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SJC Upholds Broad Termination for Convenience Clause in Public Contracts

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In A.L. Prime Energy Consultant, Inc. v. Massachusetts Bay Transportation Authority, 479 Mass. 419 (2018), the Massachusetts Supreme Judicial Court ("SJC") held for the first time that a so-called "termination for convenience clause" permitted a public entity to validly terminate a procurement contract *solely* in order to obtain a better price, and without exposure to liability for breach of contract. This case was groundbreaking, and provides opportunities for public entities, as discussed in further detail, below.

In this case, the Massachusetts Bay Transportation Authority ("MBTA") had entered into a competitively bid fuel supply contract with A.L. Prime Energy Consultant, Inc. ("Prime"), which contract provided in relevant part:

> Termination for Convenience. The [MBTA] may, in its sole discretion, terminate all or any portion of this Agreement or the work required hereunder, at any time for its convenience and/or for any reason by giving written notice to the Contractor thirty (30) calendar days prior to the effective date of termination….If the Contractor is not in default or in breach of any material term or condition of this Agreement, the Contractor shall be paid its reasonable, proper and verifiable costs…." [Emphasis supplied].

Approximately one year after entering into the contract, the MBTA determined it would achieve greater cost savings by opting into a competitively bid statewide contract with another vendor. As a result, the MBTA notified Prime that it intended to terminate the agreement pursuant to the above-referenced clause. Prime filed suit asserting claims based on breach of contract and the implied covenant of good faith and fair dealing.

Federal law interpreting termination for convenience clauses provides that a governmental entity may terminate a contract for convenience *so long as* a governmental entity does not act in bad faith or abuse its discretion. State precedent, in contrast, provides that "general contract principles" should be applied, including the principle that unambiguous contract language must be construed in accordance with its plain meaning.

Prime argued, therefore, that the contract should be construed under federal law, and further that the court should determine the MBTA terminated the contract in "bad faith" because its sole reason for termination was to obtain a better price. The SJC rejected Prime's argument, finding that the federal case law interpreting federal procurement contracts was incompatible with state precedent and further that the mere reference in a contract to federal regulations was not a sufficient basis to incorporate the federal standard for interpreting a termination for convenience clause.

Here, the contract language provided that the MBTA could terminate the contract "in its sole discretion" and "for its convenience and/or for any reason." The SJC determined that this language was unambiguous and not subject to interpretation in multiple ways. Moreover, because the MBTA had paid significant consideration for the fuel and restricted its termination right so as to require advance notice and payment of all costs incurred prior to termination, the SJC rejected arguments that the contract was "illusory" and lacked consideration.

In A.L. Prime, the MBTA exercised its right to terminate the contract for its convenience in order to opt into a statewide fuel contract with another vendor at a lower price. Importantly, however, the decision specifically leaves open the question whether a public entity may terminate a contract for its convenience in order to rebid a new contract in order to obtain a lower price.

Consistent with the SJC's decision in A.L. Prime, at a minimum, Massachusetts governmental entities may utilize termination for convenience clauses to take advantage of cost savings available in more favorable statewide contracts as market conditions change. However, there is the possibility that including such a clause in a contract may result in bidders increasing prices to account for the risk of such termination. Therefore, public awarding authorities will need to consider whether to include such a clause at all, and if so, ensure that the language is clear and unambiguous and that the contract provides for adequate consideration if the termination for convenience clause is invoked.

If you have any questions concerning the A.L. Prime case or any other contract or procurement issue, please contact Attorney Thomas W. McEnaney (tmcenaney@k-plaw.com) or any member of our Contracts Practice Group at 617.556.0007.