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Suspending or Terminating Your Construction Contracts: Options for School Districts

**CASH Workshop #21
February 24, 2010
Sacramento Convention Center**

Presenters:

*JOSEPH A. QUINONEZ
Montebello Unified School District*


*SHARON SUAREZ, ESQ.
Orbach, Huff & Suarez LLP*

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Reasons to Suspend or Terminate

- Lack of Funds from District or State
 - Funds frozen
 - Uncertainty of funds
 - Loss of funds
 - Changes in enrollment
 - Change in funding priorities
 - Change in facility priorities




- For Convenience
- Contractor Issues
- Protect District from breach of contract




Termination

Termination for Default
vs.
Termination for Convenience



**Termination for Default
Reasons Must Be Material**

- Failure to properly perform work
- Defective/non-conforming work
- Failure to provide sufficient, skilled manpower
- Delay in achieving substantial completion of the work
- Disregard of applicable laws, directives
- Other material deviations from the contract




Bankruptcy / Insolvency?

Be Careful:

- “ipso facto” provision may preclude termination

Solution:

- Do **NOT** rely solely on bankruptcy as the reason to default the contractor; need another material default
- Must get permission from bankruptcy court to terminate contract or contractor’s performance



Must Strictly Follow Contract Provisions and Procedures:

- Notice
- Opportunity to cure
- Notice of Default/Termination of Contract
- Demand to surety to perform under the bond?
 - Election of remedies



Terminate Contractor vs. Terminate Contract

- If terminate contract, must re-bid completion of work
- If terminate contractor's performance, then NO re-bid
- What does your contract say?
- Board action required to terminate contract



Completion of the Work:

If you want the Surety to complete, must make Demand on the Performance Bond

- Unlike Labor & Materials Payment Bonds, the obligations of Performance Bonds are not statutory
- What does your Performance Bond say?



Must review and comply with terms and conditions of Performance Bond:

- Notice of Default/Termination
- Demand performance from the Surety
- Opportunity to cure
- Opportunity to investigate
- Obligations under Bond
 - Surety completes or pays for completion
- Can you exclude the defaulted contractor from completing?



Surety may want a "Takeover" agreement

- What does your Performance Bond say?
- Why do they want one?
 - Negotiate terms and conditions of Surety's completion
 - Usually want District to forgive Liquidated Damages or make other concessions

Can Surety get involved short of termination?

- Financial assistance to contractor




By District?

- Re-bid if terminate contract
- Not required to re-bid if terminate contractor's performance
 - "Continuing Contract"
- Contract should provide for assignment of the subcontracts to the District upon request
 - Be prepared for issues of payment




Termination for Convenience

- Specific to public works construction contracts to give flexibility to public agencies
- Terminate “in the interest of” or “for the convenience of” the District
 ...is **NOT** “for cause”
- Enforceable except if exercised in bad faith
- Surety is released from obligation to complete




Termination for Convenience: What do you owe the Contractor?

- What does your contract say?
- Should pay for work provided through date of termination, plus:
- Costs directly related to the termination:
 - De-mobilizing
 - Securing the jobsite
 - Materials ordered but not delivered to jobsite
 - Possible to return, re-stock, or cancel order?
- Should **NOT** pay for profit on unperformed work or for a “termination” fee (e.g., a % of total contract)



Suspension:

- Provision should provide for maximum discretion of the District as to circumstances
- Be careful about Public Contract Code 7107:
 - Cessation of labor for a continuous period of 100 days or more due to factors beyond the control of the contractor = completion for purposes of payment of retention. Yikes!
 - Consider limiting suspension to no more than 90 continuous days



Suspension: What do you owe the Contractor?

- What does your contract say?
- Be Specific:
 - Pay for actual costs specifically incurred due to the suspension
 - Require Contractor to mitigate costs, i.e., idle equipment, stand-by costs
- If possible, direct Contractor to work in other areas, other portions of the project
- No payment for concurrent delays caused by Contractor



Other Considerations:

- What do you owe your Architect, Inspector and Construction Manager?
- What do their contracts say?
 - Should have similar suspension & termination for convenience provisions
- Do you need a replacement facility or temporary facility?




**Termination for Default:
Implications to Contractor are Huge**

- Affects ability to procure public works contracts
 - Must disclose in pre-qualification applications
- Did you just buy a lawsuit?
 - Expect a claim from the contractor
 - Defective/incomplete plans & specifications
 - Excessive RFI's
 - Owner interferences




- What if you were wrong about the default?
 - Savings clause: termination for default converts to termination for convenience if you are wrong
- Surety may not agree with you that the Contractor was in default
 - Be prepared with a back-up plan



Alternatives to Invoking Termination Provisions:


Negotiated termination of the contractor

- Contractor will want to ensure that **NOT** “for cause”
- Make sure all costs/damages are included and are released by the contractor
 - Contractor will want release for Liquidated Damages for any delays
- Confidentiality provisions: not enforceable (Public Records Act)




De-scope remainder of the work or portion of the work to bring within budget, adjust for new needs, developments (i.e., terminate “in whole or in part”)

- Negotiate deductive change order
- Issue unilateral deductive change order




- How do you value the deleted work?
 - What does your contract say?
 - Do you use the Contractor's Schedule of Values?
 - Do you independently value the deleted work?
 - Based on present values or values at time of bid?
 - Do you deduct for overhead and profit on the deleted work?
- What is fair?
- If you de-scope work, do you need or want a plan for completion?




Final Thoughts:

- Consider alternatives to termination/ suspension
 - Make sure you know what your contract and bonds provide before you make any decisions
- Carefully consider the rights and remedies of the District, the Contractor, and its Surety under each alternative
- Be smart in your plan of action
- Do you need to revise your contracts on a going forward basis?



Joseph A. Quinonez
Montebello Unified School District
Facilities Development Manager
(323) 887-7900 x6878
Quinonez_Joseph@montebello.k12.ca.us






Sharon Suarez, Esq.
Orbach, Huff & Suarez LLP
1901 Avenue of the Stars, Suite 575
Los Angeles, CA 90067
(310) 788-9200
Fax (310) 788-9210
ssuarez@ohslegal.com



ARTICLE 1: TERMINATION

1.1 Termination for Cause.




1.1.1 District's Right to Terminate. The District may terminate the Contract and/or the Contractor's performance of the Contract, in whole or in part, upon the occurrence of any one or more of the following events of the Contractor's default: (i) if the Contractor refuses or fails to prosecute the Work with diligence as will ensure Substantial Completion of the Work within the Contract Time, or if the Contractor fails to substantially Complete the Work within the Contract Time; (ii) if the Contractor becomes bankrupt or insolvent, or makes a general assignment for the benefit of creditors, or if the Contractor or a third party files a petition to reorganize or for protection under any bankruptcy or similar laws, or if a trustee or receiver is appointed for the Contractor or for any of the Contractor's property on account of the Contractor's insolvency, and the Contractor or its successor in interest does not provide adequate assurance of future performance in accordance with the Contract Documents within 10 days of receipt of a request for such assurance from the District; (iii) if the Contractor repeatedly fails to supply sufficient skilled workmen or suitable materials or equipment; (iv) if the Contractor repeatedly fails to make prompt payments to any Subcontractor, of any tier, or Material Suppliers or others for labor, materials or equipment; (v) if the Contractor disregards laws, ordinances, rules, codes, regulations, orders applicable to the Work or similar requirements of any public entity having jurisdiction over the Work; (vi) if the Contractor disregards proper directives of the Architect, the Project Inspector or District under the Contract Documents; (vii) if the Contractor performs Work which deviates from the Contract Documents and neglects or refuses to correct such Work; or (viii) if the Contractor otherwise violates in any material way any provisions or requirements of the Contract Documents. Once the District determines that sufficient cause exists to justify the action, the District may terminate the Contract without prejudice to any other right or remedy the District may have, after giving the Contractor and the Surety at least seven (7) days advance written notice of the effective date of termination. The District shall have the sole discretion to permit the Contractor to remedy each cause for the termination without waiving the District's right to terminate the Contract, or otherwise waiving, restricting or limiting any other right or remedy of the District under the Contract Documents or at law.



1.1.2 District's Rights Upon Termination. In the event that the Contract or the Contractor's performance of the Contract is terminated pursuant to this Article 1.1, the District may take over the Work and prosecute it to completion, pursuant to the Contract or otherwise, and may exclude the Contractor from the site. The District may take possession of the Work and of all of the Contractor's tools, appliances, construction equipment, machinery, materials, and plant which may be on the site of the Work, and use the same to the full extent they could be used by the Contractor without liability to the Contractor. In exercising the District's right to prosecute the completion of the Work, the District may also take possession of all materials and equipment stored at the site of the Work or for which the District has paid the Contractor but which are stored elsewhere, and finish the Work as the District deems expedient. In exercising the District's right to prosecute the completion of the Work, the District shall have the right to exercise its sole discretion as to the manner, methods, and reasonableness of the costs of completing the Work and the District shall not be required to obtain the lowest figure for completion of the Work. In the event that the District takes bids for remedial Work or completion of the Work, the Contractor shall not be eligible for the award of such contract(s).

1.1.3 Completion by the Surety. In the event that the Contract or the Contractor's performance of the Contract is terminated pursuant to this Article 1.1, the District may demand that the Surety take over and complete the Work. The District may require that in so doing, the Surety not utilize the Contractor in performing and completing the Work. Upon the failure or refusal of the Surety to take over and begin completion of the Work within twenty (20) days after demand therefor, the District may take over the Work and prosecute it to completion as provided for above.

1.1.4 Assignment and Assumption of Subcontracts. The District shall, in its sole and exclusive discretion, have the option of requiring any Subcontractor or Material Supplier to perform in accordance with its Subcontract or Purchase Order with the Contractor and assign the Subcontract or Purchase Order to the District or such other person or entity selected by the District to complete the Work.




1.1.5 **Costs of Completion.** In the event of termination under this Article 1.1, the Contractor shall not be entitled to receive any further payment of the Contract Price until the Work is completed. If the unpaid balance of the Contract Price as of the date of termination exceeds the District's direct and indirect costs and expenses for completing the Work, including without limitation, attorneys' fees and compensation for additional professional and consultant services, such excess shall be used to pay the Contractor for the cost of the Work performed prior to the effective date of termination with a reasonable allowance for overhead and profit. If the District's costs and expenses to complete the Work exceed the unpaid Contract Price, the Contractor and/or the Surety shall pay the difference to the District.


1.1.6 **Contractor Responsibility for Damages.** The Contractor and the Surety shall be liable for all damages sustained by the District resulting from, in any manner, the termination of Contract under this Article 1.1, including without limitation, attorneys' fees, and for all costs necessary for repair and completion of the Work over and beyond the Contract Price.

1.1.7 **Conversion to Termination for Convenience.** In the event the Contract is terminated under this Article 1.1, and it is finally determined by an arbitrator, court, jury or other tribunal having jurisdiction, for any reason, that the Contractor was not in default under the provisions hereof or that the District's exercise of its rights under Article 1.1 was defective, deficient, ineffective, invalid or improper for any reason, the termination shall be deemed a Termination for Convenience of the District and thereupon, the rights and obligations of the District and the Contractor shall be determined in accordance with Article 1.2 hereof.

1.1.8 **District's Rights Cumulative.** In the event the Contract is terminated pursuant to this Article 1.1, the termination shall not affect or limit any rights or remedies of the District against the Contractor or the Surety. The rights and remedies of the District under this Article 1.1 are in addition to, and not in lieu of, any other rights and remedies provided by law or otherwise under the Contract Documents. Any retention or payment of monies to the Contractor by the District shall not be deemed to release the Contractor or the Surety from any liability hereunder.




1.2 **Termination for Convenience of the District.** The District may at any time, in its sole and exclusive discretion, by written notice to the Contractor, terminate the Contract or the Contractor's performance of the Contract, in whole or in part, when it is in the interest of, or for the convenience of, the District. In such case, the Contractor shall be entitled to payment for: (i) Work actually performed and in place as of the effective date of such termination for convenience of the District, with a reasonable allowance for profit and overhead on such Work, and (ii) reasonable termination expenses for reasonable protection of Work in place and suitable storage and protection of materials and equipment delivered to the site of the Work but not yet incorporated into the Work, provided that such payments exclusive of termination expenses shall not exceed the total Contract Price as reduced by payments previously made to the Contractor and as further reduced by the value of the Work as not yet completed. The Contractor shall not be entitled to profit and overhead on Work which was not performed as of the effective date of the termination for convenience of the District or for any other damages, direct or indirect, which the Contractor or anyone claiming through the Contractor alleges resulted from the District's election to terminate under Article 1.2 or where a termination under Article 1.1 has been converted to a termination for convenience under Article 1.1.7. The District may, in its sole discretion, elect to have subcontracts assigned pursuant to Article 1.1.4 above after exercising the right hereunder to terminate for the District's convenience.



ARTICLE 2: SUSPENSION OF WORK

2.1 **District's Right to Suspend Work.** The District may, without cause, and without invalidating or terminating the Contract, order the Contractor, in writing, to suspend, delay or interrupt the Work in whole or in part for such period of time as the District may determine. The Contractor shall resume and complete the Work suspended by the District in accordance with the District's directive, whether issued at the time of the directive suspending the Work or subsequent thereto.

2.2 **Adjustments to Contract Price and Contract Time.** In the event the District shall order suspension of the Work, an adjustment shall be made to the Contract Price for increases in the direct cost of performance of the Work of the Contract Documents, actually caused by suspension, delay or interruption ordered by the District; provided however that no adjustment of the Contract Price shall be made to the extent: (i) that performance is, was or would have been so suspended, delayed or interrupted by another cause for which the Contractor is responsible under the Contract Documents; or (ii) that an equitable adjustment is made or denied under another provision of the Contract Documents. The foregoing notwithstanding, any such adjustment of the Contract Price shall not include any adjustment to increase the Contractor's overhead, general administrative costs or profit, all of which will remain as reflected in the Schedule of Values submitted by the Contractor pursuant to the Contract Documents. In the event of the District's suspension of the Work, the Contract Time shall be equitably adjusted.



SAMPLE TERMINATION PROVISIONS



ARTICLE 1: TERMINATION

1.1 Termination for Cause.

1.1.1 District's Right to Terminate. The District may terminate the Contract and/or the Contractor's performance of the Contract, in whole or in part, upon the occurrence of any one or more of the following events of the Contractor's default: (i) if the Contractor refuses or fails to prosecute the Work with diligence as will ensure Substantial Completion of the Work within the Contract Time, or if the Contractor fails to substantially Complete the Work within the Contract Time; (ii) if the Contractor becomes bankrupt or insolvent, or makes a general assignment for the benefit of creditors, or if the Contractor or a third party files a petition to reorganize or for protection under any bankruptcy or similar laws, or if a trustee or receiver is appointed for the Contractor or for any of the Contractor's property on account of the Contractor's insolvency, and the Contractor or its successor in interest does not provide adequate assurance of future performance in accordance with the Contract Documents within 10 days of receipt of a request for such assurance from the District; (iii) if the Contractor repeatedly fails to supply sufficient skilled workmen or suitable materials or equipment; (iv) if the Contractor repeatedly fails to make prompt payments to any Subcontractor, of any tier, or Material Suppliers or others for labor, materials or equipment; (v) if the Contractor disregards laws, ordinances, rules, codes, regulations, orders applicable to the Work or similar requirements of any public entity having jurisdiction over the Work; (vi) if the Contractor disregards proper directives of the Architect, the Project Inspector or District under the Contract Documents; (vii) if the Contractor performs Work which deviates from the Contract Documents and neglects or refuses to correct such Work; or (viii) if the Contractor otherwise violates in any material way any provisions or requirements of the Contract Documents. Once the District determines that sufficient cause exists to justify the action, the District may terminate the Contract without prejudice to any other right or remedy the District may have, after giving the Contractor and the Surety at least seven (7) days advance written notice of the effective date of termination. The District shall have the sole discretion to permit the Contractor to remedy each cause for the termination without waiving the District's right to terminate the Contract, or otherwise waiving, restricting or limiting any other right or remedy of the District under the Contract Documents or at law.

1.1.2 District's Rights Upon Termination. In the event that the Contract or the Contractor's performance of the Contract is terminated pursuant to this Article 1.1, the District may take over the Work and prosecute it to completion, pursuant to the Contract or otherwise, and may exclude the Contractor from the site. The District may take possession of the Work and of all of the Contractor's tools, appliances, construction equipment, machinery, materials, and plant which may be on the site of the Work, and use the same to the full extent they could be used by the Contractor without liability to the Contractor. In exercising the District's right to prosecute the completion of the Work, the District may also take possession of all materials and equipment stored at the site of the Work or for which the District has paid the Contractor but which are stored elsewhere, and finish the Work as the District deems expedient. In exercising the District's right to prosecute the completion of the Work, the District shall have the right to exercise its sole

discretion as to the manner, methods, and reasonableness of the costs of completing the Work and the District shall not be required to obtain the lowest figure for completion of the Work. In the event that the District takes bids for remedial Work or completion of the Work, the Contractor shall not be eligible for the award of such contract(s).

1.1.3 Completion by the Surety. In the event that the Contract or the Contractor's performance of the Contract is terminated pursuant to this Article 1.1, the District may demand that the Surety take over and complete the Work. The District may require that in so doing, the Surety not utilize the Contractor in performing and completing the Work. Upon the failure or refusal of the Surety to take over and begin completion of the Work within twenty (20) days after demand therefor, the District may take over the Work and prosecute it to completion as provided for above.

1.1.4 Assignment and Assumption of Subcontracts. The District shall, in its sole and exclusive discretion, have the option of requiring any Subcontractor or Material Supplier to perform in accordance with its Subcontract or Purchase Order with the Contractor and assign the Subcontract or Purchase Order to the District or such other person or entity selected by the District to complete the Work.

1.1.5 Costs of Completion. In the event of termination under this Article 1.1, the Contractor shall not be entitled to receive any further payment of the Contract Price until the Work is completed. If the unpaid balance of the Contract Price as of the date of termination exceeds the District's direct and indirect costs and expenses for completing the Work, including without limitation, attorneys' fees and compensation for additional professional and consultant services, such excess shall be used to pay the Contractor for the cost of the Work performed prior to the effective date of termination with a reasonable allowance for overhead and profit. If the District's costs and expenses to complete the Work exceed the unpaid Contract Price, the Contractor and/or the Surety shall pay the difference to the District.

1.1.6 Contractor Responsibility for Damages. The Contractor and the Surety shall be liable for all damages sustained by the District resulting from, in any manner, the termination of Contract under this Article 1.1, including without limitation, attorneys' fees, and for all costs necessary for repair and completion of the Work over and beyond the Contract Price.

1.1.7 Conversion to Termination for Convenience. In the event the Contract is terminated under this Article 1.1, and it is finally determined by an arbitrator, court, jury or other tribunal having jurisdiction, for any reason, that the Contractor was not in default under the provisions hereof or that the District's exercise of its rights under Article 1.1 was defective, deficient, ineffective, invalid or improper for any reason, the termination shall be deemed a Termination for Convenience of the District and thereupon, the rights and obligations of the District and the Contractor shall be determined in accordance with Article 1.2 hereof.

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remedies of the District under this Article 1.1 are in addition to, and not in lieu of, any other rights and remedies provided by law or otherwise under the Contract Documents. Any retention or payment of monies to the Contractor by the District shall not be deemed to release the Contractor or the Surety from any liability hereunder.

1.2 Termination for Convenience of the District. The District may at any time, in its sole and exclusive discretion, by written notice to the Contractor, terminate the Contract or the Contractor's performance of the Contract, in whole or in part, when it is in the interest of, or for the convenience of, the District. In such case, the Contractor shall be entitled to payment for: (i) Work actually performed and in place as of the effective date of such termination for convenience of the District, with a reasonable allowance for profit and overhead on such Work, and (ii) reasonable termination expenses for reasonable protection of Work in place and suitable storage and protection of materials and equipment delivered to the site of the Work but not yet incorporated into the Work, provided that such payments exclusive of termination expenses shall not exceed the total Contract Price as reduced by payments previously made to the Contractor and as further reduced by the value of the Work as not yet completed. The Contractor shall not be entitled to profit and overhead on Work which was not performed as of the effective date of the termination for convenience of the District or for any other damages, direct or indirect, which the Contractor or anyone claiming through the Contractor alleges resulted from the District's election to terminate under Article 1.2 or where a termination under Article 1.1 has been converted to a termination for convenience under Article 1.1.7. The District may, in its sole discretion, elect to have subcontracts assigned pursuant to Article 1.1.4 above after exercising the right hereunder to terminate for the District's convenience.

ARTICLE 2: SUSPENSION OF WORK

- 2.1 District's Right to Suspend Work.** The District may, without cause, and without invalidating or terminating the Contract, order the Contractor, in writing, to suspend, delay or interrupt the Work in whole or in part for such period of time as the District may determine. The Contractor shall resume and complete the Work suspended by the District in accordance with the District's directive, whether issued at the time of the directive suspending the Work or subsequent thereto.
- 2.2 Adjustments to Contract Price and Contract Time.** In the event the District shall order suspension of the Work, an adjustment shall be made to the Contract Price for increases in the direct cost of performance of the Work of the Contract Documents, actually caused by suspension, delay or interruption ordered by the District; provided however that no adjustment of the Contract Price shall be made to the extent: (i) that performance is, was or would have been so suspended, delayed or interrupted by another cause for which the Contractor is responsible under the Contract Documents; or (ii) that an equitable adjustment is made or denied under another provision of the Contract Documents. The foregoing notwithstanding, any such adjustment of the Contract Price shall not include any adjustment to increase the Contractor's overhead, general administrative costs or profit, all of which will remain as reflected in the Schedule of Values submitted by the Contractor pursuant to the Contract Documents. In the event of the District's suspension of the Work, the Contract Time shall be equitably adjusted.