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# Recent Developments: Questar Builders, Inc. v. CB Flooring, LLC: The Common Law Principles of Good Faith and Fair Dealing Apply to the Party Exercising Its Discretion to Terminate Private Party Contracts That Incorporate a "Termination for Convenience" Clause

K. Alice Young

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## RECENT DEVELOPMENT

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### **QUESTAR BUILDERS, INC. v. CB FLOORING, LLC: THE COMMON LAW PRINCIPLES OF GOOD FAITH AND FAIR DEALING APPLY TO THE PARTY EXERCISING ITS DISCRETION TO TERMINATE PRIVATE PARTY CONTRACTS THAT INCORPORATE A “TERMINATION FOR CONVENIENCE” CLAUSE.**

**By: K. Alice Young**

The Court of Appeals of Maryland held that two private parties contracting for goods or services may include contract language allowing termination for convenience, but the party with discretion to terminate must use good faith. *Questar Builders, Inc. v. CB Flooring, LLC*, 410 Md. 241, 261, 978 A.2d 651, 663 (2009). Specifically, in the absence of a breach, the terminating party must prove by a preponderance of the evidence that it exercised its discretion in accordance with the common law contract principles of good faith and fair dealing. *Id.* at 281 n.25, 978 A.2d at 675 n.25.

After fielding bids from three companies, Questar Builders, Inc. (“Questar”), the contractor responsible for a large-scale residential construction project, signed an agreement (“Subcontract”) with CB Flooring, LLC (“CB Flooring”). The Subcontract, signed on September 29, 2005, detailed that CB Flooring would purchase and install carpets throughout the project in exchange for payments totaling \$1,120,000. The Subcontract contained clauses granting Questar the discretion to terminate the contract for its convenience, even if CB Flooring did not breach the contract. Known as a “termination for convenience” clause, the contract gave Questar discretion to terminate even if neither side breached.

In January, the project’s interior decorator submitted drawings that included an allegedly higher-priced flooring product than that upon which CB Flooring based its original bid. On February 27, Questar began negotiating a different flooring agreement with CTI, one of the two companies that CB Flooring had initially outbid. On March 23, Questar’s Senior Vice President, Frank Maccherone (“Maccherone”), terminated the Subcontract in a letter to CB Flooring.

Maccherone then entered a new, nearly identical, signed agreement with CTI a few weeks later. In his termination letter, Maccherone alleged that CB Flooring breached by refusing to perform after Questar's interior decorator drawings specified materials differing from those in the bid-upon plans. Maccherone also claimed that, based on the Subcontract, even if CB Flooring had not breached, Questar had an unlimited right to terminate the Subcontract for its convenience and that Questar owed no compensation to CB Flooring.

In April 2006, CB Flooring sued Questar for breach of contract in the Circuit Court for Baltimore County. CB Flooring claimed that Questar acted in bad faith. Questar countered that CB Flooring's refusal to perform under the contract and failure to attend weekly meetings justified its termination. In the alternative, Questar alleged that the Subcontract secured its right to terminate the agreement at its convenience, claiming this as an unlimited right. Questar contended that, even if the right was not unlimited, it could base its termination for convenience on a subjective loss of confidence resulting from CB Flooring's absence from weekly meetings.

The circuit court found that CB Flooring did not breach the Subcontract. The trial judge found that CB Flooring's absence from the weekly meetings did not constitute a material breach; that it did not attempt to use the change order as leverage; and that it did not jeopardize the timely performance of the Subcontract. The trial judge also rejected Questar's alternative defense that its subjective loss of faith in CB Flooring's ability to perform met the requirement for the convenience clause. Questar challenged neither the ruling that CB Flooring did not breach nor the amount of damages awarded to CB Flooring. Questar appealed to the Court of Special Appeals of Maryland, but before arguments could be heard, the Court of Appeals of Maryland issued a writ of certiorari on its own initiative.

The court began its analysis by reviewing the Civil War-era development of government contract risk management clauses that relied on the uncertainties of war to justify the governmental voiding of contracts on short notice. *Questar*, 410 Md. at 262, 978 A.2d at 663-64. This discretion in contracts with manufacturers and suppliers enabled the government to avoid expectation damages, but provided for equitable compensation for capital already invested. *Id.* at 264-65, 978 A.2d at 665 (citing *Russell Motor Car Co. v. United States*, 261 U.S. 514, 523 (1923)). During World War II, the word "convenience" came to be associated with this type of discretionary clause, and its purpose was to allow the government freedom to terminate a contract

when justified by exigencies and uncertainties of war. *Id.* at 266, 978 A.2d at 666.

The court then explained that, in the 1960's, the government expanded its use of these "termination for convenience" clauses in peacetime military and non-military contracts. *Id.* Maryland also uses "termination for convenience" clauses in contracts with the state government. *Id.* at 267 n.17, 978 A.2d at 666 n.17. The court clarified that, when a party can cancel a contract without cause or penalty, the contract is illusory, and that courts construe contracts to avoid illusory interpretations. *Id.* at 267-68, 978 A.2d at 667. In order to uphold the discretionary use of convenience clauses without rendering the contracts illusory, courts limit government rights by applying standards for termination. *Questar*, 410 Md. at 268, 978 A.2d at 667. The strong presumption of good faith in government contracts cases, however, renders it nearly impossible for opponents to prove government breach in the face of "termination for convenience." *Id.* at 271, 978 A.2d at 669. The court explained that broad government discretion to terminate contracts for convenience derives from the incidents of sovereignty. *Id.* at 271-72, 978 A.2d at 669-70. The court then analyzed the application of a "termination for convenience" clause in private contracts that are governed by common law principles instead of principles of sovereignty. *Id.* In private party contracts, the cancelling party must exercise its discretion in good faith and in accordance with fair dealing, because the right to cancel is not an unfettered power. *Id.* at 274, 978 A.2d at 671. In the instant case, the court noted that the common law contract principles of good faith and fair dealing limited Questar's discretion to terminate for convenience. *Id.* The court explained that, without common law contract principles providing guidelines and restrictions, the contract would be rendered illusory. *Questar*, 410 Md. at 278-79, 978 A.2d at 673-74. (citing *Cheek v. United Healthcare of the Mid-Atl., Inc.*, 378 Md. 139, 142-43, 835 A.2d 656, 658 (2003)). Convenience clauses help parties manage risks due to changing technology, but common law principles of good faith and fair dealing prohibit arbitrary contract termination. *Id.* at 280, 978 A.2d at 674.

Continuing its analysis, the court noted that the trial judge correctly recognized that Questar's "gut feeling" was sufficient to trigger "termination for convenience." *Id.* at 280, 978 A.2d at 675. The trial judge, however, did not articulate findings regarding whether Questar acted in accordance with good faith and fair dealing. *Id.* at 280-81, 978 A.2d at 675. The court instructed that good faith and fair dealing should be measured objectively according to the reasonable

expectations of the parties, as derived from the contract language. *Id.* at 282, 978 A.2d at 675-76. Finally, the court suggested that the trial court may find on remand that Questar acted in bad faith if the termination was not commercially reasonable, if it sought a better bargain, or if it simply wanted to evade its obligation to perform. *Id.* at 283-84, 978 A.2d at 676-77.

The standard for judging the use of a “termination for convenience” clause in government contracts leans heavily toward accepting the discretion of the government. In contracts between private parties, however, the common law principles of good faith and fair dealing apply. Private parties must understand that a “termination for convenience” clause is not a *carte blanche* right to terminate for any reason, because an unfettered right to terminate would render a contract illusory. Rather, in order to legitimately terminate under that clause, the party must show by a preponderance of the evidence that its decision satisfies an objective standard according to the reasonable expectations of the other party and that it exercised good faith and fair dealing. The Court of Appeals of Maryland preserved this risk management tool for use by private parties but underscored the need for common law contract protections. Maryland practitioners must make convenience clauses clear so that courts can easily determine the parties’ objective expectations in the event of “termination for convenience.”