delays and requiring the subcontractor to proceed under protest overcame the subcontractor's argument that any delays gave him the right to abandon the project. As the court found in a statement which should be

of interest to subcontractors and prime contractors: “It is essential that the prime contractor on projects such as Dirksen be permitted to say to its subcontractors, in essence, 'Work now, ask questions later.'” Therefore, the court concluded that in view of the paragraph providing for the subcontractor to work under protest, even unreasonable delays would not be material breaches of the subcontract. Instead, a material breach would arise only if the prime contractor refused to pay a properly presented claim. Since the subcontractor never even presented a claim, its rights had not been breached and, instead, it had breached its subcontract by an improper abandonment.

In summary, the factual basis for abandonment was present; but the legal and contractual basis was not adequate. The subcontractor's insistence that the contract provided that “time was of the essence” did not overcome the force of the special remedies clause that also appeared in the contract.

Vermont Marble Company provides a good example of the factors that must be considered in determining whether or not to abandon a job. These factors will be reviewed in greater detail below using the multi-step approach which, it is suggested, allows for rational decision-making under the “battlefield” conditions that often occur on construction projects.

II. UNDERSTANDING THE BASIC LEGAL CONCEPT IS CRITICAL IN WEIGHING THE RISK OF ABANDONMENT

A. Material Breach of the Contract Discharges Your Duty to Perform

1. Material breach is the fundamental legal basis for abandonment.
2. Definition of Material Breach: A failure to perform by one party such that the other party does not receive substantially what he bargained for; as a result, the non-breaching party's duty to perform further is discharged.

Example: Excavation subcontractor performed work under contract with monthly payments due upon submitting progress payment requisition. Subcontractor damaged other work in a bulldozer collision, and refused to repair, pay for, or acknowledge liability.

Subcontractor did not receive the next payment and abandoned the site.

Contractor requested subcontractor to return and perform. Subcontractor refused and was then sued by the contractor for collision damage and excess costs of completion by a new subcontractor.

Which party caused the first material breach so as to discharge the duty of the other?

Here is the court's reasoning. Because the collision caused damage equal to twice the amount of an ordinary monthly payment, the excavation subcontractor had materially breached its duty to do workmanlike work when it repudiated liability.

The contractor's duty to pay was thereby suspended and it could sue for damages against the abandoning subcontractor. Query?

What if the collision was only 10% of the subcontractor's regular monthly requisition? The result probably would have been different. Courts often conclude there has been a material breach without giving reasons; hence, there is no absolutely reliable formula on which to rely in advance of weighing the decision to abandon.

At minimum, make sure the facts balance heavily in your favor.

(Hypothetical is based on *K & G Construction v. Harris*, 164 A.2d 541 (Md. 1960)).

B. Where Magnitude of the Breach is Uncertain and the Other Party is Financially Solvent

1. Remember, when a material breach occurs the contractor does not have to abandon.
2. There is always the option to perform on the contract and sue for damages later.
3. The choice, however, can be difficult because, among other things, you run the risks of (1) allowing the other side to gain an upper hand, and/or (2) acting too soon.

Example: A painting subcontractor was ordered to apply a third coat of paint where the specifications required only two. Subcontractor requested written change order or assurance for reimbursement for extra work, but the order to proceed was reiterated without the written assurance. Subcontractor walked precipitously without notice before completing second coat.

Court agreed that the “attitude” of contractor indicated a material breach. Court said it would have been more prudent for the subcontractor to stay on and complete the job according to the original contract documents, but nevertheless allowed the painting subcontractor to collect damages equal to unpaid work prior to abandonment.

The court disallowed the painting subcontractor's claim insofar as it sought lost profit because of its abandonment rather than completion of original terms.

Johnson, Inc. v. Basic Construction, Inc., 292 F. Supp. 300 (D.C. D.C. 1968).

Query: If you abandon after owner or contractor interferes with your work after your notice of intent to continue, would you get lost profits? Yes, possibly.

Did the painting subcontractor in the above example risk total rejection of his claim by the court because it could have completed original terms? Quite possibly!

The judge might have felt that subcontractor owed the contractor more, especially since the contractor was not in arrears.

C. Immaterial or Insubstantial Breach Does Not Justify Abandonment

1. Lesser breach compensable by damages will not rise to level of material breach to justify abandonment if the essentials of the bargain are still intact.

Example: A dispute arose between a contractor and owner after the contractor refused to do further corrective work without prompt payment.

Owner claimed that contractor breached because of existence of defects, such as unpainted wood and improper switches. Trial court determined that numerous small defects were compensable as damages against outstanding balance, but that contractor's failure did not constitute a breach substantial enough to extinguish the owner's duty to pay. Contractor recovered full price less cost of corrective work under doctrine of substantial performance. On appeal, however, the contractor was denied recovery as the appeals court was sympathetic to the fact that certain defects were not remedial, although the structure was still habitable. Cumulative minor defects constituted substantial breach, and the appeals court denied relief. Neither opinion nor

decision was unreasonable, but the appeals court felt that the owner had been treated too harshly. The court defined materiality as “A question that must be determined relative to all the other complex factors that exist in every instance.” *Tolstoy Const. Co. v. Minter*, 143 Cal. Rptr. 570 (1978).

D. Other Facts in Weighing Materiality of the Breach

1. Two of the many factors that affect materiality are time of breach and willfulness.

2. A breach at the outset is more likely to be regarded as material.

At the outset a party against whom a breach has occurred has a more difficult time in determining how consequential the breach ultimately will be.

3. A willful breach is more likely to be regarded as material.

a. Although there is an old rule that motives do not affect extent of damages, it is a frequent position of courts that willfulness or gross negligence will characterize a breach as material, where non-willful mistakes will not. Willfulness suggests that more unreasonable conduct will follow. This justifies protective steps, i.e., abandonment, so as to reduce your damages.

III. EXAMPLES OF ABANDONMENT

A. Scheduling and Coordination

A fireproofing subcontractor left the site of a hospital wing under construction alleging that the contractor had breached its subcontract which provided that the work would be scheduled and coordinated in a reasonable manner.

Delays and gross miscoordination by the general contractor increased the subcontractor's costs, and made the proper application of the fireproofing material to steelwork susceptible to damage. The contractor also refused to give an assurance for payment for increased costs resulting from lack of coordination and scheduling.

The court held that material breach of contract had occurred which entitled recovery of lost profits, but since actual costs exceeded price there was no profit. Subcontractor received cost of all partial performance less payment received to the date of termination.

Blake Const. v. A.J. Coakley Co., Inc., 431 A.2d 569 (D.C. App. 1981).

Note that this case indicates that abandonment where there is clear material breach does not preclude recovery of total anticipated profit.

The court in this case noted that both implicit and explicit contract duties had been breached, where the contract contained an implied condition not to interfere with performance and an express condition to schedule work and coordinate reasonably.

B. Active Owner Interference

1. Obstructive acts by engineer or architect.

Obstruction in the form of improper directions or defective plans may constitute a material breach so as to permit abandonment.

Contractor can be required to follow bad specifications strictly, but if the specifications are impossible of performance, then the defects can give rise to breach.

Savin Bros., Inc. v. State of New York, 405 N.Y.S.2d 516 (1978).

C. Passive Owner Interference - Failure to Prevent Obstruction

1. Failure to prevent third-party obstruction may justify abandonment.

Example: *Farrell Heating & Plumbing v. Facilities Develop.*, 414 N.Y.S.2d 767 (1979).

A mechanical subcontractor was to make improvements in a state mental hospital, but walked off the job when it was unable to have its work area free of the presence of hospital patients.

The court noted incidentally that the contract expressly provided for removal of the patients from these areas, but indicated that breach of implied duty to cooperate was sufficient to justify the abandonment in this case.

Argument that mental patients were independent third-parties for which defendant was not responsible was rejected.

2. Failure to resolve or remove third-party obstructions may also justify abandonment.

Example: The general contractor was hired by the owner of a hospital company to construct a hospital under a multi-phase project. The first phase contractor was responsible for excavation and placement of the foundation and foundation columns.

The first-phase contractor was also required to verify the accuracy of the location of the columns by means of an as-built survey at the completion of his work. The first act required of the second-phase contractor was to verify the accuracy of the earlier contractor's work before proceeding to install his work thereon. As soon as the second-phase contractor started on the job, he determined that the entire foundation was approximately one-half foot skewed and that numerous columns were not properly located. Thus, the second-phase contractor could not begin his work as he had anticipated. The subject was brought to the owner's attention and to the attention of the architects and engineers as well as the phase-one contractor, all of whom concluded that, in fact, the foundation and columns had been improperly installed. The choice, therefore, was to continue construction of the hospital on the basis of the erroneously-placed foundation and columns, or to correct the problem before proceeding with the rest of the work.

Did this situation present the second-phase contractor with an opportunity to justifiably abandon the project absent assurances from the owner to compensate the contractor for costs and time lost due to this problem? The contractor declined to create a confrontation over this problem and, regrettably, the rest of the project experienced similar problems. (For example, four-inch pipes to be installed in three-inch walls, inadequate ceiling space for mechanical systems, other mechanical and electrical conflicts, etc.) The second-phase contractor never received time extensions for these problems, was required to accelerate the work in order to complete on time, incurred a substantial loss and became involved in a lawsuit.

This situation taken from an actual case, presents the key factors that have to be considered in the multi-step approach to abandonment. Was there a proper factual basis to support the second-phase contractor's claim of a material breach of contract? Factually, at the outset of the project, when the foundation and column problem arose, there probably was a factual basis.

Next, was there a proper legal basis to support the contractor's claim, if it had been made, that there was a material breach of contract. Probably so in view of the fact that the owner represented the work of the first-phase contractor to be accurate and correct and, further, required the second-phase contractor to verify its accuracy as a condition precedent before he began his work.

Third, the contractor's conduct, upon discovery of the problem, may have undermined or weakened the strength of his factual and legal position because he continued to perform on the project despite the owner's rejection of his request for a time extension and compensation for impact costs, though he did reserve his rights for the future. Thus, the contractor came very close to a waiver of the right to abandonment had he decided to abandon the project at a later date as a result of this problem. As to the other elements of the multi-step approach, the contractor had excellent records, he had given proper notice, yet he had made a business decision, later regretted, not to abandon the job.

D. Owner's Wrongful Termination

1. A party may sometimes treat a failure to assure proper performance in the future as a form of breach.

In *Brady v. Oliver*, an old Tennessee case, 147 S.W. 1136 (1911), the owner ordered the contractor off the site when he anticipated that the contractor would be unable to complete the job on time. This decision was made by the owner twelve months before the completion date and therefore failed to establish a sufficient basis for anticipated inability to perform.

The contractor was therefore entitled to all unpaid costs or, if it had indicated its willingness to continue to perform, costs and lost profits once it proved a valid legal excuse preventing its continuing performance.

E. Owner Failure to Issue Changes

1. As indicated in the *Blake v. Coakley* and *Johnson v. Basic* cases above, the failure to give assurance of payment for extras may be grounds for abandonment.

Remember, however, the court will have to agree that the extras constitute a substantial demand so as not to be recoverable merely by a claim for damages, *i.e.*, the changes must substantially alter the bargain.

It is extremely difficult to fashion a general rule that enables the contractor to determine when extras which are disputed provide a sufficient basis for abandoning the project because they have substantially altered his bargain. Courts occasionally refer to percentages and compare the amount of disputed extras to the size of the contractor's original contract in order to determine whether the extras constitute a substantial portion of the contract. Obviously, if the extras in dispute are a significant portion of the contract, the contractor is in a better position to claim abandonment. However, if the contract contains a "Changes" clause, even major changes which constitute a significant percentage of the contractor's base contract may not justify abandonment. Instead, the contractor may be under a duty to proceed with the extra work under protest, with costs to be determined later.

A separate, though related, problem is the situation that is created by the owner's refusal to agree to resolve changes at a later date. Occasionally, the contractor will claim extras which will be disputed by the owner and the owner will direct the contractor to proceed with the change order work without acknowledging that he will agree to a resolution of the problem once the work is done. Thus, not only is the owner disputing the validity of the extras, but he is also saying at the outset that he will not give the contractor the remedy which the contract may provide for in the "Changes" clause. This situation probably presents a better case for abandonment than the situation presented by numerous changes that may be accommodated under a remedies clause.

F. Failure to Pay Progress Requisition May Justify Abandonment

1. Courts will often regard progress payments as essential to a contractor's duty to perform. Therefore, delay in payment can be a substantial or material breach.

2. Where an express contractual condition exists that makes timely periodic payment “of the essence,” courts will be especially likely to regard delay in payment as material. *Darrell J. Didericksen & Sons v. Magna Water*, 613 P.2d 1116 (Utah 1980). In this case, the Supreme Court of Utah held that the failure to make payments in excess of 30 days after they become due may constitute a substantial breach of contract in that it may materially impair the contractor's ability to perform and thereby allow the contractor to consider the agreement at an end.

But the absence of the express term “of the essence” may be critical.

Example: *Tri-Mar Contractors, Inc. v. ITCO Drywall*, 424 N.Y.S. 2d 737, 739 (1980). Tri-Mar performed as general contractor and agreed to make monthly payments with ten percent retainage.

ITCO, a subcontractor, abandoned and was sued. ITCO attempted to justify its abandonment on the ground that payments were late. ITCO had already accepted payments tendered ten days late.

In these circumstances the court said that ITCO breached the contract by abandonment. The contract had not expressly provided “time is of the essence.” The court said:

Unless the nature of the contract is such as to make performance on the exact day agreed upon of vital importance, or that the contract in terms provides that it shall be so, failure by a promisor to perform his promise on the day stated in the promise does not discharge the duty of the other party

Hence, Tri-Mar was guilty of mere delay; not enough to justify abandonment.

Note, further, that Tri-Mar's payments, while late, had not been suspended. In addition, ITCO had accepted payments made late, *i.e.*, it waived its right to prompt payment.

But payment in the absence of a “time is of the essence” clause must be made within a reasonable time or it will cross the line of material breach.

Example: *Zancanaro v. Cross*, 339 P.2d 746 (Ariz. 1959).

Plaintiff's contract did not provide exact time for completion of plumbing in 50-home tract. Defendant left the site with the job half done (after six months) and was assessed damages by the trial court that found that time was of the essence in the contract.

The appeals court said that generally a "time is of the essence" clause served to give a minor breach on timely performance the legal effect of a material breach. Since defendant's breach was in this case so material in and of itself, the trial court's conclusion that time is of the essence was irrelevant.

Where there is no specified time for performance, a reasonable time is implied. The trial court reasonably determined on its own judgment that six months was reasonable for total completion. Therefore, the defendant was liable for damages regardless.

If a pattern of delay has been established, it is held that either party can correct its acquiescence to untimeliness by giving notice that timely compliance will hereafter be necessary. Hence, it is possible, sometimes, to postpone the decision to abandon and reserve the right for later use.

Such new notice is often given force by the courts if it is reasonable. Courts will not allow a party to ambush another party by off-and-on-again insistence of certain terms without notice.

Taylor v. Goelet, 101 N.E. 867 (Ct.App. N.Y. 1913).

IV. SUSPENSION OF WORK VERSUS ABANDONMENT: POSTPONING THE FATAL DECISION

A. A Suspension of Work, If Properly Handled, May Produce The Same Results As Abandonment

Often, contractors will face the situation where they believe they may have a right to abandon, but are not completely convinced of the merits of their position; or they may realize they have the right to abandon but see long-term benefits in staying on a project, for example, the project may still turn out to be profitable, they may recover on claims, there is a shortage of other work, etc.

Under these circumstances, the contractor wants to get the owner's attention in a serious way, but wants to do so without going as far as a complete abandonment of the project. Therefore, either by actions (for example, cutting back on his labor force) or by notice, the contractor will signal the owner that he is entitled to abandon the job, is seriously considering the abandonment of the job and is about to do so, but 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 since, 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, having interpreted the contractor's actions as an abandonment, the other side may terminate the contract and the contractor finds that what he intended to be merely a warning, turns into the abandonment he was not prepared to undertake.

A contractor who is considering this form of quasi-abandonment should proceed very carefully and be extremely cautious in signaling his intent to the other side. Often this is done by way of a notice letter which contains carefully-drafted language that attempts to straddle the fence and prevent the contractor from falling into an unwilling abandonment or an acquiescence and waiver.

Consider the following example. The sheet metal sub-subcontractor on a project which has suffered considerable delay due to poor management and coordination by

the general contractor wants to notify his subcontractor, the mechanical subcontractor, and the general contractor that he has incurred extra costs for which he is entitled to reimbursement and that if arrangements are not made to assure him that he will be reimbursed, he will abandon the project because he believes he is entitled to do so. Therefore, following a rather lengthy letter-writing campaign, the sub-subcontractor notifies the subcontractor as follows:

In light of the developments that have occurred on this project and your inability to deliver 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 such conditions, does not become due unless the 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 sub-subcontractor had concluded that while he probably had a legitimate reason to abandon the job, he still believed that he could make money on the project and he 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 so far as to abandon the project. As a result, a letter was sent to the mechanical subcontractor which contained the language cited above, which language was based on a Virginia Supreme Court case on the subject of the material failure of performance which operates to discharge a subcontractor's duty to perform. The letter had to be carefully drafted so as to ensure that, when read by the mechanical subcontractor, the mechanical subcontractor would not read it as abandonment, but rather as a serious warning regarding the sub-subcontractor's position.

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 a reduction is contemplated and notice of the reduction is to be given to the other side, it is advisable to notify the other side of the reduction in terms of mitigating damages, that is, as a result of the material breach by the other side, the contractor, in order to reduce the damages for which the other side will be responsible, has voluntarily reduced his work force until the other side corrects the problem.

Obviously, there is a considerable amount of “brinkmanship” in this area and the contractor who wants to try and straddle the fence before making the final decision to abandon the project must proceed with extreme caution. As the *Vermont Marble* case illustrates, however, straddling the fence in an abandonment situation may prove impossible.

V. WAIVER OF A BREACH: THE HIGH COST OF FORGIVENESS

A. Legal Concept of Waiver

1. 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.
2. Waiver must be manifest by an intentional act or omission with knowledge of the party foregoing the benefit.
3. “Relinquishment of a known right.” Waiver need not be express, but may be implied from the circumstances.
4. Re-establishing the right to the benefit.
 - a. If the other party makes a substantial change in his position in expectation that the condition is permanently excused, one may not be able to reinstate the benefit.
5. Acceptance of a late payment waives your right to assert breach as regards that payment, but not to future installments if clear notice of requirement for future promptness is made.

But once one party falls passively into a pattern of indulgence, then it must clearly break the pattern to assert a future breach on the particular recurring activity.

Example: In *U.S. for the Use and Benefit of Susi Construction Co. v. Zara Contracting*, 146 F.2d 606 (2nd Cir. 1944), 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 using these grounds as material breaches to justify termination because:

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

These lessons apply with equal force in the abandonment context, where you may lose your right to assert a material breach, if you wait until after termination to assert it.

Remember, 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 in the face of a breach that could later justify abandoning, file protests and claims immediately that liquidate your damages or identify those complications that have been generated that will cause future costs that may not be presently ascertained.

VI. EXAMINE YOUR CONTRACT

- A. Contract may restrictively define material breach in certain instances or eliminate the right to abandon. For example: “no damages for delay” clauses, time extension clauses and disputes clauses.
- B. Is there compensation for delay? Is the stated compensation so clearly set out that it will be regarded as an exclusive remedy?
- C. Are there owner or contractor rights to suspend the work? Within what limits?
- D. AIA General Conditions

Contract language often provides the contractor with relatively clear guidance as to what specific acts on the part of the other side will entitle the contractor to abandon with a measure of security and minimal risk. Set forth below are contract clauses drawn from several of the Standard Form AIA Contract Documents which define the various acts that will justify an abandonment when the acts occur and provided the contractor gives the required notice.

A 107 Article 20

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 and 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

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 and for any proven loss sustained upon any materials, equipment, tools, construction equipment and machinery, including reasonable profit and damages.

A401 Article 14. 1. 1

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 damages.

1. 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 that he follows carefully the procedures set forth in such provisions for giving proper notice to the other side in order to ensure that he does not lose the benefit of the contractual right to terminate due to failure to give proper notice. 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 attempt to argue that a condition precedent, such as notice, was not fulfilled and, therefore, the termination is invalid.

2. General contractors, in particular, should ensure that the termination clause of their subcontract is, at minimum, equivalent to the termination clause in the prime contract. Otherwise, the general contractor may find himself in a situation where he has the right to abandon the project due to the material breach of the owner, but remains legally liable for payment to his subcontractors notwithstanding the fact that he has walked off the project. One way to avoid this is to ensure that there are reciprocal provisions in both the prime contract and the subcontracts, that is, that the provisions of the subcontract's termination clause reflect the termination clause of the prime contract.

The contractor can accomplish this by including language in the subcontract which gives the contractor the right to terminate the subcontract if he is forced to abandon the prime contract or is improperly terminated by the owner. However, language that seeks to accomplish this purpose must be carefully drafted inasmuch as the courts will construe such conditions very strictly and in favor of the party who has been terminated. An example of such language taken from a subcontract follows:

The Contractor shall have the right at any time to cancel this contract and require this Subcontractor to cease work thereon in the event the General Contract is canceled or terminated in accordance with its terms or by reason of the default of the owner. The Subcontractor, in such event, shall be entitled to further payment only as provided in Article 5.

Article 5, dealing with payment, states, in pertinent part, as follows:

The Contractor shall be under no obligation to make any payment to the Subcontractor except to the extent that the Contractor has received funds from the Owner for the work invoiced by the Subcontractor; that is to say, the Subcontractor shall not be entitled to payment if, for any reason, including the Owner's financial situation or lack of available funds, the owner fails to pay the Contractor in accordance with the prime contract; such payment from the Owner being a condition precedent to any obligation of Contractor to Subcontractor.

E. Problems of Abandonment in the Area of Government Contracts

1. Abandonment by the Prime Contractor

The Contractor performing work on a government project, particularly a federal project, may exercise its common law right to abandon or terminate its 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 give rise to a material breach justifying abandonment. Instead, the disputes clause requires the contractor to proceed with the work under protest where a disagreement between the parties has developed.

The disputes clause issued under the Contract Disputes Act of 1978 states as follows:

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 other governmental owners such as states, municipalities, etc., include disputes clauses in their contracts which, as is the case in the federal sector, limit the contractor's right to abandon the job notwithstanding a material breach. The reason behind this limitation springs from the government's interest in avoiding an interruption of performance, particularly in the area of military contracts where uninterrupted and prompt performance is essential and would be harmed by indefinite disputes and the threat 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, the contractor is 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 the dispute has not risen to the level of an appealable final decision, however, the contractor is still under a duty to proceed in accordance with the direction of the contracting officer which later may become his final decision. Even though the contractor may believe the government's action to be wrong, if he refuses to proceed he runs the risk of termination, though his belief as to the merits of his position versus that of the government is ultimately found to be correct.

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

The court concluded that a total failure by the government to pay over many months is a material breach just as it would be in the case of a private party. In one

instance, the contractor's right to stop performance was upheld where payments were four months behind and were admittedly due. In another case, the Agricultural Department Board of Contract Appeals held that one month's delay in progress payments constituted a material breach by the government. The Armed Services Board of Contract Appeals found that a one month's delay was also a material breach in the case of *U.S. Services Corporation*.

Other types of material breach which the government may commit include action by the government in excess of that authorized by the contract, for example, a "cardinal change" or the government's failure to follow procedures required by the disputes clause. Additionally, unreasonable and untimely inspections may justify a failure on the part of the contractor to proceed.

In summary, therefore, contractors on federal projects need to be especially cautious about exercising their right to abandon the job. Where their contract contains 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.

2. Abandonment by the Subcontractor

The 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 and, therefore, is 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 which 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 and the prime contractor, in turn, demanded that the subcontractor perform the work. The subcontractor refused on the ground that 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 was obligated to perform since the job had been completed and accepted. The subcontractor was 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 that 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 that the basic error of the prime contractor was his contention that the subcontractor was bound to the prime in every way and exactly as the prime contractor is bound by the terms of the prime contract. While it was true that the terms of the subcontract stated that the subcontractor was bound by the terms of the prime contract and that it assumed the prime contractor obligations to the government insofar as applicable to the work performed by the subcontractor, the court found that such language does 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 that the government does not recognize or deal with the subcontractor and owes him no obligation for the work he performs. 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.

The *Cleveland Electric* case offers two lessons relating to the subject of abandonment. First, merely because a subcontractor is employed on a government project does not mean the subcontractor is limited to pursuing his remedies under the disputes clause of the prime contract when a problem develops. Thus, the subcontractor's right to abandon the job may remain unaffected by the disputes clause.

Second, and of equal importance to the prime contractor, the case illustrates the necessity for a prime contractor to ensure that the terms of his subcontract pass through the risks he has assumed in his prime contract. The prime contractor in *Cleveland Electric* assumed the risk of proceeding with disputed work and pursuing his administrative remedy when he signed his contract with the government. However, he failed to ensure that the subcontractor was similarly bound to him and instead relied upon general language which incorporated by reference the entire prime contract into the subcontract. As this case made clear, the court was not willing to conclude that such general language was sufficient to hold the subcontractor to the disputes clause. Had the general contractor's subcontract been carefully drafted, the subcontractor would have been bound to the disputes clause and liable for the backcharge.

VIII. ESTIMATING RECOVERY OR EXPOSURE

A. When the Contractor Justifiably Walks

1. The contractor can initiate suit and does not have to raise his claims on the defense;
2. Suit can be filed to recover cost and profit (expectation interest); or

3. Suit can be filed to recover the value of the benefit conferred on the owner before abandonment.

Example: If the contractor was in a financial loss position on the project or for one reason or another or another supplied labor and materials in excess of the contract price, then value conferred will provide a better recovery since no profit could have been realized and the contract price would not equal costs. See, for example, the *Coakley* case discussed above.

Example: In *Jones v. City of New York*, 62 N.Y.S. 284 (1900), the city repudiated a contract and stopped paying installments to a contractor. The contractor abandoned, sued and was entitled to recover prospective profits.

4. Remember, however, contracts may create exclusive remedies for certain forms of breach which courts will respect as a matter of proper consensual allocation of risk. See, *Vermont Marble*.

B. When the Contractor Unjustifiably Walks

1. Sometimes, a breaching party may still recover, but the circumstances are fairly rare.
2. Generally, abandonment will be a material breach against the contractor if the act is not justified.
3. 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 to recover any benefit that the owner might have received which puts him in a better position than his bargain provided initially.
4. A willful breach will preclude this type of recovery.
5. Rarely will abandonment of a construction contract provide the opportunity for large restitutionary recoveries because of the monthly progress payment provisions that usually prevent the owner from accumulating great advance benefits.