

Practical Guide for termination of construction projects: Hands on application in FIDIC and NEC3 Contracts

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Abstract

Severe risk is rigorously invading the construction industry in the Middle East due to the unexpected economical recess caused by wars, terrorism, and fall back in the oil and gas products. The construction projects became a nightmare in the region for potential obstacles, risks, and potential disputes inherent due to the shortage of funding by the Employers who have been impacted by the fall back of the governmental budgets. Consequently, many new projects were postponed or cancelled and the progressing projects had been suspended, de-scoped, and or terminated. These existing circumstances generated many disputed cases and events due to improper contract management or defects in the signed contracts. This paper has adopted the termination case as the most common case in the troubled projects that may generate construction claims and un-favored disputes and will analyze the termination process to present a practical guide for successful termination and dispute free contract closure.

Key words: Construction- Termination- Practical- FIDIC- NEC3- Claim- Middle East-troubled projects

1. Introduction

Termination of the construction projects is a discretionary action may be elected by a contract party that considers himself an innocent party. The Employer has two different termination bases to process the termination, first event gives the employer the right to terminate is the contractor's default in different actions by the contractor that the Employer decides that the termination is more proactive to get a chance for surviving the project. The second case of termination is the termination for convenience, where the contractor has its reasons to terminate which are out of the contractor involvement, for reasons like change in business needs or economics and investment strategies in the Employer's organization. For the contractor entitlement to terminate the contract different standard forms of contract provides the contractor the right to terminate the contract in case of a material breach by the Employer. Termination can be categorized as contractual termination and common law/applicable law termination, depending on the default experienced in the project. This paper will discuss and analyze the termination process and procedures under the FIDIC and NEC3ECC standard forms of contracts in order to provide practical guidance for safe and successful termination process.

2. Termination Categories

The termination process in the construction contracts is classified in two categories the first category is the contractual termination, which is generated based on a contractual clause of the project contract¹. The second category is the termination based on the applicable law of the project contract, can be considered as no contractual rights to terminate, these categories are discussed in the following paragraphs:

2.1 Contractual termination

Standard forms of for construction contracts will usually recommend the essential basis upon which a contract party can terminate the projects and the procedures to be carried out in order to accomplish the termination of the contract. The standard forms for construction contracts, such as FIDIC, NEC3ECC provide clauses for termination, for example the New Engineering Contract- Engineering and Construction Contract, NEC3ECC. 2005, provides the core clause 9 for termination. Such clauses provide the innocent party to terminate the contract in some predefined and specified material breaches of contract, for example; bankruptcy/insolvency; groundless suspension of works; failure to proceed with the works; and delay in payment by the Employer. The following sections will demonstrate guidance for the termination procedures as demonstrated by the RED FIDIC 1999 and the NEC3ECC 2005. The importance of such guidance is to secure a safe and successful termination process where the innocent party remains entitled to terminate and generate the contractual clauses for termination payments and avoid any potential claims in case of wrong termination, such as, demobilization costs, early termination of subcontractors, in addition to loss of profit claims.

2.2 Applicable Law termination

In some construction contracts, the termination clause is not included and the contract doesn't enable termination in the event of any breach apart from some specific breaches only. In such circumstances the termination may be processed at the applicable law, for example the English law²/ common law, enables the innocent party to terminate the construction contract in case of the other party has committed a "repudiatory breach" and consequently the innocent party has the right to terminate the contract. In this case the innocent party should be care not to be in situation that he may be affirming the contract, i.e. not to delay the termination, or proceed with the work as issuing instructions, approving submittals, etc.³ Another case of termination under this category is when frustration occurs, then the contract automatically ends. It occurs when some circumstances had interfered to preclude the contract to be carried out as per the original plans. This case doesn't refer to ant defaults by any contract party, but the through put of such circumstances should be that advance progress cannot be achieved. Frustration reliefs the parties from their further obligations under the signed contract, but any ensued responsibilities will remain valid for either party.

¹ Eggleston, B., The NEC 3 Engineering and Construction Contract A Commentary Second Edition, Brian Eggleston © 2006 Brian Eggleston

² Rowlinson, M. (2011) A Practical Guide to the NEC3 Engineering and Construction Contract, First Edition. John Wiley & Sons, Ltd. Published 2011 by John Wiley & Sons, Ltd. ISBN: 978-1-444-33688-7

³ Legal news and guidance by Pinsent Masons, Ou-Law.com, Termination and suspension of construction contracts accessed 25 Oct., 2016

3. Termination in standard forms of contracts

The guidance for safe termination process will be evolved and integrated adopting the FIDIC and NEC3 standard forms of contracts as discussed and analyzed hereunder.

3.1 Termination for default in RED FIDIC 1999

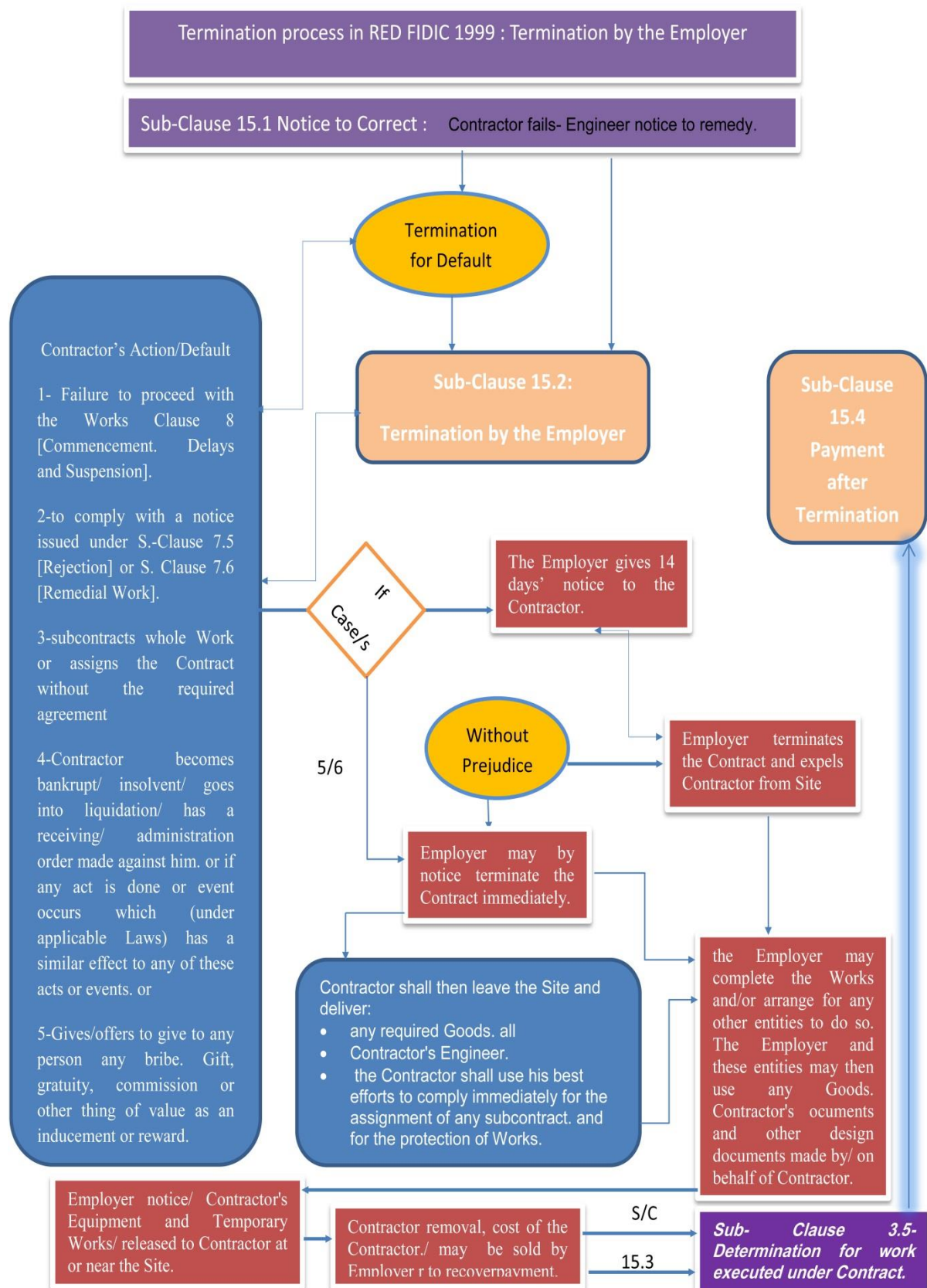
When a project progress experiences significant deviation from different project management plans, the project completion becomes a doubt, and the cost overruns continue increasing; it appears more beneficial for the Employer to terminate the project and complete the project by any other effective means. The Red FIDIC⁴ 1999 Clause 15 deals with termination by the Employer in the case of contractor's documented default. Different defaults may entitle the Employer to apply the termination clause as demonstrated in table1.

Table 3: Termination for default data

No.	Contractor's Action/Default	Remarks
1	The Contractor fails to comply with Sub-Clause 4.2 [Performance Security] - with a notice to correct, under S. Clause 15.1.	Project Initiation- project execution
2	Failure to proceed with the Works Clause 8 [Commencement. Delays and Suspension].	
3	To comply with a notice issued under S.-Clause 7.5 [Rejection] or S. Clause 7.6 [Remedial Work].	within 28 d. after receiving notice
4	subcontracts whole Work or assigns the Contract without the required agreement	Some contracts include S. contract plan.
5	Contractor becomes bankrupt/ insolvent/ goes into liquidation/ has a receiving or administration order made against him. Or if any act is done or event occurs which (under applicable Laws) has a similar effect to any of these acts or events. or	Compounds with his creditors. or carries on business under a receiver. trustee or manager for the benefit of his creditors.
6	Gives/offers to give to any person any bribe. Gift, gratuity, commission or other thing of value as an inducement or reward.	For doing any action in relation to the Contract. or for showing/forbearing to show favor or disfavor to a person in relation to contract

⁴ International Federation of Consulting Engineers, The FIDIC Contracts Guide, First Edition 2000, ISBN 2-88432-022-9

Fig 1: Termination process in RED FIDIC 1999



3.1.1 Importance of notices In RED FIDIC 1999

Alike to different standard forms of contracts, the RED FIDIC 1999 form of contract includes explicit terms for notices to be served in some specified events. Clause 1.3 sets out the need to document the contractual required notices through the agreed document management system. Notices are issued to serve in different cases as to notify a party by the other party of a contractual request/procedure/. They are also, critically, used to notify claims, changes, termination, etc.

3.2 Termination in NEC3ECC 2005

The standard Form of contract NEC3, Engineering and Construction Contract, ECC manages termination in an organized procedure, as this research is initiated in the Middle East where the NEC3 is in the development stage in the construction domain in the area, this research is considering detailed demonstration of the termination process in NEC3.

The NEC3ECC provides 21 general reasons for termination provided in clause 91 and grouped into 7 categories. Some of the reasons are contractor's caused and other are Employer's breach, also other reasons for termination may be a breach of either party or may be a consequence of an event due to an action of a third party. In the contrary to FIDIC forms, the NEC3 does not include discrete separation into different clauses for each party contributing to the termination reasons, i.e. termination by contractor and termination by Employer. For the limitation of this research the shed will be out on the Employers termination concerns and process.

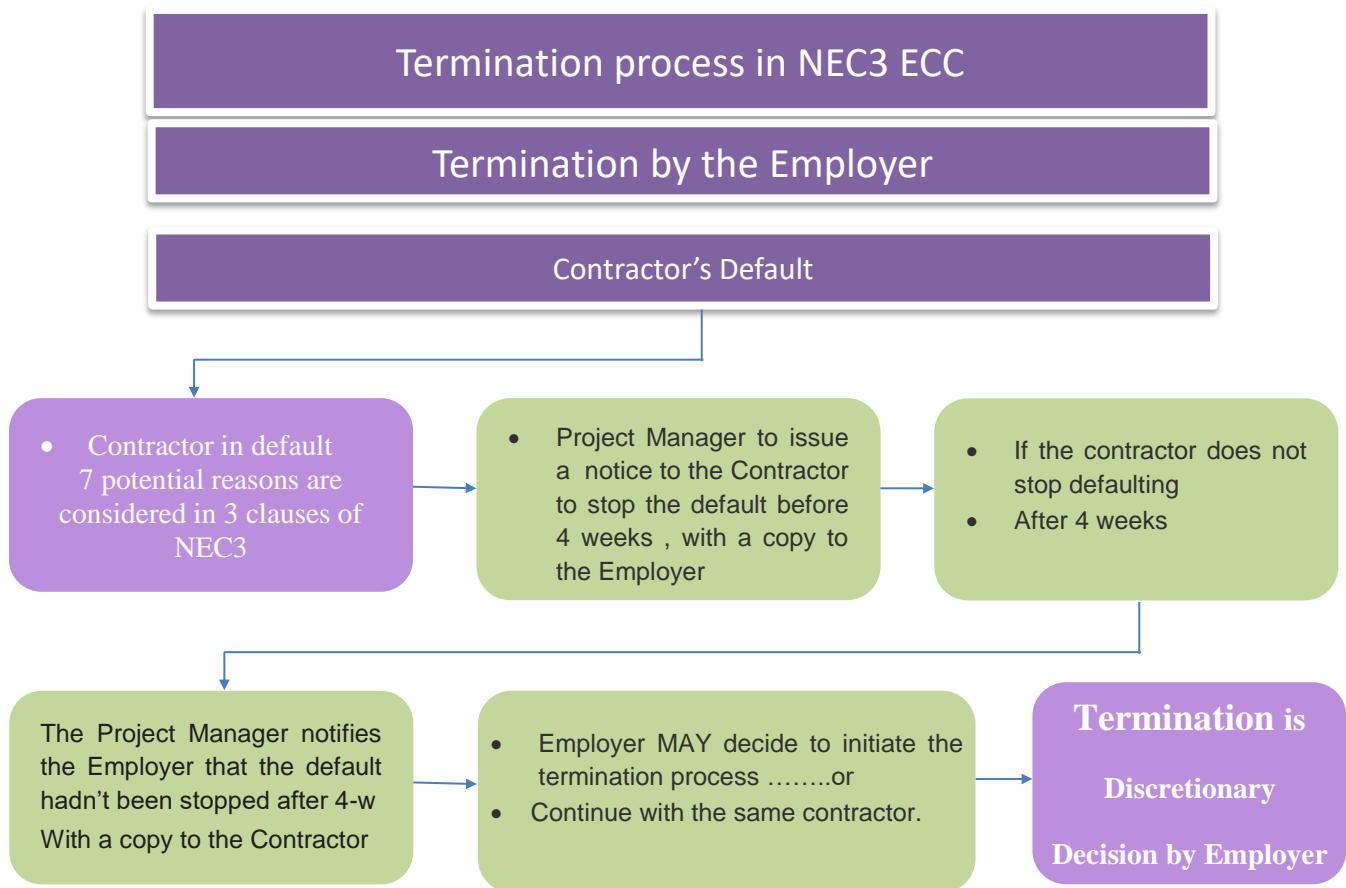
3.2.1 Termination by the Employer in NEC3ECC 2005

When the Employer decides to establish the termination mechanism, it must be sure that the reason they are depending on for justifying their decision are sufficient to proof its entitlement for termination under the contract clause, i.e. clause 91, to confirm availability of evidences, records as well. It is worthy to emphasis on the risk inherent with the case when a party initiates a termination process relaying on some reasons which are not sufficient for its entitlement to terminate the contract, it may cause a counter claim which will put the Employer at risk and my losing the case and subject to recovery payment due the contractor. So the NEC3 identified a role for the project manager to carry out which cross check the reasons in such potential termination process (clause 90.1 and Section 18.3).

3.2.2 Contractor-only defaults

All reasons included in the NEC3 entitle the Employer to terminate only when the Project Manager advises the Employer that the Contractor has performed some defaults of those reasons mentioned in the contract. In addition, the Contractor has not ceased defaulting within four weeks of the Project Manager's notification to the Employer. As demonstrated in figure 2 the Project Manager needs to notify the contractor's failure to cease defaulting to the Employer after four weeks from the initial notification to the contractor which should be copied to the Employer. The reasons for initiating the termination process may have some doubt and can be mutually interpreted either as a substantial breach of the Contractor's obligations to the Employer or not. For example the reason no 13 in the NEC3, refers to a contractor breach of his obligation not to employ any Subcontractor until the employment of that Subcontractor has been accepted by the Project Manager as stated in clause 26.2 (Section 8.3). This reason uses the word 'substantial' which includes a risk in interpreting what is considered substantial and what is not. Simple demonstration for the termination process in NEC3ECC, 2005 is shown in figure 2.

Fig 2: Termination process in NEC3, 2005



3.2.3 Applying termination in NEC3

As per clause 90.1 if a reason arises that entitles either party to terminate, and the party discretionary decides to terminate or even the Employer decides that he is going to terminate for any other reason/ for convenience, then this party initiates the process by notifying the other part and the project Manager of his intent to terminate. The notice shall contain the details of the reason/s that he is considering sufficient to entitle him to implement the contractual termination clause. Upon receipt of that notice the Project Manager is required to review and check, whether the reason/s mentioned are applicable, as set out in the contract. If the reason is applicable and is one that is set out in the contract and entitles the notifying party to terminate, then the Project Manager shall promptly issue a certificate to confirm the termination. After the issuance of the termination certificate by the Project Manager as it is set out in Clause 90.5 that, after the issue of a termination certificate, the Contractor does nothing further to provide the Works (clause 20.1 and Section 7.2).

3.2.3 Procedures after termination

After the Project Manager has issued a termination certificate, immediately the contract parties' actions and obligations are immediately determined by the procedures to be followed which are mentioned against the reason for termination as mentioned in the Termination

Table (clause 90.2). In Clause 90.3 it is set out that the parties shall implement such procedures immediately, depending on the reason that the termination was processed. The successful termination process entitles the Employer always to complete the project works and also:

- The Employer can achieve this has no limitations stated in the contract, reasonableness shall govern.
- This procedure also entitles the Employer to use any Plant and Materials (clause 11.2(12) and Section 14.2.3).
- The Contractor is obligated to remove his Equipment and Plant and Materials. As applicable upon acceptance by the Employer who may request to use any of the Equipment and plant and material in the remaining project works.

In all events the Employer is not entitled to sell or otherwise take away the Contractor's Equipment, merely can use the Equipment for completing the project works only.

4. Recommendations for termination process

Prudent practitioners are advised to consider some redefined items which may work as the vehicle to successful termination processes as set out in the contract conditions, those include but not limited to:

- i. The terminating party has to describe the reasons/justifications preferred rather than working out the issues with the oppose part to complete the project as per the signed contract.
- ii. Look for material breach to grant the right to terminate.
- iii. Proper cautioned interpretation of substantial breach is recommended to avoid challenged decision by the opposing party.
- iv. Check for any intention to abandon the contract as per the common law termination like repudiatory or anticipatory breach.
- v. Consider the difference in complicated reasons such as failure to proceed, while insolvency can be easily justified.
- vi. Contractual rights to terminate are clearer and less complicated from the common law termination.
- vii. The innocent party/ Employer in this research should consider what will be recovered upon termination based on the contract related clauses.
- viii. The common law allows more chance for recovery of losses, as the innocent party's entitlement to be put in the same situation as if the project had been completed.
- ix. The Employer will not be entitled for applying liquidated damages unless the termination is processed after the contractual completion date.
- x. The Employer shall keep in mind that all sums due for completed part of the scope of work prior to termination remain due and will be evaluated as per the contract price, and they are calculated in accordance with the pricing mechanism under the contract.
- xi. Follow the contract procedure for notices and termination procedure as a hall set out in the contract.
- xii. Waiving of rights may be unintentionally conducted by accepting a repudiatory breach or delaying the termination procedure.
- xiii. The organization legal consul shall be involved in the procedure to avoid any misconduct
- xiv. The Employer can implement the omission clause to challenge the poor performance and shortage in resources by the Contractor. In this regard the prudent

Employer/Engineer can analyze the project control reports and highlight the slippage in the early stage of the project. Hence the Employer shall eliminate changes and implement the omission clause and variation clauses regardless any claim by the contractor for loss of profit and unrecovered expenses which will be minor compared to entering into termination process and its consequential damages.

5. Conclusion

The current construction projects fall back had addressed the construction project contract to be of the essence and the closing phase as a priority and high in a project contract agreement. The industry recess revealed many circumstances that cause projects delays, lack of funding, and suspension of work, which may lead to termination by either party in the contract. This paper provided practical guidance for the discretionary process to terminate a project before completing the contractual scope of work. The guidance addressed the criticality of the termination procedure and the importance of following the contractual procedure for notice, caution, monitoring, assessment, and termination notice. The procedure in the FIDIC and NEC3ECC was adopted in order to shed the light on the proper and safe termination process that will maintain the innocent party/Employer in the claimant position and avoid any successful counter claim.

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