

Construction Law Update

Termination for Repudiatory Breach of Contract

A contracting party commits a repudiatory breach of contract when it commits a breach so serious that the innocent party is deprived of substantially all the benefit of the contract. This allows the innocent party to accept the repudiatory breach, bringing the contract to an end and giving rise to a damages claim.

The right to terminate for repudiatory breach arises at common law, so there are no definitive rules on what constitutes a repudiatory breach. As a result, claiming repudiatory breach can be risky; if the party alleging repudiatory breach gets it wrong, they can end up in repudiatory breach instead. These risks are demonstrated in the case of *Imperial Chemical Industries Ltd v Merit Merrell Technology Ltd*, where the court considered the validity of a termination for repudiatory breach in relation to defective work.

Background

In December 2012, Imperial Chemical Industries Ltd (“ICI”) engaged Merit Merrell Technology Ltd (“MMT”) to carry out works associated with the construction of a paint manufacturing facility. The contract was an amended NEC3 Engineering and Construction Contract with an initial value of £1.9m, but the scope of works expanded considerably and ICI paid MMT £20.9m. The project was running seriously late and over budget.

In February 2015, ICI wrote to MMT stating that ICI accepted the following repudiatory breaches of contract and instructing MMT to leave site:

- Widespread defects in the welding works.
- Failure to produce an adequate plan for testing and rectification of defects.
- Failure to produce requested project documents.
- Wrongful removal of project documents.
- Failure to produce evidence of welders’ qualifications.
- Refusing access to the fabrication shop.

In response, MMT denied that it was in breach of contract and alleged that ICI was in repudiatory breach.

Were the breaches alleged by ICI repudiatory?

- Defective welding

Throughout the dispute, ICI had alleged that the quality of MMT’s welding fell below the contractual standard, which ICI said required MMT to perform non-destructive testing (NDT) using radiography. ICI carried out its own radiography tests on the welds and identified many defects. However, the court found (and ICI ultimately accepted during the trial) that the parties had agreed a cheaper NDT regime of visual inspection and dye-penetrant testing of 10% of the welds. This was evidenced in meeting minutes and emails. MMT was therefore not in breach for not carrying out radiography NDT.

ICI’s expert evidence in support of its allegations was based on defects identified by radiography NDT, however, a much wider range of defects could be identified using radiography than using dye-penetration. The court stated that *“to hold MMT to a higher standard in terms of the quality of work required... when ICI expressly declined to contract with MMT for that radiographic standard... would be to rewrite entirely the bargain struck by the parties”*. The court therefore decided that only those welding defects which could be detected using the contractually agreed NDT regime (i.e. visual inspection and dye testing) could properly be characterised as defects.

The defects which were identified using the contractually agreed NDT regime fell within the 5% which was agreed by the parties’ experts as being the normal failure rate for welds of this kind. This ‘normal’ level of defects was not sufficient to constitute a repudiatory breach of contract on MMT’s part.

- Failure to produce an adequate plan for testing and rectification of defects

This was not a breach. MMT had always made clear that it would rectify any defects for which it was responsible. However, producing a plan for testing and

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rectification was impossible because ICI was insisting on a different NDT regime to that stated in the contract. Further, ICI terminated the contract whilst a third party surveyor was still in the process of identifying the defective welds.

- **Failure to produce requested project documents**

This was not a breach. ICI had made no formal written request for documents prior to the termination letter of February 2015.

- **Wrongful removal of project documents**

This was not a breach. The parties had agreed project documents could be kept at MMT's fabrication shop.

- **Failure to produce evidence of welders' qualifications**

This was not a breach and the court held that the allegation was *"without foundation"*. There was evidence that all welders had been suitably qualified.

- **Refusing access to the fabrication shop**

This was not a breach. The court found that this allegation was *"without foundation and unsupported by a shred of evidence"*.

Who was in repudiatory breach?

Given that none of the breaches alleged by ICI had been established, the court found that ICI's letter accusing MMT of repudiatory breach itself constituted a repudiatory breach which MMT had accepted. ICI's motivation in sending the termination letter had been to avoid having to pay MMT any more money, but as a consequence of ICI's own repudiatory breach, MMT will now be entitled to damages which are likely to include loss of profit on work not yet carried out.

Had ICI exercised a contractual right to terminate?

In the alternative to relying on repudiatory breach, ICI argued that it had exercised a contractual right of termination under clauses 90 and 91 of the NEC3 contract. The court rejected this argument, finding that ICI's purported termination letter was drafted in a way that *"simply cannot sustain an interpretation that it is an exercise of a contractual right to terminate"*. The

court stated that if operation of the NEC3 termination provisions was equivalent to acceptance of a repudiatory breach, *"no employer under the NEC3 form would ever need to do any more to terminate that widely used contract form than serve a notice expressly stating that the employer was accepting a repudiatory breach... safe in the knowledge that any error in characterisation of the alleged breach as repudiatory would be of no detrimental effect because it could be dressed up as exercise of the contractual mechanism"*. This would render the whole contractual termination process *"redundant and unnecessary"*.

Measure of damages for defects

Notwithstanding that ICI was in repudiatory breach, ICI remained entitled to damages for the defects in MMT's works. Since ICI had not allowed MMT to remain on site to remedy the defects, the correct measure of damages for the defects was the amount it would have cost MMT to repair them (which is likely to be a substantially lower cost than the cost to ICI of engaging a third party to carry out the remedial work).

Analysis

This case demonstrates the serious risks of alleging repudiatory breach of contract without having solid evidence to support the allegations of breach. ICI was driven by a commercial desire to remove MMT from the project, but did not have sufficient evidence to support its claims and consequently ended up in repudiatory breach itself. This will result in ICI losing even more money on a project which was already over budget. Termination for repudiatory breach should generally only be considered a last resort and is certainly not a quick fix for getting rid of an unwanted contractor.

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