The terminator – or the terminated?

by DOUG JONES

A "show cause" termination regime is found in nearly all construction contracts.

Typically, these regimes provide that if a contractor breaches defined provisions of the contract, such as time for performance, the owner may issue a notice to "show cause", requiring the contractor to remedy the breach.

If the contractor fails to do so within a specified period of time, the owner may then either terminate the contract or take the works out of the hands of the contractor.

At first glance, these clauses appear fairly simple and straightforward.

But only the most naïve of owners would take these provisions at face value, because the courts have imposed some severe restrictions on the rights of owners to terminate construction contracts in accordance with these contractual mechanisms.

In particular, they have imposed "implied" requirements for owners to act "reasonably" at various stages in the process.

Suppose, for example, that a contractor is six months late in completing a building project. During the six months of delay, the parties may have been involved in continuous negotiations to attempt to overcome the delay or minimise its effects. However, at some point the owner's management decides to initiate the "show cause" regime and terminate the contract.

In doing so, the owner may unwittingly expose itself to a quantum meruit ("reasonable price") claim—the promised land for many contractors—or substantial damages for breach of contract.

This is because if the contractor can show that the owner's attempt to terminate was "unreasonable", the owner's conduct will amount to a repudiation of the contract, entitling the contractor itself to terminate the contract and either recover a quantum meruit or sue for damages for breach of contract.

Such a claim by a contractor usually involves:

❑ A failure by the owner to comply with conditions that have to be satisfied before a notice to "show cause" may be issued

❑ Defects in the form or substance of the notice to "show cause"

❑ A failure to reasonably consider the contractor's response to a notice to "show cause", or

❑ Even if the contractor's response has been reasonably considered, a failure to reasonably consider whether or not to terminate the contract or take the works out of the hands of the contractor.

"Show cause" provisions usually say that before a notice to "show cause" may be issued the contractor must have been in substantial breach of the contract.

"Substantial breaches" are generally defined in the contract. They almost always include a breach of the contract's requirements concerning time for performance.

So owners sometimes have the impression that if a project is (say) six months late, this will constitute a "substantial breach" by the contractor.

But there may be other explanations, such as a failure by the owner's consultants to provide design information or the performance of substantial variation work. And if the owner or its consultants have been responsible for the delay, any purported termination by the owner will amount to repudiatory conduct.

And this is only the first trap for an unwary owner. Frequently, the contract also says that before a notice to "show cause" may be issued, the principal must have considered whether damages would be an adequate remedy for the breach by the contractor.

To satisfy this pre-condition, it seems the owner must be able to demonstrate, at least subjectively, that damages might not be an adequate remedy.

Hidden peril

For instance, if a building project is six months late and the owner has already sold or leased the building and must provide access to the new owners or leaseholders, damages may well not be an adequate remedy for the builder's failure to complete.

But if the owner has no obligation to grant access to new owners or leaseholders, damages may be adequate.

When it comes to terminations, what may seem trite becomes essential.

Any notice to "show cause" must be in the proper form and must strictly comply with any requirements of the contract.

If it does not, the notice will fail, even if the contractor was otherwise in breach, and any termination based on the notice will be repudiatory conduct.

Most termination regimes simply provide that if a contractor fails to "show cause", the owner may terminate the contract.

Superficially, nothing could be clearer. But what is the standard to be applied in judging the contractor's response?

This standard became a hidden peril with the Renard court case in 1992. Since then, the NSW Court of Appeal has held, on several occasions, that a power to terminate must be exercised reasonably, and specifically that an owner must give "reasonable consideration" to whether the contractor has failed to "show cause".

Not surprisingly, by the time an owner decides to activate the "show cause" regime—and particularly if negotiations have broken down—it has often already made the decision to terminate the contract. The owner might be giving lip service to the regime, but be proceeding to engage another builder and taking other steps to complete the works.

The law takes a dim view of this. Even a substantial breach by a contractor is not enough, by itself, to permit an owner to terminate. The owner must give the contractor an opportunity to respond to the notice to "show cause", and must carefully and reasonably consider the response. If it does not, its attempt to terminate will be repudiatory conduct.

The requirement to reasonably consider the contractor's response—"the first limb of Renard"—is onerous.

For example, if a builder admits in its response that there have been delays for which it was partly responsible, but says it is taking steps to alleviate these delays by increasing resources or productivity or taking some other step, it is arguable the builder has in fact "shown cause".

Similarly, if the builder explains that delays were caused by acts or omissions by the owner or its consultants, and adequately explains these delays, it is likely that it has "shown cause", rendering any purported termination by the owner unlawful.

Even after an owner has reasonably determined that a contractor has failed to reasonably respond to the notice to "show cause", the owner must reasonably consider:

❑ Whether to exercise its power to either terminate the contract or take the works out of the contractor's hands, and

❑ If so, which of these powers it should exercise.

This requirement—"the second limb of Renard"—can be more difficult than the first to satisfy, as it may not be readily apparent what matters the owner must take into account.

Some of the factors owners need to bear in mind are:

❑ The extra delays associated with engaging a new contractor and the new contractor's learning curve. Would it be more reasonable to keep the original contractor and thus minimise the delay?

❑ The project's status. If it is close to completion, it is unlikely to be reasonable for the owner to terminate the contractor.

❑ The costs which would be incurred by the owner in completing the works, compared to the amount payable to the existing contractor.

A new contractor may take over a distressed project under a cost-plus arrangement. This my be reasonable unless the likely costs of completing far exceeds the contract sum remaining to be paid to the original contractor.

Doug Jones is a partner with law firm Clayton Utz.

❑ Vipac engineers and scientists has appointed **Ian Jones** as the business development director of its building technology team, who serve Australian and overseas markets. Jones, now based in Melbourne, is a mechanical engineer and dynamics specialist who has been director for Vipac's Asia office, in Singapore, for many years.

❑ *Directors of a new company offering project management services, Cadence Australia in Sydney, have played key*

❑ Civil engineering and information technology consulting firm HDS Australia has appointed **Andrew Leedham** as a director. Leedham brings to the position more than 23 years of experience as a traffic and transport engineer. He has held management positions in two other consulting firms in SA, consulting to local and state government agencies throughout Australia.

❑ **Graham Jahn has been elected national president of the Royal Australian Institute of Architects. He has just com-**

❑ **Charles Sullivan,** a practitioner in construction and engineering law, has joined Deacons law firm as a partner and the head of the firm's construction and engineering practice in Brisbane. Sullivan has more than 15 years experience in construction law spanning residential, commercial, transport, mining and manufacturing industries. He has been involved in projects in Australia, Asia and South America.

❑ Bosch has announced that **Pascal Tabet**, director of sales at Robert Bosch (Australia), is to become general manager

❑ The board of directors of The Charles Machine Works, which manufactures Ditch Witch earthmoving equipment, has appointed **David Woods** as its chief executive officer. Woods has been chief operating officer of the company since

David Wood

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