

CONSTRUCTION : BULLETIN

Placing Sub-Contracts: 6 Top Tips

We often come across situations where contractors have made mistakes when entering into sub-contracts and ended up exposed to serious problems. Sub-contracting is inherently risky and getting sub-contracts right is crucial. In this bulletin, we explain 6 top tips anyone engaging a sub-contractor should be aware of.

1. Simply stepping down the main contract is risky

Many contractors take the view that the easiest way of sub-contracting is to step down the obligations of the main contract so that the main contract is interpreted as if the contractor was the employer and the sub-contractor was the contractor. Although this is very simple, there can be a number of disadvantages:

- Directly stepped down timescales leave the contractor with no breathing space. For example, if there is a time limit for submitting extension of time claims under the main contract, the sub-contractor will be subject to the same time limit. If the sub-contractor waits until almost the end of the time limit to submit his application, the contractor will have hardly any time at all to make a corresponding application to the employer.
- There are quite often terms in the main contract that are difficult to interpret in a sub-contracting context.
- Payment terms should never be identical in a main contract and a sub-contract because the contractor has almost no time to react if, for example, he receives a pay less notice from the employer at 4pm on a Friday and the sub-contract requires him to issue a

- pay less notice to the sub-contractor on the same day.
- It is rarely appropriate to step down insurance provisions because this is likely to impose an obligation on the sub-contractor to obtain all risks insurance, which is unnecessary if the sub-contract works are covered by the main contractor's all risks insurance.

Some difficulties with interpretation can be overcome by stepping down the main contract on a *mutatis mutandis* basis. This means the stepped down sub-contract is interpreted by changing the terms as necessary to take into account the fact that a main contract is being applied to a sub-contracting scenario. However, this approach will not overcome problems associated with identical time periods and payment terms.

2. Use appropriate terms

The many risks that sub-contracting brings must be managed by engaging sub-contractors on terms appropriate to the nature of the project. When placing a sub-contract, the best option is to use a form of sub-contract tailored to suit the main contract. For example, if a JCT Design & Build Contract is being used, sub-contractors ought to be engaged using the JCT Design & Build Sub-Contract, and any bespoke amendments to the main contract should be reflected by making corresponding amendments to the sub-contract. However, this can be time consuming.

A less time consuming solution is for contractors to develop a suite of amendments to various different standard forms of sub-contract. The form of sub-contract is then chosen



Hawkswell Kilvington

Solicitors to the
Construction and
Engineering Industries

Hawkswell Kilvington

17 Navigation Court
Calder Park
Wakefield
WF2 7BJ

90 Long Acre
Covent Garden
London
WC2E 9RZ

T: 0844 809 9566
E: enquiries@hklegal.co.uk
W: www.hklegal.co.uk

based on what main contract is used. However, the sub-contract may not be completely back to back with the main contract as there may be bespoke amendments to the main contract that are not reflected in the standard amendments to the sub-contract. It is possible to use general “sweeping up” provisions to account for this risk (such as a clause that states that any limits on the contractor’s right to an extension of time apply to the sub-contractor too), but there is always a risk that such a clause might not be interpreted in the way the contractor had hoped.

As an alternative to standard form sub-contracts, the use of bespoke conditions of sub-contract is common. This is advantageous in that engaging sub-contractors across all projects on the same terms creates certainty. The downside is that a standard set of bespoke conditions will inevitably not correspond exactly with all types of standard form main contracts. Again, this can create gaps between the liabilities and obligations of the contractor and the sub-contractor.

3. Include a “pay when paid” clause

Contractors who do not include “pay when paid” clauses in their sub-contracts are effectively taking on the entire risk of the employer becoming insolvent. Without a “pay when paid” clause, if the employer goes into administration, the contractor will almost certainly not be paid, but will still be contractually obliged to pay all his sub-contractors for their work. This could have serious financial implications for the contractor. If a “pay when paid” clause is included, the contractor is able to rely on the “pay when paid” clause to withhold payment from his sub-contractors so that the impact of employer insolvency is less disastrous for the contractor.

4. Pass liability on downstream

It is essential for contractors to take steps to ensure that any claim they face from the employer in relation to defective sub-contracted work can be passed onto the relevant sub-contractor in full. This means the contractor should:

- Ensure the sub-contractor is subject to the same obligations as the contractor in terms of the quality and specification of the sub-contract works.
- Limit the sub-contractor’s liability at an appropriate level. It is no good having a sub-contractor who is carrying out a critical element of work limiting his liability to £500,000 when the contractor is on the hook for £10,000,000 if something goes wrong.
- Monitor the sub-contractor’s professional indemnity insurance renewals for the full legal limitation period.

If there are any gaps between the liability of the contractor and the liability of the sub-contractor, it is the contractor who will take the financial hit.

5. Ensure compliance with the main contract

To minimise the risk of gaps between the liability of the contractor and the liability of the sub-contractor, it is best practice for sub-contracts to contain a clause requiring the sub-contractor to carry out the sub-contract works in a way which complies with (and therefore does not put the contractor in breach of) the main contract. Sub-contractors are often required to indemnify the contractor if their actions result in the contractor breaching the main contract. Many of the JCT sub-contracts contain this type of clause as standard, but the NEC sub-contract does not.

It is important to note that this type of clause should not be used as the primary method of putting the sub-contractor on terms that are back to back with the main contract. If there is a crucial term in the main contract then it ought to be specifically incorporated into the sub-contract terms. This type of clause should really only be viewed as a safety net that picks up on all the more minor obligations that haven’t been directly incorporated into the sub-contract but which the sub-contractor should still comply with.

Many clauses of this type refer to the main contract as being “available for inspection” or having been “deemed to be inspected”. Whilst this does save the contractor the trouble of giving each sub-contractor a copy of the main contract, it is best practice to actually provide sub-contractors with a copy of the main contract. This eliminates the risk of sub-contractors attempting to argue that they cannot comply with the main contract because they haven’t seen it.

6. Limitation periods must be the same

If the main contract is executed as a deed, the contractor is liable for latent defects in the works for 12 years from the date of practical completion of the works. However, if the sub-contract has been signed as a simple contract, the sub-contractor is only liable for latent defects in the sub-contract works for 6 years from the date of practical completion of the sub-contract works. If the employer claims against the contractor for a latent defect 8 years after practical completion and the defects relate to the sub-contract works, the contractor is out of time to pass that claim on down the line to the sub-contractor. It is essential for contractors to ensure all sub-contracts are executed as deeds if the main contract is executed as a deed. The alternative is to sign the sub-contract as a simple contract and include a clause stating that the limitation period is 12 years, but this approach is riskier because the clause could be badly drafted or not interpreted in the way the contractor anticipated.

CONTACT DETAILS

Hawkswell Kilvington Limited

17 Navigation Court
Calder Park
Wakefield
WF2 7BJ

90 Long Acre
Covent Garden
London
WC2E 9RZ

T: 0844 809 9566

W: www.hklegal.co.uk

E: enquiries@hklegal.co.uk

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