



REPLACEMENT OF THE CONTRACTOR: NAVIGATING THE PITFALLS BETWEEN SUBSTITUTION, PARTIAL TERMINATION AND VARIATION

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It is frequent in complex construction projects that the contractor fails to complete certain separable construction tasks in accordance with the agreed schedule and that the employer therefore seeks to replace the laggard for those specific tasks, while continuing the cooperation for the remaining project works (be it because those works are performed diligently or to minimize delay and disruption regarding the entire project). For example, the installation of the cooling system for a power plant may be delayed beyond the agreed milestones while the construction of the rest of the project progresses as planned. Despite the frequency of the issue, it is often not addressed in construction contracts, including widely-used model contracts, such as those of the International Federation of Consulting Engineers (“FIDIC”) or the Swiss Society of Engineers and Architects (“SIA”). This note casts some light on the available remedies in situations where a contractor is replaced and highlights possible issues that parties, and in particular employers, should be conscious of when negotiating construction contracts or in an actual replacement scenario.

REPLACEMENT OF THE CONTRACTOR UNDER A FIDIC MODEL CONTRACT

For the purposes of this analysis, we refer to the recently published second edition of the FIDIC “Yellow Book”, the 2017 FIDIC Conditions of Contract for Plant and Design-Build for Electrical and Mechanical Plant, and for Building and Engineering Works, Designed by the Contractor. The provisions on the replacement of a contractor in other FIDIC model contracts are identical or similar.

The FIDIC Yellow Book does not expressly address the replacement of contractors. If a contractor fails to meet certain milestones for the construction works or specified sections thereof, it is liable for delay damages (Article 8.8 FIDIC Yellow Book), typically in the form of liquidated damages for each day of delay. However, an employer may prefer to substitute the contractor for certain tasks if it considers that this might increase the chances of a timely completion of a project. Besides, delay damages are typically capped at a certain percentage of the contract price and will thus lose their deterring effect once the agreed cap has been reached.

As an alternative remedy pursuant to the FIDIC Yellow Book, an employer can terminate the contract after having first given a notice to correct (Article 15.1 FIDIC Yellow Book) if the contractor “without reasonable excuse” fails

to proceed with the works in accordance with the contract schedule or if the employer is entitled to claim delay damages exceeding the agreed cap (Article 15.2.1(c) FIDIC Yellow Book). Upon termination of the contract, the employer may complete the work itself or arrange for other entities to do so (Article 15.2.4 FIDIC Yellow Book); in addition, the employer may also claim from the contractor any further costs for the execution of the works as well as any losses or damage suffered as a result of their completion (Article 15.4 FIDIC Yellow Book).

However, the FIDIC Yellow Book does not contemplate a termination of the contract that is limited to certain parts of the work; a complete termination, however, may unnecessarily interrupt the project if a contractor is only behind schedule regarding certain parts of the work. As a result, the employer may prefer to exempt the delayed task from the contractor's scope of work by instructing a variation of the work (Article 13.3.1 FIDIC Yellow Book), a mechanism designed to address any changes to the work, including reductions in scope (Article 1.1.88 FIDIC Yellow Book). In this case, however, the employer will not be entitled to recover any costs resulting from the replacement of the contractor. Contrary to other model contracts (such as the SIA model contract discussed below), in respect of remedies, the FIDIC model contracts are self-contained in the sense that they do not require, or even exclude, recourse to claims under non-mandatory provisions of national laws. In the case of the replacement of a contractor, Articles 8.8 and 15.2.4 of the FIDIC Yellow Book indeed restrict the employer to the contractual remedies, under exclusion of possibly more extensive remedies otherwise available under national laws.

REPLACEMENT OF THE CONTRACTOR UNDER A SIA MODEL CONTRACT AND SWISS LAW

The SIA model construction contract (SIA norm 118:2013, hereinafter "SIA 118") does not expressly address the replacement of contractors either. Like under a FIDIC Yellow Book contract, however, a contractor who fails to meet construction milestones is liable for damages, typically in the form of liquidated damages (Articles 97-98 SIA 118). However, in contrast to a FIDIC contract, the SIA 118 contract is not self-contained regarding remedies, but instead refers to certain remedies available under Swiss law.

Hence, under Article 96(4) SIA 118, if a section of the project is delayed prior to its specific takeover date, the employer may rely on Article 366(1) of the Swiss Code of Obligations ("CO") to terminate the contract. This is the case where the contractor commences the work too late or delays progress without an excuse (i.e. where the contractor has no right to suspend the work or to an extension of time), so that a timely completion of the project cannot be expected (Article 366(1) CO).

If a project, or a section thereof, is delayed beyond the agreed takeover date, the employer has the same right to terminate under Article 107(2) CO (effectively, Article 366(1) CO extends the application of delay remedies to the phase prior to takeover as under a work contract the contractor is considered to owe not only the completion of the work but also its execution).

Irrespective of whether the delay and the termination occur before or after the takeover date, the employer is entitled to damages if the contractor cannot establish that it is not responsible for the delay. The delay damages in case of termination are not limited to liquidated damages, but any liquidated damages already paid will be deducted from the damages claim (Articles 98(3), 96(4) SIA 118).

While not expressly addressed in the SIA model contract, under Articles 366(1) and 107(2) CO, respectively, a termination of the contract limited to a specific section of the works remains possible. Hence the employer can use the termination remedy to replace a contractor for specific parts of the work for which separate milestones and takeover dates have been scheduled and to recover the costs of the replacement through claiming damages from the replaced contractor.

However, the employer bears the risk of having to compensate the replaced contractor if the conditions of the termination are not met. A termination without cause under Article 377 CO (Article 184 SIA 118) triggers the contractor's claim to full compensation (except for savings resulting from the reduced scope of work).

While it is also possible in principle for an employer to reduce the contractor's scope of work through a variation, Article 84(1) SIA 118 provides that the replacement of a contractor is not considered to be an admissible variation, unless the employer has reserved the right to reassign specific parts of the work in the tender documents (Articles 84(5), 11 SIA 188).

CONCLUSION

The FIDIC Conditions of Contract do not allow employers to replace contractors for parts of the work; the replacement can only be achieved in the context of a termination of the entire contract. Regarding the replacement of a contractor, the FIDIC Conditions of Contract further exclude recourse to remedies available under (non-mandatory) national laws. This is different under a SIA 118 contract, which expressly refers to remedies available under Swiss law. It is the application of Swiss law that grants employers the possibility to replace a contractor and claim reimbursement of costs in specific circumstances. However, additional clarity as to the requirements and legal consequences of the replacement of a contractor

is desirable both from the employer's and the contractor's perspective, as the employer bears the risk of having to pay full compensation if the conditions for replacement are not met (in addition to the costs of the replacement) and the contractor has an interest in transparency as to whether its compensation claim survives despite the replacement.

Under both FIDIC and SIA 118 contracts, parties are therefore well advised to anticipate the possible need for a replacement when drafting their contract, and to define substantive and procedural conditions for the substitution of the contractor. To this end, a substitution clause should (i) identify the milestones relevant to the completion of specific tasks, and whether substitution should be possible already before those dates if timely completion appears unrealistic; (ii) exclude defined cases of excusable delay (possibly by reference to the relevant extension of time provisions); (iii) define a notice requirement, including the circumstances where no notice is required; (iv) allocate costs and risks of the replacement work; and (v) define the consequences for the replaced contractor's compensation and a procedure to value work already performed, including whether compliance with such procedure constitutes a requirement for substitution.