TERMINATION OF CONTRACT

1. Introduction

1.1. ***Termination*** is one of the most dreaded words, be it in context of any aspect of our life. It is almost rare that Termination does not leave behind scar. In Construction Law, particularly the process of termination requires to be handled delicately and its consequences need be understood clearly. It is double edged sword and the user also gets hurt to some extent.

1.2. In modern contract there could be no condition precedent to termination. However, the procedural formalities need be performed as and by way of fairness and in good faith. Non-compliance of formalities may put the Employer or the Contractor in bad light before adjudication Forum. There is no legal requirement to observe the rules of Natural Justice in terminating the Contract except that the party terminating must faithfully follow the procedure, if laid down in Contract.

1.3. ***On Termination***, right to payment for the work done but not paid, remains unaffected, under the principle that "Nothing can be at gratis". In context of '*Right to Liquidated Damages'* the provision is strictly by way of measure of compensation for delay caused in `completion' of contract. The word 'Completion' loses its teeth on Termination by Employer, if he chooses to terminate. Hence, the clause is rendered ineffective. The Employer who otherwise could have been entitled to L.D. becomes liable to Unliquidated Damages, under common law of consequences of Breach of contract.

1.4. Except for the clause of warranties and indemnities and payments for the work done or the rights against illegal forfeitures, no contractual rights could survive effectively. What survives a part from consequences of common law is Arbitration /Mechanism of Adjudication. These are like bird `Phoenix' it rises from ashes of a destroyed and terminated contract.

1.5. There is free will to enter into a contract. However, once you enter into a contract, you are the prisoner, in/of the contract. To come out or to terminate the contract, one is a slave to the terms and conditions of contract. The Provision in Law and the terms of Contract shall govern the adjudication of consequences of the Termination of Contract.

2. Termination of 'Offer'

2.1. '***Offer'*** by itself is not Contract unless it is unilateral contract. Once 'Offer' is accepted it cannot be 'Terminated', except by process of Law and 'Terms of Contract'. 'Absolute acceptance' 'transforms '*Offer*' into '*Contract*'.

Though 'Offer' is revocable anytime before 'Acceptance', it is not so in case of 'Option Contract'.

2.2. In ***'Option Contract',*** offer is required to be kept valid for agreed time failing which Earnest Money Bond / Deposit could be forfeited. Thus, even before 'termination of contract', you run the risk of losing money as consequence of termination of offer.

2.3. '***Offer'*** dies on its rejection or expiry of its validity period or by 'Counter Offer'. If no time of validity of Offer is stipulated, Courts may decide by appreciating surrounding facts as to what should be Reasonable Time for considering the Offer as valid. Change in law subsequently, if distorts the 'bid parameter' it results in contract becoming unenforceable.

2.4. ***'Offer'*** gets '*Terminated*' on death of offeror or frustration of subject matter. Once 'Offer' gets transformed into 'Contract', the contract dictates process of termination – i.e. as per provisions in the contract. Contract usually contains fairly well drafted mechanism of termination listing, Notice of intentions to terminate as an important and mandatory provision. It may list events of conditions precedent to termination. The law also provides automatic termination on the other party repudiating the contract, abandoning the performance.

3. Ways of termination of Contract

There are five ways in which Contract gets terminated.

- Impossibility of Performance (Frustration)
- Breach of condition of Contract
- Foreclosure by agreement
- Rescission
- Completion of Contract

4. Interest in Contracts

4.1. All contracts are entered into to have three principle interests

i. Interest of Expectation of profit
ii. Interest of Reliance
iii. Interest of Restitution

4.2. While entering into a contract, a party has **interest to expect** reasonable gain. Employer gets the project envisaged and contract expects profit. If contractor abandons the project/job, Employer earns right to get executed at the ***Risk and Cost*** of the contractor.

4.3. As per trade practice, Contractor reasonably expects 10% to 15% of cost of work as legitimated profit. In event of unlawful Termination, the contractor expects and is compensated 10% to 15% of profit out of balance work, he is deprived off [***AIR 1984 SC 1703, A.T. Brij Paul Singh vs Vs. State of Gujarat***.]

4.4. Placing **reliance** on promise made by Employer, Contractor on getting contract starts investing on following heads and therefore, the losses *for the Contractor include*

- Mobilisation of Resources
- Providing of necessary infrastructure and enabling works
- Finance Arrangements Contracts with vendors / Sub Contractors

5. *Types of Termination*:

The termination of contract, unless frustrated is of two types:

5.1. Termination for convenience

5.2. Termination for default

5.3. ***Termination of Convenience*** is also known as 'no default termination'. It allows a party at anytime for its convenience to terminate contract by a notice with or without indication of a particular clause in the contract. The Contractor will have right to receive cost incurred up to termination and recover damage resulting from such termination.

5.4. There is a growing trend of Termination for Convenience by Employer. If this is envisaged, fair compensation need be paid . Modern, construction contracts provide for clause for 'Termination'. The cause of failures due to Employer as enumerated in contract may be

- Failure to provide adequate work fronts
- Failure to issue Drawings, Instructions, Materials promised in timely manner
- Failure to make timely payments
- Failure to correct situation of suspension of work within Reasonable period (say three months)
- Failure to provide reasonable facilities to perform contractual obligations.

5.5. In all cases, the Contractor earns right and entitlement to terminate the contract. He gets right to ***restitution*** resulting from 'Reliance' he placed on Employer for good faith and diligence.

5.6. In case of frustration or for whatever reason, parties may desire to foreclose or annul a contract, they may do so on terms they may agree upon. A Contract perfectly legal and valid may become unenforceable due to change in law or public policy.

5.7. **Termination for default -** In performance of the contract, either of party finds that the other party is not reciprocating its obligations or unilaterally is in default of its own obligations, in such event the party perceiving fault of the other may terminate the contract serving the notice to suspend all further performance and come forward for final settlement, either on amicable terms or may lead to disputes to be adjudicated as per contract / law. The alternative in such case may be to extend time for performance either with or without intention to recover pre-decided damages.

5.8. Before the termination of default is decided, it is important to consider following facts:

- The terms of contract as provided in termination clause
- The circumstances leading to shortfall / backlog of performance
- Defaulters explanation for the defaults
- Weightage of timely performance
- Consequences of such termination

5.9. In any event, Contract should not be terminated, if there are chances of default to be considered as excusable causes like Acts of God or circumstances beyond the control of the Agency.

5.10. This is the most common form of Termination. One of the parties makes it impossible for the other to discharge its obligation by unilaterally committing those actions of breach of conditions which make performance impossible. Law stipulates principles on which compensation is payable. Till early 18th Century, there were awards of compensation based on individual perceptions of hardships to which aggrieved party was put. However, beginning with *Hadley v/s Baxendale,* there has been almost certainty on principle of compensation.

6. Termination Notice

6.1. Wherever Notice of Termination is required to be served as per contract, it is mandatory to serve the notice to the authorised agency, providing for a *Cure Period* to improve the performance, failing which there could be an automatic termination. The notice must include briefly narrated events of defaults which has prompted the issue of termination notice.

6.2. In Construction contracts, one or the other parties may more often lose patience with Time and / or Money being invested. If 'Time' is the cause, most often Employer desires to replace agency expecting acceleration in performance and opts for Termination of contract. In such a case Employer's can terminate because of fault of Contractor on various grounds.

7. Grounds for termination

7.1. From purely whimsical act -to termination without any legal ground -to circumstances of duress, there are number of grounds for termination and they could be many not limited to following only.

- Defaults in Contracts
- Lack Resources to cope up with agreed programme
- Object of Contract is lost
- No skill to perform work to required workmanship and specification
- Lack of willingness to abide by instructions of Engineer-in-charge / Employer
- Inability to make up loss of time
- No will and Resource to amend Breach of terms of contract
- Breach of terms of contract – Time at large

7.2. Under any one/more causes or any particular listed in Termination clause, Employer may serve `***Notice***' to amend the breach in Time stipulated or Reasonable Time, failure to amend / rectify the breach in the time stipulated the contract gets terminated. However, in event of expiry of Notice Period, if parties continue to perform '***Time is at Large'.*** The contract is being performed in absence of rights / entitlement related to 'Time'. 'Time at large' could be corrected by one of the parties proposing regularisation of such period and Extension of Time (EOT). This may be done with such Extension of Time being of essence or otherwise. It is advised that issue regarding such `Time' to be compensable or otherwise be decided at such a stage. In any event, it is not advisable to be *judge in one's own cause* or else contract may get aborted through Termination under compulsion. The consequences of Delay including responsibility or Liability need be adjudicated by third party irrespective of whatever may be the provision.

8. Termination Clause

8.1. All works contract contain 'Termination Clause' providing circumstances or events which may trigger the clause leading to Termination.. Terminating

strictly in compliance of conditions enumerated is called Legitimate Termination or Contemplated Termination.

8.2. Such Termination being provided for the consequence or relief is as per provision and nothing more. The termination clause unless un-conscionable authenticates relief or compensation. Termination without justified ground is 'illegal Termination' or 'Termination Bad in Law'.

8.3. **Fundamental Breach** is which destroys possibility of further performance. It may frustrate commercial purpose and parties or party may see no sense in performing the contract. *In Techno-legal parlance, the modern test of Fundamental Breach or Frustration is*

"Does the occurrence of event deprive the party of Substantial benefit which was intended as consideration for performances?"

8.4. In construction law, the phrase ***"Material Breach"*** is same as Fundamental Breach making further performance against interest of the party. Right to Terminate is usually provided for ***"Repudiatory Breach"*** whereby a party wants to only demonstrate his decision not to discharge his contractual obligations.

9. Termination bad in law.

9.1. Any termination of contract violating the terms of contract, or against the provision of substantive law or public policy could be considered as 'termination bad in law.' This shall deprive the terminating agency any protection or privilege arising out of law and should be faithfully avoided.

10. Consequences of illegal Termination

10.1. As and when a party illegally terminates a contract, the aggrieved party is entitled to compensation under *section 73 of Indian Contract Act.* In construction, damage naturally arising out of Breach (illegal Termination) are as below

For Contractor

a. Profit on balance work due to harm to interest of expectation
b. Untimely demobilisation of Resources
c. Partial utilisation of infrastructure created
d. Consequences of failure of vendors contract
e. Loss due to distress sale of balance of material at site

f. Compensatory Retrenchment cost for Resources hired and employed to complete the works**.**

A party illegally terminating a Contract has no right to have counter claims (J.G. Engineers vs Union of India 2011 5 SCC 758.)

10.2. On Contract failing to take off or at any stage of illegal termination of performances, Employer needs to compensate Contractor for reliance so placed and investment made thereon.

For the Employer include

- Extra cost of getting balance work executed
- Damage due to delay in having return on investment
- Extra Overheads for getting balance work done
- Cost of shifting "Defect Liability" to substituted Agency.
- Compensation for getting Performance Bond released
- Extra cost for unobstructed site as result of unpaid labourers is sub-contractors not being paid.
- Cost of updating final unfinished work measured and accounted for.

10.3. In short, while final account is being settled as consequence of just and legal Termination, Employer need be placed back in position, had the contract not being terminated.

10.4. It should be remembered that to recover claims it requires acceptable evidence of loss incurred or most likely to have been incurred. Parties need be posted with contemporaneous record of expenses so far possible and should afford to the other party opportunity, for verification of cost incurred and being incurred.

10.5. All expenses and costs incurred to protect interest and to perform obligations need be restituted /reimbursed on contract being terminated.

11. ***Rescission of Contract***

11.1. The Concept is clearly mixed up with Termination as is the work "Term: is not distinguished from "Condition". While one terminates a Contract for a cause, Convenience or default or ***forecloses*** by agreement or ***abandons*** as one cannot manage performance or suffers frustration due to impracticability of a contract to perform, ***one may opt to rescind*** which is found void *ab-initio* but may discover at point during or before performance. Here ***Rescission*** is to nullify a Contract, relieving parties to return to a

position *ante* the contract. In fact voidable contracts could be performed or be rescinded. It is a slip to put an end to further performance. An accurate legal perception of "ab initio voidable" is actually a "void" contract. A void contract is illegal from beginning while a contract capable of being avoided may be contaminated by fraud, coercion, misrepresentation or mistake. The voidable contract is amenable to rescission.

11.2. ***On Rescission,*** parties are relieved of further performance, parties do not liquidate their rights accrued in course of performance till the point of opting to rescind the contract. In fact none of the parties keep an unearned advantage. However, circumstances leading to rescission are consciously ignored by Parties to continue performance, it acts as waiver and the voidability is given up.

11.3. In works contracts, if 'advance' is paid or work is executed, resources mobilised, infrastructure, utility are fully or partly provided, the contractor need be paid for the dues recoverable under the doctrine of "unjust enrichment" In fact, it is recognition of legal perception of "interest of restitution" of amount spent / invested in expectation of "interest of profit" expected.

12. ***Repudiation of a Contract***

12.1. Repudiation of a Contract is an act of indicating categorically that the obligations of the contract will not be performed by the party repudiating the contract. Anticipatory repudiation is similar to anticipatory breach of contract as both occur before the time of performance arises. It is debatable whether action can be brought for repudiation unless the time for performance has arrived.

13. ***Frustration of Contract***

13.1. With all will and effort to discharge obligations, parties may get incapacitate by flux of compelling events or operation of law to perform contract. This is not the same as void contract or impossible contract or contingent contract. Due to change of circumstances, the substance and essence of contract becomes unachievable.

13.2. It need be appreciated that innocent misrepresentation or mistake need be distinguished from frustrating force. If the circumstances which could be existing at the time one enters the contract and has no knowledge, the contract suffers from mistake, it becomes voidable. If new set of circumstances do come up subsequently, it is a case of frustration.

13.3. If and when a contract gets frustrated, the recovery of work done is on basis of quoted rates and extras / additional on basis of quantum meruit as no term of contract survives frustration except mutual agreement at settlement, if any.

13.4. ***Events causing frustration.*** This may be condition where performance is rendered impossible or impracticable due to some act of God or causes similar to those being considered Force-Majeure. It may also result as change in Public Policy i.e. new set of law/laws come into effect prohibiting object of contract to be achieved. Fundamental change in Bid Parameters, is accepted as cause of frustration. In India, though uncertain in application ***Tarapore & Co. Vs. Cochin Shipyard Ltd (1984) 2 SCC 680*** on Bid parameter is at par with many international provisions. E.g. ***German Civil Code, Article 138*** states as below

> **"*Contract could be <u>void</u> whereby a person profiting from distress, irresponsibility or inexperience of another.....*"**

Recent judicial cultures like Gulf countries, are liberal and modern compared to "wide open eye" doctrine under the Indian law resulting in contracts of Adhesion resulting in virtual annihilation of contract. ***Qatar Civil Code Article 171 (2) reads as below***

> *"However, if possible exceptional incidents occur which could not have been expected, the occurrences of which makes the fulfilment of the contractual obligation, though not impossible, but exhausting to the debtor and threatens him to grave loss, the judge may, taking into consideration the circumstances and after weighing the interest of the two parties, reduce the exhausting obligation to a reasonable margin. Any agreement to the contrary shall be void."*

13.5. In U.K., through ***Unfair Terms of Contract Act, 1977*** protects interest of parties on fair and just basis. Laws of duress, unconscionable terms, unfair terms Chapter IV of Uniform Civil Code Unconscionability in USA protect exploitation of weaker party.

14. ***Risk & Cost Recovery Valid on termination***

14.1. For successful claim for `Risk' and 'Cost', following case need be taken by Employer.

- Termination must be legal for default of Contractor and with due "Notice" to party named in Contract

- The Notice must mention briefly the faults and evidence to neglect to correct the faults / defects / deficiency on part of contractor.
- Notice may mention clause under which Termination is intended to be affected and number of days given to Contractor to cure the default.
- Intention to debit extra cost for getting performance may be expressed in Notice.
- Legal controversy is avoided by using the phrase "Withdrawal of work" rather than "Termination" as some jurisdiction do not allow clauses of contract to be operated on Termination .
- The Contractor ***must*** be invited / permitted to create record of the status of works at the time of taking over on withdrawal.
- Joint measurements of works need be taken
- Alternately, if Contractor does not co-operate, third party presence is preferred or else Contractor need be posted status of work done and a notice period to verify Employer's statement, if unilaterally taken. In short, maintaining the Evidence of work done, helps to avoid legal complication.
- It is advised to main video graphic record of work done holding tapes at some vital locations.
- Evidence of date of videos is appreciated if combined work including day's News paper headlines.
- The Record of minutes be bound and concluded by affidavit or signature of persons concerned.
- Copy of such statement of minutes, inventory of material, plant equipment need be posted to Contractor and persons concerned.
- To avoid job of record of inventories adequate Notice asking Contractor to remove his material and resources need be given, unless confiscation clause is intended to be operated or 'Advance' payment if given is outstanding.
- Caution, Employer should carefully consider consequences of confiscation / Forfeiture in case of Bank Bonds, Materials, tools, plant.
- Finally record of infrastructure / enabling works need be maintained for settlement of dispute of claims resulting from withdrawal of work.

Risk and Cost clause cannot be operated alongwith the Liquidated Damages Clause as LD is exclusive provision.

15. ***Care to be Taken for Termination.***

15.1. In case, it is intention of Contractor to stop and terminate Performance or abandon the job, following need be complied.

- Notice of intention must mention period of correction, reference to clause / circumstances need be given to Employer or party named.
- Final Bill be prepared based on final measurements of work done as per contract works, varied / altered and Extra indicating approved / disputed rate / intention to charge. Rate in dispute / or intention to charge need be accompanied by appropriate Rate analysis. Backed by supporting evidence of cost and agreed "Overheads and Profit" or as per "Trade Practice".
- Record of inventory of Tools, Plants, Materials, Equipments, need be furnished to Employer and copies of `Gate-passes' be supplied.
- Alternately, clear record of un-uselessness of Employer to permit need be maintained.
- In all events, Employer need be posted with records of unused materials. Tools, plants, infrastructure created.

15.2. In short, Employer and Contractors who may take initiative to end contractual relations need to demonstrate correct procedure and produce evidence of fairness.

16. ***Conclusion***

16.1. In all cases, '***Termination'*** should be the last option for Employer and Contractor. Experience has shown that party which terminated contract as soft solution to contract administration, has not favoured a repeat experiment of Termination. Admittedly even at high price termination is the last and only resort.

Disclaimer*: This is an Academic discussion on the law related to termination of contract as perceived by Author and is not claimed to be quotable reference work of law.*