



TERMINATION BY EMPLOYER: WHY, HOW AND HOW MUCH?

Termination can be a difficult and costly process, so it's best to follow the Arab saying of "think about the exit before you enter" prior to inking a contract. Heba Osman, Partner, Fenwick Elliott LLC, writes.



HEBA OSMAN,
FENWICK ELLIOT LLP

Construction is a multi-million dirhams business and terminating a construction contract may well cost the terminating party as much. This is why the decision to terminate a construction contract, or any contract for that matter, must be made very carefully.

At the start of a construction contract, as with the beginning of a marriage, the parties are quite optimistic and somewhat confident about the prospects for their project. The good will and cooperation shown at the start somehow blinds the parties from considering the possibility of contract termination.

It cannot be overemphasised that a careful consideration of termination provisions contained in a construction contract and of the provisions of the applicable law is necessary. This article explores common contractual arrangements relating to termination and the impact of the UAE law on such provisions.

EMPLOYER'S ENTITLEMENT TO TERMINATE

It is common knowledge that the Employer's right to terminate a contract arises when there is a default or a breach on the part of the Contractor. However, it cannot be said that an Employer is entitled to immedi-



- *fails to remedy any defects in the Works without reasonable excuse;*
- *subcontracts the whole Works or assigns the Contract without the Employer's agreement;*
- *becomes bankrupt or insolvent; or*
- *gives or offers bribery in relation to the contract.*

Whilst these events appear to be straight forward, this is rarely the case. By way of example, establishing that the Contractor failed to proceed with the Works without a reasonable excuse can become a difficult feat. Typically a construction site has various parties on it with many tasks happening at the same time, whether it is reasonable or not reasonable for the Contractor to proceed with the Works will mainly depend on the actual conditions of the site at the time and the surrounding circumstances.

Moreover, even the simple event of failure to submit the contractual letters of guarantee could become a complicated subject if the Contractor's failure to do so is in any way attributable to the Employer.

In addition to termination for default, many standard forms of contract entitle the Employer to terminate the contract at his convenience (i.e. without any default on the part of the Contractor).

The manner in which each type of termination is operated and its consequences are usually different as detailed below.

UAE law also entitles the Employer to terminate the Contract in the event of a breach that cannot be remedied by the Contractor. In particular, Article 877 of the Code, in this respect, states:

The contractor must carry out the work in accordance with the conditions of the contract. If it appears that he is carrying out what he contracted to do in a manner that is defective or contrary to the conditions [of the contract], the employer may demand that the contract be

terminated immediately in the event that it is impossible to make good the work, but if it is possible to make good then the employer may require the contractor to abide by the conditions of the contract and to rectify the work within a reasonable period, and if the period expires without the rectification having been done the employer may apply to the judge to terminate the contract or to give him leave to engage another contractor to complete the work at the expense of the first contractor.

The point here is that it is paramount that the Employer makes a careful decision as to why he is terminating the Contract to be able to select the correct legal and contractual path for termination.

FORMAL REQUIREMENTS FOR TERMINATION

During my years of practice, I have seen all sort of letters claiming to terminate the contract immediately without much of an explanation as to why or on what grounds. A valid termination notice is necessary in order for the legal effects of termination to become effective. Consequently, if a notice of termination is not valid, this affects the legality of the termination.

In order for a notice of termination to be valid, it must be sent in compliance with the Contract, which typically requires the following as a minimum:

- an advance notice requiring the remedy of the breach or default;
- time element; example: a 14 day-notice;
- reference to the provision under which the termination takes place;
- details of why the termination is taking place; and/or
- effective date of termination.

In addition to these typical contractual requirements, termination as a matter of UAE law does not happen automatically. Termination of con-

ately terminate for any breach or default (unless, of course, the contract explicitly states this in unambiguous wording, which is rarely the case).

Most construction contracts entitle an Employer to terminate the contract if the Contractor:

- *fails to submit the contractually required letters of guarantee;*
- *fails to comply with a contractual notice to correct;*
- *abandons the Works or demonstrates the intention not to continue performance of his obligations under the Contract;*
- *fails to proceed with the Works without reasonable excuse;*

tracts in the UAE, generally, can be done through one of the following methods:

- the parties' mutual agreement;
- a court judgment or decision; or
- by law.

In this respect Article 267 of the UAE Civil Code provides that: [I]f the contract is valid and binding, it shall not be permissible for either of the contracting parties to withdraw, change or terminate the contract save by mutual consent, an order of the court, or under a provision of the law.

Termination by mutual agreement may occur before or after entering into the contract. However, in practice, when parties are at the termination stage, there is usually a bigger dispute simmering which makes it difficult to agree anything, let alone agree on mutual termination of their contract.

Termination provisions establishing the right of one party or the other to terminate the contract are usually not enough for the termination to occur. These provisions usually state something along these lines:

If the Contractor fails to carry out any obligation under the Contract, the Employer may by notice require the Contractor to make good the failure and to remedy it within a specified period of time. If the Contractor fails to comply with this notice, the Employer shall be entitled to terminate the Contract.

Similarly worded provisions establish a right to terminate, but do not allow for automatic termination of the Contract by the Employer. For a termination provision to establish mutual consent to terminate and to avoid recourse to the UAE courts, the termination provision must unequivocally state that the termination occurs automatically by the Employer's notice and that there will be no need for a court order or a further notice. This is explicitly provided for in Article 271 of the UAE Civil Code.

It is, therefore, quite crucial when drafting a termination provision to



ensure that termination occurs automatically without need for recourse to the courts to confirm termination. In the absence of such provision, termination would not occur.

THE COST OF TERMINATION

As explained earlier, termination can take place due to some default on the part of the Contractor or for the Employer's convenience. Each type of termination has a different set of consequences from a financial perspective.

On one hand, if termination is for the Contractor's default, the Contract usually allows the Employer to withhold further payments that were due to the Contractor until the Employer assesses his costs and losses incurred as a result of the Contractor's default (this would include the

cost of hiring another contractor to complete the works).

On the other hand, if termination is for the Employer's convenience, the Employer would not typically be entitled to withhold any payments that are due to the Contractor, and would make all due payments to the Contractor in accordance with the Contract without delay. The Employer would also not be entitled to complete the works himself or through another contractor (if the Employer hires another contractor to complete the works in such instance, then the Contractor may be entitled to claim loss of profit).

Termination can be a difficult and costly process, and its best that parties follow the Arab saying of "think about the exit before you enter" prior to inking their contracts.