REVISITING TERMINATION

Revisiting termination: When to stick or twist?

What of a contractor who, put simply, is just not performing? What options are available to an employer who believes its contractor is not holding up its end of the bargain?

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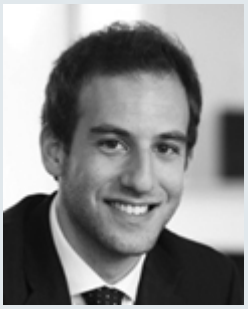

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> ***What of a contractor who, put simply, is just not performing? What options are available to an employer who believes its contractor is not holding up its end of the bargain?***

For employers, exercising a right to terminate a contractor's engagement under a building contract can be a double-edged sword. If invoked carefully and correctly, termination can be an effective way to remove non-performing contractors from a project and mitigate against further delays and the spiralling costs to complete that almost inevitably follow. Employers should take care, however, because incorrectly terminating a contract can leave an employer exposed to a claim for wrongful termination and breach of contract, and with it, liability for the contractor's loss of profit and other costs.

As arguably the most draconian right available to an employer, termination is an inherently risky enterprise. It is therefore often viewed as a remedy of last resort, and employers should proceed with caution before invoking any right of termination under a building contract.

Recap: common law vs contractual termination

Most construction contracts contain provisions governing the rights of both the employer and the contractor to terminate the contractor's employment under the contract, as well as the steps that must be followed to achieve lawful termination and the consequences and liabilities which follow termination in accordance with those contractual provisions. The main industry standard forms of construction contract including the JCT, FIDIC and NEC4 entitle the employer to terminate the contractor's engagement following the occurrence of certain specified breaches of contract.

In the unlikely event that termination rights are not specifically dealt with in a construction contract, common law provides for the termination of contracts (construction or otherwise) where one party has committed a repudiatory breach. By repudiatory breach, we mean a breach of a fundamental term of the contract or a breach which goes to the root of the contract and deprives the innocent party from the whole or most of the benefit of it.

An employer who intends to terminate a building contract on the grounds of repudiatory breach should take care not to affirm the contract (in other words, treat the contract as ongoing), or risk losing its right to terminate for repudiatory breach.

As most construction contracts contain provisions which specifically govern termination, we will focus here on contractual termination rights, rather than those arising under common law.

Contractual termination

Typically, appointments of architects, engineers, project managers and other consultants will include a right for the employer to terminate without cause (ie, 'at will'). A right to terminate at will is less commonly available to an employer under building contracts, although it does feature in some industry standard forms. For example, the NEC4 suite of construction contracts includes a 'secondary option' clause which the parties can choose to apply, or not. Similarly, the FIDIC forms of contract include a right for the employer to terminate at will. Exercising these rights is not necessarily straightforward. For instance, as per *Abbey Developments Ltd v PP Brickwork Ltd* [2003], the courts have suggested an employer will not be entitled to omit work from its contractor and award it to another unless there is a clear contractual right to do so.

The JCT suite of contracts – most commonly adopted for commercial property developments in the UK – does not include the right for the employer to terminate the contractor's engagement at will. When, then, is an employer entitled to terminate a contractor's engagement under a JCT?

The JCT Design and Build form of contract (JCT DB) includes the following employer termination rights (in clauses 8.4 to 8.6):

- contractor insolvency;
- whole or partial suspension of work by the contractor without reasonable cause;
- failure by the contractor to regularly and diligently proceed with the performance of its obligations;
- failure by the contractor to comply with an instruction to remove work or materials not in accordance with the contract;
- failure to comply with specific clauses relating to sub-contracting, assignment and compliance with the CDM Regulations; and
- the commission of an offence under anti-bribery legislation.

Many of these triggers should, at least in theory, be reasonably straightforward to establish once the relevant situation presents itself. But what of a contractor who, put simply, is just not performing? What options are available to an employer who believes its contractor is not holding up its end of the bargain?

Failure to proceed regularly and diligently

The employer's right to terminate for failure to proceed regularly and diligently is linked to other duties of the contractor set out elsewhere in the JCT DB. Clause 2.1.1 requires the contractor to:

> *… carry out and complete the Works in a proper and workmanlike matter and in compliance with the Contract Documents.*

Clause 2.3 requires the contractor to 'regularly and diligently proceed with and complete' the works by the relevant completion date.

A frustrated employer might seek to pin the contractor's failings to a breach of these contractual obligations, amounting to a failure to regularly and diligently proceed, and entitling the employer to terminate the contractor's engagement. However, establishing a failure to regularly and diligently proceed with the works can be notoriously difficult.

This is primarily because the contractor is usually entitled to programme and sequence the works as it deems appropriate to achieve practical completion by the required completion date. It is generally accepted that failure to undertake part of the works in accordance with the programme does not, of itself, amount to a breach of contract. Even a delay to the works as a whole is not conclusive of a failure to regularly and diligently proceed.

What then, does a failure to regularly and diligently proceed look like? In *West Faulkner Associations v London Borough of Newham* [1994], the Court of Appeal sought to provide some clarification, with Simon Brown LJ observing that the terms 'regularly' and 'diligently' should be construed together in what essentially amounts to an obligation:

> *… to proceed continuously, industriously and efficiently with appropriate physical resources so as to progress the works steadily towards completion substantially in accordance with the contractual requirements as to time, sequence and quality of works…*

He continued, however:

> *Beyond that I think it is impossible to provide useful guidance. These are after all plain English words and in reality, the failure [to proceed regularly and diligently] is, like the elephant, far easier to recognise than to describe.*

In *SABIC UK Petrochemicals Ltd v Punj Lloyd Ltd* [2013], the court considered the implications of a contractual duty to carry out the works 'with due diligence' and held that, while a delay to the works was not conclusive evidence of a failure to apply due diligence, it could be suggestive.

In *Vivergo Fuels Ltd v Redhall Engineering Solutions Ltd* [2013], the court provided further examples of what might be considered a failure to proceed regularly and diligently, holding that:

- a failure to achieve programmed productivity because of inadequate resourcing will usually be suggestive of a failure to proceed regularly and diligently;
- a failure to provide sufficient resource to complete the works may be relevant to the question of whether the works are proceeding regularly and diligently. However, where an employer asks a contractor to re-sequence the works or prioritise one part over another, the employer is likely to find it harder to argue the contractor has failed to sufficiently deploy its resources;
- a failure to supervise staff on site for a sufficient period of the working day is not a separate ground for establishing a failure to proceed regularly and diligently,

however, it could be evidential and relevant to the overall assessment; and
- a failure to produce a proper programme for the works is not conclusive evidence of failing to proceed regularly and diligently, as the contractor is entitled to sequence the works as it sees fit to meet the completion date. However, it may suggest a lack of due diligence.

As an interesting footnote, in the same case, the court also considered whether a failure to proceed regularly and diligently would amount to a repudiation of the building contract by the contractor. The court held that it did not, and that delay was not synonymous with a renunciation by the contractor of its obligations. The court's guidance suggests that in the case of a delay to the works, a full failure to mobilise or an abandonment of the works is likely to be necessary to establish a repudiatory breach.

A thorough, detailed analysis of the events surrounding the contractor's non-performance, possibly with expert opinion, should be undertaken to ascertain whether the contractor has indeed failed to proceed regularly and diligently with the works before any decision to terminate is taken.

The termination notice

Once an employer has satisfied itself that a failure to proceed regularly and diligently has been established, if it wishes to terminate the contractor's engagement under the JCT DB it must serve a default notice on the contractor, identifying the alleged breach. The contractor then has 14 days to address the allegations and improve the situation. If the breach continues for the full 14 days without improvement, the employer has 21 days in which to serve a further notice terminating the contractor's engagement.

Having issued a default notice, employers should be alive to the possibility of the contractor demonstrating that it has taken steps to address the alleged breach. If the contractor can show that it has improved the situation – such as through applying additional resource, even if temporarily – within the 14-day notice period, then the employer will forego its ability to serve a termination notice for the time being and fresh evidence of the contractor's failure to proceed regularly and diligently will be required. It is only if the contractor repeats a previously specified default that the employer will be entitled to serve a termination notice, which it can then do 'upon or within a reasonable time after such repetition' (as per clause 8.4.3 of the JCT DB).

The Vivergo case is a cautionary tale for employers who jump the gun and purport to terminate a contractor's engagement without following the prescribed notice requirements of the contract. Vivergo engaged Redhall to carry out work to a biofuel plant. The works were delayed and Vivergo purported to terminate Redhall's engagement under the contract. The contract was not in the form of a JCT, but it did include specific provisions governing termination. Vivergo was entitled to terminate if Redhall was in material breach by giving a warning notice requiring Redhall to pursue the rectification of a default notified to it within 14 days; failing which, Vivergo could serve a further notice terminating Redhall's employment. The court held that Vivergo had indeed issued a warning notice, but that Redhall had remedied the breach referred to in it. Consequently, Vivergo's subsequent termination notice was invalid because its right to terminate had ceased to exist and, having barred Redhall from the site without having validly terminated the contract, Vivergo was held to be in repudiatory breach.

Key considerations

What, then, should be the key considerations for an employer who is considering terminating a contractor's engagement?

1. Check the terms of the building contract. Is there a termination at will clause? Even if there is, be mindful of terminating the contractor's engagement to award the same work to another contractor without a clear, express, contractual right to do so.

2. If there is no termination at will clause, be certain that the right to terminate has arisen under the contract and that all relevant contractual grounds for termination are clearly stated in any termination notice. Consult expert or counsel's opinion if necessary as to whether the relevant contractual provisions are engaged.

3. Keep accurate records relating to the contractor's non-performance and obtain evidence from the project team of the factual circumstances surrounding the contractor's breach before any termination notice is issued.

4. Consider the ground of common law repudiatory breach if the contract does not provide other adequate mechanisms to terminate.

5. Consider whether the consent of any third party is required before you can terminate. For example, are there any funders from whom prior consent is needed?

6. Be sure to adhere to any timeframes and other notice requirements stated in the contract. Failure to do so can render a termination invalid.

7. Consider how the works will be carried out going forward. Can a replacement main contractor be appointed? Does the employer have recourse to collateral warranties from subcontractors with step-in rights that can be invoked? Document negotiations with these parties, as they may be of use during any later argument with the defaulting contractor regarding liability for losses arising from the termination.

8. Consider how termination might impact on any right to claim or deduct liquidated damages for delay, which usually run up to the date of termination, with general damages (to be assessed under usual common law principles) to apply thereafter.

9. Be mindful that the JCT DB provides that a termination notice cannot be given 'unreasonably or vexatiously', meaning with the intention of oppressing or harassing the other party.

10. Consider whether any alternatives remain other than termination? Termination should be viewed as a remedy of last resort, when other viable routes of preserving relationships have been exhausted. Can a negotiated settlement be salvaged?

Cases Referenced

- Abbey Developments Ltd v PP Brickwork Ltd [2003] EWHC 1987
- SABIC UK Petrochemicals Ltd v Punj Lloyd Ltd [2013] EWHC 2916 (TCC)
- Vivergo Fuels Ltd v Redhall Engineering Solutions Ltd [2013] EWHC 4030 (TCC)
- West Faulkner Associations v London Borough of Newham [1994] 71 BLR 1

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