



FIDIC: Termination by the Employer under the Red and Yellow Books

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This note considers termination by the Employer under the 1999 FIDIC Red and Yellow Books, which are used on international construction and engineering projects.

The FIDIC suite of contracts

This note considers termination by the Employer under the 1999 FIDIC Red and Yellow Books (the termination provisions of both forms of contract are identical).

Termination by the Employer must be distinguished from termination by the Contractor; the rights and obligations of a terminating Contractor differ from those of a terminating Employer. This note deals only with termination by the Employer.

This note uses the same defined terms as the 1999 Red and Yellow Books.

Termination by Employer

Termination of a contract is a serious step to take. Its consequences, both practical and legal, should be considered before notice is given to the Contractor. There will be significant financial consequences for the Employer if the Contractor objects to termination and the Dispute Adjudication Board (DAB) or Arbitrator later decides that the Employer was not entitled to terminate.

A party's right to terminate under the contract must be distinguished from its right to terminate at law. The grounds on which a party may terminate the contract at law depend on the governing law of the contract, and are often very narrow. In contrast, contractual termination provisions often provide greater or different remedies than are available under the governing law. The right to terminate under a contract does not necessarily exclude the right to terminate at law. However, the right to terminate at law may be excluded where an express right to terminate has been negotiated giving the same grounds for termination as at law.

Termination under the FIDIC Contract (Red and Yellow Books)

Clause 15 sets out the circumstances that may lead to a termination of the Contract by the Employer as a result of a default by the Contractor, and describes the procedures that must be followed and the financial arrangements that will apply. It also provides for an Employer's termination for convenience (where there has been no default by the Contractor). This is one of the main differences between termination by Employer and termination by the Contractor: a terminating Contractor is not entitled to terminate for convenience.

However, there are also other sub-clauses which give the Employer the right to terminate in certain circumstances:

- Sub-clause 9.4(b): failure to pass tests on completion.
- Sub-clause 11.4(c): failure to remedy defects.
- Sub-clause 19.6: optional termination payment and release (force majeure or exceptional events).
- Sub-clause 19.7: release from performance under the law.



Employer's termination for cause

Grounds for termination

The grounds on which an Employer can terminate for cause are set out at sub-clause 15.2.

Sub-clause 15.2(a)

"15.2 Termination by Employer

The Employer shall be entitled to terminate the Contract if the Contractor:

(a) fails to comply with Sub-clause 4.2 [Performance Security] or with a notice under Sub-clause 15.1 [Notice to Correct]."

If sub-clause 4.2 applies, the Employer is entitled to terminate the Contract if the Contractor:

- Fails to provide the Performance Security within the required time.
- Fails to ensure it is valid and enforceable for the period required.
- Fails to extend its validity as required.

Sub-clause 15.1 entitles the Employer to issue a notice to correct if the Contractor fails to carry out any obligation under the Contract. Under sub-clause 15.1, the Contractor must make good or remedy the failure within a "specified reasonable time". To avoid potential disputes as to whether the termination procedure was followed correctly, any notice to correct should refer specifically to sub-clause 15.1.

Sub-clause 15.2(b)

"(b) abandons the Works or otherwise plainly demonstrates the intention not to continue performance of his obligations under the Contract."

This is a general ground entitling the Employer to terminate for cause; it does not relate to a specific failure of the Contractor under the Contract. It is of limited application, available only in circumstances where the Contractor has abandoned the Works or otherwise plainly demonstrates an intention not to continue performance under the Contract.

While it should be obvious whether a Contractor has abandoned the Works, it is less clear what conduct might constitute an intention not to continue performance. Some commentators have suggested that the words "or otherwise" contemplate an intention on the part of the Contractor not to continue performance of his obligations as a whole under the Contract (Baker, Mellors, Chalmers and Lavers, *FIDIC Contracts: Law and Practice*, Informa, 2009, Chapter 8, page 445). They suggest that circumstances where the Contractor refuses to carry out a particular obligation might not be caught by the clause unless that obligation went to the root of the Contract. This concept is similar to the common law right of one party to terminate by accepting the repudiation of the other, where that repudiation amounts to demonstrating an intention to no longer be bound by the Contract.

Sub-clause 15.2(c)

"(c) without reasonable excuse fails:

- (i) to proceed with the Works in accordance with Clause 8 [Commencement, Delays and Suspension], or



- (ii) to comply with a notice issued under Sub-clause 7.5 [Rejection] or Sub-Clause 7.6 [Remedial Work], within 28 days after receiving it”.

The reference to “proceed with the Works” in paragraph (c)(i) is found only in sub-clause 8.1, however, a number of the obligations in clause 8, for example, to proceed in accordance with the programme (sub-clause 8.3) and to adopt measures to expedite progress (sub-clause 8.6), could be construed to relate to the Contractor’s obligation to proceed with the Works.

In relation to paragraph (c)(ii), sub-clauses 7.5 and 7.6 empower the Engineer to instruct the Contractor to take remedial actions or carry out urgent work required for the safety of the Works. The Employer is entitled to terminate the Contract if the Contractor fails to comply with a notice under either of these sub-clauses. It should be borne in mind that the Engineer must give reasons for any rejection under sub-clause 7.5, and an Engineer’s instruction under sub-clause 7.6 may be subject to a “reasonableness” requirement.

Sub-clause 15.2(d)

“(d) subcontracts the whole of the Works or assigns the Contract without the required agreement”.

Although it does not expressly say so, this provision relates to the prohibitions in sub-clauses 1.7 and 4.4 against the Contractor assigning or sub-contracting the whole or any part of the Contract without the prior agreement of the Employer.

Sub-clause 15.2(e)

“(e) becomes bankrupt or insolvent, goes into liquidation, has a receiving or administration order made against him, compounds with his creditors, or carries on business under a receiver, trustee or manager for the benefit of his creditors, or if any act is done or event occurs which (under applicable Laws) has a similar effect to any of these acts or events”.

Paragraph (e) places the Contractor’s finances under the spotlight. The Contractor’s insolvency amounts to an event of default entitling the Employer to terminate the Contract; which is something we may see more frequently in the current economic climate. The operation of this paragraph (e) will depend on the governing law and other applicable laws. If the Contractor is in breach of this sub-paragraph, the Employer is entitled to give notice to terminate immediately, rather than having to wait 14 days (as set out under Procedure for termination).

Sub-clause 15.2(f)

“(f) gives or offers to give (directly or indirectly) to any person any bribe, gift, gratuity, commission or other thing of value, as an inducement or reward:

- (i) for doing or forbearing to do any action in relation to the Contract, or
- (ii) for showing or forbearing to show favour or disfavour to any person in relation to the Contract,

or if any of the Contractor’s Personnel, agents or Subcontractors gives or offers to give (directly or indirectly) to any person any such inducement or reward as is described in this sub-paragraph (f). However, lawful inducements and rewards to Contractor’s Personnel shall not entitle termination.”

Paragraph (f) addresses bribery and corruption. It prohibits the giving of bribes, gifts, gratuities or commission by the Contractor’s Personnel, agents or sub-contractors, to any person for doing or allowing any action in relation to the Contract, or to gain favour.



The Employer may also terminate the Contract if the actions of sub-contractors, over which the Contractor has no control, amount to bribery and so on under this sub-paragraph.

Importantly, “lawful inducements and rewards” to the Contractor’s Personnel (that is, the Contractor’s Representative and all personnel whom the Contractor uses on Site, and who may include the staff, labour and other employees of the Contractor and of each Subcontractor and any other personnel assisting the Contractor in the execution of the Works) are excluded. However, there is no such qualification in relation to persons who do not fall under the definition of “Contractor’s Personnel”. It is also not clear which laws should be applied when considering whether an inducement or reward is “lawful”.

As above, if the Contractor is in breach of these sub-paragraphs, the Employer is entitled to give notice to terminate immediately, rather than having to wait 14 days (see Procedure for termination).

Procedure for termination

The remainder of sub-clause 15.2 sets out the procedure to be followed in the event of an Employer’s termination for cause (it does not separately number the remaining sub-paragraphs):

“In any of these events or circumstances, the Employer may, upon giving 14 days’ notice to the Contractor, terminate the Contract and expel the Contractor from the Site. However, in the case of sub-paragraph (e) or (f), the Employer may by notice terminate the Contract immediately.”

The requirement to give 14 days’ notice gives the Contractor a final opportunity to comply with the relevant obligation or discuss the issue with the Employer. It is unclear whether the notice has automatic effect; that is whether the Contract is terminated automatically 14 days after a valid notice has been given under sub-clause 15.2 or whether the Employer must give a further notice of termination. To be on the safe side, it may be advisable for the Employer to give the Contractor notice that the Contract has been terminated on the expiry of the 14-day period.

This sub-paragraph does not mention whether the Employer’s right to terminate is lost after giving the required 14 days’ notice if the Contractor resolves the event or circumstance giving rise to the notice. This is a potential area of uncertainty that the parties might want to clarify before concluding the Contract.

“The Employer’s election to terminate the Contract shall not prejudice any other rights of the Employer, under the Contract or otherwise.”

Importantly, the Employer’s rights and remedies under the Contract and at law are preserved on termination. So, for example, the Employer’s right to complete the Works itself following termination is maintained.

“The Contractor shall then leave the Site and deliver any required Goods, all Contractor’s Documents, and other design documents made by or for him, to the Engineer. However, the Contractor shall use his best efforts to comply immediately with any reasonable instructions included in the notice (i) for the assignment of any subcontract, and (ii) for the protection of life or property or for the safety of the Works.”



Following termination, the Contractor must leave the Site (which includes the places to which Plant and Materials are to be delivered) and deliver any Goods (which includes Plant, Materials, Temporary Works and Contractor's Equipment, including Subcontractor's equipment) required to the Engineer. This provision may be difficult for the Contractor to implement in practice, particularly if he wants to use his equipment on another job.

This sub-paragraph also contemplates the termination notice including instructions concerning safety and the assignment of sub-contracts. It is suggested that the notice also includes any other instructions concerning the Contractor's departure from the Site, such as a list of the Goods the Employer requires and a valuation of the Works as at termination in accordance with sub-clause 15.3. Employers should be careful not to provide these instructions too early, for example, in circumstances where the Contract may not be terminated at the expiry of the 14-day notice period. This is because these instructions could be considered to be an election to terminate under the Contract, or may amount to repudiatory or material breach of contract at law.

"After termination, the Employer may complete the Works and/or arrange for any other entities to do so. The Employer and these entities may then use any Goods, Contractor's Documents and other design documents made by or on behalf of the Contractor."

This sub-paragraph empowers the Employer to complete the Works itself, using the Contractor's Equipment, Plant and Temporary Works, Contractor's Documents and other design documents. The Employer can then claim the costs of completing the Works from the Contractor under sub-clause 15.4(c).

"The Employer shall then give notice that the Contractor's Equipment and Temporary Works will be released to the Contractor at or near the Site. The Contractor shall promptly arrange their removal, at the risk and cost of the Contractor. However, if by this time the Contractor has failed to make a payment due to the Employer, these items may be sold by the Employer in order to recover this payment. Any balance of the proceeds shall then be paid to the Contractor."

This sub-paragraph permits the Employer to sell the Contractor's Equipment and Temporary Works to discharge the Contractor's debts. This may be legally and practically difficult to implement as it depends on whether the Contractor actually owns that equipment. For example, the equipment might be subject to a Romalpa clause in favour of a financing company. In some jurisdictions, if an Employer sells equipment subject to a Romalpa clause, the legal owner would be entitled to bring a claim against the Employer for conversion.

Consequences of termination

The consequences of termination by the Employer under sub-clause 15.2 are set out in sub-clauses 15.3 (Valuation at Date of Termination) and sub-clause 15.4 (Payment after termination), as follows:

- "As soon as practicable after the notice of termination has taken effect", the Engineer is required to determine "the value of the Works, Goods and Contractor's Documents, and any other sums due to the Contractor for work executed in accordance with the Contract" (sub-clause 15.3).



- The Employer “may 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 included by the Employer have been established” (sub-clause 15.4(b)).
- The Employer “may 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” (sub-clause 15.4(c)).

Employer’s termination for convenience (without cause)

Sub-clause 15.5 gives the Employer the right to terminate the Contract at any time for convenience, that is, without any default on the part of the Contractor or other justification, as follows:

“15.5 Employer’s Entitlement to Termination

The Employer shall be entitled to terminate the Contract, at any time for the Employer’s convenience, by giving notice of such termination to the Contractor. The termination shall take effect 28 days after the later of the dates on which the Contractor receives this notice or the Employer returns the Performance Security. The Employer shall not terminate the Contract under this Sub-clause in order to execute the Works himself or to arrange for the Works to be executed by another contractor.

After this termination, the Contractor shall proceed in accordance with Sub-clause 16.3 [Cessation of Work and Removal of Contractor’s Equipment] and shall be paid in accordance with Sub-clause 19.6 [Optional Termination, Payment and Release].”

Sub-Clause 19.6 provides:

“19.6 Optional Termination, Payment and Release

If the execution of substantially all the Works in progress is prevented for a continuous period of 84 days by reason of Force Majeure of which notice has been given under Sub-Clause 19.2 [Notice of Force Majeure], or for multiple periods which total more than 140 days due to the same notified Force Majeure, then either Party may give to the other Party a notice of termination of the Contract. In this event, the termination shall take effect 7 days after the notice is given, and the Contractor shall proceed in accordance with Sub-Clause 16.3 [Cessation of Work and Removal of Contractor’s Equipment].

Upon such termination, the Engineer shall determine the value of the work done and issue a Payment Certificate which shall include:

- (a) [payment for work prior to termination];
- (b) [payment for Plant and Materials];
- (c) [other reasonable costs]... 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...; and
- (e) the Cost of repatriation of the Contractor’s staff and labour...”

Overview of termination for convenience

A termination for convenience clause is generally intended to cover circumstances where



the project is no longer required or must be abandoned for some reason; for example, if the Employer is no longer able to fund the project. The idea is to restore the Contractor to the financial position it would have been in had the project never commenced (therefore there is no allowance for profit). It follows that the Employer is not entitled to terminate the Contract in order to complete the Works himself or by engaging a new (and potentially cheaper) Contractor.

Sub-clause 15.5 is obviously of great benefit to the Employer. Whether the Contractor accepts its inclusion in the Contract really depends on the relative bargaining power of the parties. The Contractor may seek to include an allowance for profit; but this really goes against the overall intention of the clause. In any event, if the Contract is terminated because the Employer has run out of money then at a practical level the Contractor may find it difficult to get its costs back, let alone any profit on top of that.

If the volume of case law is anything to go by, termination for convenience clauses are invoked by Employers relatively regularly in the United States. However, the same cannot be said for England and Wales, where termination for convenience clauses are either not always included in construction contracts, or fault-based termination is preferred (as it is generally more financially advantageous). The English courts have confirmed the validity of these clauses (although not specifically in relation to the FIDIC suite of Contracts) in *Hadley Design Associates v The Lord Mayor and Citizens of the City of Westminster* [2003] EWHC 1617 (TCC). Although there is no case law on this point, some commentators suggest that Employers may terminate the Contract under sub-clause 15.5 where they themselves are in breach, as a pre-emptive step to prevent the Contractor making a claim for breach of contract. This is not what FIDIC intended.

Given the current global economic climate, it is likely that we will see this clause invoked more frequently as Employer's find it increasingly difficult to fund projects. However, it should be noted that the application of sub-clause 15.5 may be restricted by the governing law of the Contract; this should be checked by the Employer before invoking this clause.

Procedure for termination for convenience

The notice of termination must comply with the formalities set out in sub-clause 1.3, and must be copied to the Engineer.

Termination takes effect 28 days after the Contractor receives the notice, or after the Employer has returned the Performance Security, whichever is later.

Following termination, the Contractor must proceed in accordance with sub-clause 16.3 (Cessation of Work and Removal of Contractor's Equipment). This means the Contractor must stop all further work, deliver up Contractor's Documents, Plant and Materials and remove all Goods from the Site.

Consequences of termination for convenience

There is no provision to compensate the Contractor for the loss of profit that he would otherwise have made had he completed the Works. However, the Contractor is entitled to recover the value of work done and any other Cost or liability that he has reasonably incurred in expectation of completing the Works, together with the cost of clearing the Site and repatriating staff.



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