WATSON FARLEY
&
WILLIAMS

BRIEFING

TERMINATE IN HASTE, REPENT AT LEISURE

NOVEMBER 2017

- TECHNOLOGY AND CONSTRUCTION COURT HOLDS THAT CONTRACTOR SHOULD HAVE BEEN GIVEN OPPORTUNITY TO RECTIFY BREACHES BEFORE EMPLOYMENT WAS TERMINATED
- AN IMPORTANT REMINDER OF THE NEED TO ADHERE TO ANY CONTRACTUAL TERMINATION REGIMES

"IN CIRCUMSTANCES WHERE A PARTY INTENDS TO EXERCISE CONTRACTUAL TERMINATION RIGHTS, THEY SHOULD TAKE CARE TO ENSURE THAT THEY STRICTLY ADHERE TO THE CONTRACTUAL TERMINATION REGIME."

In a stark reminder of the risks associated with any decision to end a contract early, in *Interserve Construction Ltd v Hitachi Zosen Inova AG*[1], the Technology and Construction Court ("TCC") recently considered a number of issues arising from a termination dispute between a sub-contractor and EPC contractor. The case reinforces the view that, in circumstances where a party intends to exercise contractual termination rights, they should take care to ensure that they strictly adhere to the contractual termination regime.

Background

Hitachi Zosen Inova AG ("HZI") was the main EPC contractor on a project for the construction of an energy from waste plant in the Hartlebury, Worcestershire, UK. It entered into a related sub-contract with Interserve Construction Ltd ("ICL") in respect of certain civil works and building facilities (the "Contract").

Sub-Clause 43.1 of the Contract set out a number of contractor defaults and specified that, "subject to Sub-Clause 43.1A", HZI could rely on those defaults in order to terminate the Contract by notice to ICL. Sub-Clause 43.1A provided:

"In the case of a default by [ICL] under heads (h), (p) or (q) of Sub-Clause 43.1, [HZI] may (at its absolute discretion) notify [ICL] of the default and if [ICL] fails to commence and diligently pursue the rectification of the default within a period of

[1] [2017] EWHC 2633 (TCC)

seven (7) Days after receipt of the notification, [HZI] may by notice terminate the employment of [ICL] under the Contract."

HZI became increasingly dissatisfied with ICL's performance and delays under the Contract and opted to exercise its contractual termination rights under Sub-Clause 43.1. It served ICL with a notice of termination which referenced and relied upon defaults set out in Sub-Clauses 43.1(h) and/or 43.1(q) (namely ICL's failure to proceed regularly and diligently with the works and ICL's material breach of the Contract, respectively). The termination notice also stated that "For the avoidance of doubt, HZI does not exercise its discretion to provide a seven day period for rectification under Clause 43.1A of [the Contract]".

ICL disputed that HZI was entitled to terminate, instead arguing that HZI's purported termination constituted a renunciation and/or repudiatory breach which ICL accepted. It commenced proceedings, contending that HZI had not been entitled to terminate without first giving notice under Sub-Clause 43.1A. It also sought a declaration that it was a condition precedent to HZI having the right to terminate pursuant to Sub-Clauses 43.1(h) and 43.1(q) that HZI first issue a notice under Sub-Clause 43.1A and allow ICL a seven day period to commence and diligently pursue the rectification of the default that was the subject of the termination notice.

HZI rejected ICL's position and argued that the giving of notice under Sub-Clause 43.1A was "at its absolute discretion" and, therefore, that giving such a notice could not be a condition precedent to HZI terminating. Accordingly HZI contended it had the choice of either giving notice under Sub-Clause 43.1A (and giving ICL seven days in which to commence the rectification of the default) or simply giving notice to terminate forthwith under Sub-Clause 43.1.

"ICL DISPUTED THAT HZI WAS ENTITLED TO TERMINATE, INSTEAD ARGUING THAT HZI'S PURPORTED TERMINATION CONSTITUTED A RENUNCIATION AND/OR REPUDIATORY BREACH WHICH ICL ACCEPTED."

Analysis

Mrs Justice Jefford first considered the parties' respective interpretations of Sub-Clauses 43.1 and 43.1A by reference to the principles of contractual construction set out by the Supreme Court in *Wood v Capita*[2] (namely, that the court should look for the objective meaning of the contractual language agreed by the parties, consider the contract as a whole, giving more or less weight to the context depending on the nature, formality and quality of the drafting and, where there are rival interpretations, reach a view on which construction is most consistent with business common sense). On that basis, the judge held that the objective and natural meaning of the words "subject to Sub-Clause 43.1A" in Sub-Clause 43.1 was that HZI's right to terminate was "subject to" or conditioned upon Clause 43.1A. This meant that, in the instances covered by Sub-Clause 43.1A, HZI's right to terminate only arose if Sub-Clause 43.1A had been operated. Accordingly, if HZI intended to terminate in reliance upon any of the contractor defaults specified in Sub-Clauses 43.1(h), (p) or (q), it would first need to comply with the requirements in Sub-Clause 43.1A for HZI to give notice to ICL and give ICL an opportunity to rectify its default(s).

Mrs Justice Jefford also identified that her construction of Sub-Clauses 43.1 and 43.1A was supported by three matters relied upon by ICL:

[2] [2017] UKSC 24

1. The words "subject to" were used in the same sense elsewhere in the Contract (for example, in the terms dealing with payment and compensation events) and, in each such instance, they had the effect that a right under one clause was limited or circumscribed by the provisions of another clause;
2. HZI's construction gave no meaning to the words "subject to". Instead, on HZI's case, it had the option to terminate under Sub-Clause 43.1 and it also had the option under Sub-Clause 43.1A to notify ICL of a default and terminate in the event that ICL failed to remedy it. HZI's construction was therefore unlikely. Further, as held in *Secretary of State for Defence v Turner Estate Solutions Ltd*[3], a construction that fails to give effect to such words in a bespoke contract is all the more unlikely; and
3. There was nothing which restricted HZI from requiring a rectification of a default and putting ICL on notice that if the default were not remedied, HZI would serve a termination notice under Sub-Clause 43.1. This would, again, make HZI's construction of the "subject to" wording in Sub-Clause 43.1 pointless. Accordingly, HZI's suggestion that Sub-Clause 43.1A provided an additional and distinct termination right was "illusory".

Finally, the judge disagreed with HZI's argument that, if the operation of Sub-Clause 43.1A was a condition precedent to the right to terminate under Sub-Clauses 43.1(h), (p) and (q), its "absolute discretion" under Sub-Clause 43.1A would have no meaning. Instead, Mrs Justice Jefford held that those words emphasized HZI could exercise "absolute discretion" when deciding whether or not to issue a notice to rectify defaults under Sub-Clauses 43.1(h), (p) and (q) and clarified that HZI's failure to do so would not prejudice its rights by, say, evidencing the absence of a default or the waiver of HZI's right to rely on the default. Mrs Justice Jefford also relied upon the fact that her interpretation was supported by the use of the words "absolute discretion" elsewhere in the Contract. The declaration sought by ICL was therefore granted.

Conclusion

At the outset of this briefing, we noted that parties should think very carefully before they consider exercising rights of termination (whether under common law or the terms of their contracts). Termination is a high-stakes game and the consequences of terminating a contract without grounds to do so and/or without complying with the applicable termination regime in the contract are potentially catastrophic for the terminating party.

"WE WOULD THEREFORE GENERALLY RECOMMEND THAT PARTIES ADOPT A CAUTIOUS APPROACH WHEN CONSIDERING THEIR PREFERRED TERMINATION STRATEGY."

We would therefore generally recommend that parties adopt a cautious approach when considering their preferred termination strategy. As such, where there is even an element of uncertainty as to whether an additional procedural or notice requirement should be complied with, and where doing so will not result in material prejudice, it will generally be prudent for terminating parties to err on the side of caution. This will include, of course, ensuring that notice requirements and defect remediation periods are observed and that notices are served in accordance with the relevant contractual requirements (if any).

[3] [2015] EWHC 1150

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with one of the authors below or your regular contact at Watson Farley & Williams.

REBECCA WILLIAMS
Partner
London

+44 20 3036 9805
rwilliams@wfw.com

ANDREAS EFSTATHIOU
Senior Associate
London

+44 20 7863 8983
aefstathiou@wfw.com

Publication code number: 61167541v1