



## Subcontracts

by Nicholas Gould, Partner

### Introduction

This paper considers some of the basic concepts of sub-contracting in the construction industry. By its nature, therefore, this paper, touches upon many other substantive areas of law that are central to the study of construction law and will consider some of the problematic issues arising in respect of the relationship between employers, main contractors and sub-contractors, as well as exploring issues arising in respect of nomination and its failures.

### Basic concepts

A main contractor may engage another person in order for that sub-contractor to undertake a specific part of the main contractor's works. While this concept is not new, it has arguably become more prevalent in the modern construction industry. Much of this is due to the complexity and specialised nature of modern construction. For example, the first edition of the Standard Method of Measurement issued in 1922 contained 16 different trades. The 1988 7<sup>th</sup> Edition refers to in excess of 300 separate specialist trades. There is therefore a wide variety of specialist sub-contractors operating within this industry.

A further reason for the use of sub-contractors is the increased flexibility afforded to main contractors who may expand or reduce their construction capabilities depending upon their workload. Nonetheless this flexibility must be contrasted with the need to manage, control, and select appropriate sub-contractors. Consideration should also be given to the benefits and risks associated with sub-contracting. These issues may of course be settled in the contract (if any) between the main contractor and the sub-contractor.

In this regard, there are a variety of general principles applicable to sub-contractor relationships. First, the main contractor remains responsible to the employer for all aspects of the sub-contract. In other words, the main contractor is still responsible for time, quality and paying the sub-contractor in accordance with the contract between the main contractor and sub-contractor regardless of any issue that could arise between the main contractor and the employer. This will of course depend upon the terms of the contract between the main contractor and a sub-contractor, and might also depend on the separate contract between the employer and main-contractor. However, they are nonetheless two separate contracts and the matching or integration of similar "back to back" obligations is often unsatisfactory.

### Privity of contract

There is no direct contractual link between the employer and the sub-contractor by virtue of the main contract. In other words, the main contractor is not the agent of the employer and conversely the employer's rights and obligations are in respect of the main contractor only. The employer therefore cannot sue the sub-contractor in the event that the sub-contractor's work is defective, is lacking in quality, or delays the works. On the other hand, the employer is only obliged to pay the main contractor and so sub-contractors

cannot sue the employer for the sub-contract price even if the main contractor defaults or becomes insolvent.

These simple concepts arise because of the general principle that there is no privity of contract ordinarily between the employer and a sub-contractor. However, the employer, main contractor, sub-contractor and supplier relationships are rarely this simple in practice. The employer may wish to influence the choice of sub-contractual supplier, or indeed the terms upon which a sub-contractor or supplier is engaged. An employer may seek to use a specific sub-contractor or insist on the main contractor choosing from a limited range of named sub-contractors to which the main contractor may or may not add further potential names. The main contractor may only be prepared to undertake certain sub-contract work on particular terms, or by limiting the main contractor's risk or payment obligations. In respect of payment, the main contractor may further wish to limit his exposure by part-paying sub-contractors or sharing the risk of the employer's insolvency.

The contractor is therefore, and subject to any specific terms to the contrary liable to the employer for any default of the sub-contractor. A contrary term is clause 25.4.7 of the JCT 1998 Standard Form of Building Contract which provides for extension of time to be awarded to the main contractor for delays caused by nominated sub-contractors and nominated suppliers. When a contractor engages a sub-contractor he is simply obtaining the vicarious performance of his own obligations to the employer. The JCT 2005 family of contracts has abandoned this approach.

### Personal or vicarious performance

In the case of *Davies v Collins*,<sup>1</sup> Lord Greene at page 249 said:

“...it is to be inferred that it is matter of indifference whether the work should be performed by the contracting party or by some sub-contractor whom he employs”.

Some contractual obligations may of course be personal. However, these are usually limited to classes of contract involving a personal service, where the identity of the person carrying out the service is important. For example, a named opera singer's appearance is probably fundamental to the performance of the contract. This is rarely the case in the construction industry. In any event, in most cases it will be possible to sub-contract some elements of a single project, as some obligations might be personal while others may be performed vicariously.<sup>2</sup>

Further issues that arise include the incorporation of the main contract terms into the sub-contract, which is often carried out with limited success or indeed complete failure. Sub-contract terms themselves are often incorporated by reference, and the “battle of the forms” is not infrequently encountered when attempting to work out the terms of the contract between the main contractor and sub-contractor. A further and related issue is the incorporation or otherwise of the dispute resolution procedure, in particular arbitration.

### Relationship between main contractor and sub-contractor

A distinction is often made in the construction industry between those sub-contractors that are “domestic” and those that are “nominated”. This distinction is taken to mean that a

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<sup>1</sup> [1945] 1 All ER 247

<sup>2</sup> *Southway Group Limited v Wolff and Wolff* (1991) 57 BLR 33 (CA).

domestic sub-contractor is one selected and employed by the main contractor, for whom the main contractor is solely and entirely responsible, while a nominated sub-contractor is one selected by the employer but employed by the main contractor. If a sub-contractor is nominated then the employer usually retains some liability, despite ingenious contract drafting techniques. Nomination is further considered below. In addition to these categories, one further category should be considered; namely, that of “named” sub-contractors.

The naming of sub-contractors is a species developed in the intermediate JCT form of contract. Essentially, the employer names one or more preferred sub-contractors. To that list the main contractor may add further potential sub-contractors. The cumulative list is then used for tendering purposes and a sub-contractor is selected by the main contractor. The sub-contractor is then treated as a domestic sub-contractor of the main contractor (therefore the main contractor being solely responsible for that sub-contractor) thus avoiding the employer liability disadvantages of nomination, but whilst giving the employer some element of involvement in the selection process.

The obligations between the sub-contractor and main contractor turn upon the construction of the sub-contract. Various standard forms of domestic sub-contract have been produced, for example the NEC Purple Form, FCEC Blue Form<sup>3</sup>, DOM/1, and DOM/2 forms.<sup>4</sup> References to the nominated sub-contract that exists are considered further below. In any event, the usual rules in respect of the construction of contracts apply. The contract between the sub-contractor and the main contractor is therefore considered objectively by reference to the express terms or implied terms and in isolation to the main contract. However, in one reported case the Court took into account the main contractor’s onerous position under the main contract when considering whether the contractor should have forfeited a sub-contract because of delay on the part of the sub-contractor.<sup>5</sup>

### Incorporation of contract terms

The completion of a formal written document containing all of the terms between the main contractor and the sub-contractor is something of a rarity in the construction industry. Sub-contracts are more usually formed (that is if they are formed at all) by way of an exchange of letters, or more frequently by the main contractor issuing a “purchase order” or some similarly titled document to the sub-contractor. The letter or order then seeks to incorporate the terms of the contract. It is, of course, acceptable to incorporate the essential terms of the sub-contract provided that those essential terms are agreed and the terms incorporated are clear in their effect.

In the case of *Modern Building Wales Limited v Limmer & Trinidad Co Limited*<sup>6</sup> the Court of Appeal considered the expression “fully in accordance with the appropriate form for nominated sub-contractor (RIBA 1965 Edition).” The court held that, in reliance upon expert evidence, that the trade would take this to mean the “Green Form” of nominated sub-contract. The court held that the words were sufficient to incorporate the Green Form including the arbitration agreement such that the court granted a stay of proceedings because of the existence of the arbitration agreement.

The case of *Modern Building* is perhaps the leading case (in respect of the pre-Arbitration Act 1996 position) in respect of the incorporation of arbitration clauses into construction contracts. The proposition is that the parties do not need to make an express nor a

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3 Federation of Civil Engineering Contractors, Standard Form of Sub-Contract for use with the ICE 6th Edition.

4 Standard Form of Sub-contract for Domestic Sub-contractors for use with the Domestic Sub-contract DOM/1; and in respect of those with design obligations DOM/2

5 *Stadhard v Lee* (1863) 3 BS 364

6 [1975] 1WLR 1281 CA; 14 BLR 101

specific reference to the arbitration clause, when the arbitration clause is included within a set of standard terms. In other words, a simple reference to the standard terms will incorporate the arbitration clause as well as the rest of the terms. This proposition seems straightforward and commercially sensible.

However, *Modern Building* should be contrasted against the argument that an arbitration clause must be specifically referred to, which arises from the House of Lords case of *T.W. Thomas & Co Limited v Portsea Steamship Co Ltd*.<sup>7</sup> In that case, it was held that an arbitration clause could only be incorporated in a charter party by specific reference to the arbitration clause itself. A reference to standard terms might incorporate those standard terms, but the arbitration clause in the standard terms would not also be transposed into the contract.

The approach of the courts, therefore, has not always been consistent. For example, in *Aughton Limited v MF Kent Services Limited*<sup>8</sup> Ralph Gibson LJ held that an arbitration agreement did not satisfy the statutory requirement for a written arbitration agreement set out in the Arbitration Act 1950 and was therefore not incorporated. He distinguished building contracts from shipping contracts, stating that it was not necessary to refer specifically to the arbitration clause in order to incorporate it and that general words might be adequate. On the other hand, the shipping case of *The Rena K* in similar circumstances held that the arbitration clause was included.<sup>9</sup>

Sir John Megaw in *Aughton v Kent* adopted a more restricted approach stating that an “express and specific” reference to the arbitration clause would always be necessary in order to incorporate it in the contract between the parties. His approach was in the minority, and so not binding. However, his view is, it is submitted, also inconsistent with the proposition in *Modern Building* (but consistent with *Portsea Steamship*).

The requirement for an express reference to arbitration in the primary agreement between the parties was rejected in *Extrudakerb (Maltby Engineering) Ltd v Whitemountain Quarries Limited*.<sup>10</sup> The main contractor was carrying out resurfacing works, and the plaintiff provided their quotation for the surface water channel. The main contractor’s counter offer stated:

“The sub-contract will be the FCEC [Federation of Civil Engineering Contractors] form of sub-contract and the main conditions are G/C Works 1 (Edition 3) lump sum with quantities.”

A dispute arose and the plaintiff sub-contractor issued a writ. The defendant then applied for a stay because the FCEC Form of Contract contained an arbitration clause.

Lord Justice Carswell held that an arbitration clause could be incorporated into a building sub-contract even without a specific reference to the clause. The Judge applied the “officious bystander” test, and concluded that if such a person had been asked whether the parties had considered whether the arbitration clause should apply then the answer would clearly have been yes. This was on the basis that the parties were familiar with the terms of the FCEC Form of Sub-contract and both knew perfectly well that it contained an arbitration clause. As the parties understood the contract, and knew of the arbitration clause they both clearly intended to incorporate the arbitration clause when referring to the FCEC Form of Contract.

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7 [1912] AC 1

8 (1991) 31 CON LR 60

9 [1979] 1 All ER 397

10 [1996] Times, 10th July Northern Ireland Report, 18th April 1996

A further exception is the case of *Ben Barratt & Son (Brickwork) Limited v Henry Boot Management Limited*.<sup>11</sup> In that case reference to another document which contained an arbitration clause was not sufficient to incorporate the arbitration clause. Boot was a management contractor for work at the University of Manchester and the plaintiffs were brickwork sub-contractors. They started work on the basis of the letter of intent that said that the works would be carried out in accordance with the Works Contract/2 JCT Form. The letter of intent was found to amount to a contract. His Honour Judge John Lloyd QC considered that the different approaches of Ralph Gibson LJ and Sir John Megaw were irreconcilable.

He also placed great emphasis on the House of Lords decision of *Thomas v Portsea*, and then also the more recent House of Lords case of *Bremer Vulcan Schiffbau Und Maschinenfabrik v South India Shipping Corporation Limited*.<sup>12</sup> In that case Lord Diplock stated that the arbitration clause was a self contained contract, separate from the contract between the parties. As *Modern Building* preceded the *Bremer Vulcan* in the House of Lords by some 5 years, His Honour Judge John Lloyd QC appears to distinguish *Modern Building*, possibly on the basis that the arbitration clause, being a separate contract, needs to be specifically mentioned on the face of the letter of intent in order to be incorporated.

Nonetheless, this controversy may now have been resolved by the Arbitration Act 1996. The important requirement that an arbitration clause must be in writing has been retained by the Arbitration Act 1996, but section 5 is intended to resolve these incorporation by reference problems. Section 5(2) states that there is an agreement in writing if it is made in writing (whether signed or not by the parties), is made in an exchange of communications, or is "evidenced in writing".<sup>13</sup> Section 5(3) states:

"Where parties agree otherwise than in writing by reference to terms which are in writing, they make an agreement in writing."

Section 5(4) states:

"An agreement can be "evidenced" in writing if recorded by one of the parties or a third party with the parties agreement."

The Departmental Advisory Committee Report specifically states that this part of the Arbitration Act is an attempt to make it clear that an arbitration agreement can be incorporated by reference without being specifically referred to on the face of the contract, thus resolving the different approaches of *Aughton v Kent* and *Ben Barratt*.

Section 5 appears in precisely the same terms at section 107 of the Housing Grants, Construction and Regeneration Act 1996. The case of *RJT Consulting Engineers v. DM Engineering (NI) Limited*<sup>14</sup> considered the application of section 107 in respect of adjudication. This was an appeal from the TCC decision of HHJ Mackay, who dismissed RJT's claim for a declaration that the construction contract was not an "agreement in writing" within section 107 of the Act. The adjudicator had decided that the oral contract was sufficiently evidenced in writing by drawings, schedules and minutes of the meeting etc. HHJ Mackay agreed.

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11 [1995] CILL 1026.  
12 (1981) AC 909; [1981] All ER 289  
13 Section 5(2) Arbitration Act 1996.  
14 [2002] EWCA Civ 270

However, the appeal was allowed by the Court of Appeal. Lord Justice Ward and Lord Justice Robert Walker held that all of the terms of the construction contract had to be

evidenced in writing. It was not sufficient for merely the material terms, such as the identity of the parties, nature of the work and price, to be recorded in writing. Further, even if they were wrong, the documents relied upon in this particular case were described as "wholly insufficient".

Auld J considered that only the material terms of the agreement were required, and therefore trivial or unrelated issues did not need to be recorded. But his approach was not shared by the majority. So on one view, all of the terms of the contract need to be recorded in writing in order that a dispute under any contract can be referred to adjudication. In summary, the law relating to whether the arbitration clause was incorporated is:

Case/Law	Year	Court	Arb clause Incorporated?	Rational
<i>Thomas v Portsea</i>	1912	HL	No	Specific reference was needed. Shipping case
Arbitration Act 1950	1950			The arbitration agreement must be recorded in writing
<i>Modern Building</i>	1975	CA	Yes	A specific reference is not needed
Arbitration Act 1979	1979			Adds nothing
<i>Bremer Vulcan</i>	1981	CA		Arbitration agreement is a separate agreement
<i>Aughton v Kent</i>	1991	CA	No	The requirement for a written agreement under the AA 19950 was not satisfied. Sir John Megaw (minority) considered that a specific reference was always required.
<i>Ben Barrett</i>	1995	OR	No	<i>Modern Building</i> was in conflict (2 CA judges not agreeing). The new superior law of <i>Bremer</i> recognised that the arbitration agreement was separate to the principle agreement
<i>Extradakerb</i>	1996	NI	Yes	Parties knew that the arbitration agreement was in the standard form (based on the intention of the parties)

Arbitration Act 1996	1996			Must be in writing. Section 5 provides for incorporation by reference.
<i>RJT</i>	2002	CA	The whole agreement was NOT in writing	Adjudication case. HGCRA section 107 is in the same terms as AA 1996 section 5, but requires the whole agreement to be in writing, not just the adjudication provisions

### Incorporation of main contract terms

Far more interesting questions arise when attempting to incorporate the main contract terms into the sub-contract. A straightforward reference to those terms of incorporation is, of course, likely to cause a wide range of problems. If the main contract is directly incorporated, then the entire sub-contract, including the words of the main contractor, must be construed as between the main contractor and the sub-contractor.

Of particular interest is the case of *Geary, Walker & Co. Ltd v W Lawrence & Son*.<sup>15</sup> In that case the parties agreed that the “terms of payment for the work... shall be exactly the same as those set forth in clause 30 of the [main]... contract.” The amount of retention under the main contract would exceed the sum payable to the sub-contractor under the sub-contract by the end of the project. The Court of Appeal decided that the terms of the main contractor in respect of the payment were applicable, and also that retention should be withheld. However, the payments would be in the same proportion as the proportion of the sub-contract sum to the main contract sum. There was, therefore by implication, a pro-rata of the amount of retention by reference to the main contract payment mechanism.

A more recent, and perhaps a more frequently quoted case is that of *Brightside Kilpatrick Engineering Services v Mitchell Construction (1973) Limited*.<sup>16</sup> In that case the plaintiffs were nominated sub-contractors, and the central issue was whether the action should be stayed to arbitration. The main contractor was Mitchell Construction Limited, who became insolvent, but then the employer, Bracknell Development Corporation, entered into a new contract with Mitchell Construction (1973) Limited. That contract contained the words “the conditions applicable to the sub-contract with you shall be those embodied in the RIBA as above agreement”, which was a reference to JCT 63, (July 1971 revision) between the employer corporation, and Mitchell. There were also references to both the FASS “Green Form” and the “Yellow Form” but those had been deleted.

A dispute arose in respect of work done, but then the defendant claimed set-off for delay, and also argued that there should be a stay of the litigation pursuant to section 4 of the Arbitration Act 1950 because the true contract between them contained an arbitration clause. The Court of Appeal rather interestingly decided, regardless of the words stating that the RIBA conditions applied, that the JCT Form between the building owner and the main contractor was “wholly inapplicable” to the contract in respect of the sub-contractors. The words should be construed such that the sub-contract should be consistent with the terms of the main contract referring specifically to sub-contractors.

15 (1986) HBC (4th Edition) Vol 2, Page 382 CA

16 [1975] 2 Lloyd's Rep. 493 CA

Clause 27 dealt with main contractors and sub-contractors. The only sensible conclusion, according to the Court of Appeal, was that the sub-contract should be based on the terms of the FASS Green Form. Clause 8(a) required a certificate in writing from the architect, as a condition precedent to any claim by the main contractor against the sub-contractor in respect of damages for delay to the works. An architect's certificate had not been given and so the defendant, Mitchell Construction (1973) Limited had no right to have their claim heard in arbitration. The court therefore refused a stay and dismissed the appeal with costs against Mitchell.

In some respects this case demonstrates the unfortunate impact of the incorporation of contractual terms by reference, in this case for the contractor. The court places great emphasis on the architect's independent certifying role, when perhaps greater attention should be given to the fact that the architect is employed by the employer and the contractor is very much at the mercy of the architect when the architect is in such an important certifying role. It has been argued that in these circumstances the court should be very slow to take such a step that will effectively remove the contractor or sub-contractor's rights to claim. However, that may indeed have been the position under section 4 of the Arbitration Act 1950, but section 9 of the Arbitration Act 1996 is effectively a mandatory stay to arbitration thus removing the court's discretion in such circumstances.

### Delay

An issue relating to the incorporation of terms is risk in respect of delay. In the Court of Appeal case of *Martin Grant & Co Limited v Sir Lindsay Parkinson & Co Limited*.<sup>17</sup> The sub-contractor argued that common sense demanded that a term should be implied into the sub-contract to the effect that the sub-contractor should be able to organise its work in an efficient and profitable manner. In that case the plaintiff's were sub-contractors and the defendants main contractors. There were 4 substantial building contracts, but this case concerned just the first one. There had been some considerable delay and out of sequence working such that the sub-contractor brought a claim for damages for breach of an implied term.

Lawton LJ referred to the tender, which stated that the "sub-contractor has read the principal contract and the specification and bills of quantities..." which were embodied in the sub-contract. Clause 2 of the sub-contract stated that the sub-contractor was to provide all of his own materials and labour:

"... at such time or times and in such manner as the Contractor shall direct or require and observe and perform the terms and conditions of the Principal Contract so far as the same are applicable to the subject matter of this Contract..."

In addition, clause 3 required the sub-contractor to "proceed with the said works expeditiously and punctually to the requirements of the contractor...". Lawton LJ held that those words meant that if the main contract was extended then the sub-contractor's contract would also be extended and the sub-contractor would have to carry out such portions of the works and at such times as might be required by the contractor.

There was therefore a clear risk that the main contract, and of course the sub-contract, might take much longer than originally contemplated. He went on to hold that given



the express terms of the sub-contract there was no need for an implied term. The risk had been apportioned in the contract, and the risk and costs associated with out of sequence and uneconomic working lay with the sub-contractor.

### Dispute resolution

As the contract between the main contractor/sub-contractor and the main contractor/employer are 2 separate contracts the dispute resolution procedures need not be the same. For example, one might be subject to arbitration, and the other not, such that dispute would, in default of any other agreement, be heard in the court.

Arbitration has long been the traditional default method of dispute resolution in the construction industry. It is included in many of the standard forms, although more recently the JCT form has made arbitration optional. Nonetheless, there is a long history of arbitration in the construction industry. Given that the main contractor finds himself between the employer and the sub-contractor, the main contractor may seek to include an arbitration clause within the sub-contract.

The advantage is that disputes under the main contract and the sub-contract will be dealt with by way of arbitration, but the disadvantage is that as arbitration is a private process there could be two separate arbitrations about the same subject matter. In other words, by way of an example, the sub-contractor may bring a claim in arbitration against the main contractor, who may then seek to pass on that claim by way of arbitration to the employer. It is of course possible that different awards may be given such that a sub-contractor may be successful in its claim, whilst the main contractor may not. One way of resolving this problem is to establish a regime providing for a 3 party "tripartite" arbitration.

Terms providing for tripartite arbitration appear in some of the standard forms. The case of *MJ Gleeson Group plc v Wyatt of Snetterton Limited*<sup>18</sup> concerns clause 18(2) of the FCEC Standard Form of Sub-contract which was for use with the ICE Conditions.

In that case the employer was the Department of Transport who was in contract under the ICE Fifth Edition (1973) with Gleeson who were the main contractor. Gleeson then engaged Wyatt on the FCEC Form. A dispute arose in respect of the sub-contractor's final account. In June 1992 the sub-contractor wished to refer the matter to arbitration. On 6<sup>th</sup> August 1992 the main contractor gave notice pursuant to clause 18(2) requiring the dispute under the sub-contract to be dealt jointly with the dispute under the main contract.

Clause 18(2) states:

"If any dispute arises in connection with the Main Contract and the Contractor is of the opinion that such dispute touches or concerns the Sub-Contract Works, then provided that an arbitrator has not already been agreed or appointed... the Contractor may by notice in writing to the Sub-Contractor require that any such dispute under this Sub-Contract shall be dealt with jointly with the dispute under the Main Contract in accordance with the provisions of Clause 66 thereof. In connection with such dispute the Sub-Contractor shall be bound in a like manner as the Contractor by any decision of the Engineer or any award by an arbitrator." [emphasis added]

Clause 66 of the main contract required a decision of the engineer before a dispute could form. The sub-contract dispute marched on, and an arbitrator was appointed on 8<sup>th</sup> March 1993. At the preliminary hearing on 24<sup>th</sup> April 1993 the main contractor argued that the arbitrator had no jurisdiction because of the words of clause 18(2).

The Court of Appeal held that the main contractor had a right to serve a clause 18(2) Notice. The Notice was valid. The arbitrator appointed pursuant to the sub-contract therefore did not have any jurisdiction. It is important to note that clause 18(2) only operates if there is a dispute between the employer and the contractor, which concerns issues in respect of the sub-contractor. Further, if the main contractor had not reserved its position, but participated in the preliminary arbitration meeting then the court may have held that there had been an *ad-hoc* submission to arbitration. That did not apply in this case.

### Interaction between the main contract and sub-contract terms.

The interaction between the contractual provisions in the FCEC Blue Form and the ICE main contract were considered in two cases, the appeals of which were heard together in the Court of Appeal. *Mooney v Henry Boot Construction Limited*<sup>19</sup> and *Balfour Beatty v Kelston Sparkes Contractors Limited*<sup>20</sup> concerned appeals from a point of law in respect of arbitrators awards. The main contractors had reached settlement in respect of the main contract. Sub-contractors were unable to settle with the main contractors and received arbitration awards pursuant to the sub-contract. The arbitrators ordered the main contractors to pass on a proportion of the settlements recovered by the main contractor.

In *Mooney*, Judge Humphrey Lloyd QC considered that the main contractor was probably not due any payment under the main contract but was entitled to keep the windfall without passing anything on to the sub-contractor. In *Balfour Beatty*, Mr Recorder Crowther QC came to the conclusion that where an engineer under the main contract gave instructions as a result of unforeseen ground conditions, the sub-contractor was entitled to a fair proportion of any amount recovered by the main contractor. This was based upon the operation of clause 10(2) of the FCEC sub-contract and its interaction with clause 12 (dealing with unforeseen ground conditions) in the main contract.

Clause 10(2) of the FCEC Blue Form provided as follows:

“(1) Subject to the subcontractor’s complying with this sub-clause, the Contractor shall take all reasonable steps to secure from the employer such contractual benefits, if any as may be claimable in accordance with the Main contract on account of any adverse physical conditions or artificial obstructions or any other circumstances that may affect the execution of the subcontract Works and the subcontractor shall in sufficient time afford the Contractor all information and assistance that may be requisite to enable the Contractor to claim such benefits.

(2) On receiving any such contractual benefits from the Employer (including any extension of time) the Contractor shall in turn pass on to the subcontractor such proportion if any thereof as may in all the circumstances be fair and reasonable.

(3) Save as aforesaid the Contractor shall have no liability to the subcontractor in respect of any condition, obstruction or circumstance that may affect the execution of the subcontract Works and the subcontractor shall be deemed to have satisfied himself as to the correctness and sufficiency of the Price to cover the provision and doing by him of all the things necessary for the performance of his obligations under the subcontract.

(4) Provided always that nothing in this Clause shall prevent the subcontractor claiming for delays in the execution of the subcontract Works solely by the act or default of the Main Contractor on the ground only that the Main contractor has no remedy against the Employer for such delay."

A number of questions arose in the appeal:

1. Is clause 10(2) merely procedural or does it provide the sub-contractor with a substantive right?
2. Does clause 10(2) operate in respect of the amount actually recovered by the main contractor, or only in respect of what can be properly shown to have been recovered under the main contract?
3. What does "claimable benefit" in clause 10(2) mean?
4. Where the main contractor recovers money under clause 12 of the main contract then does clause 10(2) provide for recovery in respect of that sum recovered?

In summary, the Court of Appeal concluded:

1. Clause 10(2) is not merely procedural but gives the sub-contractor a substantive right to recovery.
2. Clause 10(2) operates in respect of what the main contractor actually recovers in respect of "claimable benefits".
3. A claimable benefit is one which is made in good faith.
4. Clause 10(2) only operates with regards to clause 12. It does not go as far as requiring the main contractor to hand over a proportion of its settlement.

In *Mooney* the Court of Appeal came to the conclusion that the sub-contract required the main contractor to pass on a fair and reasonable proportion of its recovery for unforeseen ground conditions claims. It was not acceptable to argue that the main contractor should be able to keep the entire settlement on the basis that there was no legal ground for a payment to the main contractor in the first place. The conclusion in the second case is more restrictive. Where a main contractor encounters unforeseen ground conditions, an engineer may or might not issue a variation. The contractor would be entitled to payment regardless, providing that the contractor can show that the ground conditions were unforeseen.

As a result of the Court of Appeal's analysis, the automatic sharing provisions of clause 10(2) of the sub-contract will only operate where the engineer does not issue a variation. If a variation is issued then other provisions of the sub-contract are relevant. So, in the end the sub-contractor may end up with the same or a very similar payment, but care will be needed in setting out and pleading the appropriate legal provisions depending upon whether a variation was or was not issued.

A final aspect of these cases suggests that contractual mechanisms which attempt to pass on benefits between the contracts may simply serve to lead to complex arguments about the interaction of the provisions. The difficulty is trying to strike a balance between contractual complexity and similarity in outcome in respect of related disputes.

### Name borrowing

A related problem area in dispute resolution is that of name borrowing. This procedure allows the nominated sub-contractor to commence arbitration proceedings against the employer, by "borrowing" the main contractor's name. This must be considered within the context of privity of contract, the fact that there are two separate contracts, (employer contractor, and then contractor sub-contractor) and also the strict requirement that the parties (bilaterally) must have agreed in writing to submit their disputes to arbitration.

A series of questions must then arise about the nature of name borrowing provisions. For example, what is the exact nature of the sub-contractor's right? How does the arbitration agreement manifest itself, for example, is the main contractor actually the claimant, or only nominally the claimant?

The case *Northern Regional Health Authority v. Derek Crouch Construction Co Limited*<sup>21</sup> concerned an appeal from an arbitrator's award. The issue was whether the court had the jurisdiction to open up, review and revise certificates given under the contract. The court held that they did not, but see the more recent House of Lords case of *Beaufort Development (Northern Ireland) Limited v Gilbert Ash (Northern Ireland) Limited*.<sup>22</sup> However, the sub-contractor, Crouch, was in that case exercising its right under the main contract to "borrow" the main contractor's name in order to bring the claim, and the court did not seek to take issue with the contractual mechanisms of the name borrowing provision.

For a further discussion of the name borrowing provisions in *Crouch*, and a subsequent case of *Stewart (Lorne) Limited v. William Sindall Plc and North West Thames Regional Health Authority*<sup>23</sup> see HHJ Thayne Forbes's analysis in *Gordan Durham & Co Limited v. Haden Young Limited*.<sup>24</sup>

The precise legal nature of name borrowing is a question that we may wait for some time for the Court to resolve. If there is an arbitration agreement, as indeed there usually is in the main contractor and a sub-contractor, then any issue with regards to name borrowing would find itself in arbitration rather than before the court. This is especially in the case given the mandatory stay in Section 9 of the Arbitration Act 1996.

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21 [1984] QB 644; 26 BLR 1

22 [1998] 2 All ER 778

23 (1986) 11 Con LR 99

24 (1990) 52 BLR 61

### A Licence to occupy the site

The access regime for the sub-contractor should be covered by the sub-contract. This is so that the main contractor can exert some control over the access to be afforded to all of the sub-contractors, thus giving the main contractor some control of the site. However, in the absence of any express terms there will be an implied licence that the sub-contractor may be afforded such reasonable access as will enable that sub-contractor to carry out and perform the sub-contract.

### Withholding payment, set-off and abatement

The general proposition is that a right to set-off can only be excluded by the use of very clear words.<sup>25</sup> Consideration must now also be given to the Housing Grants, Construction and Regeneration Act 1996. If the HGCR Act applies to the sub-contract, then a payment can only be withheld if the requirements of section 111 in respect of withholding notices have been complied with. That section requires that a notice be served within the agreed period before the final date for payment, or in default 7 days before the final date for payment. The notice must state, that an amount or amounts are to be withheld and the grounds for withholding that amount or each amount as appropriate.

If a contractor has a cross-claim, say for delay, against a nominated sub-contractor but the architect has certified an amount payable including an amount payable to the nominated sub-contractor, the main contractor may still be able to avoid immediate payment provided he can satisfy the court that there is a real prospect of successfully establishing the cross-claim.<sup>26</sup> The main contractor should also have served a section 111 notice if the HGCR Act applies.

These general propositions can of course be amended by the express terms of the contract. In this regard the intricate contractual provisions of clauses 4.26 to 4.29 of the NSC/C could be considered. Nonetheless, one starts from the House of Lords presumption in *Gilbert Ash v Modern Engineering*<sup>27</sup> that neither party intends to abandon any remedies, especially set-offs in the absence of any clear express words.

A HGCR Act section 111 notice is required in respect of the withholding of any amounts due under the contract. *SL Timber Systems Ltd v Carillion Construction Ltd*<sup>28</sup> is authority for the proposition that a withholding notice is only needed in respect of sums that are "due under the contract". Arguably, therefore, a withholding notice is not required in respect of an abatement, because an abatement can never be due under the contract. For example, an abatement in respect of a defective wall would not require a withholding notice, because payment in respect of the defective wall could never have been due under the contract in the first place because of its defect.

In the Court of Appeal decision, *Rupert Morgan Building Services Ltd v David Jervis & Harriett Jervis* (12 November 2003), Jervis withheld payment of part of an interim certificate but failed to issue a withholding notice as required by the UK Act.<sup>29</sup> Jervis asserted that it was still open to them to prove that items of work that made up the claim of Rupert Morgan were not done, were duplicated or represented snagging for work or which payment had already been made. Rupert Morgan contended that by virtue of section 111(1) of the UK Act, Jervis could not withhold payment.

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25 *Gilbert Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689 HL

26 *Gilbert Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689 HL

27 [1974] AC 689 HL

28 [2000] BLR 516

29 Construction Industry Law Letter 2003, 2051 et seq.

The Court of Appeal considered two conflicting interpretations as to the true meaning of section 111(1) of the UK Act, namely the “narrow” and the “wide” approach. The narrow construction, represented by Jervis, was to the effect that if work had not been done, there can be no “sum due under the contract” and, accordingly, section 111(1) does not apply.<sup>30</sup> The wider construction submitted by Rupert Morgan was that work not done cannot affect the due date but that section 111(1) of the UK Act applies and, in absence of a timeous withholding notice, the certified sum must be paid.<sup>31</sup>

The Court of Appeal preferred for the wider construction. The Court found that the parliamentary aim of section 111(1) of the UK Act was not simply to safeguard quick payment to the contractor if ordered so in the adjudication decision. LJ Jacob emphasised that the “fundamental thing to understand is that section 111(1) is a provision about cash-flow”, i.e. in the absence of a withholding notice it operates to prevent the employer withholding the sum due under the contract, and to maintain cash flow for the contractor.

According to the wider construction, rights to retain money or to set-off do not serve as a defence against enforcement. An employer that fails to give timeous withholding notice has to pay the money awarded by the adjudicator first, and can reclaim any overpayment later by way of a further adjudication or if necessary by way of arbitration or litigation. Thus, section 111(1) of the UK Act does not affect but only defers existing contractual rights to withhold payment to subsequent proceedings.

The wider interpretation fits well with the “pay now, argue later” public policy of the UK Act. However, a principal disadvantage of the wider construction from the paying party’s point of view is that if it has overpaid it is at risk of insolvency of the contractor. However, it may be possible to obtain a stay of execution if the receiving party is in serious financial difficulties and the paying party has taken immediate steps to resolve its counterclaim.<sup>32</sup> The court acknowledged this mischief but held the risk is one which can be avoided by checking the certificate and giving a timeous withholding notice. Besides, the Court of Appeal indicated that an architect’s (or engineer’s) duty might extend to ensuring that a lay employer was aware of the possibility of serving a withholding notice in sufficient detail and good time.

In the case of *Alstom Signalling Limited v Jarvis Facilities Limited (May 2004)*<sup>33</sup> the TCC applied the Court of Appeal’s approach. HHJ Lloyd QC stated that, notwithstanding the absence of a withholding notice, the paying party may still establish later what was truly due to be paid, by the use of the appropriate contractual procedures or proceedings. However, this is done by rehearing the dispute afresh in subsequent proceedings, so not strictly withholding. Therefore where an amount has been certified a withholding notice will be required in respect of any set-off or abatement.

### “Pay-when-paid” and “pay-if-paid” clauses

As one becomes further removed from the employer down the contractual chain, then complaints about the ability to receive payment increase. Those who lobby for the sub-contractors continually raise concerns about sub-contractors obtaining payment. This has manifested itself in the sub-contractors ability to be paid, protect themselves against insolvency of those in the contractual chain above them (although there might be no question about the ultimate employer’s solvency), “pay-when-paid” clauses, “pay-if-paid” clause, the ability to recover retention (if ever) and exceptionally lengthy payment periods.

30 Cf. *Woods v Hardwicke* [2001] BLR 23; (arguably) *VHE Construction v RBSTB Trust* [2000] BLR 187 and *SL Timber Systems v Carillion Construction* [2001] BLR 516

31 Cf. *Whiteways Contractors v Impresa Castelli* [2000] 16 Construction Law Report 453; *Millers Specialist Joinery v Nobles* Available on [www.adjudication.org](http://www.adjudication.org); *Levolux AT Limited v Ferson Contractors Limited* [2003] Construction Industry Law Letter 2003, p.1956 and Keating on Building Contracts (7th Edition 2001, para 15–15H).

32 The effect of the contractual payment machinery has been illustrated in the case of *Shimizu Europe Limited v LBJ Fabrications Limited* (29 May 2003), Construction Industry Law Letter 2003, 2015 et seq. In this case, the contractual payment machinery required the issue of an invoice in order to trigger a period of time leading to the final date for payment. Thus, it was held possible by the TCC to serve a valid withholding notice before the final date for payment of the adjudicator’s decision which will be effective against the adjudicator’s decision

33 . Available on [www.adjudication.org](http://www.adjudication.org)

A distinction was made in respect of pay-when-paid and pay-if-paid in the New Zealand case of *Smith & Smith Glass Limited v Winston Architectural Cladding Systems Limited*<sup>34</sup>. In that case the sub-contractor, Winston was to provide curtain walling for a commercial property. They sub-sub-contracted the glazing work to Smith. The main contractor went into receivership in December 1989. Winston then purported to terminate the employment of Smith. Smith then sought to recover \$100,000 for work done. Winston disputed liability, but said that in any event it would not be liable to pay Smith until it had itself been paid. It relied upon the payment clause which stated:

“Payment will be made within 5 working days of receipt of the client’s cheque... [and] we will endeavour (this is not to be considered a guarantee) to pay... claims within 5 days, after payment to [us] of monies claimed on behalf of the sub-contractor.”

Smith argued that there was a distinction between a clause that operated as a condition precedent, in other words payment only arises if paid and a clause that simply defines a time for payment, in other words payment only arises when paid.

The Judge considered that this clause could do no more than identify the time when payment was to be made. If the parties intended that there be a payment by a third party to one of the contracting parties before that party paid the other, then a clear condition precedent to payment would need to be “spelled out in clear and precise terms and accepted by both parties”. The clause was held to do no more than identify the time at which certain things must be done in order for payment to be made. It could not be considered a “if” category preventing payment.

In the United States, a similar clause attempting to make payment of a sub-contractor subservient to the main contractor has been construed as merely postponing payment for a reasonable time.<sup>35</sup> The term could not disentitle a sub-contractor from payment because of the employer’s insolvency.

Section 113 of the HGCRA prohibits conditional payment provisions. It states:

“A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, unless that third person or any other person payment by whom is under the contract (directly in or indirectly) a condition of payment by that third person, is insolvent.”

Insolvency is then defined. Perhaps, therefore, somewhat ironically, pay when paid clauses are now prohibited, but a clause stating that payment will not be made in the event of, say the employer’s insolvency, will be effective.

In the case of *Midland Expressway Limited v Carillion Construction Limited and Others (No. 2)*, [2005] EWHC 2963, TCC, Mr Justice Jackson QC considered the operation of Section 113. The four defendant contractors worked together in a joint venture known as CAMBBA. The Secretary of State granted a Concession Agreement in February 1992 for MEL to design, construct and operate the Birmingham Northern Relief Road, known as the M6 Toll Road. Midland and CAMBBA entered into a design and construct contract in September 2000.

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34 [1992] 2 NZ LR 4733; (1993) CILL 898  
35 *Thomas. J. Dyer Co Limited v Bishop International Engineering Company 303F. 2d 655 (USA) [1962].*

CAMBBA contended that a dispute had arisen in connection with payment arising from Change No. 11 to the design and construct contract. CAMBBA wished to refer the dispute to adjudication. Midland sought a declaration and injunction to prevent the building contractors from referring the claim to adjudication.

MEL contended that on the true interpretation of the contract, the Adjudicator did not have any jurisdiction. The proper dispute was between the Secretary of State and MEL and CAMBBA, where MEL were simply a conduit between CAMBBA and The Secretary of State. Further, clause 7.1.3(a) stated that the contractor would only be entitled to payment if it followed the conditions precedent set out in the design and construct contract. Clause 7.1.4 required a determination of the price adjustment to the Concession Agreement, and further that the money had been certified and paid to MEL under the Concession Agreement.

Mr Justice Jackson QC noted that the parties had conceded that the design and construct contract was a construction contract under the HGCRA. CAMBBA's request for payment had been rejected. As a result there was a dispute between the parties which could be referred to adjudication. The condition precedent requiring a resolution under a separate contract for payment before making payment under the design and construct contract was exactly the sort of thing that Section 113 of the HGCRA guarded against. The pay-when-paid provision was therefore ineffective. CAMBBA did not have to wait until any issue in respect of its payment had been resolved under the dispute resolution procedure in the Concession Agreement.

In conclusion, the declaration and injunction sought by MEL was not granted. CAMBBA was entitled to proceed with the adjudication.

Some have argued that while the HGCRA goes some way to alleviating delay in sub-contractor payment it at the same time gives credence to clauses which state that payment will not be made in the event that the person making payment does not receive his payment because of the insolvency of some third party payer.

Further, the HGCRA does not apply in all circumstances. Nonetheless, it may be arguable that the Unfair Contract Terms Act 1977 might make the clause subject to the requirements of reasonableness.

### Conditions precedent: time

The need for an architect's delay certificate as a condition precedent either to payment or to quantification can be a very effective limitation on common law rights. For example see:-

- *Brightside Kilpatrick* above;
- *Pillar v. D J Higgins Construction*<sup>36</sup>; and
- *Chatbrown Ltd v. Alfred McAlpine Construction (Southern) Limited*<sup>37</sup>

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36 (1986) 34 BLR 43

37 (1987) 35 BLR 44



## Employer and main contractor relationship

### Control mechanisms

A variety of control mechanisms may be used by the employer or his agents in a main contract in order to attempt to control the extent of sub-contracting. These include:

- Prohibition clauses
- Approval procedures

### Prohibition

The main contract may contain a prohibition or limitation on the main contractor's ability to sub-contract. For example, clause 19.2.2 of the JCT Standard Form of Building Contract (1998 edition) states:

"The Contractor shall not without the written consent of the Architect (which consent shall not be unreasonably delayed or withheld) sub-let any portion of the Works. The Contractor shall remain wholly responsible for carrying out and completing the Works ... notwithstanding the sub-letting of any portion of the Works."

The purpose of the clause is to provide some level of control by the employer in respect of the portions of the works that are sub-let. In addition, it also provides the employer with an opportunity to identify which elements of work are being sub-contracted and to whom. However, consent can only be withheld if it is reasonable to withhold consent. Arguably, it may be reasonable to withhold consent where the architect and/or employer has had some particularly bad experience with a sub-contractor, or given the particular circumstances and nature of the works it is unreasonable to sublet a particular part of it. In any event clause 19.2.2 does not expressly prohibit sub-contracting. By contrast, clause 19.1.1 prohibits the assignment of the contract by either the employer or the contractor without the written consent of the other.<sup>38</sup>

The 2005 version states at clause 7.1:

"Subject to clause 7.2, neither the Employer or the Contractor shall without the written consent of the other assign this Contract or any rights thereunder"

Clause 7.2 provides that the employer may after practical completion assign the benefit of the contract to a freeholder or leaseholder or allow them to use the employer's name in order to obtain benefits under the building contract. This will only apply if the contract particulars provides for it. These provision are distinct from the third party rights set out in clause 7A of the JCT 2005 standard form.

### "Or other approved"

In the case of *Leedsford Limited v Bradford City Council*,<sup>39</sup> it was held that the main contractor was not entitled to extra payment when the employer refused permission to obtain cheaper stone from a supplier other than the one specified. The contract stated that the

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<sup>38</sup> See *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85

<sup>39</sup> (1956) 24 BLR 45 CA

contractor was to obtain stone from “x company or other approved firm”. The Court of Appeal held that the words “or other approved” provided the contractor with no additional rights. The employer’s architect did not have to act reasonably in refusing consent. Neither did he have to give any reasons for withholding his consent.

Keating suggests that the architect has an absolute right to require performance by a particular named firm (providing he is acting honestly) and that this right is not limited to just the provision of the materials.<sup>40</sup> While this may be true, a further way of considering this case is that on the construction of the terms the contractor was taken to have allowed for supplying the stone from the particular company within his price. Arguably this would include not only paying for and ensuring the delivery of the stone, but also ensuring that the stone could be delivered at the appropriate time in order to meet the completion date. While this concept could be equally applicable to those that carry out some portion of the sub-let works, the employer may still be liable to the main contractor for delay or re-nomination caused by the failure of the specified sub-contractor.<sup>41</sup>

## Liability of sub-contractors to employers

In addition to the particular issues arising from sub-contracting, whether domestically or by way of nomination, it is worth separately considering the potential liability on the part of a sub-contractor towards an employer. There may be a direct contract, or collateral warranty, or indeed an implied contract. There may also be instances where despite the general rule that in the absence of a contract a party cannot bring a claim for economic loss in tort, there are of course exceptions. These issues are now considered below.

### Collateral warranties

A collateral warranty is a direct contract between the sub-contractor and the employer. The term is often used in the construction industry to refer to the seemingly endless raft of formal written collateral warranties (usual executed as deeds) that sub-contractors are frequently required to provide in favour of employers and other third parties such as purchaser, tenants and funding institutions. A collateral warranty can of course exist in the form of a formal document. It is of course easier to evidence and rely upon. Examples include the JCT’s Nominated Sub-contractor Agreement NSC/W and now the JCT 2005 suite of sub-contractor collateral warranties documents.

On the other hand, a collateral warranty may be formed in an informal way, perhaps in correspondence or even orally. Nonetheless, the usual legal requirements for a contract must be satisfied. In other words, there must be a clear offer which has been accepted the subject matter which is certain, there must be an intention to create legal relations, and there must be consideration. The requirement for valuable consideration gives rise to the greatest difficulty in these scenarios. However, in practice valuable consideration exists where the employer insists upon the main contractor entering into a sub-contract with a particular sub-contractor after the warranty has been given by that sub-contractor to the employer. In that situation the employer can sue the sub-contractor or supplier for any loss caused by breach of the warranty.

The most frequently quoted authority is that of *Shanklin Pier Limited v Detel Products Ltd.*<sup>42</sup> In that case the claimant owned a pier and intended to repair it, and in particular have the pier repainted. Detel Products warranted to Shanklin Pier that their paint would not only

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40 Keating (2001) “Keating on Building Contracts” 7th Edition, Sweet & Maxwell, London, Page 354 at para 12-26

41 *Bilton (Percy) Ltd v Greater London Council* [1982] 1 WLR 794 HL

42 [1951] 2 KB 854, although the proposition is also supported in *Bickerton Limited v NW Hospital Board* [1969] 1 ALL ER 77, 982 and 995, CA; *North West Metropolitan Regional Hospital Board v T A Bickerton & Son Ltd* [1970] 1 ALL ER 1039; and *Esso Petroleum Company Limited v Mardon* [1976] QB 801 CA.

be suitable for the repainting of the pier, but would also provide an impervious layer thus giving rust protection for some 7 to 10 years. The claimant relied upon this warranty, and then when engaging the contractor, instructed the contractor to place an order for this paint, rather than be the bituminous paint that was originally specified.

The paint was a total failure and the claimants sought to recover damages direct from the defendant. Arguably, they may not have been able to recover any damages from the contractor. This is on the basis that the contractor could not be said to have warranted those materials (even today by virtue of an implied duty under section of the Sale of Goods Act 1979) because it was the sub-contractor that warranted the goods to the employer and the main contractor as a matter of fact made no comments about them. This is despite the fact that the contract for the sale of the paint was in fact between the main contractor and the defendant.

This may be in contrast to cases where an “assurance” by a sub-contractor carrying out design work was not in fact intended to be given as a warranty. Nonetheless, in those situations it may be taken to be a negligent mis-statement.<sup>43</sup>

While the warranty given in *Detel Products* was in respect of its quality or fitness for purpose, warranties may also be given with regards to the time for performance, design or indeed any other matter.

## Negligence

A sub-contractor might have a duty of care to the employer or indeed future occupiers and/or owners of the building in respect of personal injury and property damage to other property.<sup>44</sup> This liability most likely extends to physical damage to the building if that actual physical damage gives rise to some danger to the safety and health of the occupants and lawful visitors. However, it appears that there is no liability from the sub-contractor to the employer in respect of defects as the loss to the employer is considered unrecoverable pure economic loss.<sup>45</sup> However, the liability of sub-contractors to an employer is not that straightforward, and the following issues should also be considered:-

- Special reliance; *Junior Books Limited v Veitchi Company Limited*<sup>46</sup>
- Negligent mis-statements
- Concurrent liability in contract and tort
- Negligent selection by main contractor
  - Non-delegable duty
  - Strict liability and statute
- Assignment, *Linden Gardens* and *Panatown*<sup>47</sup>
- The Third Party (Contracts) Act 1999
- The Defective Premises Act 1972
- Duty to warn
- Civil Liability (Contribution) Act 1978

These issues are considered below.

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43 *IBA v EMI and BICC* (1980) 14 BLR 1 HL

44 *Donoghue v Stevenson* [1932] AC 562

45 *Murphy v Brentwood District Council* [1990] 2 All ER 908 HL

46 [1982] 3 All ER 201

47 *Alfred McAlpine Construction Limited v Panatown Limited* [2001] All ER (D) 41 (APR) HL

### The specialist sub-contractor exception: *Junior Books*

The Scottish case of *Junior Books Ltd –v- The Veitchi Company Ltd* represents the high water mark for liability in tort for sub-contractors to employers in respect of negligence.<sup>48</sup> In this case a contractor was engaged to construct a factory for the building owner. The defendant sub-contractors were engaged to lay a specialist composite floor. The floor was defective and began to crack almost immediately. However, there was no danger to the health and safety of the occupants, nor any danger to other property of the building owner. Regardless, the floor needed replacement because of the defects. There was no direct contract between the employer and the sub-contractor, but the building owner sought the costs of replacement and loss of profit while the flooring was being relayed from the sub-contractor, and succeeded in the House of Lords.

The House of Lords categorised the owner's loss as pure economic loss, but considered that the building owner had a valid cause of action. This is on the basis that there was a sufficiently close relationship between the parties so that the sub-contractor owed a duty of care to the building owner to avoid causing the building owner consequential loss in respect of the defects. One of the key factors appears to be that the building owner had nominated the defendants as sub-contractors. The building owner had selected them because of their particular expertise and the relationship was so close that it almost created privity of contract, but of course did not.

The leading speech was given by Lord Roskill and he based his analysis on Lord Wilberforce's infamous two stage test for establishing a duty of care set out in *Anns –v Merton LBC*.<sup>49</sup> This approach was of course overruled in *Murphy –v Brentwood DC*.<sup>50</sup> Not only does this cast doubt on the reliability of *Junior Books*, but in subsequent cases the courts have distinguished *Junior Books*. For example, the predecessor of the Southern Water Authority was unsuccessful in taking action against a sub-contractor in the case of *Southern Water Authority –v- Carey*.<sup>51</sup> In that case the Water Authority's predecessor had entered into a contract for the construction of a sewerage works. The works in question were carried out by sub-contractors, and under the main contract the main contractors were to make good any defects arising within 12 months of completion. A further express term of the contract stated that this liability was in respect of defective materials, workmanship or design, but not that the work was fit for a particular purpose.

The work was defective and the entire sewerage scheme failed. The Authority sued the sub-contractor in negligence. The High Court decided that the sub-contractor was not liable in tort as a result of the terms of the main contract. The terms of the main contract negated a duty of care which might otherwise have existed. The Court therefore considered that the terms of the main contract established the scope of the risk which the plaintiff had chosen to accept, and as a result this in turn limited the tortious duty that the sub-contractor might otherwise have owed to the plaintiff.

### Negligent mis-statements

The problem of irrecoverability for economic loss in tort has in some instances been superseded by the House of Lords decision of *Hedley Byrne & Co Ltd –v- Heller & Partners Ltd*.<sup>52</sup> In that case, it was said obiter that a person suffering financial economic loss as a result of relying upon a false statement made negligently has in particular circumstances

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48 [1983] 1 AC 520

49 [1978] AC 728

50 [1990] 2 All ER 908

51 [1985] 2 All ER 1077

52 [1964] AC 465.

a valid claim in negligence against the maker of that statement. The Lords differed in their formulation of these circumstances, but nonetheless the approach has been followed and developed in subsequent cases.

Consideration should also be given to the Misrepresentation Act 1967, in particular section 2(1) (reverses burden of proof) and section 2(2) (damages may be awarded in lieu of rescission).

A sub-contractor may therefore be liable to the employer by virtue of the drawings and/or specification or other documents produced by the sub-contractor, if those documents have been produced negligently.

### Concurrent liability in contract and tort

The leading case is *Henderson & Others v Merrett Syndicates Limited & Others*<sup>53</sup>. In that case Lord Goff referred to the traditional procurement approach, where a building owner entered into a contract with a main contractor, who in turn then employed sub-contractors and suppliers. Lord Goff said at page 195 of the Judgment:

“But if the sub-contracted work or materials do not in the result conform to the required standard, it will not ordinarily be open to the building owner to sue the sub-contractor or supplier direct under the Hedley Byrne principle, claiming damages from him on the basis that he has been negligent in relation to the performance of his functions. For there is generally no assumption of responsibility by the sub-contractor or supplier direct to the building owner, the parties having so structured their relationship that it is inconsistent with any assumption of responsibility.”

While then the House of Lords found that concurrent liability in contract and in tort could exist under a *Hedley Byrne* principle in respect of Lloyd’s names they did not believe that the principle extended to the position where a chain of contracts existed between parties. In other words, a chain of contracts from employer to main contractor and then sub-contractor means that the parties have structured their relationship such that liability flows up and down a contractual claim and predisposes the notion that one can “leap” across the main contractor in order to bring an action direct against the sub-contractor on the *Hedley Byrne* principle.

The position has been specifically considered in the case of *Simaan General Contracting Co. v Pilkington Glass Limited (No.2)*<sup>54</sup>. That case concerned the liability of nominated suppliers direct to the building owner. Bingham LJ considered whether the *Hedley Byrne* principle would assist the building owner. He said at page 781:

“I do not, however, see any basis on which the Defendants [nominated supplier] could be said to have assumed direct responsibility for the quality of the goods to the Plaintiff [building owner]; such a responsibility is, I think, inconsistent with the structure of the contract the parties have chosen to make.”

However, the approach of the principle that a chain of contracts is inconsistent with an assumption of responsibility for the purposes of the *Hedley Byrne* principle does not sit easily with the House of Lords decision of *Junior Books Limited v Veitchi Co. Limited*.

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53 [1995] 2 AC 145.  
54 1988 QB 758.

### Negligent selection of sub-contractor (tortious claims)

The general principle is that a contractor owing a duty of care to an employer can discharge that duty by delegating its duty to an independent contractor or indeed a sub-contractor. By way of example, the landlord in *Haseldine –v- C A Daw & Son Ltd* was not liable for the negligent installation of a lift as the lift had been installed by an independent contractor whom the landlord had selected with care.<sup>55</sup>

The principle was considered more recently in *D & F Estates Ltd & Others –v- Church Commissioners for England & Others*.<sup>56</sup> This case concerned the tortious liability of a main contractor to an occupier in respect of problems encountered with the plastering. The plastering had been carried out by a sub-contractor. Lord Bridge reaffirmed the principle of discharge by delegation to an independent contractor. The main contractor may therefore discharge his duty of care by the selection of an appropriate sub-contractor. It should be remembered that this duty is in respect of a person's tortious, duties to third parties. For the purposes of this paper, that means the main contractor's liability to third parties arising from torts committed by a sub-contractor. There are, however, exceptions.

First, if the main contractor is in fact careless in its choice of sub-contractor then the main contractor may become liable for the sub-contractor's default.<sup>57</sup> Second, there are some "non-delegable duties". So, even if the main contractor is careful in his selection of the sub-contractor, the main contractor cannot avoid liability because the duty is said to be non-delegable. This occurs where the work being carried out by the sub-contractor is particularly dangerous. One example is an inspection in respect of checking for gas leaks.<sup>58</sup> Finally, the main contractor may well be unable to escape liability in respect of "strict" liability or "absolute" tortious liability or liability pursuant to a statute, when that statute makes liability strict. Taking even extreme care will not constitute a defence to liability.

### Assignment, *Linden Gardens* and *Panatown*

Before considering an assignment it is essential to understand the difference between a benefit and a burden under a contract. In respect of construction, the burden on the Contractor is an obligation to complete the work and its benefit is the right to receive payment. The burden on the employer is to pay and the benefit is to receive the completed building. The fundamental principle of assignment is that a burden cannot be assigned without consent of the other party. So, a contractor cannot assign his ability to complete the works<sup>59</sup> and a debtor cannot relieve himself by simply assigning the burden of payment to someone else.<sup>60</sup>

A contractor might assign the benefit of receiving retention money or indeed other sums due under the contract in order to obtain credit from suppliers, or funding institutions. An assignment of money due will normally be enforceable, but if there is an arbitration clause then a dispute will be subject to arbitration in the normal way.<sup>61</sup>

A party can freely assign their rights under the contract, unless there is an express provision to the contrary. Clause 19.1 of the JCT Standard Form of Building Contract 1998 states that neither the employer nor the contractor shall without the written consent of the other to assign the contract. In the case of *Linden Gardens v. Lenesta Sludge Disposals*<sup>62</sup> it was held that clause 19.1 in the JCT did prohibit assignment without consent. In this case, a

55 [1941] 2 KB 343

56 [1989] AC 177

57 *Saper –v- Hungate Builders Ltd* [1972] RTR 380

58 *Pass of Ballater, SS (Owners) v Cardiff Channel Dry Docks and Pontoon Co Ltd* [1942] 1 All ER 79

59 *Nokes v. Doncaster Amalgamated Collieries Limited* [1940] AC 1014 HL.

60 *Tolhurst v. Associated Portland Cement Manufacturers (1900) Ltd* [1903] AC 414. This decision affirmed the previous 2 KB 660 decision.

61 *Shayler v. Woolf* [1946] CH. 320 CA.

62 [1994] 1 AC 85 HL.

subsequent owner was seeking to take action against the builder for defective work. The subsequent owner thought that the building contract had been assigned to them, and therefore that they would be able to take action against the contractor pursuant to the contract for the defective works. However, as the assignment had been prohibited by the contract it had not been assigned to the subsequent owner, and so that subsequent owner could not, it initially appeared, sue under the contract.

The House of Lords considered that there was an exception to the general rule that only the original employer could sue. They held that the plaintiff subsequent owner could sue to recover its own loss provided that:-

1. The loss was foreseeable, and that the Contractor's original breach would cause loss to later owners;
2. The contract must prevent an assignment;
3. A third party must have no other cause of action (for example, a collateral warranty) and;
4. "Substantial damages" had been incurred by and will be for the benefit of the third party subsequent owner.

The Court of Appeal expanded this concept in the subsequent case of *Darlington Borough Council v. Wiltshier Northern Ltd.*<sup>63</sup> In that case there was no prohibition on assignment, and the claimant authority had no initial proprietary interest in the property. However, as Morgan Grenfell (the Lender) could recover substantial damages for the benefit of the authority, then the authority could sue the contractor direct. This was because the rights had passed to them by way of assignment.

A further important consideration is the House of Lords case of *Alfred McAlpine Construction Limited v. Panatown Limited* (27 July 2000). In that case it was held that the principle in *Linden Gardens* was not applicable where the Plaintiff had a direct contractual right to sue the defendant. A collateral warranty existed, and the plaintiff was therefore restricted to taking action pursuant to that collateral warranty rather than on the *Linden Gardens* principle.

### Contracts (Rights of Third Parties) Act 1999

The doctrine of privity of contract means that a contract cannot confer rights nor impose obligations arising under it on any person except the parties to it.<sup>64</sup> The general rule comprises two limbs. The first is that a party cannot be subject to a burden by a contract to which he is not a party. The second limb is that a person who is not a party to a contract cannot claim the benefit of it. The second limb, often referred as to the "third party rule" has been extremely controversial. The Contract (Rights of Third Parties) Act 1999 attempts to redress some of those controversial aspects. It essentially seeks to provide that a third party can obtain benefits under a contract, but only in certain circumstances.

There are two central operative parts to the Act:

- 1) "The contract expressly provides that" a third party may enforce the contract; and
- 2) A term of the contract "purports to confer a benefit" on a third party unless on the proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party".

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63 (1994) 69 BLR 1 CA.

64 Treitel G. (1995) *The Law of Contract*, 9th Edition, Sweet & Maxwell, London, page 534

The first limb is relatively clear. If, for example a sub-contract states that a future purchaser and/or tenant can benefit from the sub-contract then a future purchaser or tenant may be able to sue the sub-contractor direct. The second limb is essentially a rebuttable presumption of a benefit. In other words, if the contract is silent then one looks to the intent of the parties to see whether on the proper construction of the contract they intended the third party to benefit. It is highly arguable that the parties to a sub-contract intended future purchasers and/or tenants and/or occupiers to benefit from the contract. This argument is based on the House of Lords principle in *Linden Gardens*.

However, the Act is facilitative and permissive, and in that respect can be expressly excluded. Many of the standard forms in the construction industry quite simply as a matter of routine exclude the operation of the Act. This is unfortunate in some respects, because the Act could be used to avoid the proliferation of written collateral warranties and at the same time could also be used to limit a contractor or sub-contractor's exposure to future owners.

### Defective Premises Act 1972

The Defective Premises Act 1972 imposes certain duties on those undertaking the work for or in connection with dwellings. A contract is not required. The duties are in addition to any other duty owed and cannot be excluded or restricted.<sup>65</sup> The Act therefore provides a direct claim against the person who owes a duty to see that the work is carried out in a "workmanlike or, as the case may be a professional manner, with proper materials and so that as regards that work the dwelling will be fit for habitation when completed."<sup>66</sup>

Therefore, a sub-contractor undertaking work in respect of a dwelling house may find that they could be the subject of a direct action by a subsequent owner by virtue of the Defective Premises Act. Nonetheless, there are defences. For example, if the sub-contractor were working under the "instruction" of another then those instructions might discharge the duty imposed on the sub-contractor. "Instructions" are not defined in the Act, but it is suggested that it refers to a person specifying the way that a particular item of work is to be carried out.

### Duty to warn

The Defective Premises Act 1972 does not introduce a duty to warn, although one may already exist pursuant to the contract or perhaps even in tort. A specialist sub-contractor may have a duty to warn where for example, a design is defective, and the specialist nature of the sub-contractor's work is such that a sub-contractor does or ought to recognise the defect. A general contractor would not normally have a duty to warn (essentially to guard the architect against his own liability for negligent design).<sup>67</sup>

### Civil Liability (Contribution) Act 1978

The Civil Liability (Contribution) Act 1978 provides that a person is liable in respect of the "same damage" to recover a contribution, regardless of the legal basis of liability, from another person. It does not matter whether the legal basis of the claim is in tort, breach of contract, a breach of trust or otherwise.

The important, and perhaps restricting application of the Act is that the damage must be "same damage". Therefore, it is conceivable that a party might take direct action against a

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<sup>65</sup> See Section 6(3) of the Defective Premises Act 1972.

<sup>66</sup> Section 1(1) of the Defective Premises Act 1972.

<sup>67</sup> University Court of the University of Glasgow v. William Whitfield and John Laing (Construction) Ltd (third party) (1988) 42 BLR 66.



sub-contractor (say by virtue of a collateral warranty) on the basis that the sub-contractor is worth more than others who share liability for the same damage. The sub-contractor would then need to defend, but may also be able to use the Act to seek contributions for others. In this respect, the Act is a benefit to the sub-contractor, however, the Act can of course work to the sub-contractor's detriment as others may seek contribution from the sub-contractor in respect of a claim made although not done directly against the sub-contractor.

## Employer's liability to sub-contractors

There are a number of issues which could be considered under this heading. These include direct payments, instructions, and guarantees.

### Direct payment

In respect of nomination, Clause 35.13.5 of the JCT Form of Contract (1998) provides for direct payment from the employer to the nominated sub-contractor in certain circumstances. This right is only available where it is expressly set out in the contract. There is no implied right to payment.<sup>68</sup> One might question why the employer would want to undertake such an obligation. This is because the employer may lose much more money if the main contractor becomes insolvent and the work ceases. The replacement of a new main contractor is not only expensive but will also cause delay to the project.

However, the replacement of a specialist nominated sub-contractor could cause considerable delay and expense. In the event of the main contractor's insolvency it may therefore be in the employer's interest to make a direct payment in order to keep nominated sub-contractors working whilst the main contractor is replaced.

There is, however, a danger that the main contractor's liquidator may seek payments from the employer in respect of the nominated sub-contractor. While there are arguments that direct payment may defeat a liquidator's claims,<sup>69</sup> a liquidator's claim might prevail thus leading the employer to make a double payment in some instances.<sup>70</sup>

### Instructions

The employer has no right to direct the sub-contractor to carry out any specific work. The architect has no implied authority to contract on behalf of the employer, and therefore no power to direct the sub-contractor.

However, if the employer instructs the sub-contractor to carry out works or deliver goods then he may find that he has formed a separate contract, based upon an express or implied promise to pay the sub-contractor.<sup>71</sup>

### Guarantees

If a sub-contractor wants the employer to guarantee payment, then such guarantee must be recorded in writing. In the absence of a writing, a guarantee is invalid by virtue of operation of the Statute of Frauds 1677.

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68 *Milestone (JA) & Sons Ltd (in liquidation) v. Yates Castle Brewery Ltd* [1938] 2 All ER 439.

69 *Re: Tout & Finch Limited* [1954] 1 All ER 127.

70 *Mullan & Sons (Contractors) Limited v. Ross & Another* (Unreported) 7 December 1995.

71 *Dixon v. Hatfield* (1825) 2 Bing 439.

In the recent decision in *Actionstrength Ltd (trading as Vital Resources) v International Glass Engineering IN.GL EN Spa*,<sup>72</sup> the House of Lords held that an oral guarantee was unenforceable because it did not comply with section 4 of the Statute of Frauds 1677. Further, the promise to pay could not give rise to an estoppel preventing the defendant from relying on the statute.

### Guarantees and direct payments

In the absence of a valid guarantee, there may still be circumstances where a sub-contractor or supplier can demonstrate a right to a direct payment from the employer. For example, in the case of *Sydenhams (Timber Engineering) Limited v CHG Holdings Limited*<sup>73</sup> the employer was found to be liable for direct payments to the specialist sub-contractor after the insolvency of the main contractor.

There is, however, one further problem in this situation. It relates to the rule against preferences arising from the Insolvency Act. It is not possible for an employer to make a direct payment to a sub-contractor as a result of insolvency and at the same time withhold money from the main contractor. It may be possible for the insolvency practitioner to show that the payment from the employer to the sub-contractor is an unlawful preference in favour of the sub-contractor in circumstances where the money should have been paid to the main contractor. The problem for the employer is that the employer may end up making the payment twice. Once to the sub-contractor and then again to the main contractor without any chance of receiving re-payment from the insolvent main contractor.

It is not necessarily the case that the employer will not receive monies from the main contractor as a result of its insolvency. Should the insolvent contractor be found, once an entire account has been completed, that any assets are available, then those assets will be distributed on a *pari passu* basis. This simply means that the assets will be distributed equally between creditors of a similar standing. Generally speaking, most creditors to insolvent construction companies receive little if anything.

In *Sydenhams*, CHG was the employer for a hotel development. Rybarn was the main contractor and Sydenhams had carried out a portion of the design and construction works. Rybarn went into administration. Sydenhams made a claim for payment direct against the employer. HHJ Peter Coulson QC examined the dealings between the parties and concluded that there was a direct contract between the employer and Sydenhams for the main contractor became involved. Once the main contractor was involved, a tripartite agreement was reached between the three of them. As a result of the direct contract between Sydenhams and CHG, the sub-contractor had a valid claim. In effect, the sub-contractor was in direct contract with the employer throughout.

In *B Mullen & Sons v John Ross and Malcolm London*<sup>74</sup> the court followed the House of Lords' decision in *British Eagle v Air France*<sup>75</sup> it is confirmed that a sub-contractor should not be paid direct by an employer in circumstances where a main contractor was insolvent because an employer would be seen to be making a preferential payment. However, this rule would not apply where there is a direct contract.

The Scottish Extra Division, Inner House, Court of Session, came to the conclusion in the case of *Brican Fabrications Limited v Merchant City Developments Limited*<sup>76</sup> that there was a tripartite contract between the employer, main contractor and sub-contractor

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72 [2003] BLR 207

73 Unreported, 3 May 2007, TCC

74 Unreported 7 December 1995

75 [1975] 1 WLR 758

76 [2003] Scot CS 201 (17 July 2003)

or at least a bilateral contract between the sub-contractor and employer. Importantly, the employer had *guaranteed* payment orally to the sub-contractor before the sub-contractor agreed to work for the main contractor.

The main contractor subsequently went into liquidation owing money to the sub-contractor. The employer refused to honour the oral arrangement on the basis that the guarantee was not in writing. However, the court concluded that there was at minimum a bilateral agreement between the sub-contractor and the employer and it was on this basis that the sub-contractor agreed to enter into the main contract afterwards.

### The protection of sub-contractors under French law

On 31 December 1975, French legislation was introduced specifically to protect sub-contractors<sup>77</sup>. The effect of this law was to introduce the rights or guarantees to payment with regards to amounts due under sub-contracts. Three distinct types of protection were introduced:

1. A payment guarantee;
2. Civil liability for the employer;
3. The ability for a sub-contractor to make a direct payment claim against the employer.

The main contractor must provide the sub-contractor with a bank guarantee which covers every amount due under the sub-contract. This guarantee is personal in the sense that it must refer to the individual sub-contractor. This means that main contractors in France need to provide each sub-contractor with a guarantee in respect of each package of work. This is a considerable administrative burden for French contractors.

At the same time, the employer has a duty to ensure that the main contractor performs its legal duties with regards to that sub-contractor in respect of engaging the sub-contractor and delivering the guarantee. This means that the employer gets to see that the main contractor enters into a sub-contract with the sub-contractor (and so complies with contractual requirements such as health and safety and identification of the price) and then ensures that the appropriate guarantee is provided by the main contractor. In effect, what this means is that if the employer fails to do that, then the employer is liable.

The effect is that the sub-contractor will have a claim against the main contractor for failing to provide a guarantee and perhaps more importantly direct against the employer also for the main contractor's failure. The sub-contractor can only obtain payment for any amount owed by the main contractor, and so cannot obtain any additional benefit.

The effect of this law is also important with regards to international contracts. Where parties choose French law, then this law will automatically apply. So, a sub-contract being carried out in another country (other than France, but subject to French law) will still obtain that benefit.

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<sup>77</sup> Law number 75-1334 of 31 December 1975 See Malinvaud, C (2006) "Protection of sub-contractors under French law: an overview" SCL paper 134, December.

## Nominated sub-contractors and suppliers

Many of the standard forms of contract incorporate terms allowing the employer to nominate a sub-contractor. For example, Part 2 of the JCT Standard Form of Building Contract (1998 Edition) deals with nominated sub-contractors and nominated suppliers. Clause 35 deals with nominated sub-contractors and clause 36 deals with nominated suppliers. Clause 58 and 59 of the ICE 7<sup>th</sup> Edition deals with provisional sums and nominated sub-contractors. In this context it is common practice for the architect to select and then negotiate with a sub-contractor and then settle the terms with that sub-contractor before even consulting the main contractor.

This procedure allows the architect to identify a sub-contractor who is supplying a long lead in element of the work (for example a lift or other specialist equipment) and secure not only that sub-contractor's design input but also a manufacturing and delivery slot before the main contractor has even been selected. A further advantage might be the selection of a specialist sub-contractor that is required to carry out some of the initial works on site. For example, specialist piling operations that might be required very early on in the main contractor's programme thus removing the need for the main contractor to tender, select and then provide for a long lead in period for its own domestic sub-contractor thus extending the contract period.

These are advantages with regards to an early commencement of works, but further advantages include the selection of an appropriate contractor with whom the architect and/or employer has some confidence, the ability to obtain design information, and integration of design and coordination information, and greater control in respect of quality.

The main contractor is then contractually obliged to use that sub-contractor, although in some instances there may be a right to raise reasonable objections.

Given that the contract is then in fact between the main contractor and the sub-contractor, and not the employer, the procedures for appointing nominated sub-contractors are somewhat intricate. While clauses 35 and 36 deal with nomination in the JCT 1998 contract between the main contractor and the employer, it is a series of separate documents that establish the nominated sub-contract between the sub-contractor and the contractor. These include the NSC/C which is the JCT Standard Form of Nominated Sub-Contract Conditions, and the Articles of Nominated Sub-Contract Agreement (Agreement NSC/A) which refers to the conditions and incorporates those by reference. A further document is then used for tendering,<sup>78</sup> whilst a fourth document provides a nominated sub-contract standard form warranty.<sup>79</sup> A standard form of instruction is also available.

These procedures are now rarely used. The preference now is for employers and their advisers to insist on the contractor engaging an employer selected sub-contractor as the main contractor's domestic sub-contractors.<sup>80</sup> The perceived advantage is of course that the risk for those domestic sub-contractors rests solely with the main contractor, while the contractual regime with regards to nominated sub-contractors shares that risk between the main contractor and the employer. The limitations on the main contractor's liability to the employer are limited in respect of design, and extensions of time. However, and despite attempts to pass more risk to the contractor there are some inherent problems with nomination which are difficult to overcome.

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<sup>78</sup> JCT98 NSC/T Part 1 Invitation to Tender.  
NSC/T Part 2 – Tender by a sub-contractor and  
NSC/T Part 3 – Particular Conditions  
<sup>79</sup> NSC/N (Employer/Nominated Sub-  
contractor Agreement)

<sup>80</sup> These are sometimes loosely referred to as  
"Domesticated" sub-contractors

The architect, when selecting a nominating sub-contractor, does not act as agent of the employer.<sup>81</sup> In theory then the main contractor has no cause of action against the employer with regards to any default or delay caused by the nominated sub-contractor, unless the risk has been shared in the express terms of the contract.

### Description and design

Typically, a nominated sub-contractor's or nominated supplier's work is incorporated by a simple one line reference to a "PC sum" for each element of nominated work. For example "allow the PC sum for piling work to be carried out by a nominated sub-contractor...£XXX." The main contractor may then add attendance and profit. The amount of the PC sum is merely an estimate, and once the contract sum is known, the architect issues an instruction replacing the PC sum with an instruction to use the specific nominated sub-contractor for the nominated sub-contract sum. How then, does this description impact on the liability of the main contractor?

The House of Lords has considered whether a main contractor might be liable to the employer in respect of latent defects in materials delivered by a nominated supplier. In the case of *Gloucestershire County Council v Richardson*,<sup>82</sup> the House of Lords held that the main contractor's liability to the employer was limited to the extent of the nominated supplier's liability to the main contractor by operation of the terms of the nominated sub-contract.

The rationale for this decision was that the main contractor had been directed to enter into the contract by the employer, and therefore the scope of the rights and obligations of that contract were agreed by the employer. Arguably, this logic must apply to "domesticated" sub-contractors; the key factor being the employer's insistence that a specific sub-contractor be engaged by the main-contractor. It is the substance of the instructions and the terms of the contract not the name tag of "domestic" or "nominated" that governs the liability of the employer and main contractor in respect of the actions of the sub-contractor.

Alternatively, the employer could set out the full details of the nominated sub-contractor's work in the main contract. Most usually, this will involve some element of design. By including the full details in the main contract, arguably the design obligation is also imposed on the main contractor. For example, these elements might include steelwork connections, the electrical installation, a lift or the heating installation. In respect of this approach, a further House of Lords case of *IBA v EMI & BICC*<sup>83</sup> held that where a main contractor had accepted design obligations in the main contract, he was then liable for the sub-contractor's negligent design.

### Design liability

*Sinclair v Woods of Winchester Limited (No 2)*<sup>84</sup> concerned an application before HHJ Coulson QC to seek permission to appeal on two questions of law arising out of an arbitrator's award. Sinclair as employer had engaged an architect and the builder Woods. Penguin Pools Ltd was the nominated sub-contractor. As the Judge set out, there are four basic ingredients necessary for such an application to succeed:

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81 Mitchell –v- Guildford Union (Guardians of) (1903) 68 JP 84

82 [1969] 1 AC 480 HL

83 (1980) 14 BLR 1 HL

84 Unreported TCC case of 22 November 2006

1. The identification of a true question of law – i.e. not a complaint about the arbitrator's findings as fact dressed up as a point of law. It is not possible for a party to seek permission to appeal on the findings of fact no matter how wrong they might seem to be.
2. Which point of law substantially affects the rights of the parties.
3. On which point of law the arbitrator is obviously wrong, or if it is a point of general/public performance where the decision was at least open to serious doubt.
4. Where it is just and proper for the Court to determine.

The Judge also quoted with approval the words of HHJ Lloyd QC in *Vascroft v Seaboard Plc* where he stated that the Court “should read an arbitral award as a whole in a fair and reasonable way. The Court should not engage in minute textual analysis.”

The first alleged point of law related to concurrent causes of damage to flat roofs. This part of the application failed. HHJ Coulson QC said that a question of law should be capable of being expressed in a sentence. Here, it was set out in a lengthy paragraph of submission. Further, the point raised was a matter of causation namely what was the operative cause of the problem with the flat roofs. The Arbitrator decided that whilst some areas were attributable to the Defendants, they did not cause the underlying problem with the flat roofs. The design flat roofs meant that they were doomed to fail. Questions of causation are mixed questions of fact and law. The Judge reiterated that, in any event, when considering causation, there is no formal test. The Courts rely on common sense to guide decisions as well as any alleged breached as a sufficiently substantial cause of loss.

The second alleged question of law also failed. This related to liability for defective specialist design. Certain items were installed in accordance with the design of the heating system which was part of the specialist design work carried out by the Respondent's nominated subcontractor. In other words, if a main contractor subcontracts works to a nominated subcontractor, then a nominated subcontractor carries out design work as well, is the main contractor, without more, liable to the employer for that design work? The Judge said the answer to that question was emphatically no.

Where an employer nominates a specialist subcontractor to carry out work, one of the reasons for this is that the subcontractor will be performing a specialist design function in addition to the actual carrying out of the works on site. In such circumstances, the design work performed by the specialist subcontractor is usually, and ought to be, subject of a direct warranty from the specialist subcontractor to the employer. If the carrying out of the work on site is subcontracted by the main contractor to the nominated subcontractor, but the extent to which the main contractor is liable even for defects in the workmanship of the nominated subcontractor, will depend on the precise terms of the various contracts. Here, the main contract documents did not include any obligation on the part of the Defendants to perform any design work at all. A main contractor cannot acquire design liability merely because he is instructed to enter into a subcontract with a nominated subcontractor who is going to do some design work on behalf of the employer. The design work believed to be the subject of a direct warranty will remain part of the architect's non-delegable obligations.

## Design development

Nominated sub-contractors, suppliers, and even domestic sub-contractors and suppliers often are called on to produce “manufacturing drawings” or “shop drawings” or “installation drawings”. In other words, they are asked to take the architect’s “concept design” or “intent design” and produce detailed drawings which enable the components to be made and installed.

In some instances it is quite simply a case of reproducing the architect’s design. However, it is more likely that there may be some “design development”. If there is any element of design development, then those further drawings are usually considered part of the original design.<sup>85</sup>

However, this approach should be contrasted with the approach of His Honour Judge Seymour in the case of *Co-Operative Insurance Society Limited –v- Henry Boot Scotland Limited*.<sup>86</sup> In that case, at page 19 of the judgment, His Honour Judge Seymour QC stated that the obligation of Boot “was to complete the design, that is to say, to develop the conceptual design [of Co-Op] into a completed design capable of being constructed. . . . assessing the assumptions upon which it is based and forming an opinion whether those assumptions are appropriate. . . . the concept of “completion” of a design of necessity, in my judgment, involves a need to understand the principles underlying the work done thus far and to form a view as to its sufficiency.” Some consider that this case no longer applies to the redrafted design obligations in the 2005 form, however, this remains to be seen in practice.

## Implied terms

The usual implied terms in respect of satisfactory quality, completion within a reasonable time and to a reasonable price may be implied.<sup>87</sup> In practice, these terms are more likely to be exceeded by the express terms of the contract.

Generally, if the employer relies on the contractor for selecting certain materials then there will be an implied term that those goods will be reasonably fit for their purpose. However, if the employer has directed the main contractor to use a nominated sub-contractor or supplier then it cannot be said that the employer had in fact relied on the contractor’s skill. In those circumstances the fitness for purpose obligation will not be implied, unless there is an express term in the main contract, or the parties intended the contractor to accept such liability because of the surrounding circumstances.<sup>88</sup>

Keating identifies the important ramification of this principle.<sup>89</sup> It will mean that the employer will not have a remedy in respect of any elements that have been nominated if it turns out that they are a good quality but unfit for their purpose.

## Problems with the nomination process

In theory, nomination provides the employer with the advantage of choosing his own specialist contractor and agreeing a price and the terms of contract with him. Indeed, the employer, or the architect on his behalf, can negotiate a variety of nominated sub-contractors, whom the main contractor is then obliged to use. The employer then has the advantage of dealing with one main contractor, rather than a series of direct contracts with sub-contractors.

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85 *Holland Hannen & Cubitts v WHTSO* (1981) 18 BLR 80

86 [2003] CLJ Vol 19 No 2

87 *Sale of Goods Act 1979 and Sale of Goods and Services Act 1982*

88 *Young & Martin Limited v McManus Childs Limited* [1969] 1 AC 454 HL

89 Keating on Building Contracts, page 362, at paragraph 12-49

In the case of *Bickerton –v- North West Metropolitan Regional Hospital Board*<sup>90</sup> Lord Reid noted that these objectives were perhaps incompatible. Given that the nomination procedure is dealt with by virtue of the main contract and also a separate nominated sub-contract which is relatively complex and of course reliant upon the drafting of the provisions it is easy to see how the Court can suggest that these perceived advantages to the employer may be unjust and so refer to the use of “unclear language” in order to refuse to hold the contractor liable for the default of a nominated contractor or supplier. This may even be the case where the employer does not appear to have a remedy. There are several important House of Lords cases dealing specifically with nomination under the JCT provisions.

The first of these is *Bickerton –v- North West Metropolitan Regional Hospital Board* referred to above. In that case the nominated sub-contractor was insolvent and went into liquidation before starting work on site. The liquidator did not affirm the contract. The contractor asked for a variation order nominating a further sub-contractor, but the employer refused. Instead, the employer asked the contractor to complete the works, which the contractor agreed to do without prejudice to his contractual rights. The contractor then brought a claim for additional costs. The Court of Appeal held that the employer was bound to make a second nomination, and as the employer had failed to do that the contractor’s claim was valid.

The House of Lords dismissed the appeal, adding that on the true construction of clause 27 of the RIBA Form of Contract any sums payable in respect of prime cost works were to be expended in respect of nominated sub-contractors, and the contractor could not expend those monies without proper instructions. The contractor did not in any event have the right nor the duty to carry out that work as the whole purpose of the contractual provisions were that the work would be carried out by a nominated sub-contractor designated by the employer. If, therefore, the original nominated sub-contractor “dropped out” there was an implied duty on the employer to make a further nomination. As a result the contractor was entitled to recover money in respect of further work that he had done on the basis of quantum meruit.

Lord Reid in the House of Lords is frequently quoted as he stated that it is a clear breach of contract by the employer if the employer’s failure to nominate a sub-contractor in the first place, or re-nominate them as appropriate, impedes the execution of the contractor’s own work.

### Delay in nomination

It seems then from the leading judgment of Lord Reid in *Bickerton* that if there is a delay in making a nomination the contractor may well have a valid claim for extra time and money against the employer. This reimbursement may arise by virtue of the express terms of the contract, for example in respect of the JCT 98 Form see clauses 26 and 35. Further, a claim for damages for breach of contract may arise from an express or an implied term of the contract. However, whilst a delay in nominating a replacement sub-contractor may also lead to that result, a delay caused by the original nominated sub-contractor’s withdrawal could be at the main contractor’s risk.

The next House of Lords case is that of *Percy Bilton Ltd –v- Greater London Council*.<sup>91</sup> In that case a nominated sub-contractor went into liquidation during the course of the

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90 [1970] 1 WLR 607 HL

91 [1982] 1 WLR 794 HL



works. The architect knew that he needed to re-nominate, however there was some delay in re-nomination. The main contractor requested an extension of time because the replacement nominated sub-contractor could not complete the work within the original timeframe.

The House of Lords held that a distinction needed to be made between the period of time lost by the withdrawal of the first nominated sub-contractor, and then the period of time required in respect of the subsequent nominated sub-contractor. The delay caused by the original sub-contractor was not covered by clause 23 and therefore the contractors were not entitled to any extension of time, and the time not being at large meant that the completion date remained unaffected.

However, the subsequent delay resulting from the Authority's failure for several months to re-nominate was covered by clause 23(f) which was delay "by reason of the contractor not having received in due time necessary instructions...from the architect...". The contractor therefore was awarded further time in respect of the replacement sub-contractor's delay, but not the first. The result was that the contractor was liable for liquidated damages for his failure to complete as a result of the inability to obtain an extension of time in respect of the original sub-contractor's liquidation.

Lord Fraser of Tullybelton concluded that the real problem was that the contractor had accepted the notice of intention to repudiate the sub-contract from the sub-contractor. The sub-contractor stated that they would be withdrawing their labour from site. The court considered that this was a notice of intention to repudiate. The contract provided that the sub-contract could be determined if the sub-contractor suspended the works for 10 days or more. However before the 10 days had elapsed the main contractor simply accepted the repudiatory breach. The contractor was not obliged to accept that repudiation, and if he had refused to accept the repudiation the contract would have remained alive thus allowing the main contractor to claim an extension of time under clause 23(g) in respect of sub-contractor delays.<sup>92</sup>

The sequential contract analysis is helpfully set out on page 801 of the judgment, which in summary comprises:

- 1) The general rule is that the main contractor must complete the work by the date for completion. If he does not he is liable for liquidated damages.
- 2) The exception to the payment of liquidated damages is if the employer prevents the main contractor from completing his work.<sup>93</sup>
- 3) The general rules may be amended by the express terms of the contract.
- 4) Clause 23 amended the general rules.
- 5) Withdrawal of a nominated sub-contract was not caused by the fault of the employer nor covered by the provisions of clause 23. Clause 23(g) related to nominated sub-contractor "delay", but withdrawal from site of the nominated sub-contractor is not delay.
- 6) Therefore, a nominated sub-contractor withdrawal falls under the general rule and the main contractor takes the risk.
- 7) However, delay by the employer in re-nominating is an express term within clause 23(f) entitling the main contractor to an extension of time.

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92 pages 801-802

93 *Holme v Guppy* (1838) 2 M&W 387; and *Wells v Army & Navy Co-operative Society Limited* (1902) 86 LT 764

This case like many other construction specific cases turns upon the construction of the contractual regime agreed between the main contractor and the employer

in respect of the nominated sub-contractor. The court needs to apportion the risk of the breach in respect of the nominated sub-contractor either on the employer or the main contractor, because those are the parties to the contract in question.

The case of *Rhuddlan Borough Council v Fairclough Building Ltd*<sup>94</sup> in the Court of Appeal considers some further questions. In this case the contractor, Fairclough, entered into a contract for the construction of a leisure complex. It was based upon the JCT Standard Form of Building Contract 1963 Edition with Quantities. The nominated sub-contractor, Gunite, had carried out a large amount of work, but then became insolvent and so stopped work thus repudiating its sub-contract. At that stage Gunite was 8 weeks late. The contractor asked the architect to re-nominate. Gunite stopped work in September 1977 and the architect re-nominated on 24 February 1978. In addition, there were defects in Gunite's work, but the replacement nominated sub-contractor had not been instructed to carry out remedial works. The contractor objected to:

- 1) the time taken to re-nominate;
- 2) the time required for the new contractor to complete (which would effectively have led to an overrun of the date for completion);
- 3) and a separate instruction for the main contractor to carry out the remedial work to Gunite's work.

The Court of Appeal upheld the first instance decision that the architect's instruction in respect of the second nominated sub-contractor was invalid as that sub-contractor could not complete the work within the time allowed under the main contract. The contractor was therefore entitled to refuse the nomination, thus following the dicta of Sir David Cairns in *Percy Bilton Ltd -v- GLC*. In the Court of Appeal it had been argued that the employer would need to vary the terms of the main contract if it was impossible to find a sub-contractor that could complete the work within the existing timescale. If this were right then there would be a lacuna in the contractual machinery. However, the Court of Appeal considered that in such circumstances there had been an implied term that if the nomination were accepted by the main contractor then an appropriate extension of time would also be granted.

Second, the instruction was also invalid because it did not include the remedial work. This is simply the application of the principle in *Bickerton* that the contractor is not liable to perform any part of the nominated sub-contract works. Third, the employer could therefore not charge the contractor for the costs of the remedial work when the employer was obliged to re-nominate and the re-nominated sub-contractor should have been obliged to carry out that work.

Finally, the contractor was not entitled to an extension of time for the delay incurred by Gunite (8 weeks) before they withdrew from site. This was because clause 23(g) had been amended by the addition of "but such delay would only be considered for those reasons which the contractor could obtain an extension of time under the Contract." Therefore the contractor could only get an extension of time if the delay was due to one of the other events specified in clause 23. It may of course have been interesting to see what the outcome might have been if the contractor had argued that the architect should not have nominated Gunite in the first place.

Ian Duncan Wallace considers that these cases are quite simply straightforward insolvency cases. He argues that the main contractor has an opportunity to object to the appointment of a nominated sub-contractor. Therefore, the simple scheme in respect of the risk of a nominated subcontractor is that the main contractor may object if there is reason to doubt the solvency or the ability of the nominated sub-contractor.

Once the sub-contract is concluded, then the main contractor becomes fully responsible for the sub-contractor as if that sub-contractor were domestic to the main contractor. The alternative school of thought is that if the employer wishes to identify his own sub-contractor and agree the terms and the price, then why should the employer not remain responsible for finding not only a satisfactory replacement, but also for the sub-contractor's defaults.

Arguably, these are issues which can and should be resolved in the express terms of the agreements between the parties. While the intricate provisions of the JCT Form when considered above demonstrates that the main contractor is protected to some extent, the whole process is less than perfect.

**Nicholas Gould**

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February 2004 (updated Mar 2011)

## Subcontracts

### Appendices: Essential Reading

- 1) *Bickerton –v- North West Metropolitan Regional Hospital Board* [1970] 1 WLR 607 HL
- 2) *Brightside Kilpatrick Engineering Services v Mitchell Construction (1973) Limited.* [1975] 2 Lloyd's Rep. 493 CA
- 3) *Percy Bilton Ltd –v- Greater London Council* [1982] 1 WLR 794 HL
- 4) *Martin Grant & Co Limited v Sir Lindsay Parkinson & Co Limited* (1984) 29 BLR 31
- 5) *Rhuddlan Borough Council v Fairclough Building Ltd* (1985) 30 BLR 26
- 6) *Ben Barratt & Son (Brickwork) Limited v Henry Boot Management Limited* [1995] CILL 1026.
- 7) *Extradakerb (Maltby Engineering) Ltd v Whitemountain Quarries Limited.* [1996] Times, 10<sup>th</sup> July Northern Ireland Report, 18<sup>th</sup> April 1996
- 8) Arbitration Act 1996, Section 5 (in writing) and Section 6 (Definition and Arbitration Agreement)



































