Incorrect Termination of Building Contracts

By Stefano Marchesin, construction lawyer of Lovegrove Solicitors

We do find instances where the stress that results from delays in construction projects leads to some rash decisions. If things turn sour in a renovation or home build, remember that written contracts will have a termination protocol or procedure. This procedure must be followed if rights under the contract are to be protected.

The Consequences of Incorrect Termination

If a party to a contract has its contract terminated in circumstances where the grounds to terminate were fraught or the way by which the termination occurred was flawed then this is referred to in legal vernacular as a repudiation or " the evincing of an intention to no longer be bound by the contract". It is otherwise known as a wrongful termination.

The consequences of a repudiation can be parlous for the repudiator. Damages can be sought for repudiation, depending on the commercial dealing the damages can be sizeable and could range from the thousands to the millions of dollars. The damages will be the losses that are sustained by the aggrieved party that flow from the repudiation. A repudiation at law only crystallizes if the repudiation is accepted by the aggrieved or the "terminated" party. A repudiator could commit a repudaitory act but the other side may elect not to accept the repudiation and may elect to renegotiate or patch things up.

Once a repudiation has been accepted however the contract is at an end. Before a party decides to accept a repudiation he/she or it should have regard to the consequences of the cessation of contractual relationships. There can be a down side to acceptance and the downside may be the inability of one being able to rely upon contractual remedies.

Take for instance a contract that allows a contracting party to lodge a caveat, charge or a debenture on the other party`s property. If the ability to lodge the charge is based upon a contractual condition then its legal potency likewise relies upon the existence or efficacy of the contract. If the contract is at an end the ability to maintain the charge may well be at an end.

Thus the innocent party, when confronted with a serious contractual breach that would be of sufficient gravitas to constitute a repudiation, may elect not to allege , let alone accept repudiation. He, she or it may instead choose to invoke contractual remedies and may choose to initiate legal proceedings for damages or specific contractual performance.

So the decision to accept a repudiation has to be intelligent and carefully thought through. In the building industry for instance it is common for lawyers to bang off letters accepting repudiation with considerable alacrity as it enables their client to lodge a claim in "quantum meruit". A quantum meruit claim enables a builder to claim all provable costs incurred in the carrying out of the building work. This can prove to be a "God Send", particularly in circumstances where the contract was attended by very tight margins, but should not be misinterpreted as a carte blanche as the costs have to be proven.

Correct termination

Depending on the contract in regard to builders, the termination procedure sometimes begins with a **Notice of Suspension** to suspend the works.

This must be used with care. Proper grounds must be used within the contract. A written notice needs to be prepared, signed/dated and served on the owner.

For example, the HIA – New Homes Contract

The grounds for suspension are specified in clause 35.

Includes:

- the owner failing to make a progress payment within 7 days after it becomes due;
- the owner is in breach of the Contract, including for example failure to provide evidence of capacity to pay or access to the land, directing trades on site, or going into early possession of the Works.

Ideally you should seek legal advice before preparing a notice of suspension.

The notice needs to be served by registered post and the owner must remedy the breach within 7 days after receiving the notice.

If works later recommence the builder is entitled to an automatic extension of time for the period of the suspension.

Notice of Termination

The builder can terminate pursuant to clause 42 of the New Homes contract by written notice but the builder must first serve a notice of intention to terminate. This is based on the owner being in "substantial breach" of the Contract.

The builder cannot terminate unreasonably or vexatiously or if the builder is in substantial breach of the contract (clause 42.4, New Homes Contract).

Two written notices are required, ie:

1. a notice of intention (also known as a notice of default); and
2. a notice of termination if and only if the first notice is not complied with by the owner.

So care must be exercised, even if the paper trail is correctly followed.

The builder should also not suspend unless they have reasonable grounds. The danger is that it could appear to be repudiatory conduct in any dispute. The notice of intention to terminate must specify the substantial breach or breaches and allow 10 days for the owner to remedy this.

It also needs to say if the breach(es) are not remedied, the builder intends to end the Contract. It is strenuously recommended that you have a lawyer draft both notices for you, to avoid any later argument that the notice is defective.

Conclusion

Contractual rights can be lost by incorrect termination of the contract. Utmost care must be taken breaches of the contract be mistaken for a repudaitory act, as a breach of the contract does not automatically mean that the contract can or must be terminated. Termination procedure in the contract must be correctly followed.

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