"When we recover from the recession, there will be a shortage of skills and we are already below capacity"
MICHAEL BROWN, CIOB

Termination for convenience clauses

CONTRACT

PHILLIP COADY

Termination for convenience clauses allow an employer to terminate a contractor's employment without having a reason. Commonly used in the US but rare in the UK, the recession could change things because employers may choose the reassurance of a no-strings option to stop a project.

A termination for convenience clause allows the employer to determine the contractor's appointment easily without having to show the contractor's default. The clause may also limit the employer's financial liability to the contractor.

The contractor should also have a similar clause in its subcontracts. But these clauses raise critical legal questions:

- Is there a duty of good faith on the employer when exercising this right?
- Is the terminated party entitled to receive its costs? Do these include loss of profit?

There is little English case law to help with the answers. *Abbey Developments v PP Brickwork* did not directly concern termination for convenience. But the judge noted that the parties had struck a bargain and Abbey could not use a variation or termination procedure to get out of it. In particular, the judge did not believe that, without express words, Abbey could simply take away PP's work and substitute another contractor.

The judge also thought that if the employer terminated for convenience, then the contractor

would be entitled to its loss of profit. Even if the contract expressly excluded loss of profit, such a clause might be unenforceable.

More recently the Supreme Court of Victoria, Australia, reviewed the law on termination for convenience clauses, in particular whether an employer must operate one in good faith. An employer terminated a contract for convenience but the contractor then applied for an injunction to prevent the employer from proceeding with the termination.

The Court only had to decide if there was a serious issue to be tried as to whether the employer was under an obligation to exercise its right to terminate in good faith. It did not have to decide if there actually was such an obligation. Because the employer did not dispute there was a serious issue to be tried and the judge agreed, it gives us no definitive answer to the key question.

The safe course for employers wishing to operate such a clause is to do so "in good faith", but what does that mean? Termination where a project is abandoned is an obvious case, but getting rid of a poorly performing or too expensive contractor is not.

And an employer wishing to exclude loss of profit from the contractor's entitlement on termination must clearly say so in the contract, although that is no guarantee that the courts will accept the exclusion.

Phillip Coady is an associate at Mayer Brown International