Termination, Risk and Force Majeure

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Presented at the Seminar "FIDIC Global Conditions of Contract", New Delhi, January 2001

1. Introduction

The above title is a rearrangement of the title given to this portion of Technical Session 3 of this contracts seminar. The rearrangement is to cater to the numerical sequence of the General Conditions Clauses. Termination is addressed in two clauses: 15, "Termination by Employer; 16, "Suspension and Termination by Contractor". Clause 17 is "Risk and Responsibility", and Clause 19 is "Force Majeure".

Within the limited time available for review of these Clauses during Technical Session 3, the approach taken is to concentrate on the text of the Conditions of Contract for Construction, with commentary on differing wording in the other two principal sets of Conditions: Plant and Design-Build; and EPC Turnkey Projects. This approach is assisted by the fact that in all three principal sets of Conditions most of the texts of these four Clauses are identical. some comparisons are made with the corresponding provisions of the 4th Edition of the Conditions of Contract for Works of Civil Engineering Construction (1987) (hereinafter "the 4th Edition"), with which attendees will be familiar.

2. Clause 15, Termination by the Employer

Most of the grounds for termination by the Employer are familiar from the 4th Edition: failing to proceed with and prosecute the works, subcontracting the whole of the Works, assigning the contract without permission, failure to comply with the instructions of the Engineer, and becoming insolvent. The 4th Edition provisions regarding "repudiation" of the Contract, and regarding "persistently and flagrantly neglecting" to comply with Contract obligations are gone, replaced at least partially by sub-Clause 15.2(b), which applies if the Contractor abandons the Works, or "otherwise plainly demonstrates the intention not to continue performance".

Emphatic adjectives of ten point one to potential disputes. Here one wonder whether disagreements may arise over whether some conduct "plainly" demonstrates an "intention" not to continue performance. Short of express repudiation, and intention to abandon is not always easy to infer from conduct.

Perhaps responding to the current emphasis on the subject among, inter alia, international development banks, the grounds for termination now include bribery. The Sub-Clause seems to have been modeled on Sub-Clause 15.5 of FIDIC's Conditions of Contract for Design-Build', First Edition, 1996 (now apparently being abandoned by FIDIC, and hereinafter referred to by the color of its cover as the Orange Book). The wording is sweeping: it covers not only "bribe" but also any it gif t, gratuity, commission or other thing of value", whether given "directly or indirectly", if it is "an inducement or reward" for "doing or forbearing to do any action in relation to the Contract" or for it showing or forbearing to show favor or disfavor to any person in relation to the Contract. "Only 1awful inducements and rewards to Contractor's Personnel" are excluded. For whatever reason, the Sub-Clause does not use as a criterion whether or not the act in question is unlawful in the project Country (or any other country in which the act is alleged to have occurred).

With such broad wording, one can imaging drastic scenarios in which a minor infringement which is not itself unlawful is used to justify termination.

The 1999 Edition refers to termination of the Contract, and not, as the 4th Edition did, to termination of the Contractor's employment. One assumes that the Edition language was an effort to insure that such action would not (as the then provision said) "thereby [release] the Contractor from any of his obligations or liabilities". The 1999 Edition provides that "The Employer's election to terminate the Contract shall not prejudice any other rights of the Employer's under the Contract or otherwise", but it remains to be seen whether such stipulation will encounter any enforcement problems: it would appear to depend upon the effect of "termination" under the law applicable to the Contract.

Sub-Clause 15.2 provides that the terminated Contractor must deliver to the Engineer any "required Goods, all Contractor's Documents, and other design documents made by or for him". [Goods" are defined as "Contractor's Equipment, Materials, Plant and Temporary Works"; "Contractor's Documents" are defined as "the calculations, computer programs and other software, drawings, manuals, models and other documents of a technical nature (if any) supplied by the Contractor under the Contract".]

There is no indication of the intention of the adjective in "required Goods", but perhaps it means those required by the Engineer to be delivered to him. The

adjective is missing in the similar provision of Clause 16, "Suspension and Termination by the Contractor", Sub-Clause 16.3(b). A further unexplained difference between the two types of termination is that under SubClause16.3(b), the obligation to 'hand over" these items is subject to their having been paid for, whereas payment is not a condition to the obligation to "hand over" under the Clause dealing with termination by the Employer.

Before commenting on the Employer's ability to terminate for convenience, it should be noted that the EPC Turnkey Condition do not contain Clause 15.2(c)(ii), although the Plant and Design-Build Conditions do. One can see no logical reason for the omission from the EPC Turnkey Conditions, and it may be an erratum in printing.

Sub-Clause 15.5 introduces a right of the employer to terminate for convenience, a concept absent from the 4th Edition. It seems to have been taken from the Orange Book; however, the Orange Book provided that for six years after termination the Employer could not recommence work so terminated without the consent of the Contractor. Sub-Clause 15.5 abandons any time limitation on recommencement and instead adopts a test of intent: "The Employer shall not terminate the Contract under the Sub-Clause *in order* to execute the Works himself or to arrange for the Works to be executed by another Contractor: (Underlining added) Clearly the new wording affords less protection to the terminated Contractor.

Sub-Clause 15.5 provides that the steps to be taken by the Contractor and the payment to be made to the Contractor are lo, be in accordance with two other Sub-Clause, 16.3 and 19.6.

Sub-Clause 16.3, at (b), contains a seeming inconsistency with Sub-Clause 15.2, as noted above. Sub-Clause 19.6 contains provision which may give rise to difficulties regarding payment, and these are discussed below, when considering Clause 19, "Force Majeure".

3. Clause 16, suspension and Termination by the Contractor

Other than as noted above, Clause 16 needs little comment. Sub-Clause 16.1 and 16.2 are modified in the *E*PC Turnkey Condition because of differences in payment provisions, compared to those in the Construction Conditions.

There is a seeming lack of balance between the provision regarding failure to perform: Sub Clause 16.2(d) requires a "substantial" failure by the Employer before

the Contractor is entitled to terminate, whereas such adjective is not found in Sub-Clause 15. This may (or may not!) reflect an intention that Sub-Clause 15.1 requires a "warning" from the Engineer before the Employer's entitlement to terminate arises under Sub-Clause 15.2: I say "may not" because despite the provision in Sub-Clause 15.2(a) referring to sub-Clause 15. 1, the other alphabetical sub-divisions of sub-Clause 15.2 do not refer to Sub-Clause 15.1, and furthermore, the wording of Sub-Clause 15.1 is permissive rather than mandatory - "the Engineer *may* be notice require". (Underlining added)

Whatever the intention of FIDIC, it does seem that on such a serious matter as termination of the Contract, some opportunity to "cure" the breach should be given to each Party, except for those breaches which cannot be cured within cannot be cured within a short "cure" period. (Both Clauses 15-and 16 require 14 days notice of termination, but there is no express provision for opportunity to "cure".)

Sub-Clause 16.2 introduce grounds for termination which were not in the 4th Edition - failure of the Engineer to certify and issue Payment certificates within the required time limits, and failure of the Employer to provide "reasonable evidence" in respect of a failure to comply with Sub-Clause 2.4, "Employer's Financial Arrangements", itself a provision new to the 1999 First Edition, enabling the Contractor to demand "reasonable evidence that financial arrangements have been and are being maintained which will enable the Employer to pay the Contract Price". Although one can foresee argument over what constitutes "reasonable evidence", this new provision affords significant new protection to the Contractor. Indeed, one would hope that Invitations to Tender will come to include the Employer's proposed evidence of both the relevant financial arrangements and the intended plan for their maintenance during performance during performance of the Contract.

4. Clause 17, Risk and Responsibility

This Clause opens with provision for the Parties' indemnifying each with respect to loss or damage to third parties. The fundamental concepts are not from those of the 4th Edition, but the wordings are very different and it is submitted, much clearer. The indemnity of the Contractor extends to his "design (if any)", and as would be expected, the if any" provision is not present in the other two major Conditions, both of which foresee design work by the Contractor.

The next two Sub-Clauses deal with care of the works, and Employer's risk, and their fundamental allocation of risk is unchanged from the 4th Edition, except that

the last paragraph of Sub-Clause 17 .2 introduces a potentially contentious change regarding liability for loss or damage to the Works after a Taking-Over. Formerly, the Taking-Over certification effected a clear "cutoff" of Contractor liability; the new provision introduces liability for loss or damage af ter Taking-Over if it "arose from a previous event for which the Contractor was liable".

In the EPC Turnkey Conditions, there are significant omissions from the list of Employer's Risks regarding care of the Works" use or occupation by the Employer; design of any part of the works by the Employer; any operation of the forces of nature which is Unforeseeable or against which an experienced contractor could not reasonably have been expected to have taken adequate protective precautions. Those omissions from the EPC Turnkey Conditions reflects the FIDIC decision to allocate increased risk to the Contractor on EPC Turnkey projects.

Clause 17 includes the provision relating to intellectual and industrial property rights, broadening the scope of the 4th Edition "Patent Rights" Sub-Clause. The indemnification of the employer against third party claims on these matters is curiously worded: it is narrower than the 4th Edition, and worded differently than the other two new Conditions: it is with respect to claims arising "out of or in relation to (i) the manufacture, use, sale or import of any goods, or (ii) any design for which the Contractor is responsible", whereas the other two new Conditions refer to" (i) the Contractor's design, manufacture, construction or execution of the Works, or (ii) the proper use of the Works". Perhaps this will be a point of future harmonization in subsequent Editions.

Sub-Clause 17.4(b) provides that the Costs to be paid for rectifying loss or damage to the Works by-reason of Employer's Risks will include "reasonable profit" for only two Risks - use or occupation by the Employer, and design of any part of the Works by the Employer. The purpose of this restriction on profit is not clear. Under the 4th Edition, rectification of loss or damage arising from all Employer's Risks gave rise to an entitlement to an addition to the Contract Price, determined under Clause 52 relating to valuation of variations.

Clause 17.6 introduces two new limitations on liability under the Contract. The first, which extends to both Parties, excludes liability for loss of use, loss of profit, loss of contracts, and indirect or consequential loss or damage". This limitation concept appears to. have been taken from the Orange Book. It should be noted that the concept of "indirect or consequential loss or damage" (as a limitation on

compensable damages for breach of contract) may not be known under the applicable law, especially if it is the law of a Country whose legal system is not based on the common law. Even among common law jurisdictions, one can find inconsistency in interpretation of the term "consequential".

The second limitation is a financial "cap" on the Contractor's liability to the Employer. With certain exceptions, his maximum liability is a sum stated in the Particular Conditions or if no sum is stated there, then the Accepted Contract Amount, which is the amount stated in the letter accepting the Tender.

5. Clause 19, Force Majeure

This Clause is a combination of a new provision for defined events of force majeure, and a new wording of a provision covering impossibility (or illegality) of performance. The latter provision is a reworking of the 4th Edition Clause, "Release from Performance".

The definition of force majeure is broad: the event or circumstance must be "exceptional", beyond the Party's control, not one which could have reasonably been provided for before the Contract was made, and having arisen is not reasonably capable of being avoided or overcome, and is not substantially attributable to the other Party.

As mentioned before, adjectives sometimes warn of potential for dispute, and here there are both adjectives and adverbs to note - exceptional, reasonable, and substantially Also, from Sub-Clause 19.2, it appears that force majeure relief is available for prevention of part of one's obligations, even if other obligation remain capable of performance. The only exceptions to force majeure relief are payment obligation of the Parties to each other.

Examples of force majeure are given, but it is noted that the examples are not in limitation, and any event or circumstance which meets the above criteria will qualify.
Sub-Clause 19.5 contains a limitation that could be significant in many contracts: it dies not give the Contractor the benefit of any additional or broader definitions of force majeure in any subcontracts, thus opening the possibility of a major subcontractor being excused while the Contractor is not.

There are notice requirements to be met, but if met, the Contractor has relief with respect to time for completion and, with two exceptions, relief with respect to additional Cost.

For extended force majeure delay to "substantially all of the Works", the Clause provides for either Party to terminate the Contract. The payments to the Contractor upon such termination are the same as those for the Employer's termination for convenience, and for release from performance under Sub-Clause 19.7. The wording of the payment terms will be familiar to those acquainted with the provisions of the 4th Edition for termination by reason of "Special Risks".

However, one sees a potential area of difficulty: whereas the 4th Edition "Special Risks" called for payment (insofar as not already paid) of "all work executed prior to the date of termination at the rates and prices in the Contract and in addition [proportional payment for preliminary items]", Sub-Clause 19.6(a) refers to "amounts payable for any work carried out for which a price is stated in the Contract", and has no reference to proportionality for preliminaries. (in passing, it is worth noting that the need for proportionality principles also could arise in connection with sizeable lump sum items on which work has begun but has not been completed.