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Best Practices When Terminating for Cause a Downstream Contractor/Subcontractor

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By Jeffrey Bright

Terminating for cause a downstream contractor (or subcontractor) is considered the "nuclear option" when handling breaches of contract. Terminating for cause usually increases the risks and likelihood of litigation. Frequently, by the time the terminating party contacts the lawyer, it has already made the decision to terminate and wants the lawyer to effectuate the termination as quickly as possible. But a snap termination may cause compound problems. Instead of a quick termination, best practice is to follow a methodical, well-documented approach.

Follow the Contract Documents

Most contracts outline a process for declaring breach and terminating the contract. Generally, these steps must be followed. Some contracts identify with specific precision the types of breaches that allow for termination versus other remedies. The governing law (e.g., which state's law applies) can have significant effect on the righteousness of a termination. Some states rigidly require all processes, notices, and terms set forth in the contract termination clauses to be satisfied prior to termination. Other states may allow exceptions to the drawn-out termination process, affording quick termination that shortcuts contractual notice clauses, depending on the circumstances. Still, whether a contract can be terminated more quickly than set forth in the contract is open to interpretation, and terminating more quickly than the contract strictly requires increases the risk of wrongful termination. Meanwhile, if the contractual processes have been followed, it significantly reduces the risk of a wrongful termination.

Thus, as a general rule of thumb, following the contract processes for declaring breach and termination is a good start.

Best Practice is to Issue a Notice to Cure

Most contracts that outline a process for termination also require issuing a notice to cure prior to termination. As previously stated, it is best to follow the contractual requirements. Even if the contract does not require a notice to cure, it is typically best practice to still issue a notice to cure.

There are two main reasons why this is recommended. First, if the default party cures the breach, then, perhaps there is no need to terminate, because the work has been brought "back on track." Generally, forcing the defaulting party to cure the breach at its own cost is less expensive than terminating and fronting the costs to bring in another trade to finish or cure the work.

Second, when proving that the termination was justified, typically it must be demonstrated that the defaulting party was in "material breach" of the contract. If the breach pertains to a critical component of the work, and the defaulting party fails to cure it after a proper notice, that is very strong proof that the defaulting party was in material breach and cannot perform. Thus, the termination for cause is more likely to be adjudged as righteous and justified after a failed cure opportunity. Meanwhile, if no opportunity to cure was provided, the defaulting party can argue that it would have cured the breach. If the breach could have been cured, that is strong evidence that the breach was not material (it was fixable).

Thus, a notice to cure is typically the “other foot dropping” that proves the default could not be cured and therefore the defaulting party was in material breach. Some states require a notice to cure to be issued prior to termination for cause.

Lastly, sometimes the breach has *already, previously* been cured by the defaulting party. Occasionally, an irritated higher-tier party will provide a lengthy list of transgressions and reasons for termination, but all of them are old, stale, and already cured. Generally, it is problematic to terminate for cause, if the reason for the termination has already been cured. Usually, terminating for cause requires the defaulting party to be in *current, uncured breach* at the time of termination. If terminating a party for yesteryear’s transgressions, then, you are not technically terminating for breach of contract (it was already cured); instead, you are terminating because you are still angry about it. But that is not a justified basis for termination under the law. It is an uncured (or uncurable) material breach that justifies termination, not a subjective opinion that the party was incompetent due to past issues that are of no current moment.

Document the Breach of Contract, the Remediation, and the Costs/Losses

When terminating a defaulting party, it is important to document breach. Photographs, daily logs/reports, notices to cure, and meeting minutes should corroborate and prove the breach. Documentation of the redesign or remediation work should be well maintained, including annotated sketches or drawings to explain the details of the breach and remediation. Likewise, clear, segregated cost tracking proving the specific additional costs for remediation and cure of the issue should be maintained.

Also, best practice is to maintain documentation of the curative work to show and explain the steps taken to cure the issue. Often, the curative work itself speaks volumes as to what the problem was.

Preserve Evidence, Allow Access to Evidence, and Avoid Spoliation

Obviously, the evidence of breach, notice, termination, and the remediation work should be preserved. Relatedly, it is best to provide notice of the pending remediation work and allow the terminated party access to the site for a last inspection of the issue prior to the remediation work occurring. This is because, once the remediation work commences, the evidence of breach will inherently be destroyed and manipulated. Sometimes the terminated party will dispute the evidence, and argue that if it had been allowed the opportunity to inspect the defect, it would have been able to prove that the work was in fact satisfactory or a less expensive cure could have been utilized. The best approach is to allow the terminated party to access the site to inspect the work and observe the remediation work. The terminated party cannot interfere with the work or project, of course, but providing reasonable access for inspection (and sometimes destructive testing) is the best practice.

Lastly, sometimes, if allowed to inspect prior to the final termination, the defaulting party might present analysis or evidence to change minds about the course for remediation.

Ensure that All Interested Parties Have Been Given Notice

Sometimes there is a reason to give notice of the termination to third parties. For example, if there is a performance bond posted by the defaulting party, typically it is best to give notice to the surety. Also, sometimes the contract documents require notice of a termination to be given to either a lender, higher tier, or owner.

Consider Whether Statutes Impose a Limitation or Constraint on Termination

Sometimes the basis for termination might conflict with a separate statute. For example, under the Bankruptcy Code it is technically a violation to terminate a contract on the basis of a declared bankruptcy. You must seek bankruptcy court approval for terminating a contract with a bankrupt debtor. Other times, statutory payment acts or other statutes may require a process or steps to be taken prior to termination. This is particularly true if there are withholdings or demands for payment, which is frequently the case.

Ultimately, termination of a party on a construction project is a very strong action with significant repercussions. Missteps in the termination process can compound losses and escalate risk. Care must be taken to approach the termination with careful consideration of strategy and planning in the best interests of both the project and the litigation claims/defenses. It is highly recommended to consult with legal counsel starting with the notice and termination period. Lastly, these approaches are general points for consideration; recognize that each specific situation, project, or contract will have different factors to consider when terminating a downstream party.

JEFFREY C. BRIGHT is a Principal attorney in Offit Kurman's Construction Practice Group and maintains a multi-state construction law practice, representing contractors, subcontractors, owners, construction managers, design-builders, and design professionals. He is licensed and active in construction law matters in PA, MD, DC, VA, and CA. In addition to handling construction litigation and project disputes, including termination of contracts mid-project, he regularly advises on the preparation, revision, and negotiation of construction contracts for various project delivery systems. He can be reached at jeff.bright@offitkurman.com.