G. *Defects after the guaranty period*

118. The liability for defects ceases at the expiration of the guaranty period. The contractor has no contractual obligation to rectify defects which appear outside this period. As a matter of good practice, contractors would, at the purchaser's request, repair any defects which may appear outside the guaranty period at the expense of the purchaser.

[A/CN.9/WG.V/WP.4/Add.7*]

XVII. Termination

A. *General remarks*

1. In this study the term "termination" denotes the dissolution of a contract brought about by breaches of obligation, exonerating circumstances or other grounds. It may be noted that a contract can be put to an end only for the future or retrospectively. The term "termination" in this study also covers "rescission", "cancellation" and "avoidance" of a contract.

2. In a works contract a termination clause usually makes provision for only serious breaches of obligation (see part two, VII, *Quality*** and XI, *Delays and Remedies*)*** or for non-performance due to exonerating circumstances (see part two, XIII, *Exoneration*).****

B. *Grounds for termination*

1. *Breach of contract*

3. To put an end to a works contract is never a decision to be taken lightly nor is it one of slight consequence. The costs involved in a particular works contract coupled with the nature of its performance may render the question of termination one in which the parties would only have recourse to after all other remedies prove ineffective.

(a) *Breach of contract by the contractor*

4. Not every breach of contract is serious enough to enable the aggrieved party to terminate the contract. The Sales Convention recognizes this fact and grants the buyer and the seller the right to avoid the contract only in specific cases. Article 49 of the Sales Convention provides:

"(1) The buyer may declare the contract avoided:

"(*a*) If the failure by the seller to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract; or

"(*b*) In case of non-delivery, if the seller does not deliver the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of article 47 or declares that he will not deliver within the period so fixed."

5. Article 25 of the Sales Convention contains a definition of what is to be considered as a fundamental breach: one which results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.

6. In a works contract the parties usually specify in detail the grounds for termination.

(i) Delay in completion

7. It is not uncommon to find certain delays in the completion of a large industrial plant. Before the purchaser is given the right to terminate the contract he must usually give the contractor an additional period of time to complete the works. For instance clause 20.5 of both ECE 188A/574A provides:

"If any portion of the Works . . . remains uncompleted, the Purchaser may by notice in writing to the Contractor require him to complete and . . . fix a final time for completion . . . If . . . the Contractor fails to complete within such time, the Purchaser shall be entitled . . . to terminate the Contract in respect of such portion of the Works."

8. A similar provision is contained in clause 31.2 of FIDIC-EMW. The relevant portion of the clause reads:

"If for any reason, other than one for which the Employer or some other contractor employed by him is responsible, the Contractor fails to complete within such time, the Employer may by further written notice to the Contractor elect

"either (*a*) To require the Contractor to complete,

"or (*b*) To terminate the Contract in respect of such Portion of the Works . . ."

In contrast to the position in some other forms under study, the above clause does not require the employer to terminate the contract even after failure of the contractor to complete within the additional period of time which had been given to him. The purchaser is still given the option to require the contractor to complete the works.

9. The UNIDO model contracts also treat the question of delay as a ground for termination of the

* 3 April 1981.
** A/CN.9/WG.V/WP.4/Add.2 (reproduced above).
*** A/CN.9/WG.V/WP.4/Add.4 (reproduced above).
**** A/CN.9/WG.V/WP.4/Add.5 (reproduced above).

Contract. For example article 33.7.1 of UNIDO-TKL provides:

"Where the CONTRACTOR has made default or delayed in commencing or in executing, completing or delivering the work or any portion thereof to the reasonable satisfaction of the PURCHASER, and the PURCHASER has given notice thereof to the CONTRACTOR and has by such notice required the CONTRACTOR to put an end to such default or delay, and such default or delay continues for a period of (. . .) after such notice was given; . . . the PURCHASER may, without any other authorization, cancel the Contract . . .

10. Article 33.7.4 of UNIDO-TKL further provides that the purchaser has the right to cancel the contract when the contractor has "abandoned" the work.

11. Before dealing with the FIDIC Conditions further it must be noted that they give the purchaser the right to terminate not in all cases of breach of contract by the contractor. According to these Conditions in some situations the purchaser has the right to "enter upon the Site and expel the Contractor therefrom *without thereby voiding* the Contract, or releasing the Contractor from any of his obligations or liabilities under the Contract, or affecting the rights and powers conferred by the Contract on the Employer or the Engineer . . ." (Clause 44.1 of FIDIC-EMW) This right is dealt with here under termination since its effects are quite similar to those of an ordinary termination clause. It would appear that this approach is to give as much protection as possible to the purchaser.[1]

12. Clause 44.1 of FIDIC-EMW provides, *inter alia,* the following contingencies as grounds for expelling the contractor:

". . . if the Engineer shall certify in writing to the Employer that in his opinion the Contractor:

"(*a*) Has abandoned the Contract, or

"(*b*) Without reasonable excuse has failed to commence the Works or has suspended the progress of the Works for twenty eight days after receiving from the Engineer written notice to proceed . . ."

13. Clause 63.(1) of FIDIC-CEC is identical to the above clause but goes further by adding that if the contractor:

"(*c*) Has failed to remove materials from the Site or to pull down and replace work for twenty-eight days after receiving from the Engineer written notice that the said materials or work had been condemned and rejected by the Engineer under these conditions . . ."

(ii) Non-conformity of work

14. Not only does the delay in completion cause serious difficulties to the purchaser but also breach of contractual stipulations regarding quality (see part two, VII, *Quality*). Clause 44.1 of FIDIC-EMW, therefore, provides that the purchaser may expel the contractor with the legal effect as described in paragraph 11 *supra,*

". . . if the Engineer shall certify in writing to the Employer that in his opinion the Contractor:

". . .

"(*c*) Despite previous warnings by the Engineer, in writing, is not executing the Works in accordance with the Contract, or is neglecting to carry out his obligations under the Contract so as seriously to affect the carrying out of the Works . . ."

15. Clause 63.(1) of FIDIC-CEC is worded slightly differently although the effect is similar. Here the purchaser has the right to expel the contractor, if the contractor,

"(*d*) Despite previous warnings by the Engineer, in writing, is not executing the Works in accordance with the Contract, or is persistently or flagrantly neglecting to carry out his obligations under the Contract . . ."

(iii) Unauthorized assignment and sub-contracting

16. The construction of large industrial works requires skill and experience by the contractor. The assignment of a works contract to a third party is therefore usually possible only with the consent of the purchaser.

17. Some conditions treat unauthorized assignment by the contractor as serious enough to give the purchaser the right to terminate the contract. According to clause 44.1 of FIDIC-EMW and clause 63.(1) of FIDIC-CEC the employer may enter upon the site and expel the contractor therefrom "[i]f the Contractor shall assign the Contract, without the consent in writing of the Employer first obtained . . ."

18. Article 33.7 of UNIDO-TKL grants the purchaser the right to cancel the contract "where the CONTRACTOR has . . . made an assignment of the Contract without the approval of the PURCHASER."

19. On the other hand, sub-contracting is very common in the construction of large industrial works. Unless it is not prohibited by the contract sub-contracting *per se* does not give rise to objections. The contractor must make sure, however, that any sub-contracting does not affect the proper execution of the work. Clause 63.(1) of FIDIC-CEC gives the purchaser the right to expel the contractor "if the Engineer shall certify in writing to the Employer that in his opinion the

[1] On the other hand, in case of breach of contract by the purchaser the contractor has the right to terminate the contract under the FIDIC Conditions. (Clause 41.3 of FIDIC-EMW speaks of "to terminate the Contract" while clause 51.1 of FIDIC-EMW, "to terminate his employment under the Contract.") It may also be noted that in case of bankruptcy of the contractor the purchaser may terminate the contract under clause 45 of FIDIC-EMW while under clause 63.(1) of FIDIC-CEC, he may only expel the contractor. These are further discussed below. The reasons for such distinction in treatment are not clear.

Contractor: . . . (*e*) has, to the detriment of good workmanship, or in defiance of the Engineer's instructions to the contrary, sub-let any part of the Contract . . ."

(b) *Breach of contract by the purchaser*

20. Under article 64 of the Sales Convention:

"(1) The seller may declare the contract avoided:

"(*a*) If the failure by the buyer to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract; or

"(*b*) If the buyer does not, within the additional period of time fixed by the seller in accordance with paragraph (1) of article 63, perform his obligation to pay the price or to take delivery of the goods, or if he declares that he will not do so within the period so fixed."

21. Similar grounds for termination are found in works contracts.

(i) Non-taking of delivery

22. The failure to take delivery of the plant by the purchaser on the due date constitutes a breach of contract (see part two, X, *Acceptance and Take-over*).* In such a case, according to clause 10.2 of both ECE 188A/574A "the Contractor may require the Purchaser by notice in writing to accept delivery within a reasonable time. If the Purchaser fails for any reason whatever to do so within such time, the Contractor shall be entitled . . . to terminate the Contract in respect of such portion of the Plant as is by reason of the failure of the Purchaser aforesaid not delivered . . ."

23. The FIDIC Conditions grant the contractor the right to terminate the contract "in the case of the Engineer's failure to issue an interim certificate . . ." (clause 41.3 of FIDIC-EMW), or "in the event of the Employer: . . . (*b*) interfering with or obstructing the issue of any certificate of the Engineer . . ." (clause 51.1 of FIDIC-EMW).

24. For the last-mentioned case, above, FIDIC-CEC clause 69.(1) uses the wording: "(*b*) interfering with or obstructing or refusing any required approval to the issue of any such certificate . . ."

25. The UNIDO model contracts do not contain similar provisions.

(ii) Non-payment

26. Clause 11.7 of both ECE 188A/574A gives the contractor the right to terminate the contract if the purchaser has not made payment within a period of delay stipulated by the parties.

27. Under the FIDIC Conditions the contractor is entitled "to terminate his employment under the Contract" according to clause 69.(1) of FIDIC-CEC (see also clause 51.1 of FIDIC-EMW):

"In the event of the Employer:

"(*a*) Failing to pay to the Contractor the amount due under any certificate of the Engineer within thirty days after the same shall have become due under the terms of the Contract . . ."

2. *Exonerating circumstances*

28. Apart from termination on the ground of breach, exonerating circumstances constitute one of the most common grounds for the termination of a works contract. Two cases may be distinguished: first, where certain circumstances make any further performance impossible and secondly, where circumstances prevent performance for a period of time (see part two, XIII, *Exoneration*).*

29. Under clause 25.3 of both ECE 188A/574A, if circumstances beyond the control of the parties affect the timely performance of the obligations by the parties, and "if, by reason of any of the said circumstances, the performance of the Contract within a reasonable time becomes impossible, either party shall be entitled to terminate the Contract . . ."

30. The FIDIC Conditions also provide for the termination of the contract when one of the parties is prevented from performing because of the outbreak of war. (Clause 46.1 of FIDIC-EMW; clause 65.(6) of FIDIC-CEC).

31. Apart from war as above-mentioned, the FIDIC Conditions do not make provision for termination in other exonerating circumstances.

32. Under the UNIDO model contracts, the purchaser is allowed to terminate the contract in the event that the purchaser is subject to any circumstances which are wholly unavoidable and/or beyond his control (article 33.1 of UNIDO-TKL).

33. In the case of a prevailing and continuous *force majeure* the UNIDO model contracts make provision for the possibility of termination of the contract by both parties (article 34.5 of UNIDO-TKL).

3. *Other grounds for termination*

34. In some forms under study other grounds are also included for termination. They relate to the financial situation of the other party.

35. The FIDIC Conditions deal with the case of bankruptcy of the contractor and of the purchaser separately. Clause 63.(1) of FIDIC-CEC provides that the purchaser may expel the contractor

* A/CN.9/WG.V/WP.4/Add.3 (reproduced above)

* A/CN.9/WG.V/WP.4/Add.5 (reproduced above).

"[i]f the Contractor shall become bankrupt, or have a receiving order made against him, or shall present his petition in bankruptcy, or shall make an arrangement with or assignment in favour of his creditors, or shall agree to carry out the Contract under a committee of inspection of his creditors or, being a corporation, shall go into liquidation (other than a voluntary liquidation for the purposes of amalgamation or reconstruction), or if the Contractor shall . . . have an execution levied on his goods . . ."

36. Clause 45 of FIDIC-EMW uses a slightly different wording, and does not grant the purchaser the right to expel the contractor but states that

"[t]he Employer shall be at liberty

"(*a*) To terminate the Contract . . . if the Contractor shall become bankrupt or insolvent, or have a receiving order made against him, or compound with his creditors, or being a corporation commence to be wound up, not being a members' voluntary winding up for the purpose of amalgamation or reconstruction, or carry on its business under a receiver for the benefit of its creditors or any of them . . ."

37. On the other hand, the contractor may terminate the contract, according to Clause 69.(1) of FIDIC-CEC,

"[i]n the event of the Employer

". . .

"(*c*) Becoming bankrupt or, being a company, going into liquidation, other than for the purpose of a scheme of reconstruction or amalgamation . . ."

38. In the same situation clause 51.1 of FIDIC-EMW provides that the contractor is entitled to "terminate his employment under the contract".

39. Under the UNIDO-TKL only the insolvency or bankruptcy of the contractor is covered. Article 33.7 permits the purchaser to cancel the contract where the contractor has become insolvent or where he has committed an act of bankruptcy.

40. The FIDIC Conditions contain another ground for termination by the contractor in a situation which amounts in fact to a termination by the purchaser. Clause 69.(1) of FIDIC-CEC entitles the contractor to terminate his employment under the contract

"[i]n the event of the Employer:

". . .

"(*d*) Giving formal notice to the Contractor that for unforeseen reasons, due to economic dislocation, it is impossible for him to continue to meet his contractual obligations . . ."

41. Clause 51.1 of FIDIC-EMW contains a similar provision without the requirement of a formal notice to the contractor.

C. *Time for termination and procedure to be followed*

42. It has been mentioned that in works contracts for the construction of large industrial works the termination is considered as a last recourse in cases of breach of contract. The various clauses dealing with the obligations of the parties contain provisions requesting the creditor to grant to the debtor additional periods of time within which to perform his obligations. It is only at the end of this additional period of grace that the creditor can terminate the contract.

43. Within what period of time after the lapse of such additional period of grace, is the aggrieved party entitled to terminate?

44. Some provisions call for immediate termination after the grounds have been established. On the other hand, in two cases of breach of contract by the contractor or by the purchaser the ECE General Conditions entitle the aggrieved party to terminate the contract without mentioning a time limit (clauses 10.2, 20.5 of both ECE 188A/574A).

45. In the case of non-payment by the purchaser, the contractor is entitled to terminate the contract "within a reasonable time" after the lapse of time mentioned in paragraph 26, *supra* (clause 11.7 of both ECE 188A/574A).

46. Termination "within a reasonable time" is also contained in articles 49 and 64 of the Sales Convention. Such a provision may imply that the creditor loses the right to terminate the contract after the lapse of a "reasonable time".

47. In cases of exonerating circumstances the contract may be terminated "at any time" according to clauses 46.1 of FIDIC-EMW and 65.(6) of FIDIC-CEC. (A similar situation is provided for in article 33.1 of UNIDO-TKL.)

48. The FIDIC-EMW Conditions contain different provisions in case of bankruptcy. If the contractor becomes bankrupt or insolvent the purchaser shall be at liberty "to terminate the Contract *forthwith*" (clause 45), but if the purchaser becomes bankrupt, the contractor is entitled "to terminate . . . by giving *14 days'* prior notice" (clause 51.1).[2]

49. In FIDIC-CEC no distinction is made, and for both parties, 14 days' notice is required for termination in case of bankruptcy (clauses 63.(1) and 69.(1)).[3]

50. The requirement of 14 days' notice is also contained in both the FIDIC Conditions in regard to termination (or expelling, see paragraph 11, *supra*) in

[2] The reasons for these different provisions are not clear.

[3] The periods mentioned in paras. 48 and 49 are not periods of grace.

most cases of breach of contract (clauses 44.1 and 51.1 of FIDIC-EMW, clauses 63.(1) and 69.(1) of FIDIC-CEC).[4]

51. The requirement of *one month's* notice is contained in clause 41.3 of FIDIC-EMW in the case of the engineer's failure to issue an interim certificate.

52. Nearly all conditions require the termination to be exercised by giving a *notice in writing* to the other party (for instance clauses 10.2, 11.7, 20.5 of both ECE 188A/574A, all relevant clauses of the FIDIC Conditions).

53. UNIDO-TKL requires a notice in writing in the case of termination (article 33.1 dealing with exonerating circumstances), but no notice need be given in the case of cancellation (article 33.7 dealing with breach of contract by the contractor).

54. All the various clauses of the ECE General Conditions providing for termination include the mention *"without requiring the consent of any court"*. This phrase has been added to satisfy the law of some countries (for instance France) where otherwise a termination can be exercised only by resort to a court order.

55. Similarly, article 33.7 of UNIDO-TKL provides that the purchaser can cancel the contract "without any other authorization", a wording which might also be aimed at satisfying certain legal systems.

56. The FIDIC Conditions make no reference whatsoever to a court authorization. Attention must be drawn however to the fact that in case of default of the contractor the Conditions provide for the purchaser to enter upon the Site and expel the contractor without voiding the contract. This difference, slight in fact but clear in law, would most likely be interpreted by tribunals as not necessitating a court authorization.

D. *Consequences of termination*

57. Generally, once a contract is terminated the parties must be put in the same stead as at the time of the conclusion of the contract. Sometimes, when the parties cannot be put back in the same position, the contract is terminated for the future only. This last eventuality is the one most often encountered in works contracts in view of their very nature.

58. As termination puts an end to the contract, both parties, as a general consequence, are no longer expected to perform their obligations under the contract. Article 81 of the Sales Convention provides as follows:

> "(1) Avoidance of the contract releases both parties from their obligations under it . . ."

59. However, in every contract there are some provisions which should not be nullified by the termination. Termination does not mean the end of all obligations under the contract. Article 81 of the Sales Convention therefore continues:

> "Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract."

60. The parties in particular would not be released from any obligations to pay damages which may be due. Clause 27.1 of both ECE 188A/574A reads as follows:

> "Termination of the Contract, from whatever cause arising, shall be without prejudice to the rights of the parties accrued under the Contract up to the time of termination."

61. As far as the other consequences of termination are concerned, the various forms under study distinguish whether termination was caused by breach of contract or exonerating circumstances.

1. *Breach of contract*

62. Article 20.5 of both ECE 188A/574A provides as follows in case of non-completion:

> ". . . the Purchaser shall be entitled . . . to terminate the Contract . . . and thereupon to recover from the Contractor any loss suffered by the Purchaser by reason of the failure of the Contractor . . . up to an amount . . . or . . . that part of the price payable under the Contract which is properly attributable to such portion of the Works as could not in consequence of the Contractor's failure be put to the use intended."

63. Clause 31.2 of FIDIC-EMW uses similar language in the case of prolonged delay by the contractor.

64. As mentioned above, under the FIDIC Conditions, when the contractor is in default, the employer may enter the site and complete the work. The wording used in both sets of conditions varies slightly but the outcome is quite similar. Clause 63.(1) of FIDIC-CEC provides in case of default by the contractor:

> "the Employer may . . . enter upon the Site and the Works and expel the Contractor therefrom without thereby voiding the Contract, or releasing the Contractor from any of his obligations or liabilities under the Contract, or affecting the rights and powers conferred on the Employer or the Engineer by the Contract, and may himself complete the Works or may employ any other contractor to complete the Works. The Employer or such other contractor may use for such completion so much of the Constructional Plant, Temporary Works and materials, which have

[4] The periods mentioned in paras. 50 and 51 have the effect of a period of grace.

been deemed to be reserved exclusively for the execution of the Works, under the provisions of the Contract, as he or they may think proper, and the Employer may, at any time, sell any of the said Constructional Plant, Temporary Works and unused materials and apply the proceeds of sale in or towards the satisfaction of any sums due or which may become due to him from the Contractor under the Contract."

65. FIDIC-CEC Conditions then go on to explain how various questions are dealt with in the event the employer enters on the site and expels the contractor. They read as follows:

Clause 63.(2) "The Engineer shall, as soon as may be practical after any such entry and expulsion by the Employer, fix and determine *ex parte,* or by or after reference to the parties, or after such investigation or enquiries as he may think fit to make or institute, and shall certify what amount, if any, had at the time of such entry and expulsion be reasonably earned by or would reasonably accrue to the Contractor in respect of work then actually done by him under the Contract and the value of any of the said unused or partially used materials, any Constructional Plant and any Temporary Works."

Clause 63.(3) "If the Employer shall enter and expel the Contractor under this Clause, he shall not be liable to pay to the Contractor any money on account of the Contract until the expiration of the Period of Maintenance and thereafter until the costs of execution and maintenance, damages for delay in completion, if any, and all other expenses incurred by the Employer have been ascertained and the amount thereof certified by the Engineer. The Contractor shall then be entitled to receive only such sum or sums, if any, as the Engineer may certify would have been payable to him upon due completion by him after deducting the said amount. If such amount shall exceed the sum which would have been payable to the Contractor on due completion by him, then the Contractor shall, upon demand, pay to the Employer the amount of such excess and it shall be deemed a debt due by the Contractor to the Employer and shall be recoverable accordingly."

66. According to article 33.7 of UNIDO-TKL, in case of default of the contractor, "the PURCHASER may . . . cancel the Contract and take all or any part of the Contract and/or of the work to be undertaken by the CONTRACTOR out of the CONTRACTOR's hands and may employ such means as the PURCHASER sees fit to complete this Contract and/or the works . . ."

67. In the event the contract is cancelled and the work taken out of the hands of the contractor, article 33 of UNIDO-TKL provides as follows:

"33.8: Where this Contract or any portion or portions thereof has or have been taken out of the CONTRACTOR's hands . . . the CONTRACTOR shall not . . . be entitled to any further payment including payments then due and payable but not paid and the obligation of the PURCHASER to make payments as provided for in the Terms of Payment shall be at an end, and the CONTRACTOR shall be liable to settle costs and/or damages under the Contract . . .

"33.9: Where this Contract, or any portion or portions thereof has or have been taken out of the CONTRACTOR's hands . . . and is subsequently completed by the PURCHASER . . . the PURCHASER may at its option determine the amount, if any, of retention monies and progress claims of the CONTRACTOR unpaid at the time of taking the work out of the CONTRACTOR's hands that, in the PURCHASER's opinion, are not required by the PURCHASER for the purposes of the Contract and . . . the PURCHASER shall, if of the opinion that no financial prejudice to the PURCHASER will result, authorise payment of that amount to the CONTRACTOR.

"33.10: The taking of this Contract, or of any portion thereof, out of the CONTRACTOR's hands pursuant to this Article does not operate so as to relieve or discharge the CONTRACTOR from the obligations imposed upon the CONTRACTOR by this Contract and by law.

"33.11: If this Contract, the Works, or any part thereof is taken out of the CONTRACTOR's hands pursuant to this Article, all material, plant and interest of the CONTRACTOR in all real property, licences, power and privileges acquired, used or provided by the CONTRACTOR for purposes of this Contract shall be the property of the PURCHASER and in particular, but without affecting any liability or obligation of the CONTRACTOR and/or any PURCHASER right imposed, conferred, or contemplated by any other provision of this Contract, the PURCHASER may, at his option, utilize the equipment or sell or otherwise dispose of, at public auction or at private sale or otherwise, the whole or any portion of such material, and/or plant at such price or prices as he may consider reasonable and retain the proceeds of any such sale or disposition as well as all other amounts then or thereafter due by the PURCHASER to the CONTRACTOR, all in satisfaction or partial satisfaction (as the case may be) of any loss or damage which the PURCHASER has sustained or may sustain by reason aforesaid.

"33.12: Subject to Article 33.11 above, if the PURCHASER considers that any PURCHASER property-interest possessed by virtue of the application of Article 33.11 above, is no longer required for the purposes of the Contract, and that it is not in the interests of the PURCHASER to retain such property-

interest then, upon written notice to such effect from the PURCHASER to the CONTRACTOR, such property-interest shall become the property of the CONTRACTOR."

68. On the other hand, in the event that the contractor terminates the contract the consequences envisaged in the various conditions are different.

69. In such a case the contractor, according to clause 51.2 of FIDIC-EMW, "upon the giving of such notice . . . shall with all reasonable despatch remove from the Site all Contractor's Equipment brought by him thereon." A similar provision is contained in clause 69.(2) of FIDIC-CEC.

70. Clause 51.3 of FIDIC-EMW provides that "[i]n the event of such termination the Employer shall be under the same obligations to the Contractor in regard to payment as if the Contract had been terminated under the provisions of Clause 46 (Outbreak of War) hereof, but in addition to the payments specified in Clause 46.3 the Employer shall pay to the Contractor the amount of any reasonable loss or damage to the Contractor arising out of or in connection with or by consequence of such termination." (The position in clause 69.(3) of FIDIC-CEC is identical.)

71. Termination of the contract by the contractor for breach of contract by the purchaser does not deprive the contractor of any rights already acquired. Thus clause 51.4 of FIDIC-EMW provides:

"Nothing in this Clause contained shall prejudice the right of the Contractor to exercise, either in lieu of or in addition to the rights and remedies in this Clause specified, any other rights or remedies to which the Contractor may be entitled."

72. Under the ECE General Conditions if the contractor terminates the contract for reasons of breach of contract by the purchaser, the contractor is entitled to damages. The General Conditions, however, appear to assume that the parties have agreed to limit the amount of such damages.

73. Clause 10.2 of both ECE 188A/574A in case of not accepting delivery by the purchaser, grants the right to the contractor "to terminate the Contract . . . and thereupon to recover from the Purchaser any loss suffered by reason of such failure . . . or . . . that part of the price payable under the Contract which is properly attributable to such portion of the Plant."

74. In case of non-payment, according to clause 11.7 of both ECE 188A/574A "the Contractor shall be entitled . . . to terminate the Contract and thereupon to recover from the Purchaser the amount of his loss . . ."

75. As long as no assembly or erection on site is involved but only supply of equipment the following provisions of the Sales Convention could well be taken into consideration in regard to works contracts:

Article 81: "(2) A party who has performed the contract either wholly or in part may claim restitution from the other party of whatever the first party has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently."

Article 84: "(1) If the seller is bound to refund the price, he must also pay interest on it, from the date on which the price was paid.

"(2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them:

"(*a*) If he must make restitution of the goods or part of them; or

"(*b*) If it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods."

2. *Exonerating circumstances*

76. In the event the contract is terminated because of circumstances beyond the control of the parties, clause 25.4 of both ECE 188A/574A provides that "the division of the expenses incurred in respect of the Contract shall be determined by agreement between the parties."

77. And, in the event the parties do not come to an agreement, clause 25.5 provides: "it shall be determined by the arbitrator which party has been prevented from performing his obligations and that party shall refund to the other the amount of the said expenses incurred by the other . . . If the arbitrator determines that both parties have been prevented from performing their obligations, he shall apportion the said expenses between the parties in such manner as to him seems fair and reasonable, having regard to all the circumstances of the case."

78. A formula is provided in clause 25.7 of both ECE 188A/574A to assist the arbitrator in determining the apportionment of liability:

"There shall be credited to the Purchaser against the Contractor's expenses all sums paid or payable under the Contract by the Purchaser to the Contractor. There shall be credited to the Contractor against the Purchaser's expenses that part of the price payable under the Contract which is properly attributable to Plant delivered to the Purchaser or, in the case of an incomplete unit, the value of such Plant having regard to its incomplete state. In either case due account shall be taken of any work done in the erection of such Plant."

79. Where the amount to be credited exceeds the amount of such expenses the party shall be entitled to

recover the excess. "'Expenses' means actual out-of-pocket expenses reasonably incurred after both parties shall have mitigated their losses as far as possible. Provided that as respects Plant delivered to the Purchaser the Contractor's expenses shall be deemed to be that part of the price payable under the Contract which is properly attributable thereto, due account being taken of any work done in the erection of such Plant" (clause 25.6 of both ECE 188A/574A).

80. The FIDIC Conditions deal with the consequence of a termination in case of war in the following manner. Clause 46 of FIDIC-EMW provides:

"46.2. . . . the Contractor shall with all reasonable despatch remove from the Site all Contractor's equipment and shall give similar facilities to enable his Sub-Contractors to do so.

"46.3. If the Contract shall be terminated as aforesaid the Contractor shall be paid by the Employer (in so far as such amounts or items shall not have already been covered by payments on account made to the Contractor) for all work executed prior to the date of termination at the rates and prices provided in the Contract and in addition:

"(*a*) The amounts payable in respect of any preliminary items, so far as the work or service comprised therein has been carried out or performed, and a proper proportion as certified by the Engineer of any such items the work or service comprised in which has been partially carried out or performed.

"(*b*) The cost of materials or goods reasonably ordered for the Works or for use in connection with the Works which shall have been delivered to the Contractor or of which the Contractor is legally liable to accept delivery (such materials or goods becoming the property of the Employer upon such payment being made by him).

"(*c*) A sum, to be certified by the engineer, being the amount of any expenditure which in the circumstances was reasonably incurred by the Contractor in the expectation of completing the whole of the Works, in so far as such expenditure shall not have been covered by the payments in this Sub-Clause before mentioned.

"(*d*) The reasonable cost of removal under Sub-Clause 2 of this Clause and (if required by the Contractor) return thereof to the Contractor's works in his country or to any other destination at no greater cost.

"(*e*) The reasonable cost of repatriation of all the Contractor's staff and workmen employed on or in connection with the Works at the time of such termination.

"Provided always that, against any payments due from the Employer under this Sub-Clause, the Employer shall be entitled to be credited with any outstanding balances due from the Contractor for advances in respect of Plant and materials, and any sum previously paid by the Employer to the Contractor in respect of the execution of the Works."

81. Clause 65.(8) of FIDIC-CEC is worded similarly, there is, however, a slight difference in the last paragraph:

"Provided always that against any payments due from the Employer under this sub-clause, the Employer shall be entitled to be credited with any outstanding balances due from the Contractor for advances in respect of Constructional Plant and materials and any other sums which at the date of termination were recoverable by the Employer from the Contractor under the terms of the Contract."

82. The UNIDO model contracts provide, for the event when the contract is terminated by the purchaser because he is subject to any circumstances which are wholly unavoidable and/or beyond his control, as follows (for instance in article 33 of UNIDO-TKL): The contractor shall cease all operations and the purchaser will pay to the contractor an amount equal to the greater of:

Article 33.3.1: "The cost of the Works properly supplied or done by the CONTRACTOR as at the date of the termination less all amounts already paid to the CONTRACTOR by the PURCHASER, and less all amounts which the CONTRACTOR is liable under the Contract to pay to the PURCHASER or owing to the PURCHASER, or which the PURCHASER claims is due as damages pursuant to other Articles herein, and

Article 33.3.2: "The amount calculated in accordance with the Terms of Payment which would have been legitimately payable to the CONTRACTOR up to the date of Termination provided the CONTRACTOR had in fact fulfilled his contractual obligations to such date, without prejudice to PURCHASER-rights as expressly provided for in this Contract."

83. If the purchaser terminates the contract for reasons of the said circumstances, he has not only obligations vis-à-vis the contractor, but will, according to article 33.5 of UNIDO-TKL, also acquire certain rights:

". . . to obtain from the CONTRACTOR where he is also the Process Licensor the documentation for know-how and basic engineering . . . to receive all detailed engineering documents, calculations, computer printouts and other materials related thereto as completed up to the date of the Termination . . . to receive lists of all equipment for which orders have been placed, together with all copies of Purchase Orders for plant supplied and not supplied . . . to take delivery and receive the shipping papers for all equipment . . . to receive all completed or incomplete

documentation pertaining to work and services . . . to take over the Works including all work done to date on the Site . . . to receive copies of all detailed Civil Engineering, Piping, Instrumentation, lay-out and erection drawings."

3. *Other grounds for termination*

84. Termination by one of the parties as a consequence of a deterioration of the financial situation of the other party is usually treated in the same manner as termination after a breach of contract. For instance clause 45 of FIDIC-EMW provides that if the contractor shall become bankrupt or insolvent the purchaser shall be at liberty to terminate the Contract and to act in the same manner as provided in case of contractor's default.

85. Clause 63.(1) of FIDIC-CEC, where the consequence of the contractor's bankruptcy is not termination but that of expelling the contractor, treats this case in the same manner as a breach of contract by the contractor.

86. Under both FIDIC Conditions when the purchaser becomes bankrupt the contractor may terminate and the consequences would be the same as in case of non-payment (clause 51 of FIDIC-EMW, clause 69 of FIDIC-CEC). Similarly, the UNIDO model contracts deal with the question of bankruptcy of the contractor as if it were a breach of contract (article 33.7 of UNIDO-TKL).

XVIII. Applicable law

A. *General remarks*

87. In works contracts, parties have an abiding interest in making sure that their rights and obligations are as certain and as predictable as possible. With a view to promoting certainty and predictability and thereby minimizing the possibility of disputes, contract documents usually contain detailed description of the extent of the work to be performed. Disputes, however, do occur and the disputes will have to be resolved in the framework of a legal system or systems. A stipulation of applicable law in the contract by the parties has a great potential for avoiding difficult choice of law problems by the courts.

88. Since the construction of large industrial works is performed over a relatively long period of time subsequent changes in applicable law can produce results which were not contemplated by the parties. Because of these difficulties, parties should try to minimize the chances of recourse to the applicable law by spelling out as fully and as clearly as possible their rights and obligations. Paragraph 45 of the ECE Guide suggests:

". . . It may . . . be recommended to the parties . . . to draw up contracts in a sufficiently specific and detailed manner so that, if a dispute should arise, recourse to a national law would be necessary only in exceptional cases."

B. *Choice of applicable law*

89. A variety of considerations such as the parties' familiarity with and confidence in the law of a given country may influence the parties' choice of applicable law. The parties are likely to choose one of the following laws: the law of the country where the plant is to be built, the law of the contractor's country, or the law of a third country.

90. Article 36.1 of UNIDO-CRC states some possibilities:

"The laws applicable to the Contract shall be the laws of (*neutral country*) or the law of (*the land where the Plant Site is located*) or as otherwise agreed between the parties in conformity with laws of the country where the Plant is located."

UNIDO-STC and UNIDO-TKL have identical provisions.

91. The counter-proposal does not suggest any applicable law and leaves the matter to the parties:

Article 36.1: "The laws applicable to the Contract shall be . . ."

92. The FIDIC-CEC and FIDIC-EMW make provisions for parties to state the applicable law. Clause 5.1 of FIDIC-CEC provides that there shall be stated in Part II of the Conditions:

"the country or state, the law of which is to apply to the Contract and according to which the Contract is to be construed."

93. Under the ECE General Conditions, the law of the contractor's country is stipulated, subject to a qualification. Clause 28.2 of both ECE 188A/574A provides:

"Unless otherwise agreed, the Contract shall, so far as is permissible under the law of the country where the Works are carried out, be governed by the law of the Contractor's country."

94. The fact that applicable law is stipulated by the parties does not mean it will always be applied by the Courts in which an action is brought. The *lex fori* may restrict the parties' freedom to choose the applicable law.

C. *Additional legal regulations*

1. *Administrative and other municipal laws*

95. The performance of a works contract is a complex undertaking involving, *inter alia,* the supply of

plant and machinery, the construction of the works, the transfer of technology and licensing arrangements. These operations often entail compliance with various laws and regulations in the contractor's and purchaser's countries that are particularly susceptible to governmental economic and social policy. The mandatory requirements of applicable national law in the areas of property rights, patent laws, safety regulations, labour law and currency laws and regulations may affect the performance of the contract.

96. Parties often anticipate and make provision for the effects of municipal law on their contractual obligations. In the forms under study there are express provisions making the contractor responsible for complying with the laws which may apply. Clause 26 of FIDIC-CEC states:

"(1) The Contractor shall give all notices and pay all fees required to be given or paid by any National or State Statute, Ordinance, or other Law, or any regulation, or bye-law of any local or other duly constituted authority in relation to the execution of the Works and by the rules and regulations of all public bodies and companies whose property or rights are affected or may be affected in any way by the Works.

"(2) The Contractor shall conform in all respects with the provisions of any such Statute, Ordinance or Law as aforesaid and the regulations or bye-laws of any local or other duly constituted authority which may be applicable to the Works and with such rules and regulations of public bodies and companies as aforesaid and shall keep the Employer indemnified against all penalties and liability of every kind for breach of any such Statute, Ordinance or Law, regulation or bye-law."

97. If compliance with the law requires payment of fees by the contractor, the contractor is entitled to be reimbursed. Clause 26.3 of FIDIC-CEC provides:

"The Employer will repay or allow to the Contractor all such sums as the Engineer shall certify to have been properly payable and paid by the Contractor in respect of such fees."

98. The wording under FIDIC-EMW is slightly different but the practical effect is the same. Clause 18.1 of FIDIC-EMW states:

"The Contractor shall, in all matters arising in the performance of the Contract, conform in all respects with the provisions of any National or State Statute, Ordinance or other Law or any Regulation or By-law of any local or other duly constituted authority that shall affect the Contractor in the performance of his obligations under the Contract, and shall keep the Employer indemnified against all penalties and liability of every kind for breach of any such Statute, Ordinance, Law, Regulation or By-law."

99. Under the ECE General Conditions, the contractor's responsibility to observe the law applicable to the works is stated by implication. Clause 5.1 of both ECE 188A/574A states:

"The Purchaser shall, at the request of the Contractor and to the best of his ability, assist the Contractor to obtain the necessary information concerning the local laws and regulations applicable to the Works and to taxes and dues connected therewith."

100. The UNIDO model contracts expressly require the contractor to observe all laws that may apply not only to the works but in general. Article 36.2 of UNIDO-CRC states:

"The CONTRACTOR, his staff, and representatives shall observe all codes, laws and regulations in force in the country of the PURCHASER and in the region where the Plant is located."

2. *Notification of law applicable to the works*

101. Construction work is often subject to a wide array of local administrative regulations in connection with performance. The approval of the work plan by the local authority may be hedged around with restrictions relating to health, labour and safety requirements. There may even be requirements relating to equipment, materials and the qualitative level of performance the plant has to meet. The problem here is that in ordinary circumstances, local law is not well known to the contractor.

102. Under some forms under study the party who is more familiar with local laws has an obligation to inform the other of the provisions of local laws and regulations. Frequently the obligation to inform is placed on the purchaser. Clause 18.2 of FIDIC-EMW states:

"The Employer shall give the Contractor assistance to enable the Contractor to ascertain the nature and extent of and to comply with any Laws, Regulations, Orders or By-Laws having the force of law in the country where the Plant is to be erected, which may affect the Contractor in the performance of his obligations under the Contract, and will if so requested procure for the Contractor copies thereof at the Contractor's expense."

103. Under the FIDIC-CEC, the purchaser has no obligation to assist the contractor.

104. The UNIDO model contracts also do not place an obligation on the purchaser to inform the contractor of applicable local laws; the purchaser is however required to provide the contractor with the necessary approvals, permits and licences required by the local authority. Article 5.15 of UNIDO-CRC provides:

"The PURCHASER shall obtain and make available to the CONTRACTOR all necessary permits/approvals and/or licences from local authorities

and/or Government as may be necessary for the timely execution of the Contract inclusive of import licences, visas for CONTRACTOR's personnel, entry permits, work permits, etc."

105. Under clause 5.1 of both ECE 188A/574A, the contractor may request the purchaser for the necessary information on the local laws and regulations that may be applicable to the works.

D. *Subsequent changes in the laws*

106. Even where the parties have taken into account the implications of existing law, their expectations may not be realized because of subsequent changes in the applicable laws. Subsequent changes in the laws may in fact make the performance of the contract unusually burdensome. (For the effects of this situation on the parties' obligations, see part two, XIV, *Renegotiation.*)*

107. The FIDIC Conditions provide for a revision of the contract price to reflect changes in the law which may affect the performance of the contract. Clause 70.(2) of FIDIC-CEC provides:

"(2) If, after the date thirty days prior to the latest date for submission of tenders for the Works there occur in the country in which the Works are being or are to be executed changes to any National or State Statute, Ordinance, Decree or other Law or any regulation or bye-law of any local or other duly constituted authority, or the introduction of any such State Statute, Ordinance, Decree, Law, regulation or bye-law, which causes additional or reduced cost to the Contractor . . . in the execution of the Works, such additional or reduced cost shall be certified by the Engineer and shall be paid by or credited to the Employer and the Contract Price adjusted accordingly."

108. All UNIDO model contracts have also provided for subsequent changes in the laws which may affect the performance of the work. Article 36.2 of UNIDO-CRC provides:

". . . In the event that any code, law or regulations are enacted after the Effective Date of the Contract . . . to have adverse effect on the CONTRACTOR's obligations, scope of work, prices and/or time schedule under this Contract, the PURCHASER shall either:

"36.2.1 Obtain appropriate exemption(s) from the relevant authorities on the CONTRACTOR's behalf, or

"36.2.2 Negotiate with the CONTRACTOR for commensurate change(s) in the scope of the work to be performed under the Contract, together with such changes in price as properly reflect the actual increased costs that are anticipated . . ."

109. Under the counter-proposal the reference point of subsequent changes in the law in force is the date of issue of the invitation to bid.

110. Under the ECE General Conditions, there is also provision for a commensurate adjustment of the contract price. Clause 5.2 of both ECE 188A/574A provides:

"If, by reason of any change in such laws and regulations occurring after the date of the tender, the cost of erection is increased or reduced, the amount of such increase or reduction shall be added to or deducted from the price, as the case may be."

* A/CN.9/WG.V/WP.4/Add.5 (reproduced above).

Part three

[A/CN.9/WG.V/WP.4/Add.8*]

LIST OF QUESTIONS FOR POSSIBLE CONSIDERATION BY THE WORKING GROUP

A. *Introduction*

1. General questions concerning the future work of the Working Group have already been described in part one. This part of the study, which identifies specific questions, is not intended to be exhaustive. The questions have to be considered in the context of each of the specific topics under study.

2. It may, however, be emphasized that general questions regarding the methodology for any future work (see part one, paragraphs 39-46) would have to be kept in mind throughout because an adequate formula may be found only after consideration of the specific questions related to each topic.

3. In addition it would be important to point out that the following questions would also be relevant to the entirety of specific questions:

(*a*) Bearing in mind the various types of contract for the supply and construction of large industrial works (see part one, paragraphs 22-26), can a common approach be adopted for each topic under consideration irrespective of the type of contract, or should different approaches be adopted? Or is there another approach—that a common approach be taken to certain topics, while others have to be tailored to certain types of contract?

* 12 May 1981.