



ADB

FIDIC Contract Management Workshops

Termination

ASCI Hyderabad Day 4 (Part I) – 31 August 2023

James Perry

BSc Civil Engineer, Juris Doctor,
FIDIC President's List Adjudicator,
FIDIC Accredited International Trainer
Partner, PS Consulting, Paris

This is not an ADB material. The views expressed in this document are the views of the author/s and/or their organizations and do not necessarily reflect the views or policies of the Asian Development Bank, or its Board of Governors, or the governments they represent. ADB does not guarantee the accuracy and/or completeness of the material's contents, and accepts no responsibility for any direct or indirect consequence of their use or reliance, whether wholly or partially. Please feel free to contact the authors directly should you have queries.

Outline

1. Broad Legal Principles Applicable to Termination
2. Step by Step Procedure – No. 1 What are the Grounds
3. Step by Step Procedure – No. 2 Notice under SC 15.2
4. Step by Step Procedure – No. 3 The Engineer's Role
5. Additional Grounds to terminate in the Gold Book
6. Questions 1 - 6

Broad Legal Principles Applicable to Termination

- With some exceptions discussed below, the party in default must normally be allowed **an opportunity to cure the default within a reasonable time** – A right to cure.
- A contract can only be terminated for a **material breach** of contract.
- Minor breaches of contract are compensated by general damages – usually money, but can also be an order for specific performance.

Board Legal Principles Applicable to Termination

- If a party terminates a contract and it is later determined that the termination was wrongful, then **the party who wrongfully terminated is said to have repudiated the contract.**
- Wrongful termination is a breach of contract and the subsequently deemed repudiation means that the other party will be awarded damages as if it had terminated the contract justly for cause.
- In other words, if a party incorrectly evaluates his right to terminate, or makes a procedural error when deciding to terminate, **the tables are flipped on party who wrongfully terminated.**

Board Legal Principles Applicable to Termination

- The analysis of the factual circumstances in relation to the above legal principles are a matter of law and are not usually spelled out in the conditions of contract.
- This means that **contract administrators and project managers cannot rely on the conditions of contract to tell them everything they need to know about their right to terminate.**

Board Legal Principles Applicable to Termination

- It is therefore **imperative to seek legal advice from a qualified construction lawyer** before deciding to terminate.
- **Openness with the lawyer is key**, so he/she can understand any implications of the breaches of the Employer's obligations and to help avoid making fatal procedural errors.

Step by Step Procedure – No. 1 What are the Grounds

Employer entitled to terminate the Contract for default if the Contractor:

1. fails to comply with a notice of remedial action;
2. fails to maintain an acceptable Performance Security;
3. abandons the Works or plainly demonstrates an intention not to comply with any of his obligations under the Contract;
4. fails to expedite progress of the Works or to comply with instructions to rectify defects within 28 days of receipt;
5. subcontracts the whole of the Works;
6. becomes bankrupt or insolvent, enters into liquidation or dissolution;
7. gives or offers any bribe, gift, gratuity or commission;

SEE Sub-Clause 15.2

Step by Step Procedure – No. 1 Additional Grounds 2017 RB

Employer entitled to terminate the Contract for default if the Contractor:

1. fails to comply with an Engineer's binding determination or binding agreement;
2. fails to comply with a DAAB decision whether binding or final and binding;
3. A JV member becomes bankrupt or insolvent, enters into liquidation or dissolution AND the other members do not promptly confirm their joint and several liability;

SEE Sub-Clause 15.2.1

Step by Step Procedure – No. 1 What are the Grounds

Fails to comply with a notice of remedial action - FAQ

- SC 15.1 states that if the Contractor fails to carry out any obligation under the Contract, the Engineer **may** by notice require the Contractor to make good the failure within a specified reasonable time.

Question: Must the Engineer always give a notice under SC 15.1 before moving to terminate?

Answer: Under FIDIC, a “pre-notice” under SC 15.1 is not required if the grounds for termination falls under items listed in the previous two slides.

Comment: Recall the Contractor’s right to cure – not a bad idea to issue a SC 15.1 pre-notice, but usually not fatal if there is no SC 15.1 notice.

Step by Step Procedure – No. 1 What are the Grounds

Fails to expedite progress of the Works - FAQ

- No SC 15.1 “pre-notice” required, but advisable. The Employer may terminate after giving 14 days’ notice under SC 15.2.
- 2017 RB: A second Notice is then required to immediately terminate the Contract under SC 15.2.2.

Question: How much must the Contractor be in delay before the Employer can terminate?

Answer: Recall, [the Contractor must be in material breach – the delay should be substantial.](#)

Lesser delays can be “escalated” by giving a notice to correct under Sub-Clause 15.1 and termination based on failure to comply with a notice to correct, if this turns out to be the case.

Comment: Erroneous decisions to terminate are frequently made because delays due to the Employer’s risk events (including concurrent delay) have not been properly evaluated,

Step by Step Procedure – No. 1 What are the Grounds

Becomes bankrupt or insolvent, enters into liquidation etc... - FAQ

- No SC 15.1 “pre-notice” required, but advisable. The Employer may terminate after giving 14 days’ notice under SC 15.2.
- 2017 RB: A second Notice is then required to immediately terminate the Contract under SC 15.2.2.

Question: Is the Employer always obliged to terminate if the Contractor enters into bankruptcy protection or liquidation procedures?

Answer: No. Obviously if the Contractor stops work, the Contract should be terminated. However, if the legally appointed administrator allows continued performance and the Contractor is continuing normally, the Employer should evaluate if it is wise to terminate and may allow the Contractor to continue.

Step by Step Procedure – No. 2 Notice under SC 15.2

PB : How does the Sub-Clause 15.2 14 days' notice work - FAQs

- SC 15.2 states: The Employer may, upon giving 14 days' notice to the Contractor, terminate the Contractor and expel the Contractor from the Site. (No 14 days' notice required in cases of bankruptcy and corruption.)
- Notice must comply with the formalities of Sub-Clause 1.3 [*Notices and Other Communications*].
- It is advisable that the notice mention SC 15.2.
- While not stated, the notice needs to identify the event or circumstances on which the Employer is relying. More than one cause can be cited.

Step by Step Procedure – No. 2 Notice under SC 15.2

PB: How does Sub- Clause 15.2 14 days' notice work - FAQs

- Question: Is the SC 15.2 14 days' notice a cure period?
- Answer: There is ambiguity in the FIDIC wording. The FIDIC Guide indicates that termination takes effect automatically 14 days after issue of the notice under SC 15.2. This would mean it is not a cure period.
- Note some leading FIDIC commentators consider the wording is not clear and “advise” issuing a second notice at the end of the 14 days' period. In the **Gold Book**, it has been clarified that the 14 days is a cure period and the second notice is required.

Step by Step Procedure – No. 2 Notice under SC 15.2

2017 RB: How does Sub- Clause 15.2.1 14 days' notice work - FAQs

- SC 15.2.1 states: The Employer shall be entitled to give a Notice (which shall state that it is given under this Sub-Clause 15.2.1) to the Contractor of the Employer's **intention** to terminate the Contract may, upon giving 14 days' notice to the Contractor (No Notice of intention to terminate required in cases of subcontracting violations, bankruptcy and corruption.)
- Notice must comply with the formalities of Sub-Clause 1.3 [*Notices and Other Communications*].
- It is now obligatory to mention that the Notice is given under SC 15.2.
- While not stated, the notice needs to identify the event or circumstances on which the Employer is relying. More than one cause can be cited.

Step by Step Procedure – No. 2 Notice under SC 15.2

2017 RB: How does Sub- Clause 15.2.1 14 days' notice work - FAQs

- Question: Is the SC 15.2.1 14 days' notice a cure period?
- Answer: The ambiguity no longer exists. It has been clarified that the 14 days is a cure period and the second notice is required to effect the termination, assuming the Contractor fails to remedy the matters described in the notice.

Step by Step Procedure – No. 2 Notice under SC 15.2

PB/2017 RB: How does Sub- Clause 15.2 /15.2.1 14 days' notice work - FAQs

- Question: Can a termination notice be retracted?
- Answer: Same as PB, only by mutual agreement between the Parties.
- Question: What happens if no action is taken by the Employer after the reasonable time period stated in a SC 15.1 notice to correct?
- Answer: To be safe, the notice to correct should be considered to have expired and a fresh notice to correct should be issued, if and when the Employer truly wishes to terminate on the basis of the grounds stated in the notice to correct.
- Comment: Notices to correct under SC 15.1 are sometimes issued as a “threat”, this can be dangerous for the reasons stated above.

Step by Step Procedure – No. 3 The Engineer's Role

- The decision to terminate is the Employer's alone.
- The Engineer does not have to determine if the grounds for termination are valid or invalid.
- However, if termination is based on delay, and if there are pending Contractor claims for EOT which may impact the Employer's right to terminate, it is highly recommended, essential really, to wait until the Engineer has issued its determination on the EOT claims.
- After termination, it is the Engineer's responsibility to agree or issue determinations on all financial matters related to the termination.
- Unless a DB/DAAB decision in the meantime finds otherwise, the Engineer should proceed on the basis that the Employer's termination was valid.

Step by Step Procedure – No. 3 The Engineer's Role

- **Financial step No. 1:** Under SC 15.3, the Engineer agrees or determines the value of the Works, Goods and Contractor's Documents and any other amounts due to the Contractor for Works executed at the date of termination.
- This should be done as soon as practicable and the Contractor informed, but under SC 15.4, no payment has to be made pending completion of the calculation of all the Employer's damages.
- The latter will likely not take place until after the expiry of the DNP of the replacement contractor.

Step by Step Procedure – No. 3 The Engineer's Role

- **Financial step No. 2:** Under SC 15.4:
- The Employer must submit a claim under SC2.5/SC 20.2(a) for its damages.
- Any amounts due to the Contractor can be withheld until;
 - a) **all costs to complete** are calculated and claimed by the Employer and the Engineer has agree or determined the amount and
 - b) **all costs of remedying any defects and damages for delay** have been calculated and claimed by the Employer and agreed or determined by the Engineer.
- The Employer may encash the full value of the Performance Security, but it will have to pay any balance due to the Contractor after the results of Financial Step Nos. 1 and 2 are netted out, taking into account the Performance Security encashment.
- The Employer should encash the Advance payment guarantee, but only to the extent of any unrecovered advance payment amounts.

Step by Step Procedure – No. 3 The Engineer's Role

- **Financial step No. 2:** Under SC 15.4:
- Note the Employer can encash the Performance Security if any of the reasons stated in SC 15.2 are applicable, even if no notice of termination has been given.
- Note that delay damages are not generally considered to be recoverable if the termination notice is issued before the Time for Completion at the time, but legal advice should be sought.
- **2017 RB:** SC 15.4(c) confirms that Delay Damages are not recoverable **if** the termination notice is issued before the Time for Completion

Question No. 1:

Does the Dispute Board or do the arbitrators have any jurisdiction to decide on the validity of termination after the Contract has been terminated by one of the Parties (besides the position on legal jurisdiction, Dispute Board and the arbitrators are paid by the Contractor and the Employer but one of the Parties may not be willing to pay)?

Jurisdiction: Either Party has the right to refer the validity of the termination to the DB. A DB decision is usually required before either Party has the right to go to arbitration.

Payment of the DB and arbitrators: The Parties are jointly and severally liable to pay the DB. Both Parties must pay an advance for the arbitration. If one Party fails to pay their part of the advance, the other must advance the payment. If neither Party pays the advance the dispute ends.

Question No. 2:

Besides the poor performance of the Contractor, the Employer may decide to terminate the contract for reasons such as (i) Contractor is in default of government taxes related to the Contract and the Employer has received letters from the tax authorities to withhold the payment; (ii) Contractor has not extended the validity of the Performance Security etc. It is likely that the Employer may not have followed the contractual provisions for such termination due to the urgency (protecting the financial interest of the Employer). What is the legal and contractual position on this?

Government letter ordering withholding of payments due to unpaid taxes: It is quite possible that such a government letter would not constitute grounds for termination. Breach of SC 1.13(b) to pay taxes but by withholding, he has arguably paid them.

Question No. 2:

Urgency to protect financial interests of the Employer:

- Regardless of the perceived urgency, the procedures must be followed, or there is a risk of the termination being overruled as invalid/ wrongful.
- In the case of an expired Performance Security, a reasonable time to cure is advised. **And 14 days at least is required under the 2017 RB.**
- Recall, the **PB** it is not clear if the 14 days' notice under Sub-Clause 15.2 is a cure period or not. It is therefore recommended to give an SC 15.1 notice to correct, even if this is not strictly required under SC 15.2.

Question No. 3:

What part of the Performance Security can be encashed upon termination of the contract (whole or part?). What is the basis and timeframe for determination of the encashment?

What amount can be encashed and what is the basis? This question was answered in the slides above. The whole amount can be encashed for when the Contract is terminated for any reason described in Sub-Clause 15.2.

Comment: The Performance Security is usually a “first demand” guarantee, so the bank cannot challenge the call to encash. However, the Contractor can challenge the call in court. This can delay and even permanently block the call, especial if the bank is a foreign bank. Recommend insisting on a Performance Security from an Indian bank.

Question No. 3:

What is the timeframe? Any time there is a breach of Sub-Clause 15.2. Therefore, the Performance Security can be called either; a) before the notice of termination, b) at the notice of termination, or c) at any point thereafter.

If encashed for say failure to remedy a defect or pay a DB/DAAB decision and there has been no notice of termination, the Employer should only encash the unpaid amount owed by the Contractor, not the whole amount.

Question No. : 4

Generally, the termination of contract by one Party is closely/ immediately followed by termination by the second Party (their objective is to protect their financial interest and prevent any claims or penalties under the contract).

At times, the Contractor may terminate the Contract in anticipation of the termination by the Employer – therefore the Employer’s termination is preceded by the Contractor’s termination. Sometimes, the Contractor also issues a notice for termination soon after the Employer’s termination. Subsequently, the parties file legal cases to determine whose termination is contractually and legally valid and the matter is decided through long legal proceedings.

Is there a way to simplify the determination and avoid long legal proceedings?

Question No. : 4

Discussion: This is always going to be a complicated legal issue, however here are some principles:

- When one Party terminates there is no need for the other to issue its own termination notice if it disagrees with the termination. The “terminated” Party needs only to contest the validity of the termination. Recall that if the claim of wrongful termination prevails, the Contract is deemed repudiated by the Party who wrongfully terminated and the other Party may claim damages as if he has rightfully terminated the Contract.
- Both Parties may have been in breach when a Party issues a notice of termination. In this case, usually the first termination is considered valid, but the other Party’s Contract breaches are still to be compensated for by general damages,
- There is no magic solution to avoid long legal arguments in a termination case.

Question No. 5:

Once arbitration and termination is initiated, the matter becomes legal and the focus shifts to contractual procedures from the actual merits of the case. The case with strong merits may be lost just due to a minor procedural lapse. Can the contractual provisions be simplified to have higher focus on merits and less on procedures?

Discussion: FIDIC already has relatively simple procedures. For example FIDIC is not strict on quoting the exact Sub-Clauses.

The main issue in FIDIC PB is the 14 days' notice procedure and this can be corrected by adopting the language from the Gold Book or 2017 RB.

The disputes are usually over whether the termination was wrongful and this is a merits question: was the Contractor in delay, or were the delays excused as Employer delays or concurrent Employer and Contractor delays.

It is key for the Engineer to have kept good records and for the Employer to consult a lawyer.

Question No. 6:

Termination is meant to be the last resort after all attempts for improvement have failed and it takes a long time to arrive at a decision to terminate a contract. Valuable time is lost in the process. The primary reason is that the Employer/Engineer do not have effective contractual mechanism (teeth) to enable early corrective actions by the Contractor, except for issuance of notices. Interim liquidated damages have been tried in a few contracts but these penal measures further erodes the financial capacity of the contractor and affect performance.

What are (or could) be the enabling/deterring provisions under the Contract to ensure performance of the Contractor from the very beginning so that actual termination is averted.

Question No. 6:

Discussion:

- No Contract provisions can save an Employer if the Contract has been awarded to an underfinanced Contractor, or on the wrong procurement method or with poor Drawings and Specifications or Employer's Requirements.
- An Employer's best hope of avoiding termination is in the procurement phase by vigorous pre-qualifications procedures and requirements, not awarding design-build contracts based on detailed Employer's Requirements and taking the time to properly develop the Employer's design and secure rights and ownership to all parts of the Site.
- A fair allocation of risk is also crucial.

Question No. 6:

Discussion:

- During execution, the Engineer needs to react quickly to monitor the programme and react quickly to early delays by using Sub-Clause 8.3 and 8.6.
- Employers must understand all of their obligations and act quickly to respect them.
- It may be useful to set up a system of a joint account to manage the advance payment.

Question No. 6 (con't):

If termination appears to be the eventual remedy in the 1st year of execution itself, what are the quickest steps for termination of the contract.

Discussion: The issue is likely to be delay in the first year. The best course of action is therefore as described above. The Engineer must be on top of the programme and be issuing notices under Sub-Clauses 8.3 and 8.6.

The Engineer and the Employer must be honest with themselves however and recognise when they need to expedite actions to meet their own obligations (timely approvals of documents or provision of Site access for example) and recognise when their delays in meeting their obligations are either the reason for the delay in advancement of the Works or are concurrent delays.

Thank You!