

**MUTUAL TERMINATION OF CONTRACT IN
CONSTRUCTION PROJECTS**

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requirement for the award of the degree of
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*To my beloved Wife, Sons and Mother,
Sister and Brother,
and Family.*

Thank you for your support, guidance and everything.

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ABSTRACT

In the present climate where the construction industry is facing an unprecedented rise in the cost of construction materials, the issue of termination is sometimes foremost on the minds of the contracting parties, especially contractors who have not properly estimated the costs during a project lifecycle. Introduction of the mutual termination clause is intended for use by the parties to an existing contract who may wish to terminate the contract and release each other from the contract. Under this form, the original contract is terminated and the parties enter into a mutual release of the contract as well as of any claims that may be pending by one party against the other. Under the Contract Act 1950, the contract may be discharged by mutual consent of contracting parties according to clause 63 and 64 of the Act. A contract may be discharged by an agreement that it shall no longer bind either party. As it is their agreement which binds the parties, so by their agreement they may be loosed from the contractual tie. Mutual termination agreement unequivocally stated that the parties agreed to a mutual termination subject to the terms and conditions set out therein. The effect of this is that the principle contract is thereby rescinded and the parties thereon are bound by the terms and conditions of the mutual termination agreement. Henceforth, if any claim should arise between the parties it is governed by the mutual termination agreement and not by the principle contract which had expressly been rescinded by mutual consent. A termination by mutual consent is an agreement between employer and the contractor to cease work under the contract. Even though in the mutual termination agreement it is clearly stated that the contractor is not entitled or shall not make any claim or demand for any payment, loss, damages, compensation or whatsoever against the client, however in certain circumstances, the disputes still arise and need to be brought to the court for final judgement.

ABSTRAK

Dalam situasi masa kini, dimana industri pembinaan mengalami kenaikan terhadap harga bahan binaan utama, isu penamatan menjadi keutamaan di dalam pemikiran pihak-pihak yang berkontrak terutamanya kepada kontraktor yang telah tidak membuat anggaran kos yang terperinci dan tepat semasa pelaksanaan projek. Pengenalan kepada fasal penamatan secara bersama adalah bertujuan untuk kegunaan oleh pihak-pihak berkontrak yang berhasrat untuk menamatkan dan melepaskan mereka daripada ikatan kontrak. Dibawah fasal ini, kontrak induk akan ditamatkan dan pihak yang berkontrak tersebut perlu secara bersama melepaskan mereka disamping itu segala tuntutan yang mungkin timbul ditangguhkan oleh pihak yang berkenaan. Di bawah Akta Kontrak 1950, suatu kontrak boleh ditamatkan secara persetujuan bersama oleh pihak yang berkontrak selaras dengan fasal 63 dan 64 Akta tersebut. Kontrak boleh ditamatkan secara perjanjian dan ianya tidak lagi mengikat diantara satu pihak dengan pihak yang lain. Sebagaimana dengan perjanjian yang telah mengikat pihak berkenaan, maka dengan perjanjian juga mereka boleh melepaskan daripada ikatan kontrak. Perjanjian penamatan bersama dengan jelas menyatakan bahawa pihak-pihak adalah bersetuju kepada perjanjian penamatan bersama tertakluk kepada terma dan syarat-syarat yang dinyatakan di dalamnya. Kesan daripada itu, ialah kontrak induk akan terbatal dan pihak-pihak adalah terikat dengan terma dan syarat-syarat yang dinyatakan di dalam perjanjian penamatan bersama tersebut. Maka, jika terdapat sebarang tuntutan diantara pihak berkenaan ianya hendaklah selaras dengan perjanjian penamatan bersama dan bukannya di bawah kontrak induk yang mana ianya telahpun dibatalkan secara bersama. Penamatan secara persetujuan bersama ialah perjanjian diantara majikan dan kontraktor untuk memberhentikan kerja di bawah kontrak. Walaupun, di dalam perjanjian penamatan secara bersama dinyatakan dengan jelas bahawa kontraktor tidak layak atau tidak boleh mengemukakan sebarang tuntutan atau permohonan bagi bayaran, kehilangan, kerosakan, pampasan atau yang seumpama denganya terhadap majikan, bagaimanapun dalam keadaan tertentu pertelingkahan masih lagi timbul dan ianya perlu dibawa kepada mahkamah untuk mendapatkan pengadilan.

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LIST OF ABBREVIATIONS

AC	-	Appeal Cases
AIR	-	All India Reports
Bing	-	Bingham Reports
BLR	-	British Law Reports
CIDB	-	Construction Development Industry Board
Con LR	-	Construction Law Reports
ISM	-	Institute of Surveyor Malaysia
MBAM	-	Master Builders Association Malaysia
MC	-	Malayan Cases
MLJ	-	Malaysia Law Journal
PAM	-	Pertubuhan Arkitek Malaysia
PWD	-	Public Work Department
UTM	-	Universiti Teknologi Malaysia
JKR	-	Jabatan Kerja Raya
LPT2	-	Lebuhraya Pantai Timur Fasa 2
PKJ	-	Package
RM	-	Ringgit Malaysia
SPP	-	Surat Pekeliling Perbendaharaan
KM	-	Kilometre
S.O	-	Superintending Officer
BQ	-	Bill of Quantities
CH	-	Chainage
LLM	-	Lembaga Lebuhraya Malaysia
Resp	-	Respondent
VOP	-	Variation in Price
LAD	-	Liquidated Ascertain Damages

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CHAPTER 1

INTRODUCTION

1.1 Background of Study

In the current economic climate, many construction projects face unforeseen challenges to completion. Participants in such projects would be well advised to consider the legal and economic implications of termination of the project and the related contracts¹

The construction industry may experience a slowdown for the rest of the year given the recent increase in fuel and building material prices since the government raised the price of fuel by 41 per cent on June 5, 2008. Construction costs have gone up at all levels of the value chain from building materials such as sand, cement, concrete and roofing materials to logistics (Tan Sri Jamilus Hussein, 2008)².

¹ CA (Joe) Davis, Daniel R. Smith (2010) *Legal Issues in Construction Contract Termination*, University of Texas

² *Fuel price rise likely to hit building sector*, News Strait Times, June 25, 2008

During the month of November 2009, a total of 254 projects contributing to a combined value of RM2.1 billion were recorded as at 31 December 2009. This was an improvement of 26.4% in terms of number of projects awarded, and 4.1% in terms of project value, compared with those recorded during the same period in 2008.³

Since the fuel price hike, the sector has seen an average increase of 30 per cent per sq inch of space, house prices may also increase between 25 per cent and 30 per cent and projects under the Ninth Malaysia Plan may not reach their targets. Some of the contractors had rejected letters of award for construction jobs because there was no profit to be made due to the high price of building materials (Datuk Osman Abu Bakar, 2008)⁴.

Among the solutions, the government can compensate the contractors on the cost difference, especially on steel and cement costs. Projects can also be staggered and lengthened periodically such as awarding 30 projects a year instead of 50 a year so that demand for building materials can stabilise and prices can soften. Helping contractors will also benefit the government in the long run because the infrastructure and amenities are for the people (Datuk Osman Abu Bakar, 2008).⁵

The government has introduced Treasury's Instruction namely "*Surat Pekeliling Perbendaharaan (SPP) Bilangan 3 Tahun 2008*" by the Ministry Of Finance Malaysia in August 2008. One of the contents in the instruction is about "Mutual Termination" stated that "*if the contractors unable to continue the project due to increasing of construction material price, the contractor is given option to apply for mutual termination of contract.*"⁶.

³ Fuel price rise likely to hit building sector, News Strait Times, June 25, 2008, Ibid.

⁴ News Strait Times, June 25, 2008, Ibid.

⁵ News Strait Times, June 25, 2008, Ibid.

⁶ SPP Bil.3/2008, *Pelaksanaan Syarat Perubahan Harga Di Dalam Kontrak Kerja*, August 6, 2008

In April 2005, the RM2.6 billion Double Track Railway project from Rawang to Ipoh with length of 180KM had been terminated based on mutual agreement between contractor DRB-Hicom and the government.⁷

According to Works Minister, the RM3.7 billion Second Phase East Coast Highway project linking Jabor in Pahang and Kampung Gemuroh in Kuala Terengganu had been terminated for six (6) packages based on mutual agreement for the benefit of all the parties involved and the continuation of the project.⁸

Even though standard forms of construction contract have several reasons listed under the provided clauses which allow the employer or the contractor to terminate the contract but, the mutual termination of contract is not included in the condition of contract to the standard forms of construction contract. However, under the Contract Act 1950, the contract may be discharged by mutual consent of contracting parties according to clause 63 and 64 of the Contract Act 1950.⁹

A contract may be discharged by an agreement that it shall no longer bind either party. As it is their agreement which binds the parties, so by their agreement they may be loosed from the contractual tie. To render an agreement effective as a discharge it must be a valid agreement. Such an agreement must be accompanied by all the elements such as mutual intention, consent by parties, and parties having capacity.¹⁰

In the English case of *Foster v Dawber [1851]6 Exch.839*, it was held that ‘*it is competent for both parties to an executor contract, by mutual agreement, without any satisfaction, to discharge the obligation of that contract. But an executed*

⁷Johardy Ibrahim (2005), *DRB-Hicom : Landasan Berkembar Diserahkan Sukarela*, Utusan Malaysia, May 16, 2005

⁸ (2010), *Cost of highway go up by 15%*, New Straits Times, August 3, 2010

⁹ Contract Act 1950 (Act 136), International Law Book Services, 2010

¹⁰ Handbook Of The Law Of Contracts, WM L. Clark. Jr.

contract cannot be discharged except by release under seal, or by performance of the obligation, as by payment, where the obligation is to be performed by payment'. The agreement to discharge must therefore be under seal, or be supported by some other consideration on the part of the person seeking to be released.¹¹

Meanwhile, in the case of *Morris v Barron & Co. (1918) AC.1*, it was held that *'after signed the mutual termination agreement, parties are no longer bound by the sub-contract'*.¹²

Introduction of the mutual termination clause is intended for use by the parties to an existing contract who may wish to terminate the contract and release each other from the contract. It is designed for use either by individual parties or by a corporation or other entity. Under this form, the original contract is terminated and the parties enter into a mutual release of the contract as well as of any claims that may be pending by one party against the other.¹³

1.2 Problem Statement

The construction industry is a complex industry with many parties involved in its process and operations, often brought together to work for a particular project. Due to its multi-faceted nature and involvement of numerous parties, disputes are often inevitable. One common dispute in the construction industry is the issue of 'determination' of the Contractor's employment or termination of the contract by the Employer or the Contractor itself.¹⁴

¹¹ J.Beatson, *Anson's Law Of Contract*, 28th Edition, Oxford University Press, April 2, 2002, Page 516.

¹² <http://www.lawofcontract.co.uk>

¹³ [http://www.lawofcontract.co.uk/termination and release](http://www.lawofcontract.co.uk/termination%20and%20release)

¹⁴ MBAM Article : *Construction Contract & Management Issues*, Master Builder Journal, Vol.3, 2010

One of the common problems in the construction industry which often has serious implication on the project and the parties concerned is the determination of the Contractor's employment under the contract or termination of the construction contract. The Contractor's employment can be determined or a construction contract can be terminated by an express term in the contract such as determination/termination clauses, or termination at common law.¹⁵

The general contract law relating to the release of the parties from being bound by their contractual duties is called '*discharge of contract*'. Standard forms of construction contract have several clauses that relate to termination of the contracts. However they normally use the term 'determination of the contractor's employment under the contract'. A normal determination clause sets out the reasons, the procedure and the effects of the exercise of right of determination by both parties.

Most construction contracts whether in bespoke forms or standard forms of contract, would normally incorporate an express provision and/or clause, setting out the parties' rights and remedies in the event of determination of the Contractor's employment or termination of the contract. Clauses 25 and 26 of PAM 2006 Standard Form of Building Contract provide for the determination of the Contractor's employment by the Employer and the determination of its own employment by the Contractor, respectively. Similarly, Clauses 44 and 45 of CIDB 2000 Standard Form of Contract for Building Works provide for determination by the Employer and determination by the Contractor, respectively. In PWD Form 203 (Rev.2007), Clauses 51, 52 and 53 respectively provide for termination by the Employer, as follows;

- based upon events and consequences of default by the Contractor;
- on national interest; and
- on corruption, respectively.

¹⁵ MBAM Article, Vol.3, 2010, Ibid

It is to be noted that although PWD Forms only provide for termination of contract, they envisage the procedures, mechanisms and forms of recovery and remedies to be within the contract, and not outside the contract. There is no express provision for termination by the Contractor hence any termination by the Contractor can only be done at law, unless the disputing parties agree to a mutual termination.

The right to terminate is both important and practical as it helps to ensure the contract is performed as agreed. It also helps to form the basis upon which parties may renegotiate with each other if their contractual relationship encounters difficulties.¹⁶

The decision to terminate, either by the contractor or employer, should not be taken in circumstances where there is a minor breach or no breach at all (convenience). The decision to terminate should only be exercised in the event of a major breach or an incident occurring which is the fault of neither party e.g. events constituting *force majeure*.

In the present climate where the construction industry is facing an unprecedented rise in the cost of construction materials, the issue of termination is sometimes foremost on the minds of the contracting parties, especially contractors who have not properly estimated the costs during a project lifecycle.¹⁷

In recent experience, it is suggested that notwithstanding contractual agreement on the price of materials, contractors sometimes threaten termination based on some other pretext and given the current scarcity of available contractors with capacity to resource projects.

¹⁶ Omar Al Saadoon & Eric Teo, *Coping with termination*, Master Builder Article, 4th quarter 2008

¹⁷ Master Builder Article, 4th quarter 2008, Ibid.

A contractor may sometimes, due to certain reasons such as increase of wages, material price, etc., requests an employer to increase payment or to renegotiate, which is higher than the price agreed in the contract between them. This contractor is asking the employer to enter into a new contract with him with a new consideration for him (i.e. the increased payment). However, the employer has a right not to accept such offer. If the employer is forced to enter into the new contract under the contractor's threat to terminate the original contract, the new contract will be voidable at the option of the employers. This is provided in section 15 of the Contracts Act 1950, which covers economic duress. Mocatta J. in the case of *North Ocean Shipping Co Ltd v. Hyundai Construction Co Ltd & Anor*¹⁸ held, *inter alia*, that the defendant's threat to break the contract without any legal justification unless the plaintiffs increased their payments by 10% did amount to duress in the form of economic pressure and, accordingly, the agreement of June 1973 was a voidable contract which the plaintiffs could either affirm or avoid.¹⁹

Also, in an earlier and well-known American case of *Watkins v. Carrick*,²⁰ the contractor contracted to carry out excavation work but unexpectedly struck solid rock. He refused to proceed unless he was paid extra. It was held that the contractor was not entitled for the additional payment. Furthermore, the court also held that the contractor had given no consideration for the employer's promise of additional payment. Consideration for the employer might exist if the contractor provides the employer with a genuine practical benefit, or there is uncertainty whether or not an item of work falls within the original contract.²¹

The contractor in this circumstance is committing an economic duress upon the employer and subsequently inducing a new contract. Hence, if a contractor refuses to proceed with work unless he is paid at a higher rate than that previously agreed, the employer is entitled to refuse payment except at the originally agreed

¹⁸ [1979] 1 QB 705; [1979] 3 WLR. 419 Queens Bench Division

¹⁹ Yow Kah Lun, (2006). *Voidable And Void Construction Contracts*, Master Thesis, Universiti Teknologi Malaysia, Skudai, Pg.71

²⁰ *Watkins v. Carrig*, 91 N.H. 459 (N.H. 1941)

²¹ Yow Kah Lun (2006). *Ibid*. Pg. 72

rate, and even avoid the contract. Moreover, if no consideration is given by the contractor to the employer in such situation, the new contract is void, as provided in section 26 of the Contracts Act.²²

According to John Wong, termination that is often termed to be a taboo among the players in the construction industry owing to the severity of the consequences arising from it. Common words such as determination or forfeiture are termed as synonymous to termination. Briefly, termination of contract takes place at a point in time in the course of a contract period when a legally binding contract is brought to an end before it has been discharged by performance due to the acts of one or both parties.²³

Mutual termination agreement unequivocally stated that the parties agreed to a mutual termination subject to the terms and conditions set out therein. The effect of this is that the principle contract is thereby rescinded and the parties thereon are bound by the terms and conditions of the mutual termination agreement. Henceforth, if any claim should arise between the parties it is governed by the mutual termination agreement and not by the principle contract which had expressly been rescinded by mutual consent.

In other words, after having signed the mutual termination agreement the parties are no longer bound by the principle contract and hence no action can be brought on the principle contract. With reference to the case of *Morris v Barron & Co. (1918) AC.1*, it was held that '*after signed the mutual termination agreement, parties are no longer bound by the sub-contract*'.²⁴

²² Yow Kah Lun (2006). Ibid. Pg. 73

²³ John Wong. (2005), *Terminated or be Terminated*. The Malaysian Surveyor. 39.1, Pg.12

²⁴ <http://www.lawofcontract.co.uk>

A termination by mutual consent is an agreement between employer and the contractor to cease work under the contract. Such a termination would be used in a situation where mutual problems make it undesirable to continue the work, but in which assessing responsibility to either party would not be fair or reasonable under the circumstances. There usually will not be a clear indication of failure on the part of either party, and thus a payment by one party to the other to cover the costs of termination is generally not appropriate.²⁵

Even though in the mutual termination agreement it is clearly stated that the contractor is not entitled or shall not make any claim or demand for any payment, loss, damages, compensation or whatsoever against the client, however in certain circumstances, the disputes still arise and need to be brought to the court for final judgement.

Payment issues are always the factor of disputes between the employer and the contractor. What are the most frequent disputes associated with the mutual termination of contract in construction project? What are the positions especially concerning the value of work done performed under the principle contract before its termination, the performance bond, the advance payment bond, material on site and also loss and expense when the contract would be mutually terminated?

Therefore, this study will focus on the process and procedure of the termination contract by mutual agreement and also to identify the most frequent disputes associated with the mutual termination of contract in construction project and its solution based on cases which have been referred to the court.

²⁵ Bonneville Purchasing Instructions, (2007) *Contract Termination*, Transmittal 07-2, Pg.20-2

1.3 Objective

The objectives of this study are;

- 1) To determine the process and procedure for termination of contract by mutual agreement in construction projects.
- 2) To identify the most frequent disputes associated with the mutual termination of contract in construction project and its solutions.

1.4 Limitation of Research

There are not many cases either in Malaysia and England that have dealt with the mutual termination of contract in construction contract.

1.5 Scope Of Study

The scope of this study focused on the interpretation aspects of the mutual termination of contract in construction projects. In order to achieve the objective, this study will deal with the projects that have been mutually terminated. Six (6) packages of the Second Phase East Coast Expressway Project which had been mutually terminated have been chosen as project case studies.

This study also has been conducted based on Contract Act 1950, and relevant standard form of construction contract in Malaysia, mainly PWD 203A (Rev. 2007) standard forms of contract for public project used in Malaysia together with other relevant Acts available.

1.6 Significance Of Study

This research is very important as the findings will act as a guideline to the parties in the construction project mainly to the client and the contractor which may face business difficulties due to termination.

Thus, this research perhaps would contribute towards enhancement of knowledge of the contracting parties by shedding some information and knowledge regarding their rights.

1.7 Research Methodology

In order to achieve the research objectives, a systematic process of conducting this study had been organised. Basically, the process of this research consists of five (5) major stages, which involve identifying the research issue, literature review, data collection, data analysis, conclusion and recommendation.

1.7.1 Stage 1 : Identifying The Research Issues

The first stage of research involves initial study, which is discussion with friends and lecturers regarding the research topic and initial literature review to get an idea of the research issue. The objective and scope of the research will be determined after the initial study and the outline will be prepared in order to identify the type and sources of data related to the research.

1.7.2 Stage 2 : Literature Review

After the research issue and objectives have been identified, various documentation and literature review regarding to the research field will be collected to achieve the research objectives. Generally, secondary data is collected from the latest reading materials in printing form such as books, journals, research papers, reports, newspapers as well as from the internet. It is important to identify trends and developments over time in construction industry, as well as the general state of knowledge concerning the subject area of termination of contract such as background, definition, procedures, relevant events and etc.

1.7.3 Stage 3 : Data Collection

The 3rd stage of research process is data collection which is consists of primary data and secondary data.

1.7.3.1 Primary Data

Primary data have been collected mainly through documentary analysis from Malayan Law Journal, Construction Law Report and other law journals through the LexisNexis law database via UTM library electronic database and current law journal online database. The cases relating to the research matter have been collected and only important cases have been used for the analysis at the final stage.

In order to achieve research objective, primary data also will be collected through the process of interviews. This technique hopefully will help in obtaining information in actual basis. The respondent will come from professional in the construction industry such as government officers who involved in the construction project, consultants, contractors and others construction professionals.

1.7.3.2 Secondary Data

Secondary data is data obtain from research done by third parties other than the author. Sources secondary data consists of books, articles, journal, and seminar papers. These sources are important to complete the literature review. The data also will be collected from the relevant Acts, Treasury Instruction, and Standard forms of contract.

In summary, the methodology of this research adopts from literature review together with the conduction of the semi-structured interviews with various construction professional involved in the construction project.

1.7.4 Stage 4 : Research Analysis

In this stage involves data analysis, interpretation and data arrangement. This process is to process and convert the data collected to information that is useful for the research. Arrangement of data tends to streamline the process of writing of the paper.

1.7.5 Stage 5 : Conclusion and Recommendations

In the last stage, the author will review the whole process of the study with the intention to identify whether the research objectives have been achieved. After presenting the research findings, further research will be suggested.

1st STAGE**INITIAL STUDY**

- DISCUSSION (Friends & Lecturers)
- LITERATURE REVIEW (Books, journal, internal)

2nd STAGE**LITERATURE REVIEW**

IDENTIFY THE RESEARCH ISSUE

IDENTIFY THE RESEARCH OBJECTIVE, SCOPE
AND OUTLINE

IDENTIFY TYPE AND SOURCES OF DATA

3rd STAGE**DATA COLLECTION**

- PRIMARY DATA
 - Law Journal, Law Report, Interview

- SECONDARY DATA
 - Books, Articles, Journal, Acts
 - Treasury Instruction, Standard Form of Contract

4th STAGE**DATA ANALYSIS AND
INTERPRETATION****5th STAGE****WRITING AND
CONCLUSION****Figure 1.1 – Research Methodology Flowchart**

1.8 Conclusion

As a conclusion, in order to achieve the research objectives, a systematic process and methodology of study shall be determine and identified in early stage. A researcher need to focus and conducted the study based on an appropriate method.

Thus, a study on mutual termination of contract in construction projects hopefully will benefit to the contracting parties in the construction industry as a guideline and references in the future.

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