

Termination: fortune may favour the brave (and well-prepared)

Termination of contracts is on the rise, even though it is still regarded as a last resort, one that carries risks. Terminating parties should treat the process as a project in its own right, advise [Angus Rankin](#), [Mat Parente](#) and [Jess Webster](#) of [Vinson & Elkins](#).

KEY POINTS

- Recently parties seem increasingly willing to terminate major construction contracts rather than soldier on as in the past.
- While termination may still be a last resort, risks for the terminating party can be mitigated by careful planning and treating the termination as a 'project' in its own right.
- A termination 'steps plan' and timetable will need to be prepared with military precision – a process that should start well before the termination notice is sent.
- This article covers some key points to consider in deciding whether and how to terminate.

Termination of major construction contracts has traditionally been seen as a last resort, leading many parties to soldier on in bad situations given the potential risks of terminating. However, recently we have seen parties increasingly willing to terminate (or at least seriously consider it), and other stakeholders, such as lenders, increasingly give approval for terminations.

Even so, termination is still something of a 'nuclear option'. It's risky and requires careful planning. There are serious consequences for the terminating party who gets it wrong. This article covers some key points to consider in the decision-making process.

Pick your battles: is termination necessary to achieve your aims?

When relations severely deteriorate, it is easy for parties to see termination as the only feasible way out. However, it is crucial to plan in advance how the project will progress post-termination. Novel and/or complex technologies are often involved, and there may be no viable alternatives to the current provider(s). In other areas – such as civil works – perhaps the market of alternatives is bigger. Looking objectively early on at what alternatives are available and on what terms is essential.

It is also important to go back to the contract to see, first, what steps can be taken by implementing the contract rather than ending it, and second, what contractual provisions apply on termination. If there are alternatives to termination, the aggrieved party may still need to look for other levers to encourage the defaulting party to perform. One more conciliatory option might be to settle certain issues, potentially on an interim basis which could be revisited at project completion. This may not be appropriate where the counterparty presents a credit risk, or where commercially paying out additional sums cannot be countenanced. A middle ground is considering whether a partial de-scope is appropriate (although clear contractual wording is generally required to allow the de-scope of work from one contractor and transfer to another).

A more aggressive approach is to commence proceedings while the project is ongoing. Where parties are stuck in a rut this can bring parties back to the negotiating table. But this approach can be high risk: once proceedings are underway parties

may get more entrenched and become stuck in expensive and lengthy formal proceedings – a party taking this route needs to be willing to see it through at a time when completing the project is a higher priority.

What termination avenues are available

Contractual termination grounds

If termination is still on the table, then the terminating party will need to consider what termination grounds are available. This needs care: if the purported termination is wrongful, it will constitute a ‘repudiatory breach’ in its own right (explained below), entitling the other party to terminate and claim damages.

The first port of call is the contractual termination provisions. If there are objective termination grounds, e.g. termination being triggered by reaching a liability cap, this can provide surer footing to the terminating party than, say, ‘material breach’ or some other similar test.

There is plenty of case law on the interpretation of termination clauses. However the English courts have recently affirmed that there is no universal legal definition for ‘material’ breach. In all but the most egregious of cases, it can be difficult for a party to be completely confident that such tests are satisfied.

Termination grounds at common law

If the contractual termination requirements are not satisfied, or there are limited contractual rights (as might more often be the case for contractors’ termination rights), parties should consider any termination rights available under the applicable governing law. Under English law, common law rights of termination will generally be available unless expressly excluded.

Under English law, a breach of contract allowing an aggrieved party to terminate without being liable in damages is known as a repudiatory breach. This is a serious breach going to the heart of the contract. Examples include renunciation of the contract (where one party refuses to perform its obligations in some essential respect or shows an intention not to perform) or sufficiently serious breach of an intermediate term (i.e. a breach depriving the aggrieved party of substantially all the benefit of the contract).

A party facing a repudiatory breach can either treat the contract as continuing irrespective of that repudiatory breach (known as affirming the contract), or accept the repudiation and treat the

contract as terminated. Although the aggrieved party does have some time to elect whether to affirm or terminate, rights to terminate at common law can be inadvertently waived as doing nothing for too long may be seen as an affirmation which once made is irrevocable.

Whether looking to rely on contractual or common law grounds we recommend that parties try not to rely on a ‘technical breach’ if possible. For example, commonly on projects a contractor might be in delay but not issue an Extension of Time request (or rather there is room for debate on whether the contractor has satisfied the notice requirements). Rather than relying on the contractor’s failure to issue an EoT notice, the owner could instruct an independent delay expert to assess the delay attributable to each party, grant the contractor the recommended EoT plus some buffer, and then terminate the contract based on the net delay which the expert identified as attributable to the contractor. This gives the owner some comfort that it has acted reasonably, and would later be found to have properly terminated (whether or not the ‘lack of notice’ argument goes entirely the owner’s way).

Know the process for terminating and follow it to the letter

If the substantive termination grounds are met, it is important to ensure compliance with any contractually specified process, and to check any related agreements, including finance documents, for any other steps that may need to be taken such as gaining lender consent. This is bound to take time. The termination process can give rise to controversy: notice formalities (including content, timing, who should send it, who the addressees are) and clauses providing a party an opportunity to cure a breach within a certain timeframe all need to be strictly complied with. We have found it quite common for parties to serve notices via the informal channels that parties use in every-day project correspondence rather than as specified in the contract – if in doubt, do both.

A termination notice should be an unequivocal termination and sufficiently clear: it should not be capable of being construed as merely a demand for performance or a threat. If a party has both contractual and common law termination routes, it is usually advisable to include all possible termination grounds in the termination notice. That way, if one route is deficient, the other routes might still be relied on.

Prepare the termination action plan

The termination process starts long before the termination notice is issued. A number of issues need to be carefully considered, and a 'termination steps plan' will need to be prepared with military precision. Analyse the current state of play of the project, what time zones the key players are in and map out what time people will be receiving correspondence, including when holidays and weekends fall in different jurisdictions. This has to be considered not just for the parties, but the wider cast of players involved including lenders (and their legal and technical advisers) and potentially those holding project security.

A key step in devising the termination action plan is lining up replacement contractors or perhaps manpower/technical advisers if the terminating party intends to complete the work itself. One common route is to contract directly with project subcontractors. There may be contractual avenues, such as assignment rights, to help getting those subcontractors on board following a termination. Where a terminated project has been in disarray and the subcontractors have struggled to get paid they may welcome dealing with a party higher up the contractual chain, although conversely some might see it as a good opportunity to strike a hard bargain in getting a better deal going forward. However, parties must be careful in any discussions with subcontractors. First, to comply with applicable confidentiality terms. Second, to avoid inadvertently renouncing the main contract by evidencing in the subcontractor discussions an intention not to perform.

Make sure also to consider any 'showstopper' items that will be required to complete the works once the outgoing contractor leaves the project. As far as possible don't let the contractor walk off with a bargaining-chip. These might be technology licences, third party consents, drawings and documents, or even key people. Involving the party that will use the finished works (often the O&M contractor) or an independent consultant to brainstorm what will be

needed to operate the project can be useful to identify such items.

In parallel consider the post-termination practicalities at site, for example, how handover and mobilisation of the new contractor will work (including how the parties' title in different equipment and materials operates), and how the site will be secured. It will be important to record in detail the precise state of the works at termination, both to understand what is owed to the outgoing and incoming contractors, and to enable an accurate calculation of any damages claimed from the outgoing contractor. We often see project owners instruct independent quantity surveyors to attend site around the time of termination to prepare a thorough record of the state of the works.

In the run up to terminating and thereafter keep thorough documentary evidence. Contemporaneous records equal power in disputes as they tend to be given more weight than witness evidence or documents created later. Get legal advice on what records to keep, and sometimes more importantly, what should not be recorded. Plan project correspondence carefully, mindful that such records will be key in telling the story during the final account stage or in future disputes.

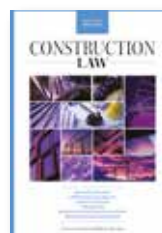
Increasingly often, when a party terminates it will also call on any available project security. Vinson & Elkins has previously written in this publication on the fundamentals that should be checked before any call on security is made or when defending a bond call.

To conclude, we are seeing terminations become more common. Managed well, risks can be mitigated but terminating requires care and is its own 'project'. There are many moving parts and – importantly – once the starting-pistol on termination is fired, events can move with incredible speed not only at the project site itself but in the ensuing melee of parties seeking interim relief in the courts, making use of emergency arbitration provisions and the like. Termination may still be a tool of last resort to salvage a project, but fortune may favour the brave (and well-prepared). **CL**

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