

### **FEDERATION'S ANNUAL SHOW & CONVENTION – ONLY A FEW PLACES REMAIN**

If you haven't booked for the gala dinner dance on Saturday 29 March at the Dalmahoy Golf & Country Club already you'll have to hurry as there are only a few places left available. Contact the SDF office (01786 448838) as soon as possible to reserve your rooms.

The exhibition is open from 9.00 am on Friday 28 March, also at the Dalmahoy, and entry is free. Please note the show closes for lunch at 1.00 where presentations will be made. Again, call the office to reserve a lunch at £25 per person. We look forward to seeing you.

### **PLACING SUB-CONTRACTS: 6 TOP TIPS**

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

#### **1. Simply stepping down the main contract is risky**

Many contractors take the view that the easiest way of sub-contracting is to step down the obligations of the main contract so that the main contract is interpreted as if the contractor was the employer and the sub-contractor was the contractor.

Although this is very simple, there can be a number of disadvantages:

Directly stepped down timescales leave the contractor with no breathing space. For example, if there is a time limit for submitting extension of time claims under the main contract, the sub-contractor will be subject to the same time limit. If the sub-contractor waits until almost the end of the time limit to submit his application, the contractor will have hardly any time at all to make a corresponding application to the employer. There are quite often terms in the main contract that are difficult to interpret in a sub-contracting context.

Payment terms should never be identical in a main contract and a sub-contract because the contractor has almost no time to react if, for example, he receives a pay less notice from the employer at 4 pm on a Friday and the sub-contract requires him to issue a "Pay less notice to the sub-contractor" on the same day.

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

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

associated with identical time periods and payment terms.

## **2. Use appropriate terms**

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

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

As an alternative to standard form sub-contracts, the use of bespoke conditions of sub-contract is common. This is advantageous in that engaging sub-contractors across all projects on the same terms creates certainty. The downside is that a standard set of bespoke conditions

will inevitably not correspond exactly with all types of standard form main contracts. Again, this can create gaps between the liabilities and obligations of the contractor and the sub-contractor.

## **3. Include a “pay when paid” clause**

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

## **4. Pass liability on downstream**

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

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

- (c) Monitor the sub-contractor's professional indemnity insurance renewals for the full legal limitation period.

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

### **5. Ensure compliance with the main contract**

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

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

Many clauses of this type refer to the main contract as being "available for inspection" or having been "deemed to be inspected". Whilst this does save the contractor the trouble of giving each sub-contractor a copy of the main contract, it is best

practice to actually provide sub-contractors with a copy of the main contract. This eliminates the risk of sub-contractors attempting to argue that they cannot comply with the main contract because they haven't seen it.

### **6. Limitation periods must be the same**

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

## **TENDER PRICES TO RISE AS DEMAND RECOVERS**

Tender prices fell by 0.8% in 3rd quarter 2013 compared with 2nd quarter 2013, but rose by 6.3% compared with the same quarter in 2012. It should be noted that the annual increase is exaggerated by a significant fall in tender prices in 3rd quarter 2012, this being part of the volatility in prices seen in 2012, when tender prices were bottoming out. There has been a

settling down at the higher tender price levels seen at the beginning of the year, which could be indicative of an initial reflex action by contractors to unsustainable contractor margins. It is anticipated that tender prices will rise over the next six months, a feeling also reflected in the results of the recent BCIS survey of contractors, where all bar one of the contractors were expecting tender prices to rise over this period.

### Forecast to 4th Quarter 2018

New work output looks likely to have grown in 2013, preparing solid foundations for growth in new work output to continue to grow at an increasing rate over the forecast period, as the wider economic picture improves. However, some sectors and regions will fare better than others.

Construction demand will stand at around 14% below the pre-recession peak at the end of 2013, and although tender prices have risen by 6% over the last year, increases over the next two years are expected to be a little more moderate, though still rising ahead of building cost increases. With new work output forecast to return to its pre-recession peak in 2016, and increases gathering pace over the

remainder of the forecast period, it is believed that tender prices will rise more sharply, as contractors try to mitigate some of their losses made during the long recessionary period, and capacity constraints put upward pressure on prices. Tender prices at the end of the forecast period will be in the order of 25% above the previous peak in 2007.

### Summary of Forecasts

Annual % Change	4Q11	4Q12	4Q13	4Q14	4Q15	4Q16	4Q17
	to 4Q12	to 4Q13	to 4Q14	to 4Q15	to 4Q16	to 4Q17	to 4Q18
Tender Prices	+0.9%	+5.3%	+3.8%	+4.1%	+5.5%	+7.4%	+7.6%
Building Costs	+0.3%	+1.0%	+2.6%	+2.8%	+3.0%	+3.5%	+4.0%
Nationally Agreed Wage Awards	+0.6%	+1.6%	+2.3%	+2.9%	+3.4%	+3.9%	+3.9%
Materials Prices	0	0	+1.5%	+2.7%	+3.0%	+3.2%	+3.8%
Retail Prices	+3.2%	+2.7%	+3.0%	+2.9%	+3.2%	+3.4%	+3.3%
Construction New Work output*	-10.9%	+2.0%	+4.7%	+5.8%	+5.8%	+6.3%	+7.0%

\* Year on Year (4Q11 to 4Q12 = 2011 to 2012)

## Monthly Bulletin of Indices

YEAR	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
2003	631	632	632	635	635	632	664	667	667	667	667	667
2004	667	667	666	666	667	667	709	709	710	710	711	712
2005	711	713	713	713	713	714	769	769	769	768	769	770
2006	769	770	770	769	769	769	793	794	793	793	793	793
2007	793	795	795	795	795	795	824	825	825	825	826	826
2008	826	827	827	831	831	832	874	874	874	873	873	874
2009	874	875	874	874	875	875	875	875	875	876	876	876
2010	876	878	878	878	879	879	879	879	879	879	880	880
2011	880	885	885	885	888	889	898	898	909	908	908	911
2012	910	911	913	912	910	912	912	914	915	915	924	924
2013	939	940	943	942	941	938	937	937	938	937	937	937*
2014	941*	941*										

\*Provisional