

University of Vienna Suspension and Termination

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Nicholas Gould

Partner, Fenwick Elliott LLP

Visiting Senior Lecturer, King's College London

1 Introduction

1.1 This paper considers the following:

- 1.1.1 General principles of termination
- 1.1.2 The right to terminate or claim damages or both
- 1.1.3 Common law termination or repudiation
- 1.1.4 Contractual termination
- 1.1.5 Contractual termination clauses
- 1.1.6 Suspension
- 1.1.7 Contractual procedures for termination and suspension (FIDIC, ICE, NEC, JCT)
- 1.1.8 Entitlement to damages and costs arising from termination

2 General principles of termination

2.1 The law surrounding termination can be confusing and is littered with legal terminology (much of which is frequently used incorrectly). Terms such as “forfeiture”, “fundamental breach”, “determination” (and “termination”), “rescission”, “conditions”, “warranties” and “repudiation” are regularly used by lawyers.

2.2 The purpose of this section is to provide you with an overview and understanding of the underlying principles rather than simply to focus on the terminology that accompanies

termination issues; an innocent party's primary concern will be bringing the contract to a lawful end if that party considers the other side is not sticking to the bargain. In order to avoid incurring unwanted liabilities, that innocent party will have to ensure that the termination is justified and that it is done in accordance with any procedural requirements.

- 2.3 This section will provide an introduction to the basics surrounding termination as well as some practical examples of what circumstances are likely to give rise to a right to terminate at common law (as opposed to under the contract). We will later examine the contractual grounds for termination under the FIDIC form of contract.

3 *The right to terminate or claim damages or both?*

- 3.1 Where there is a contract between two (or more) parties, a breach of the terms of that contract will give the injured party the right to bring an action for damages and/or (depending on the seriousness of the breach and the term of the contract that has been breached) to terminate the contract.
- 3.2 Whether a party is entitled to damages only or is entitled to damages and to terminate the contract depends on the status of the terms of the contract in question.
- 3.3 Traditionally, in English law, the terms of a contract have been classified as being either "conditions" or "warranties", the difference being that any breach of a condition entitles the innocent party, if he so chooses, to treat himself as discharged from further performance under the contract, and in any event to claim damages for loss sustained by the breach. A breach of warranty, on the other hand, does not entitle the innocent party to treat himself as discharged but to claim damages only.¹
- 3.4 In practice, the distinction between conditions and warranties is not often relied upon, but as will be seen below, there will be an important distinction between breaches of contract which give rise to a right to terminate and those which simply entitle the innocent party to claim damages.

¹ See *Chitty on Contracts*, Volume I: *General Principles* (London: Sweet & Maxwell, Thirtieth Edition) ("*Chitty*"), Section 12-019.

4 *Common law termination or repudiation*

- 4.1 The right of an innocent party to bring to an end or terminate a contract because of breach by the other can arise both at “common law” and also by virtue of express terms of the contract in question.² By “common law” we mean English law as developed through the decisions of the courts, rather than law recorded in legislation.
- 4.2 Common law termination occurs where the guilty party has committed a “repudiatory” breach of contract. A repudiatory breach is a breach of a term of the contract which is so serious in itself that it would be unreasonable to expect the other party to continue with the contract.
- 4.3 Such a breach is usually called a “*repudiatory breach of contract*”. When it is accepted by the innocent party it is called the “*acceptance of repudiatory breach of contract*” or simply “*repudiation*”.
- 4.4 By accepting a repudiatory breach, the innocent party brings the contract to an end. Importantly, until the innocent party does accept the repudiation, the contract continues to exist. Conversely, if the innocent party fails to accept the repudiation, that party will be taken to have affirmed the contract and it will remain valid. There is some Court of Appeal authority that the innocent party can spend some time making up their minds before accepting a repudiation, but exactly how long it is entitled to do this for depends on the facts.³
- 4.5 A repudiatory breach may also occur where there is a breach of a term which, while not by itself sufficiently serious, may be so protracted or repeated, despite protest or notice by the innocent party, that it demonstrates either an intention not to be bound by the contract, as in the case of deliberate and continued breaches (however minor), or simply an involuntary inability to perform the contract properly.⁴
- 4.6 Other situations in which a repudiatory breach might arise include where one party actually informs the other of their intention not to perform the contract as a whole, or

² See Atkin Chambers, *Hudson’s Building and Engineering Contracts* (London: Sweet & Maxwell, Twelfth Edition), (“*Hudson*”), Section 8-004.

³ *Allen v Robles* [1969] 1 WLR 1193.

⁴ For example, an employer’s failure to prepare the site and decision to give large parts of the works to another party in *Carr v AJ Berriman* (1953) 27 ALJR, High Court of Australia.

some part of it, either presently or in the future, or where a party acts in a way as to render their own future performance impossible.⁵

- 4.7 Because the right to terminate (by accepting a repudiation) arises at common law, the innocent (or terminating) party will have that right regardless of whether there is a detailed termination clause in the contract. Although it should be noted that where the parties have expressly agreed to rules that will apply in the circumstances of a termination, such contractual terms may modify the right to terminate at common law.
- 4.8 For example, if the contract were to provide that a 30-day cure period must be given to allow a defaulting party to remedy a specific breach, the innocent party could not rely on that same breach as providing grounds to accept a repudiation.
- 4.9 Whether or not a breach of contract will constitute a repudiatory breach of contract will depend on the facts of each case and the terms of the contract in question.
- 4.10 Examples of what is likely to, and what is not likely to, constitute a repudiatory breach of contract by a contractor include:
- 4.10.1 **Abandonment** – Refusing to carry out the works is often an act of repudiation.
- 4.10.2 **Defects** – The existence of defects is not usually an act of repudiation. As a rule of thumb defective work will not be treated as repudiatory if it will not prevent substantial completion taking place. However, if the seriousness of the breaches is such that it becomes clear that the contractor does not intend to, or cannot, perform its obligations, then this may amount to a repudiation by the contractor. This, of course, will depend on the facts of the case but *Sutcliffe v Chippendale & Edmonson*⁶ sheds some light on the situation.

The case involved an allegation that the defendants (a firm of architects) had over-certified the contractor's work owing to the number of defects. The employer had ordered the contractor off site and others were engaged to complete the work. The contractor then became insolvent and so the employer sought to recover the cost of the remedial works from the defendants. The

⁵ See *King v Allen (David) Bill Posting Ltd* [1916] 2 AC 554 where a billposting site was alienated after the grant of a licence to post bills thereon.

⁶ (1971) 18 BLR 157.

issue as to whether the employer had grounds to terminate the building contract was considered. The judge agreed with the employer's argument that an accumulation of defects, which on their own would not amount to a repudiation, could be regarded as such. The judge also relied on the fact that the quality of work was generally deteriorating as the works progressed, and the number of defects was multiplying (many of which the contractor had tried unsuccessfully to put right). This, coupled with delay on the part of the contractor, entitled the employer to order the contractor off site.

4.10.3 **Delay** – Delay by the contractor is usually not an act of repudiation unless the time is of the essence. This is one of the areas that arises most frequently in practice. So does delay on the part of the contractor amount to a repudiation of the contract? As a rule of thumb, and where time is not of the essence (discussed below), delay does not amount to a repudiation. As ever, though, it depends on the circumstances. If the contractor's delay means that he cannot or will not carry out the contract, then it may amount to a repudiatory breach if the delay deprives the innocent party of substantially the whole benefit of the contract.⁷

Even if the employer is on reasonably certain grounds that the delay amounts to a repudiation of the contract, then it is almost always necessary to give notice to the contractor to that effect before accepting that repudiation. In *Felton v Wharrie*⁸ the plaintiff had agreed to demolish some houses for the defendant within 42 days. This date was missed and when asked by the employer whether it would take one, two or three months to complete the contractor said that he could not say. The contractor carried on with the work and two weeks later the employer ejected the contractor from the site. It was held that the employer had no right to do so because he had failed to inform the contractor that he treated the contractor's response in failing to confirm how long the works would take as a refusal to carry out the work and should not have waited two weeks. Essentially, the employer must act quickly and communicate to the contractor any dissatisfaction with their performance.

4.11 What is the effect of making time of the essence and how can it be done?

⁷ *Shawton Engineering Ltd v DGP International Limited and DGP Ltd* [2006] BLR 1, CA.

⁸ See *Hudson's Building and Engineering Contracts*, Eleventh Edition, at Section 4.214.

- 4.12 The first point to note is that time is not of the essence in relation to the whole contract. The issue is whether time is of the essence in relation to a particular obligation. Time is not considered of the essence unless:
- 4.12.1 the parties state that a term relating to time must be strictly complied with; or
 - 4.12.2 the nature of the subject matter of the contract or the surrounding circumstances show that time should be considered of the essence; or
 - 4.12.3 a party who has been subjected to unreasonable delay gives notice to the other party and makes time of the essence.
- 4.13 In construction contracts points 4.12.1 and 4.12.2 are rarely an issue. Construction contracts do not tend to make the timing for the performance of any obligations of the essence. Similarly, the subject matter of the contract is not such that completion should be considered of the essence. Instead, it is point 4.12.3 which is relevant. Despite the comprehensive provisions in standard contracts dealing with time, there are circumstances where the employer is entitled to make time of the essence.
- 4.14 The effect of making the contractor's obligation to complete the works 'of the essence' is essentially to put the contractor on notice that unless he completes by a specified date, then the employer will treat this as a repudiation of the contract. Unsurprisingly, getting this process right is not without its pitfalls for the employer.
- 4.15 This has been considered recently in *HDK Limited v Sunshine Ventures & Others*⁹ and includes a useful overview of the law in this area. The case concerned three separate building contracts. HDK (the contractor) sought payment of outstanding sums and Sunshine (the employer) was claiming damages for non-completion and defects in the works. In a nutshell, the contractor was late in completing his works. The employer was becoming increasingly frustrated with progress, and on 26 September 2006 wrote to the contractor requiring him to "*complete the work ... as soon as possible*". He then wrote again on 30 September 2006 requiring him to "*complete the outstanding works as a matter of urgency*". On 24 November 2006 a letter was issued to the contractor terminating the contract. The issue was whether the September letters had the effect of making time of the essence and essentially setting up the termination in November. It was held that they were not. They failed on two grounds. First, they did not convey in

⁹ [2009] EWHC 2866 (QB).

clear terms that unless the notice was complied with then the employer would treat the contract as at an end. Second, they did not specify a date by which the contractor was to complete. The result of the failure to properly make time of the essence meant that the termination letter of 24 November was effectively a repudiation of the contract on the part of the employer.

4.16 In summary, the points the employer needs to bear in mind when wishing to make time of the essence as a result of delay on the part of the contractor are:

4.16.1 a reasonable time for performance must have elapsed;

4.16.2 the notice to the contractor must set out a requirement for completion by a specified date;

4.16.3 the specified date for completion must not be unreasonably soon in the circumstances judged at the time the notice is given;

4.16.4 the notice must make clear that the employer will treat the failure to complete by the specified date as a repudiation by the contractor (i.e. the contractor must be in no doubt as to the consequences of failing to complete by the date specified); and

4.16.5 the employer himself must not be committing a breach of contract that is affecting the contractor's ability to complete.

4.17 What amounts to a reasonable time for performance to have elapsed will, of course, depend on the circumstances. A court will take into account the original agreed date for completion, the effect of any variations and the conduct of the parties.

4.17.1 ***Other breaches*** – The key question to ask is whether the breach goes to the “*root of the contract*”.

Examples of what is likely to, and what is not likely to, constitute a repudiatory breach of contract by an employer include:

4.17.2 ***Refusal*** – An absolute refusal by the employer to carry out his part such that the contractor cannot carry on with his works is a repudiation of contract.

- 4.17.3 **Rendering completion impossible** – If the contractor cannot get possession of the site because the employer refuses to give it then the employer is very likely to be in repudiatory breach of contract.
- 4.17.4 **Ordering the contractor to stop work** – This can be a repudiation of the contract by the employer in certain circumstances.
- 4.17.5 **Failure to pay instalments** – A failure to pay instalments cannot amount to a repudiation if there is no contractual duty to pay them in the first place.

In practice, of course, most building contracts will have some mechanism for interim payment. Whether or not non-payment amounts to repudiation depends on the circumstances. If just one instalment out of many is unpaid then it is unlikely to amount to a repudiation.

However, the issue to consider in relation to non-payment is not so much the non-payment itself but whether, in the circumstances, that amounts to a refusal or inability to pay (which will amount to a repudiation by the paying party). *Hudson* (a leading English construction law textbook) also suggests that repeated failure to pay on time, despite warnings from the contractor, may amount to a repudiation on the part of the employer if it is done in order to derive financial advantage.¹⁰

So what the courts are looking for is evidence of foul play or bad faith. This, of course, will be a question to be considered by looking at all the circumstances at the time.

However, a word of warning to the contractor who considers that the employer's poor payment habits amount to a repudiation of the contract. The contractor needs to bear in mind possible set-offs which the employer may have (these set-off rights are most unlikely to have been excluded in the contract and so remain available to the employer). If the employer can establish a set-off against sums due, then the contractor's course of action in treating non-payment as a repudiation may backfire. The comfort for the contractor in this situation lies in the fact that the set-off must be for genuine

¹⁰ See *Hudson*, Section 4.222. [Please specify which edition]

loss, and be known to the employer at the time. The employer will not be able to raise a set-off if the grounds for that set-off only come to light at a much later date.

For example, the employer will not be able to set-off in respect of defective work if that defective work was not known to him at the time the contractor alleged that the employer's non-payment amounted to a repudiation of the contract.

4.17.6 ***Under-certification*** – Under-certification will not usually amount to a repudiation.

4.17.7 ***Suspending the works*** – Whether this would constitute a repudiatory breach of contract will depend upon whether there is a contractual right to suspend the works for the employer and whether that right has been properly exercised.

5 ***Contractual termination***

5.1 In addition to a common law right to terminate by accepting a repudiation, parties to a contract can, and very frequently do, agree upon express termination provisions for the benefit of a party where certain defined events occur.

5.2 We will consider below the defined events included within FIDIC for this purpose.

5.3 Similarly, the parties may indicate expressly by the contractual agreement that a single breach of a particular contractual obligation is to have the same consequences as a fundamental breach entitling the innocent party to rescind the contract, even though otherwise (without that agreement) it would not have amounted to a fundamental breach justifying immediate termination.

5.4 It is worth emphasising at the outset that any termination, whether it arises at common law, or by virtue of the termination provisions within the relevant construction contract, is fraught with risk.

5.5 This is because a decision to bring a contract to an end, if not justifiable either under the contractual termination clauses or at common law, will itself be a repudiatory breach of contract which the other party can accept.

5.6 Whilst there is normally little doubt as to whether the contract has actually ended in these circumstances, issues as to which party terminated, and how the termination was carried out, will have a very significant impact on which party has liability for the costs of completion and for the terminated party's lost profits. (Please see Section 6 below for more information in relation to this).

5.7 Some points to note arising out of a termination which you should be aware of, and which are often forgotten, are as follows:

5.7.1 ***No reason given or bad reason given*** – Where a party refuses to perform a contract, giving a wrong or inadequate reason, or no reason at all, he may later justify his refusal if there were at the time facts in existence which would have provided a good reason, even if he did not know of them at the time of his refusal.¹¹ For example, where an employee brings an action against his employer alleging that he has been wrongfully dismissed, the employer can rely on information acquired after the dismissal when seeking to justify the dismissal.

This general rule is subject to a number of exceptions. First, a party cannot rely on a ground which he did not specify at the time of his refusal to perform “*if the point which was not taken could have been put right*”.¹² Second, a party may be precluded by the operation of the doctrines of waiver or estoppel from relying on a ground which he did not specify at the time of his refusal to perform.¹³

5.7.2 ***Arbitration agreements are separate contracts*** – Arbitration agreements are considered to be separate contracts and so are not generally repudiated or terminated even when the agreement that contains them is repudiated.¹⁴ As a result an arbitrator appointed under an arbitration clause will have jurisdiction to decide whether a contract has been repudiated by one of the parties.¹⁵

¹¹ See *Chitty*, Section 24-014.

¹² *Helisler v Anglo-Dal Ltd* [1954] 1 WLR 1273.

¹³ In order to invoke this it is necessary to show that there was an unequivocal representation made by one party or otherwise which was acted upon by the other. It may not be easy to establish the existence of such an unequivocal representation in practice.

¹⁴ *Heyman v Darwins Ltd* [1942] AC 356.

¹⁵ See Keating, Section 16-012. [Please provide full details as Keating has not been mentioned before]

6 *Contractual termination clauses – some basic principles*

6.1 We will consider at Section 8 below the termination provisions in the FIDIC forms of contract. However, it is perhaps worth noting at this stage some of the basic principles underlying contractual termination clauses. These are as follows:

6.1.1 contractual termination clauses must be followed absolutely and entirely in accordance with their drafting. A failure to do this may result in the party attempting to terminate committing a repudiatory breach of contract itself;

6.1.2 a party that believes that it is operating the contractual provisions, but is subsequently found to have not been entitled to do so, is likely to have repudiated the contract;

6.1.3 contractual termination provisions do not usually exclude local law remedies;

6.1.4 the grounds for operating the termination provisions must exist;

6.1.5 the notices must be served in accordance with the contract, which means identifying the ground or grounds and complying strictly with the timetable;
and

6.1.6 most termination provisions require the issue of a second notice of termination, which must be issued in accordance with the contract, by the correct party, and in accordance with the timetable of the contract.

6.2 If there is any doubt as to how the termination provisions should be implemented and/or interpreted, advice should be sought. It is very important not to apply the provisions incorrectly!

7 **Suspension**

7.1 Suspension may offer a contractor a remedy less drastic than termination, but nonetheless very helpful, in certain circumstances. For example, where the employer has not paid monies due to the contractor in accordance with the construction contract.

- 7.2 A contractual right of suspension provides a right to suspend (all or part) of the works, which would not generally exist under the local law.
- 7.3 Under English law, there is no right (outside of a contract) to suspend work for non-payment.¹⁶ Under English Law therefore an unpaid party will only have the right to suspend performance in two circumstances. These are:
- 7.3.1 if there is a contract term allowing suspension; and/or
 - 7.3.2 if Section 112 of The Housing Grants, Construction and Regeneration Act 1996 (the “Construction Act”) applies.
- 7.4 The Construction Act will only apply to construction contracts that fall within the very strict criteria laid down in the Act. These criteria are extensive but for your purposes the main point to note is that the Construction Act does **NOT** apply to any construction contracts (as defined within the Construction Act) where the works are outside of England, Wales or Scotland.
- 7.5 If the construction contract is for works within England, Wales and Scotland and falls within the definition under the Construction Act, then the statutory provisions will apply, notwithstanding what choice of law is made by the parties.
- 7.6 Should you undertake a construction project within the UK, then you should consult with English lawyers in order to ascertain whether the Construction Act applies to the works. If applicable, the Construction Act also regulates other aspects of the parties’ relationship, such as payment and dispute resolution methods.
- 7.7 If the Construction Act does apply then a right to suspend will exist if:
- 7.7.1 payment of a sum due has not been made and the final date for payment (as defined within the Construction Act) has passed without a withholding notice (as defined within the Construction Act) being served (see section 112(1)); and
 - 7.7.2 the contractor has given at least 7 days’ notice of intention to suspend stating within that the ground(s) on which it is entitled to suspend (section 112(2)).

¹⁶ See PLC Construction, *Suspension for non-payment under the Construction Act 1996*, PLC Practice Note. [Please provide publication date]

- 7.8 The right to suspend under the Construction Act ceases as soon as the party in default makes payment.
- 7.9 Where the Construction Act does not apply, that is, on any project outside the UK, English law does not confer any right to suspend unless such right is given expressly in the contract.
- 7.10 It may of course be that the law of the jurisdiction in which the works are situated also implies a right to suspend the works along the lines of the Construction Act. This should be investigated with local lawyers.
- 7.11 In summary, the key points to consider in relation to suspension are as follows:
- 7.11.1 Is there an express right to suspend the works under the construction contract?
 - 7.11.2 Is there a right to suspend under the local law?
 - 7.11.3 Must all work be suspended?
 - 7.11.4 Does suspension mean just that, or is slowing down acceptable?
- 7.12 The FIDIC provisions for suspension are discussed later on in this talk.

8 Contractual procedures for termination and suspension

8.1 This section considers the key FIDIC provisions for suspension and termination (other than as a result of *force majeure*). The clauses referred to below come from the FIDIC Yellow Book although there are similar provisions in the other FIDIC forms.

8.2 *FIDIC – Suspension by the engineer*

- 8.2.1 Clause 8.8 provides that “The Engineer may at any time instruct the Contractor to suspend progress of part or all of the Works...”

- 8.2.2 Clause 8.9 deals with the consequences of suspension, providing the contractor with the ability to claim for delays and/or additional costs.
- 8.2.3 If suspension continues for more than 84 days, the contractor can ask the engineer for permission to proceed (Clause 8.11). If only part of the works has been suspended then the contractor might treat that suspension as an omission, unless the engineer within 28 days gives permission for the contractor to continue working.
- 8.2.4 If the suspension affects the whole of the works then the contractor can give notice under Clause 16.2 that it wishes to terminate the contract.

8.3 *FIDIC – Suspension by contractor*

- 8.3.1 Clause 16 provides for suspension and termination by the contractor.
- 8.3.2 Clause 16.1 broadly provides that if the engineer fails to certify interim payments, the employer fails to provide reasonable evidence that it can pay the contract sum or the employer fails to comply with the payment provisions in Clause 14.7 of the contract, then the contractor may, after giving not less than 21 days' notice to the employer, suspend or reduce the rate of work.
- 8.3.3 This is unless the contractor then receives the payment certificate, reasonable evidence that the employer has financial arrangements properly in place to pay the contract sum or payment (depending on what breach has been committed by the employer and was specified within the notice).
- 8.3.4 A contractor can claim an extension of time and prolongation costs as a result of a suspension under Clause 16.1. The engineer should then issue a Clause 3.5 determination in respect of any additional time or money.

8.4 *FIDIC – Termination by the contractor*

- 8.4.1 The contractor is entitled to terminate under Clause 16.2 if:

- 8.4.1.1 the contractor does not receive reasonable evidence that financial arrangements are in place to allow for payment of the contractor within 42 days after the notice under Clause 16.1;
- 8.4.1.2 the engineer fails to provide, within 56 days of a Statement and supporting documents requesting payment, the payment certificate;
- 8.4.1.3 the contractor is not paid within 42 days after the expiry of the time for payment;
- 8.4.1.4 the employer “*substantially*” fails to perform his obligations under the contract;
- 8.4.1.5 the employer fails to enter into the detailed contract agreement within 28 days after the Letter of Acceptance (as provided for under Clause 1.6) or assigns the contract in breach of the provisions within Clause 1.7;
- 8.4.1.6 there is a prolonged suspension which affects the whole of the works and lasts for more than 84 days (subject to notice requirements being complied with) (Clause 8.11); or
- 8.4.1.7 the employer becomes insolvent.

8.5 If these events occur then the contractor “*may, upon giving 14 days’ notice to the employer, terminate the Contract*”.

8.6 *FIDIC – Consequences of termination*

- 8.6.1 After the final notice of termination, the contractor can then cease all work except for any works instructed by the engineer for “*the protection of life or property or the safety of the Works*” (see Clause 16.3).
- 8.6.2 The contractor should hand over all documents, and any plant and materials for which the contractor has been paid, but then remove all other goods from the

site. It is important to remember to leave anything behind that is necessary for the safety of the site.

8.6.3 The provisions within FIDIC for the recovery of any costs and outstanding monies due to the contractor upon such a termination are dealt with in the final part of this presentation.

8.7 *FIDIC – Termination by employer*

8.7.1 Clause 15.2, broadly speaking, allows the employer to terminate the contract if the contractor:

8.7.1.1 fails to provide the Performance Security as required under the contract;

8.7.1.2 fails to comply with a Notice to Correct;

8.7.1.3 abandons the work or demonstrates an intention not to continue performance;

8.7.1.4 fails without reasonable excuse to proceed with the works;

8.7.1.5 fails to comply with a Notice of Rejection (Sub-Clause 7.5) or remedial works (Sub-Clause 7.6) within 28 days after receiving the notice;

8.7.1.6 subcontracts the whole of the works without agreement;

8.7.1.7 assigns the contract without agreement;

8.7.1.8 becomes insolvent; or

8.7.1.9 commits an act of bribery or corruption.

8.7.2 For most of the grounds for termination the employer must give 14 days' notice to the contractor, but can then terminate and expel the contractor from site.

However, if the contractor is insolvent or is involved in any form of corruption, the employer can terminate the contract forthwith.

8.7.3 The contractor is then to leave site immediately. The employer may then complete the works using goods, materials and the design of the contractor.

8.7.4 The contractor's entitlement to its costs and any outstanding monies in such circumstances is outlined in more detail in the final section below.

8.8 *Timing and procedure*

8.8.1 In summary, the important steps are:

8.8.1.1 properly identifying the grounds for suspension or termination and recording them;

8.8.1.2 issuing the first notice in accordance with the contract;

8.8.1.3 allowing time to elapse;

8.8.1.4 carefully considering whether the second notice should be issued, in particular whether the grounds for termination still exist;

8.8.1.5 formally issuing the second notice within time; and

8.8.1.6 demobilising from the site, but ensuring that the site is left in a safe state.

9 Entitlement to damages and costs arising from termination

9.1 The damages and costs payable to (or by) a contractor upon termination of the contract will depend upon whether the termination was carried out in accordance with the terms of the construction contract (i.e. whether it was a lawful termination), in which case the provisions of the construction contract will govern what is payable, or in breach of the terms of the construction contract (i.e. an unlawful termination or repudiation of the contract).

9.2 Before examining each of these scenarios in turn, it is worth setting out some basic principles relating to the award of damages under English law. It is important to note at the outset that these principles are very different from those applied under American law in that punitive or exemplary damages are very rarely, if ever, awarded.

9.3 *Basic principles*

9.3.1 Damages are awarded to put the claimant as nearly as possible “in the same position as he would have been in if he had not sustained the wrong for which he is now getting compensation or reparation”.¹⁷ As a general rule damages awarded under English law are compensatory rather than punitive.

9.3.2 Under English law there are two types of losses for which damages may (depending on the circumstances) be recoverable following a breach of contract. These two categories of loss were first set out in the famous case of *Hadley v Baxendale*¹⁸ and are as follows:

9.3.2.1 losses arising naturally, that is, according to the usual course of events, from the breach of the contract in question (“**Direct Losses**”); and

9.3.2.2 losses which may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach of it (“**Consequential Losses**”)

9.3.3 It is worth noting that loss of profit, loss of revenue as well as costs of repair, replacement, mitigation and associated losses may constitute direct losses under the first limb of *Hadley v Baxendale*. This will depend on the circumstances.¹⁹

9.3.4 Consequential losses are those which do not flow directly and naturally in the ordinary course of events.²⁰ These losses will only be recoverable if they would

¹⁷ *Livingstone v Rawyards Coal Company* (1880) 5 App Cs. 25 at 39, HL.

¹⁸ 156 ER 145.

¹⁹ See *McCain Foods (GB) v Eco-Tec (Europe) Limited* [2011] All ER (D) 225 (Jan).

²⁰ See Stephen Furst and Vivian Ramsey, *Keating on Construction Contracts* (London: Sweet & Maxwell, Eighth Edition) (“Keating”), Section 8-007.

have been within the reasonable contemplation of the parties, or, put another way, if it were known by both parties that such losses would be a consequence of the breach of contract.

- 9.3.5 The key passage from *Hadley v Baxendale* as to when damages for such consequential losses may be recovered is as follows:

“If the special circumstances were communicated by the plaintiffs to the defendants, and thus known to the parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.” [Emphasis added]

- 9.3.6 Assuming that there is no provision within the construction contract that excludes or limits the recovery of consequential losses, then whether or not they can be recovered will depend on the “*special circumstances*” that were communicated to the defendant as at the time the contract was entered into.²¹ The losses must also ordinarily follow from the breach or, even if the special circumstances were communicated at the time the contract was entered into, the losses will not be recoverable.

- 9.3.7 A party claiming damages for breach of contract must also prove causation, that is, they must establish on the balance of probabilities an effective causal connection between the defendant’s breach of contract and the loss resulting from it.²² An intervening act by a third party or indeed by the claimant themselves may break the chain of causation.²³

²¹ *Keating*, Section 8-005.

²² See *Keating*, Section 8-011 for further discussion. The focus of this talk is on types of loss that can be recovered for a breach of contract rather than causation. If you would like further information on causation, please let us know. [Suggest this last sentence deleted for website]

²³ *Monarch Steamship Co v Karlshamns Oliefabriker* [1949] AC 196 at 226.

9.4 *Damages payable upon unlawful termination / repudiation of the contract*

- 9.4.1 If a contract is brought to an end by one party unlawfully, that is, without valid justification or not in accordance with contractual procedures, the contract may be considered to have been repudiated.
- 9.4.2 The other possibility, if this is provided for in the contract, is that the contract may be deemed to have been terminated “for convenience” rather than on the basis of the alleged default. In these circumstances, the parties’ respective entitlements would be defined by the contractual clauses outlining what should happen in the event of a termination for convenience.
- 9.4.3 If the contract is repudiated, then upon acceptance of the repudiation, the innocent party will be entitled to damages, including loss of profit on the contract, calculated on normal principles.²⁴
- 9.4.4 The innocent party may also be entitled to recover consequential losses (depending on the wording of any exclusion or limitation clauses within the construction contract in question) subject to those losses being within the parties’ reasonable contemplation at the time they entered into the construction contract as outlined above.
- 9.4.5 Termination under express provisions of the contract frequently involves seizure or use of plant. Where that forfeiture then turns out to be wrong (because, for example, there was in fact no right to terminate under the contract and it was therefore repudiated) then the contractor will be entitled to damages for any plant seized by the employer in conversion.²⁵
- 9.4.6 Where a contractor is owed unpaid monies or has other claims already due under the contract prior to repudiation, then those claims will be recoverable in their own right.

²⁴ *Hudson*, Section 8-023.

²⁵ *Hudson*, Section 8-024.

- 9.4.7 Similarly, an employer's counterclaims which arose prior to the repudiation (for example, liquidated damages claims or claims for defective work) will also survive.²⁶
- 9.4.8 The practical significance of this rule is that, depending on the profitability or otherwise of the instalments in question or of the contract prices generally, it may well suit a contractor accepting repudiation to obtain payment of sums due rather than proceed to recover damages for breach of contract.²⁷
- 9.4.9 It had previously been the position under English law that in the event that an employer/owner repudiated a contract, the contractor could seek compensation on a *quantum meruit* basis, that is, be paid a fair amount for the work done prior to the repudiation, rather than being entitled to payment on the basis of the contract value of the work done.
- 9.4.10 In circumstances where the work was unprofitable for the contractor, that is, execution of the work had, in fact, cost the contractor more than it was entitled to be paid, this measure of compensation provided the contractor with the prospect of a considerable windfall.
- 9.4.11 For this reason, it is no longer considered to be the correct measure of damages for repudiation under English law. Instead the contractor will only be entitled to be paid the contract value of work completed.

9.5 *Lawful termination under the construction contract*

- 9.5.1 If the construction contract has been terminated in accordance with its own provisions (i.e. lawfully) then the contract provisions will determine what damages and costs are payable to the contractor. The payments due to a contractor upon lawful termination will normally depend on:
- 9.5.1.1 who terminated the contract, that is, employer/owner or contractor; and/or
- 9.5.1.2 what grounds it was terminated under.

²⁶ *Hyundai Heavy Industries v Papadopoulos* (1980) 1 WLR 1129; see also *Hudson*, Section 8-024.

²⁷ *Hudson*, Section 8-025.

9.6 *Payment under the termination provisions in the FIDIC Silver book*

9.6.1 By way of example, where the construction contract is terminated for *force majeure*, then under Clause 19.6 of the FIDIC Yellow book, the Contractor is entitled to:

- (a) *“The amounts payable for any work carried out for which a price is stated in the contract;*
- (b) *The Cost of Plant and Materials ordered for the Works which has been delivered to the Contractor, or of which the Contractor is liable to accept delivery; this Plant and Materials shall become the property of (and be at the risk of) the Employer when paid for the Employer, and the Contractor shall place the same at the Employer’s disposal;*
- (c) *Any other Cost or liability which in the circumstances was reasonably incurred by the Contractor in the expectation of completing the Works;*
- (d) *The Cost of removal of Temporary Works and Contractor’s Equipment from the Site and the return of these items to the Contractor’s works in his country (or to any other destination at no greater cost); and*
- (e) *The Cost of repatriation of the Contractor’s staff and labour employed wholly in connection with the Works at the date of termination.”*

9.6.2 If the Contractor has lawfully terminated the construction contract under Clause 16.2 then he is entitled not only to payment in accordance with Clause 19.6 as set out above but also to the return of his performance security and the *“amount of any loss of profit or other loss or damage sustained by the contractor as a result of this termination”* (see Clause 16.4).

9.6.3 In contrast, if the employer has lawfully terminated the contract under Clause 15.4 of the contract then the employer is entitled to:

- 9.6.3.1 proceed to determine its claims under Clause 2.5 and then deduct any monies due from the contractor as determined or set off such sums or claim them from the contractor (see Clause 15.4 (a), Clause 2.5 and Clause 3.5) (albeit this will be subject to the dispute resolution provisions within Clause 20);
- 9.6.3.2 *“withhold further payments to the Contractor until the costs of design, execution, completion and remedying of any defects, damages for delay in completion (if any), and all other costs incurred by the Employer, have been established”;*
- 9.6.3.3 *“recover from the Contractor any losses and damages incurred by the Employer and any extra costs of completing the Works, after allowing for any sum due to the contractor under Sub-Clause 15.3 [Valuation at Date of Termination]. After recovering any such losses, damages and extra costs, the Employer shall pay any balance to the Contractor.”*
- 9.6.4 The grounds upon which a contract is terminated, and who carried out the termination, will therefore make a significant difference to the monies, if any, that are recoverable by a contractor following termination.
- 9.6.5 It will also determine when those monies are paid to the contractor. If the employer has terminated the contract in accordance with the provisions of FIDIC the contractor is not likely to receive any further payments for a long time.

Nicholas Gould

Partner, Fenwick Elliott LLP

Aldwych House

71-91 Aldwych

London WC2B 4HN

Tel: +44 (0) 20 7421 1986

Fax: +44 (0) 20 7421 1987

ngould@fenwickelliott.com

www.fenwickelliott.com