



Welcome to the January edition of *Insight*, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

**In this issue we discuss the dos and don'ts of terminating construction contracts.**

# Insight

## To terminate or not to terminate?

## The dos and don'ts of terminating construction contracts

You may be thinking about terminating a contract for various reasons. Your commercial needs might have changed; the contract may no longer suit those needs; the contract may no longer be profitable or may have become too expensive; the other party may be preventing you from performing your obligations under the contract; you might have lost staff which may make your contractual obligations difficult to fulfil; the other party may be suffering from cash flow problems (in which case you may be paid late or not at all); or the other party may not be performing quite as well as you had hoped (possibly due to cash flow problems).

Whatever your reason(s), the consequences of getting it wrong can be costly. This nineteenth issue of *Insight* provides advice on (i) how to terminate, (ii) tactical considerations and (iii) practical tips, with a view to ensuring that any termination is well thought out, and ultimately successful.

### How to terminate

First, you should think about whether it would be best for you to terminate at common law or under the provisions of the contract.

Your contract will usually entitle you to terminate under the common law but common law termination is much riskier than contractual termination and should be avoided if at all possible. To terminate at common law, you would have to identify a breach of contract (or cumulative breaches of contract) that is sufficiently serious to entitle you to treat the contract as being terminated with immediate effect. This will be very fact specific. If, for example, the other party walks away from the contract

then this would constitute a sufficiently serious breach. Annoying, but less significant, cumulative breaches (such as occasional late payments, occasional defective workmanship and missing one or two non-critical deadlines) would not qualify.

The safer route is to terminate under the contract. The majority of standard forms contain express provisions which regulate the circumstances under which either or both parties can terminate the contract. Standard forms usually, for example, contain a clause the effect of which is that walking away without good reason will constitute a ground for termination. Provided you can establish one of the grounds for termination in the contract (and have supporting evidence), then you ought to be able to terminate under the contract. Contractual termination is easier to make out than common law termination as it is fact specific and there is no requirement to prove the breach is serious. For safety's sake, therefore, it is usually best to terminate under the provisions of the contract.

### Tactical considerations

#### Reputation

Think long and hard before making any decision to terminate. You may have public relations issues to consider which might require careful pre-planning.

#### Strategy

You might be considering termination as part of a strategy whereby you are escalating matters with a view to improving your commercial and/or negotiating position. If this is the case, you should still ensure that any termination is technically sound to avoid coming unstuck.

#### Logistics

Prior to terminating, you need to have alternative contractors lined up to complete the work. If you are unable



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to find alternative contractors who are available at reasonable cost, the better option might be for you to try and re-negotiate your existing contract. Whatever the outcome following termination, you need to be well prepared.

### *Timing*

You should think very carefully about when to terminate the contract. If you terminate before the contractual completion date you will lose your entitlement to claim liquidated damages. The completion date would not have been met and liquidated damages would not have accrued.

### *Costs consequences*

Consider the costs consequences of termination and make sure the costs do not outweigh the benefits. If the other party argues that the termination was wrongful and takes legal action against you, then you might find yourself incurring significant costs to defend your position.

Alternatively, the other party may become insolvent or have financial difficulties in which case it may not be possible for them to pay any direct or consequential costs of termination to which you might otherwise be entitled.

### Practical tips

#### Things to do

- Check the wording of your contract to ensure that you can prove one of the grounds for termination set out in the contract.

- Make sure you have your facts and evidence in order. One of the most common grounds for termination is a "failure to proceed regularly and diligently". To prove this ground, you will need to have carried out a detailed assessment of the progress of the works and have identified the moment(s) in time at which there was a failure to proceed regularly and diligently. You may also have had to serve a notice requiring that progress improve.
- Be sure to comply with any termination procedures set out in the contract to the letter: usually this will involve serving the correct notices with the correct content at the correct time. If you ignore the contractual procedure, you risk (i) being in breach of contract yourself and (ii) paying the other party damages arising out of your breach.
- Serve any notice on the address, and in the manner specified, in the contract.
- Be consistent. Don't leave the other party in any doubt that the contract has come to an end. Give clear instructions to site staff that the contract has finished and be sure to include a reservation of rights when engaging in any correspondence relating to the contract post-termination (for example, in relation to demobilization).
- Try and reduce or restrict your losses following any termination as much as possible: you will not be able to recover damages from the other party which you could reasonably have avoided in the usual course of business.

#### Things not to do

- Do not delay. If you delay following any termination, you risk affirming the contract by conduct which might remove your right to terminate, in which case the contract will continue in full effect.
- Be very careful to make sure you do not inadvertently let the contract continue by allowing the other party to carry on working. If you do, you risk affirming the contract. This would mean the contract would not come to an end and the level of damages you might otherwise have been able to claim may be reduced.

### Conclusion

Due to the inherent risks involved, the termination of a contract should always be regarded as a measure of last resort. Before deciding to terminate, you should try and exhaust all other avenues by meeting with the other party to discuss the issues that are causing problems and, if necessary, put them in writing as this may improve or even resolve matters. Even if your discussions/correspondence are unsuccessful, they should reduce the likelihood of a dispute as any eventual termination should not come as a surprise.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston. [lkingston@fenwickelliott.com](mailto:lkingston@fenwickelliott.com). Tel +44 (0) 207 421 1986

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