Breaking Ground

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EXCULPATORY CLAUSES: WILL PENNSYLVANIA COURTS PERMIT OWNERS TO CONVERT TERMINATIONS FOR DEFAULT INTO TERMINATIONS FOR CONVENIENCE?

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Many standard form construction contracts include exculpatory clauses which permit owners of construction projects to convert wrongful terminations for default into terminations for convenience. Consider the following hypothetical:

- Owner A hires Contractor B for a construction project.
- Owner A believes Contractor B's work is untimely or defective.
- Owner A abruptly terminates the contract without notice or an opportunity to cure as required in the contract.
- Contractor B alleges and proves that the termination was wrongful, i.e., for default.

Can Owner A limit its damages by relying on an exculpatory clause in the contract that converts a wrongful termination for default into a termination for convenience? In Pennsylvania, at least, it's unclear.

Generally, with respect to these types of exculpatory clauses, "[t]he rule in Pennsylvania is that [they] cannot be raised as a defense where (1) there is an affirmative or positive interference by the owner with the contractor's work, or (2) there is a failure on the part of the owner to act in some essential matter necessary to the prosecution of the work." Coatesville Contractors & Engineers, Inc. v. Borough of Ridley Park, 509 A.2d 862, 865 (Pa. 1986) (citations omitted).

In 2003, the Pennsylvania Board of Claims, an administrative board which hears claims against the Commonwealth arising from contracts with the Commonwealth, held that under certain circumstances a wrongful termination can constitute "interference" and bar application of termination-for-convenience exculpatory clauses. See Able-Hess Associates, Inc. v. Slippery Rock Univ., No. 3369 (Oct. 27, 2003).

The Able-Hess Board found that Slippery Rock University ("SRU") could not convert a wrongful termination for default into a termination for convenience in accordance with the contract where SRU egregiously interfered with Able-Hess' performance and "arbitrarily" terminated the agreement even though it "had no reason to believe that the project was behind schedule." Id. at 16, 19. Among the many acts or omissions by SRU that the Board determined to be an "interference" with the agreement are the following:

- SRU shifted the location of the Project's building footprint by 14 feet after issuing the NTP, which added to the delay to Able-Hess' design work.
- SRU rejected one of Able-Hess' important subcontractors even though the subcontractor was listed as approved in the Project Specifications.
- SRU demanded a recovery schedule from Able-Hess at a time when the Project was not behind schedule, and subsequently rejected the proposed recovery schedule without analyzing it.
- SRU defaulted Able-Hess for not submitting a list of its subcontractors even though such list was not contractually required at the time of default.
- SRU defaulted Able-Hess for failing to mobilize at the site even though it had mobilized and commenced work two weeks prior to default.

It appeared to the Board that, "in the real world, the expectations of [SRU] at this phase were quite unreasonable." "[N]o matter what work was done, what design submissions were made, or what recovery schedules were submitted, [SRU] had lost faith in Able-Hess and decided to fire them. What [SRU] never brought into evidence was why. Other than the inability to see the building begin to rise, phoenix-like, it felt justified in firing an experienced general contractor three months into a thirteen-month project."

The Board's reasoning is simple: a materially breaching party should not be able to invoke the contract for protection. "The Board can envision no worse an interference with a contractor's work than being kicked-off the job by a wrongful termination. As such, the termination for convenience clauses contained in the instant provisions cannot be used as a defense to Plaintiff's claims." See also Camenisch v. Allen, 44 A.2d 309, 310 (Pa. Super. Ct. 1945) (a party that materially breaches a contract cannot thereafter seek to enforce the contract for its own protection).

The Slippery Rock case embodies the colloquial phrase that "bad facts make bad law." If adopted by the Commonwealth Court, then there would be no instances where an owner could ever avail itself of a similar exculpatory provision. Such a holding would defy basic contract principles which afford parties the opportunity to bind themselves to enforceable terms.

Although exculpatory clauses generally cannot be raised as a defense where the owner interferes, it is hornbook contract law that "contract terms will not be construed in such a manner so as to render them meaningless." Girard Trust Bank v. Life Ins. Co., 364 A.2d 495, 498 (Pa. Super. Ct. 1976). In our hypothetical, the foregoing rules conflict: if wrongful termination constitutes "positive interference by the owner with the contractor's work," then an exculpatory clause that converts a wrongful termination into a termination for convenience is necessarily rendered meaningless.

Although no Pennsylvania court has resolved this narrow issue, other jurisdictions have enforced such exculpatory clauses. Consider the Court of Appeals of Texas' decision in Gulf Liquids New River Project, LLC v. Gulsby Eng'g, Inc., 356 S.W.3d 54 (Ct. App. Tex. 2011). There, the owner wrongfully terminated its contract when it improperly determined that the contractor failed to comply with a condition precedent to payment. The termination-for-convenience clause specifically limited the owner's damages in the event of a wrongful termination to those associated with a termination for convenience, including "payment for the percentage of Work actually completed by [the contractor], plus overhead and profit equal to 8 percent of actual

costs to date." The Gulf Liquids Court enforced this exculpatory clause and reasoned as follows:

The clause expressly contemplates that if [the owner] wrongfully terminates [the contractor], the termination will be deemed a termination without cause, and limits [the owner's] damages accordingly. *Such a clause would never be enforceable if by wrongfully terminating the owner also loses the right to exercise the termination-for-convenience clause and the limitation-of-damages provision found therein.* Because the contract expressly contemplates that the owner may wrongfully terminate the contractor, and then limits the contractor's damages to those specified in the clause, we will not render that provision meaningless by holding that the owner's rights are waived by committing the very breach that the clause contemplates. *Such circular reasoning would render the termination-for-convenience clause meaningless, which we will not do.* (emphasis added).

Likewise, in Christopher Glass & Aluminum, Inc. v. Tishman Constr. Corp. of Ill., No. 1-19-1972-U, 2020 Ill. App. Unpub. LEXIS 1665, (App. Ct. of Ill. Sep. 30, 2020), the termination clause provided that if the owner wrongfully terminated the contractor for cause, such termination shall be deemed a termination for convenience. In the event of a termination for convenience, the general contractor's "sole and exclusive remedy" was payment for the percentage of work actually completed plus overhead and profit on actual costs to date. The Christopher Glass Court found that the reasoning in Gulf Liquid was "sound and consistent with federal jurisprudence surrounding termination for convenience clauses." The Court limited the owner's damages accordingly so as not to render the termination-for-convenience clause meaningless.

The foregoing cases are in stark contract with Able-Hess. The cases enforcing termination-for-convenience clauses recognize that the parties' inclusion of the exculpatory language evidences that they intended for "interference" to include action beyond mere wrongful termination. On the other hand, the Able-Hess Board decreed that wrongful termination alone could constitute interference.

In resolving this issue in the future, Pennsylvania courts must be careful not to convert this legal issue into a factual one. Accepting the position that certain actions constitute interference could create absurd results where the "wrongfulness" of a wrongful termination is a matter of varying degree that differs from one wrongful termination to another. Such a holding would set a poor precedent and subsequently require Courts to subjectively evaluate and rank each wrongful termination against others, which would most likely lead to inconsistent results. A new "sliding scale" of wrongful terminations would make it difficult for owners and contractors to negotiate contracts and navigate terminations.

It goes without saying that language in contract documents is often the most critical factor in a construction dispute. Signing a contract without fully reviewing and understanding its legal implications can leave parties little bargaining power. This is particularly poignant in the case of exculpatory clauses, which parties may rely on to their detriment on the blanket assumption that such clauses are always enforceable. BG

Act of November 10, 1999, P.L. 491, as amended, 35 P.S. §§ 7210.101-7210.1103; See Commonwealth v. Null, 186 A.3d 424, 427 (Pa. Super. 2018) (quoting Flanders v. Ford City Borough, 986 A.2d 964, 969 (Pa. Cmwlth. 2009)).

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