



CONSTRUCTION



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Understanding Contract Termination



By: [John T. Trout, Esq.](#)

What does it mean to terminate a contract?

To terminate a contract means to end the contract prior to it being fully performed by the parties. In other words prior to the parties performing all of their respective obligations required by the contract, their duty to perform these obligations ceases to exist.

In general, the effect of the termination of a contract is to discharge the parties from their unperformed obligations under the contract. However, termination does not affect liabilities of the parties for breaches of the contract that occurred prior to the contract being terminated. And, despite the fact that future obligations to perform under the contract terms have been extinguished, if appropriate, the parties remain entitled to pursue claims for damages under the common law and as provided by any termination provisions that may be contained within the contract.

The right to terminate.

There are two basic types of termination: 1) termination for cause, otherwise known as termination for default; and 2) termination for convenience. A party's right to terminate its contract may originate from the general principles of contract law or it may arise out of the terms of the contract itself. On the other hand, termination for convenience may originate only from the terms of a contract which provide for such termination, for there is no general contract principle allowing termination for convenience. A termination for cause is available only in response to a material breach of the contract by the other party. What qualifies as a material breach to the contract may be determined by a review of the contract case law or what qualifies as a material breach or default may be stated in the contract itself. A failure to perform any contract term is a breach of the contract. However, substantial damages are recoverable only from a material breach and a material breach entitles the non-breaching party to treat the material breach as a breach of the entire contract. Whether there has been a material breach depends upon the seriousness of the breach and the likelihood that the injured party has, nevertheless, received substantially what it had contracted to receive under the contract. The extent of the monetary damage suffered by the non-breaching party is not necessarily determinative of material breach. Materiality of the breach must be determined on a case-by-case basis and in light of the purposes for which the party entered the contract.

The following facts are considered by courts in determining whether a breach was material:

1. Was there a failure of an essential feature on the contract which had induced the non-breaching party to enter the contract;
2. Did the breach go to the substance of the contract and defeat the non-breaching party's purpose for making it;
3. Did the breach affect a matter of vital importance going to the essence of the contract;
4. Did the non-breaching party receive substantially less or different from that which he had bargained to receive?

Steps to proper termination.

The terms of the contract itself sometimes identifies the conditions under which a party may be found in material breach or default or conditions under which a party may terminate for convenience. Service of notice and proper completion of other procedural requirements necessary for termination under the contract terms must be followed exactly. Otherwise, the termination might not be authorized by the contract and therefore be a wrongful termination.

Although termination under general principles of contract law does not specifically require prior notice and an opportunity to cure, providing notice and opportunity to cure may prompt the defaulting party into curing the default and will place the non-breaching party in a more favorable light should the dispute end up in arbitration or litigation. And, cure of the breach or default is usually preferable to termination and the often accompanying legal action.

Wrongful termination.

In the event a party terminates the contract without having justification either under general principles of contract law or under the terms of the contract, such a termination is called a wrongful termination. A wrongful termination is a repudiation of the contract, and is therefore in itself a material breach of the contract.

Damages related to termination.

Damages available to the non-breaching party following its termination of the contract or in response to a wrongful termination by the other party include direct damages, consequential damages, and all other damages necessary to place the non-breaching party in the same position it would have been in should the contract have been completely performed by the parties. In the context of a contractor wrongfully terminating its contract with an owner, the owner would be entitled to recover from the contractor the costs of hiring a replacement contractor to finish the Work, costs associated with delay of completion of the project including lost profits from use of the completed project, any additional costs for completion due to the termination, and any additional costs related to administration of the project, including additional costs for project management.

On the other side, in response to an owner's wrongful termination of a construction contract, the contractor would be entitled to recover the cost of its work to the point of termination plus all overhead incurred, plus lost profits and overhead. In the event of an owner's wrongful termination of the contractor following substantial completion, the contractor would be entitled to recover the contract amount less the actual cost the contractor would have incurred in completing the balance of the project.

Conclusion

Contract termination is a drastic step and should be avoided, if possible. However, there are times when termination is appropriate, such as when the terms of the contract or the law allow for termination and it would also be the best way to mitigate damages. Under these circumstances, the contract should be terminated with caution and with good legal advice.

IRS "Safe Harbor" for Misclassified Employees?



By: [Blake R. Nelson, Esq.](#)

Recently the Minnesota Department of Labor and Industry ("DOLI"), the Federal Department of Labor and the IRS entered into an enforcement partnership to pursue companies that misclassify employees as independent contractors. Then, just days later, the IRS announced a new program intended to assist employers to "voluntarily reclassify" independent contractors to employees.

Named the "Fresh Start" program, it is designed to reduce the cost of reclassification and create a specific process for doing so. Any construction contractors that claim to use independent contractors or subcontractors should review this program and their own practices to avoid misclassifying employees as independent contractors. For example, it is very common in the construction industry to misclassify a sales representative as an independent contractor rather than an employee.

These developments from DOLI and the IRS also came only days after the Minnesota Court of Appeals issued an opinion about worker classification for unemployment purposes. Specifically, the Court of Appeals upheld an Administrative Law Judge's reclassification of a transportation driver despite the existence of written independent contractor agreement, holding that the driver was an employee rather than an independent contractor.

The Minnesota Court of Appeals noted the standard five-point test used when distinguishing between an employer and an independent contractor:

- 1) The right to control the means and manner of performance;
- 2) The mode of payment;
- 3) The furnishing of materials or tools;
- 4) The control of the premises where the work is done;
- 5) The right of the employee to discharge.

In this case, the Court of Appeals found that the driver was an employee because:

- 1) The driver worked full time for the provider;
- 2) The driver was available for set hours;
- 3) The provider instructed and corrected the driver's behavior; and
- 4) Either party had the ability to terminate the relationship on short notice.

This reclassification was upheld despite the existence of a written independent contractor agreement specifically disclaiming the driver as an employee and stating he was an independent contractor.

Misclassification of employees as independent contractors is a particularly problematic issue in the construction industry. DOLI, the Minnesota Department of Revenue, and the IRS all very closely scrutinize whether an individual classified as an independent contractor is actually an employee. Individuals are deemed employees unless proven otherwise, and the financial ramifications and penalties for misclassification can be severe.

Hellmuth & Johnson handles both construction and employment matters and can assist you in navigating this issue. For more information about employee versus independent contractor classification and subcontractor agreements, please contact Blake Nelson at (952) 746-2131 or bnelson@hjawfirm.com.

More information . . .
about the IRS "Fresh Start" Program can be found at <http://www.irs.gov/newsroom/article/0,,id=246203,00.html>

H&J Announcements

H&J Adds New Attorneys ...

Russell "Mick" Spence, Jr. has joined the firm as a partner in the Business & Corporate practice group. He litigates and counsels entertainment, intellectual property and business clients in a wide variety of legal matters. Combining his passions for creativity, commerce, advocacy and success, Mick has established a reputation as the go-to attorney for both creative talents and entrepreneurial businesses. We look forward to his complimentary practice strengthening the business services we provide, while expanding our growth to benefit both existing and new clients.

Joshua R. Ward has also joined the firm as an associate and is a member of the IT & eCommerce and Business & Corporate practice groups. He obtained his JD from William Mitchell College of Law where he served on the Editorial Boards of the *William Mitchell Law Review* and *Cybaris: An Intellectual Property Law Review*.

This newsletter provides general information on legal matters, and should not be relied upon as legal advice. A qualified attorney must analyze the relevant facts and apply the applicable law to provide specific legal advice. If you require legal advice or want additional information regarding the services we offer, please contact David Hellmuth at 952-941-4005 or dhellmuth@hjawfirm.com



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