

## Your Contractual Questions Answered

# Is Determination Of Employment And Termination Of Contract The Same In Meaning And Implications?

By The Entrusty Group

**Entrusty Group, a multi-disciplinary group of companies, of which, one of their specialisation is in project, commercial and contractual management, has been running a regular contractual questions and answers section for Master Builders members in the Master Builders Journal.**

**In this instalment of this series, Entrusty Group will provide the answer to another frequently asked question above.**

One of the common problems in the construction industry which usually has serious implications on the project and the parties concerned is termination of contract or determination of employment by the Employer or Contractor. The action of determination or termination almost always brings the contracting parties into arbitration or litigation. However, although the implications are serious for the parties concerned to arrive at such a precarious state, many players in the construction industry still lack the understanding and appreciation of the difference between determination of employment and termination of contract. Often the term has been construed, mistakenly, as being the same in meaning and implications when in fact they are somewhat different and can be well distinguished. Further, it is often said that a contract has been determined or the Contractor's employment has been terminated, which in the strictest sense and interpretation, is wrong. It means that although the employment of the contractor has ended, the contract nevertheless still subsists but the rights and obligations of the parties are governed by the post determination provisions as set out in the contract.

This article serves to clarify and act as a guideline for Employers and Contractors including Sub-contractors to exercise their rights contractually and/or at common law, carefully and with caution when a contracting party chooses to embark on such drastic recourse or remedy for breach committed by the other party in the contract.

### What is Determination of Employment?

When used in the context of construction contracts, the word 'determination' is employed in connection with the bringing to an end the Contractor's employment under the particular contract. In determination, it is the Contractor's obligation and responsibility to carry out the works under the contract that is terminated and not the contract. The contractual and common law rights of the parties remained intact and are not invalidated due to the determination.

Most of the Malaysian standard forms of construction contracts only carry provisions for determination of the Contractor's employment by the Employer in the event of

specified breach by the Contractor of its obligation to complete the works accordingly or conversely determination of its own employment by the Contractor if Employer breaches its contractual obligations as provided in the particular contract. PAM 2006 & PAM 1998 cl 25 & cl 26, IEM 1989 cl 51 & 52 and CIDB 2000 cl 44 & cl 45 provide for determination of the Contractor's employment by either contracting parties except for JKR 203A cl 51 and JKR DB/T cl 54 which provide for determination of Contractor's employment by the Employer only.

### What is Termination of Contract?

Termination of contract occurs when a valid and enforceable contract is brought to an end either by becoming impossible to perform due to unforeseeable circumstances at the time the contract was formed or by the actions of one or both parties.

Termination at common law can be done through repudiation in a narrow sense where the repudiating party refuses to perform the contract or by defective performance where a contracting party's performance is so grossly defective as to go

to the root of the contract. It takes place when the guilty party commits any repudiation, which is a breach of a fundamental term. This is a condition that the parties have expressly or impliedly agreed to be crucial so much so that its breach entitles the innocent party to discharge himself from further performance under the contract. This is provided and illustrated in Section 40 of the Contracts Act 1950. The entire contract is brought to an end and parties are excused from further performance when the contract is repudiated by one party and the other party accepts the repudiation. When repudiation occurs, the innocent party can sue for damages resulting from the breach of contract. This is provided and illustrated in Section 76 of the Contracts Act 1950.

However, a contract may be also terminated by exercise of express rights set out in the provision/s of the contract itself, which may have similar wordings and implications to a determination clause as provided under most of the standard forms of construction contracts. Examples of which, are 'Termination for Convenience', 'Termination by Default' or 'Termination without Default' clauses. The Employer may terminate the contract by exercising powers expressly provided under such termination clauses. Such clauses, which often come with certain procedures and terms, somewhat improve the common law rights of the parties by giving specific grounds for termination which would not normally entitle one party to terminate at common law. Nevertheless it must be appreciated that such express termination is conceptually different from the determination of the employment of the contractor in that by such termination, the rights and obligations of the parties are arguably that as if the contract has been terminated at common law even though the parties may have

prescribed the consequential express rights and obligations.

### **Determination of Employment under Construction Contracts**

The determination of employment clauses in most of the standard forms of construction contracts set out the following basic outline:

- (a) Either party may determine the employment by giving notice of default. If the defaulting party fails to remedy the default within a required period, a notice of determination is issued to the defaulting party provided it is not be given unreasonably or vexatiously;
- (b) A list of events of default entitling a party to distinguish between remediable and non-remediable defaults; and
- (c) Available solutions for the non-defaulting party in the event of determination.

Under most construction contracts, determination of Contractor's employment may be exercised either by the Employer or the Contractor, as described below. There is no such provision for determination of the Employer's employment, as the Contractor cannot determine the Employer's employment other than to determine its own employment under the contract.

### **Determination of Contractor's Employment by Employer under Construction Contracts**

As stipulated under most construction contract provisions on determination procedures, the Architect/P.D./Engineer/S.O. must give the Contractor notice by registered post specifying the defaults, provided that such notice is not given unreasonably or vexatiously. If the Contractor does not attempt to remedy the defaults within 14 days after receipt of such notice, then the Employer may within a further ten days determine the employment of

the Contractor under the contract. Same or similar provisions can be found under PAM 2006 & PAM 1998 cl 25.2, JKR 203A cl 51 (a), JKR DB/T cl 54.1, IEM 1989 cl 51 (a) and CIDB 2000 cl 44.1 (a), (b) & (d).

Further, in the event of the Contractor's insolvency or bankruptcy, the employment of the Contractor under the contracts shall be automatically determined and the notice of default is not required under PAM 2006 & PAM 1998 cl 25.3. However, under JKR 203A cl 51 (b), JKR DB/T cl 54.2 and IEM 1989 cl 51 (b), the Employer may without prejudice to any other rights, send a notice by registered post to determine the employment of the Contractor. In the case of CIDB 2000 cl 44.2, the Employer may without prejudice to any other rights or remedies, by notice, determine the employment of the Contractor under contract and the determination takes effect on the date of the receipt of notice.

CIDB 2000 cl 44.1 (c) also provides for situation when the Contractor ends the Specified Default or the Employer does not give further notice to determine but the Contractor repeats the Specified Default, then the Employer may without prejudice to any other rights or remedies, by a further notice, determine the employment of the Contractor and such determination takes effect on the date of the receipt of notice.

In addition, the Employer may proceed to claim for the performance security deposit (i.e. Bank Guarantee, Performance Bond, etc) against the issuing body and use the deposit to set off any direct loss and expense claim incurred by the Employer due to the Contractor's default leading to determination of Contractor's employment.

The following *Table 1* tabulates the Employer's express rights to determine the Contractor's employment upon the Contractor's

**Table 1: Express Rights of the Employer to determine the Contractor's Employment upon the Contractor's defaults**

Contractor's Defaults	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
Fails to commence Works in accordance with the Contract	CI 25.1 (a)					CI 44.1 (a) (i)
Fails to provide Performance Security Deposit						CI 44.1 (a) (ii)
Suspension of Works	CI 25.1 (b)	CI 25.1 (i)	CI 51 (a) (i)	CI 54.1 (a)	CI 51 (a) (i)	CI 44.1 (a) (iii)
Fails to proceed regularly and diligently	CI 25.1 (c)	CI 25.1 (ii)	CI 51 (a) (ii)	CI 54.1 (b)	CI 51 (a) (ii)	CI 44.1 (a) (iv)
Fails to execute Works in accordance with the Contract			CI 51 (a) (iii)	CI 54.1(c)	CI 51 (a) (iii)	
Fails to remove defective work		CI 25.1 (iii)	CI 51 (a) (iv)	CI 54.1 (d)	CI 51 (a) (iv)	CI 44.1 (a) (v)
Assignment or Sub-letting without consent	CI 25.1 (e)	CI 25.1 (iv)	CI 51 (a) (v)	CI 54.1 (e)	CI 51 (a) (v)	CI 44.1 (a) (vi)
Abandoned the Contract	CI 25.1 (f)	CI 25.1 (v)				
Failure to comply with Architect/ P.D./Engineer/S.O.'s instructions	CI 25.1 (d)	CI 25.1 (vi)				CI 44.1 (a) (vii)
Contractor's bankruptcy	CI 25.3	CI 25.3	CI 51 (b) (i), (ii), (iii) & (iv)	CI 54.2 (a), (b), (c) & (d)	CI 51 (b) (i), (ii), (iii) & (iv)	CI 44.2 (a), (b), (c) & (d)

**Table 2: Rights and Duties of Employer and Contractor for Determination of Contractor's Employment by Employer**

Brief Description of Relevant Contract Clauses	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
The Contractor must vacate the site and remove all equipment and personnel (including his sub-contractors)	25.4 (a) & (c)	25.4 (i) & (iii)	51 (c) (i) & (iv)	54.3 (a) & (d)	51 (c) (i) & (iv)	44.3 (a) & (b)
The Employer is entitled by himself or to employ others to complete the outstanding works	25.4 (a)	25.4 (i)	51 (c) (ii)	54.3 (b)	51 (c) (ii)	44.3 (c)
The Contractor is not entitled to any monies until after completion of the outstanding works by the Employer	25.4 (d)	25.4 (iv)	51 (c) (v) & (vi)	54.3 (e) & (f)	51 (c) (v) & (vi)	44.3 (e) & (f)
The Contractor must assign to the Employer, contracts with his suppliers and sub-contractors upon notice by the Employer	25.4 (a) & (b)	25.4 (ii)	51 (c) (iii)	54.3 (c)	51 (c) (iii)	44.3 (d)
The Employer to claim expenses, loss and damages suffered.	25.4 (d)	25.4 (iv)	51 (c) (v)	54.3 (e)	51 (c) (v)	44.3 (f)

defaults and *Table 2* summarizes the rights and duties of the Employer or Contractor upon determination of the Contractor's employment by Employer.

### Determination of Own Employment by Contractor under Construction Contracts

As stipulated under PAM 1998 cl 26.1 and IEM 1989 cl 52 (a), the Contractor is required to issue notice by

registered post or recorded delivery to determine its own employment under contract. Under PAM 2006 cl 26.2 and CIDB 2000 cl 45.1 (b), the Contractor must give 14-days default notice to the Employer. If the Employer continues with the default, the Contractor may within ten days after the expiry of the 14 day notice by a further notice determine his own employment, provided that such notice is not given unreasonably or vexatiously.

Further, in the event of the Employer's insolvency or bankruptcy, the employment of the Contractor under the contracts is automatically determined and the notice of default is not required under PAM 2006 cl 26.3. However, under CIDB 2000 cl 45.2, the Contractor may without prejudice to any other rights or remedies by a notice determine its own employment under contract and the determination takes effect on the date of the receipt of notice.

JKR 203A and DB/T contracts do not have any provisions for the Contractor to determine its own employment.

CIDB 2000 cl 45.1 (c) also provides that in the event if the Employer ends the Specified Default or the Contractor does not give further notice to determine but the Employer repeats the Specified Default then the Contractor may without prejudice to any other rights or remedies may by a further notice to the Employer, to determine its own employment under contract and the determination takes effect on the date of the receipt of notice.

In addition, the Contractor is given a right under PAM 1998 cl

26.3 to detain all unfixed goods and materials which may become the property of the Employer as security for all monies due to him. Further, the Contractor is entitled to be returned the performance security deposit furnished to the Employer, unless it has an express term covering the eventuality of automatically lapsing upon determination of own employment by the Contractor.

The following *Table 3* indicates the express rights of the Contractor to determine its own employment upon the Employer's default and *Table 4* summarizes the rights and duties of the Employer or Contractor for determination of its own employment by the Contractor.

## Termination of Contract at Common Law

The termination of contract at common law is a serious step which should be taken only after careful consideration and appropriate professional advice sought. The right to terminating a contract depends on the nature and the seriousness of the consequences of the other party's breach. The breach must either be of a fundamental term of the contract, often described as one that goes to the root of the contract, or alternatively the consequences of the breach must be such that they substantially deprive the innocent party of the entire benefit intended by the contract.

**Table 3: Express Rights of the Contractor to determine its Own Employment upon the Employer's defaults**

Employer's Defaults	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
Failure to pay	Cl 26.1 (a)	Cl 26.1 (i)	-	-	Cl 52 (a) (i)	Cl 45.1 (a) (i)
Interference with Certificates	Cl 26.1 (b)	Cl 26.1 (ii)	-	-	Cl 52 (a) (ii)	Cl 45.1 (a) (ii)
Suspension of Works	Cl 26.1 (d)	Cl 26.1 (iv)	-	-	-	-
Failure to appoint S.O. upon his death	26.1 (c)	-	-	-	-	Cl 45.1 (a) (iii)
Employer's Insolvency	26.3	Cl 26.1 (iii)	-	-	Cl 52 (a) (iii)	Cl 45.2 (a), (b), (c) & (d)

Note: JKR form of contract does not allow for the rights of the Contractor to determine his own employment upon the Employer's defaults.

**Table 4: Rights and Duties of Employer or Contractor for Determination of its Own Employment by Contractor**

Brief Description of Relevant Contract Clauses	PAM 2006	PAM 1998	JKR 203A	JKR DB/T	IEM 1989	CIDB 2000
The Contractor to cease works and vacate the site and remove all equipment and personnel (including his sub-contractors)	26.4 (a)	26.2 (i)	-	-	52 (b)	45.3 (a)
The Contractor is entitled to be paid the amount representing the value of the works done to date resulting from the determination	26.4 (b)	26.2 (ii)	-	-	-	45.3 (b) & (c)
The Contractor is entitled for loss and expense suffered by them resulting from the determination	26.4(b)	26.2 (ii)	-	-	-	45.3 (b)

Note: JKR forms of building contract does not allow for the rights and duties of Employer or Contractor for Determination of Own Employment by Contractor

The following relevant case laws discuss the typical grounds that may constitute repudiation by the Employer or Contractor, as the case may be, to cause a termination of contract at common law:

(a) Failure to give possession of the site

In the case of *Attorney General of Singapore v Wong Wai Cheng Trading and Union Contractors (1980)* - The Court of Appeal in Singapore held that a delay in site possession by a period of 30 months which was in excess of the contract period (24 months) itself was not a fundamental breach having regard to the express provisions in the contract that shows that the parties had clearly contemplated at the time the contract was made that hindrances and delays, including late site possession, to the execution of Works were to be allowed for. In the event of such delays, the contract expressly provides that the Contractor would be compensated. The Court came to the conclusion that there was no fundamental breach unless the continued performance by the Contractor under contract was rendered impossible or would result in something totally different from that which the contract contemplated.

(b) Failure to Pay

*Haji Abu Kassim v Tegap Construction Sdn Bhd (1981)* - The Judges at the Court of Appeal agreed with the High Court Judge's decision that the termination of the contract was bad in law and the appellant had failed to honour the architect's certificate. It was found that at that relevant time, the appellant did not have the funds to make payment and used the complaint that the respondent used inferior materials in construction as a breach of agreement, which was found to be completely without merit.

*Lep Air Services Ltd v Rolloswin (1973)* - The House of Lords held



Construction work in progress

that the payment of £10,060 out of £24,000 due as payable in instalments was a breach as such, constituting a repudiation of the contract.

(c) Completion made impossible by prevention or hindrance

*Pembinaan LCL Sdn Bhd v SK Styrofoam (M) Sdn Bhd (2007)* - This is a case where appellant wrote to the respondent that it was entitled to temporarily stop work based on physical impossibility or hindrance to doing work. The respondent terminated the contract after the appellant did not recommence work. Arbitration took place where the Arbitrator ruled that the respondent's termination of the contract was invalid and consequently the respondent had acted in breach of contract. However, when the respondent challenged the Arbitrator's decision, the High Court Judge held that the Arbitrator had committed errors of law and set aside the Arbitrator's award. Upon appeal in the Court of Appeal, the learned Judge was convinced with the Arbitrator's findings that the respondent was in breach of contract because its notice of termination was bad at common

law rendering the award beyond attack. The learned Judge set aside the High Court Judge's orders and restored the Arbitrator's award.

*William Cory & Son Ltd v City of London Corporation (1951)* - Lord Asquith held that 'a term is necessarily implied in any contract that neither party shall prevent the other from performing it'. An Employer who without lawful excuse, by his acts of hindrance or prevention, renders impossible the completion of the Works by the Contractor could be held liable to have repudiated the contract.

(d) Abandoning the Works

*Cheok Hock Beng v Lim Thiam Siong (1992)* - The owners of the land terminated the agreement with the developer on the grounds that the developer had repudiated them by failing to carry out construction works or unable to perform them. The High Court found that the plaintiffs (owners) were entitled to repudiate the agreement and an order that the possession of the land be given back to the plaintiff.

*Rice v Great Yarmouth Borough Council (2003)* - In this case Great Yarmouth Borough Council argued

that an express termination clause should be applied literally, that the council could terminate Rice's four-year employment contract as gardener for a breach of any of his obligations under the Contract by abandoning his works. However, the Court of Appeal said the idea that the clause 'would entitle the council to terminate a contract such as this at any time for any breach of any term flies in the face of commercial common sense.' The court made clear that despite the reference to a breach of any obligation, before the contract could be terminated there had to be either a single breach serious enough to be repudiatory on its own or an accumulation of breaches that together could be described as repudiatory. The test applied was whether the council was deprived of substantially the whole benefit of what it had contracted for over a given period. It was held on facts that the test was not met and so Council was not entitled to terminate the contract which taking into account a drought during the summer and the Council's own behaviour that had contributed to Rice's inability to perform of his obligations and complete his works.

#### (e) Defective works

*DCMD Museum Associates v Shademaker (M) Sdn Bhd (1999)* – In this case, the plaintiff issued a notice of default (despatched 'By Hand' instead of 'registered post') requesting the defendant to remedy all faults within 14 days failing which the plaintiff would terminate the sub-contract. The defendant refused to accept the plaintiff's repudiation of the sub-contract and an injunction was granted by the court restraining the defendant from being on the construction site. The learned Judge agreed with the plaintiff that by service to the sub-contractor informing of default includes service by hand. Moreover, the defendant had replied to the notice refusing repudiation

or termination of sub-contract and therefore, the defendant cannot claim service of notice was not carried on him.

*Hoening v Issaacs (1952)* - In a lump sum contract which the sum is payable on completion, the Owner cannot refuse to pay although there are small items which are not in compliance with the specification of the contract when the work is substantially completed. The Owner is obliged to make prompt payment of the contract sum less an allowance based on the cost of completing the defective work. However, even if the Contractor completes the performance of the work in accordance with the specifications, the Owner waives the right to enforce such condition when he takes benefit of the work by using the apartment and defective furniture, as such, the Owner is obliged to pay to Contractor which he had completed the works after making the above described deductions of defective works. Further, defective works during the currency of the contract would only amount to a repudiatory breach where the defects are of such magnitude that the Contractor had no hope of rectifying them.

Interestingly, in the case of *Malayan Flour Mills Sdn Bhd v Raja Lope & Tan Co & Anor (1998)*, whereby pursuant to Cl.63 of the contract for the construction, completion and maintenance of civil and building works for a boiler breeder farm, the applicant terminated the services of the respondents and the dispute went before an arbitrator, who decided that the termination was unlawful in his interim award, based upon a Tanzanian Court of Appeal case of *Mvita Construction Co Ltd v Tanzania Harbours Authority (1988)*, which held that a party cannot resort to the common law remedy of acceptance of repudiation when they have relied upon a contractual term to exercise its power to

excuse the other party from further performance of their obligation under the contract.

In an originating motion application to the High Court, the applicant sought, apart from whether there was any misconduct on the part of the learned arbitrator, whether a party could resort to common law remedy where his rights under the contract had been exercised. It was held that '*Since the applicant had exercised his remedy under the contract, the applicant was bound by its terms. Accordingly, the applicant cannot resort to common law to govern the termination...*' The honourable High Court judge, Nik Hashim J, also found that there was no misconduct on the part of the learned arbitrator as he was right in his findings and conclusions. Since the termination was bad in law, it follows that the termination is unlawful.

#### Conclusion

A contract can be lawfully terminated by either a contractual determination or a common law termination.

In most of the standard forms of construction contracts, determination clauses are usually drafted as provisions for determination of Contractor's employment under contract, whereby the Contractor's duty or entitlement to carry out further work under contract ceases but the rights of the parties under the contract and at common law remain intact. A party may lawfully determine the Contractor's employment by exercising powers expressly provided for in the contract, usually under determination clause, as provided in most of standard forms of construction contracts. In common law termination, it takes place when the guilty party must have committed a fundamental or repudiatory breach and innocent party must have by word or action, elected to accept the repudiation.

This process does not depend on any express contractual provisions.

It is a good prudent practice to ensure that determination of employment clauses by the Employer/Contractor are included in the construction contracts to clearly and properly state the contractual rights and liabilities of the parties in the event of a contractual determination or termination before the execution of the contract to mitigate any future problems and arbitration/litigation proceedings, if the parties should need to take such drastic action. Any determination or termination must be exercised with considerable caution and care. The determining/terminating party must demonstrate that it has elected to determine the employment or terminate the contract by communicating to the other party, usually in writing. Any determination/termination notice provisions and/or procedures must strictly comply with the terms and conditions of the contract.

Notwithstanding, any party contemplating to determine or terminate, which is a serious action often with far reaching consequences, should only do so after due consideration and professional advice sought, prior to pursuing such drastic action which very often ends up in arbitration or litigation. Disputing parties should consider and attempt amicable settlement first by mutual termination, if possible. Another possible dispute resolution route is through alternative dispute resolution such as mediation, rather than to embark straight on to a long drawn and/or costly legal/arbitration proceedings to resolve their dispute. **MBJ**

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In the next issue of the MBAM journal the article will answer the question on **'Is Determination Of Employment And Termination Of Contract The Same In Meaning And Implications?'**



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