



# **UNDERSTANDING THE MUTUAL INFLUENCE OF CONTRACT AND SUBCONTRACT TERMS ON CONSTRUCTION RELATIONSHIPS**

**فهم الاثر المتبادل لنصوص العقد وعقد الباطن على علاقات المقاولات**

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## **Abstract**

This dissertation was prepared in an attempt to highlight research points for consideration by contract drafters in the construction industry upon drafting main contract and subcontract documents. The research covered points to consider if a firm desires a subcontract to be treated as a general contract (back-to-back agreement).

The aim of this study was to identify the relationship between main contracts and subcontracts in construction practice; a construction relationship involves employers and main contractors on one side, and main contractors and their subcontractors on another side.

This study aimed to identify the practical influence of the terms of main contracts on subcontracts and vice versa. Such influences are examined in the particular areas of common construction terms that are most likely to be influenced as a result of the overall construction relationship.

The particular areas discussed in this dissertation include some drafting examples and subjects for the understanding of the mutual influence of contract and subcontract terms on construction relationships. The main subjects are conditional payment clauses, liquidated damages, deadlines and dispute resolution. Numerous other sub-points derived from these main points are duly discussed in this dissertation.

This topic was researched with concentration on UAE and UK laws and is supported with literature reviews of the civil and common law backgrounds. Particular consideration and references are given to the FIDIC's Conditions of Subcontract for Construction 2011.

The topic of this dissertation is seen as an important one because contract drafting is a sensitive practice that ought to be skilfully performed, and lots of circumstances should be considered for the purpose of achieving a project that is successful for the employer and for the other construction parties. Among these considerations are the balancing of risks between the construction parties and the particular circumstances to consider when

drafting main contracts and subcontracts in general, as well as back-to-back subcontracts in particular.

## ملخص البحث

تم اعداد هذه الرسالة فى محاولة لتوضيح بعض النقاط البحثية لأخذها فى الاعتبار من قبل معدى عقود المقاولات ومقاولات الباطن، هذا البحث يغطى تحديداً مواضيع محددة لأخذها فى الاعتبار عند الرغبة فى إعمال عقود الباطن المصاغة بإعتبارها (ظهر بظهر).

بناءً على ذلك فإن الهدف من هذه الدراسة هو لتحديد العلاقة بين العقود الرئيسية وعقود الباطن فى علاقة المقاولات التى تتضمن أرباب الأعمال والمقاولين الرئيسيين من جهة، وكذا المقاولين الرئيسيين ومقاولى الباطن من جهة أخرى.

هذه الدراسة تهدف الى تحديد اثر شروط العقود الرئيسية على عقود الباطن والعكس من ذلك، وذلك عند التطبيق العملى لهذه الشروط، هذه الآثار تم بحثها بالرجوع الى بعض من شروط المقاولات الشائعة التى يحتمل ان تلقى اكبر قدر من التأثير كنتيجة لعلاقات المقاولات.

إن المواضيع المحددة التى تم بحثها فى هذه الدراسة شملت بعض الامثلة ذات الصلة بصياغة العقود، أى شملت بعض المواضيع من أجل فهم الأثر المتبادل لنصوص العقد وعقد الباطن على علاقات المقاولات، هذه المواضيع الرئيسية هى: (1) شروط السداد المشروط، (2) التعويض الاتفاقى، (3) المواعيد الاخيرة، (4) تسوية النزاعات، كما ان هناك العديد من المواضيع المتفرعة عن هذه المواضيع الرئيسية تم مناقشتها كذلك ضمن هذا البحث.

تم تجهيز هذا البحث بالتركيز على قانون دولة الامارات العربية المتحدة، وقانون المملكة المتحدة وبالإستناد على الفقه الصادر من الخلفيات القانونية اللاتينية ونظام القانون العام الانجليزى، كما وتم التركيز تحديداً على الشروط العامة لعقد فيديك لمقاولات الباطن 2011.

إن موضوع هذه الرسالة يعتبر من المواضيع المهمة وذلك لأن مسألة صياغة العقود هي مسألة حساسة ويجب ممارستها بعناية، وهناك الكثير من الظروف المحيطة التي يجب وضعها في الاعتبار من أجل الوصول الى غايات رب العمل وباقي أطراف المشروع ألا وهي نجاح المشروع، ومن بين تلك الإعتبارات مسألة عمل موازنة لتوزيع المخاطر بين أطراف المقاوله، وكذا مسألة الوضع في الإعتبار بعض المسائل الخاصة عند صياغة عقود المقاولات الرئيسة ومقاولات الباطن بشكل عام، وكذا عند صياغة عقود المقاولات (ظهر بظهر) بشكل خاص.

## **Keywords**

Contract, subcontract, contractor, construction, employer, project, payment, privity, drafting, nomination, laws, agreement, collaboration, documents, FIDIC, Red Book, liability, warranty, influence, work, back to back, reference, claim, dispute, obligations, defects, security, certificate, notification, insurance, damages, engineer, supplier, termination, delay, court.

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- Traffic Act 1995
- Law No. 27-2007 regarding Ownership of Jointly Owned Properties in the Emirate of Dubai, Article 26

## **UK Laws**

- Statute of Frauds 1677, Section 4
- Contracts (Rights of Third Parties) Act 1999
- Road Traffic Act 1988
- Housing Grants, Construction and Regeneration Act 1996, Section 113

## **French Laws**

- Subcontracting Law 1975, Law No. 75-1334 issued on 31 December 1975, Article 12

## **Table of Standard Form of Contracts**

### **FIDIC Series**

- Conditions of Subcontract for Construction for Building and Engineering Works Designed by the employer 2011, Clauses 1.10, 5.2, 8.2, 8.7, 10, 11.2, 11.3, 12, 14.1, 14.7, 15.1, 15.3, 19.1, 20, 20.3, 20.4, 20.6 and 20.9
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- Plant and Design-Build Contract 1st Edition (1999 Yellow Book)

### **The Joint Contracts Tribunal Series (JCT)**

- JCT 98 Clause 35.13

### **Institution of Civil Engineers Series (ICE)**

- Clause 59.7

## **Dedications**

*I dedicate this effort to my beloved parents:*

*Professor Ali Bannaga*

*&*

*Nagat Hasib*

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## **Chapter 1 – Introduction**

### **Research Objectives**

The objectives of this research are as follows:

- a) To identify and explain the relationship and legal framework taking place between construction parties, as well as the related legal rules and the exceptions to such legal rules.
- b) To identify what particular terms or consequences of a traditional construction contract should be taken into consideration by employers, main contractors and subcontractors when drafting a general subcontract, a group of interlocking construction and supplier agreements, or a back-to-back construction agreement.

### **Research Questions**

- a) What legal options are available in contractual or judicial practice for employers, main contractors or subcontractors to preserve their rights under a construction arrangement limited by rules of privity of contracts?
- b) How can construction subcontract terms and adopted contract policies affect and influence the overall construction arrangement or a particular member of the overall construction arrangement?
- c) What drafting mechanisms in contracts should be considered by employers, main contractors and subcontractors when drafting a general subcontract, a group of



interlocking construction and supplier agreements, or a back-to-back construction agreement?

## **Research Scope**

This research is limited to the matters and topics associated with the research questions raised above; the research is concluded with reference to UAE and UK laws, along with reference to the international series of FIDIC contracts.

## **Research Structure**

This dissertation starts with an introduction in Chapter 1, which describes the objectives, questions and scope of the dissertation, as well as its structure and methodology.

Chapter 2 covers the literature review about the topic as introduced in regard to the matters of contractual collaboration between main and subcontract documents. The literature review also covers other subjects related to the idea of back-to-back contracts, the principles of privity of contracts, some of the common exceptions to the privity rules and the incorporation of contractual terms.

Chapter 3 covers the findings and discussions and is titled as “Significant clauses of back-to-back subcontracts” by explaining what certain effects and influences may occur as a result of construction arrangements involving one or a group of owners, main contractors and subcontractors in regard to some of the most common construction issues. Such issues are numerous but are all derived from four main issues: conditional payment clauses, liquidated damages, deadlines and dispute resolution mechanisms. This chapter therefore discusses certain points for contract drafters to take into consideration by way of incorporation.

Chapter 4 is basically a continuation of Chapter 3 but concentrates on one matter: dispute resolution mechanisms and their related influences between the project parties.

Chapter 5 provides the conclusion of the dissertation and the related recommendations produced as a result of the findings and discussions of this research.

## **Research Methodology**

The methodologies adopted in this research are qualitative and doctrinal; the research is conducted by making reference to the commonly recognized construction practices under both common and civil legal systems. The research's major references are derived from the FIDIC set of documents; however, certain references are also made to UK, UAE and French laws and case laws in support of the findings and discussions, although legal references are provided mostly for elaboration purposes.

## **Chapter 2 – Literature Review**

### **2.1 Introduction**

The topic of this research is associated with a number of issues that have been previously examined and discussed by many scholars and researches. Specifically, the questions of this dissertation investigate: what options available in contractual or judicial practices preserve the rights of one party or another, how subcontracts and adopted contract policies affect and influence the overall construction arrangement, and what mechanisms in contracts should be considered by the construction parties when drafting such interlocking documents.

This literature review, in association with the questions explored in this research, examines the proposed idea of having some sort of collaboration in contractual documents between the parties: in other words, having interlocking sets of documents governing the relationships between main contractors, subcontractors and project owners. This review is necessary to examine further the notions of back-to-back contracts, the incorporation of contract terms and how privity rules affect the aforementioned issues.

### **2.2 What Is a Construction Contract?**

In the civil law systems of the UAE, Egypt, Syria, Iraq, Lebanon and several other countries, a construction contract is defined as:

“A contract whereby one of the parties undertakes to make a thing or to carry out work against a counter value undertaken to be provided by the other party”<sup>1</sup>

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<sup>1</sup> UAE Civil Transaction Code, s. 872

In France, a construction arrangement is categorized as a type of hire agreement contract; therefore, it is not seen as an independent type of contract as derived from the ancient Roman rules, which divided hiring contracts into three main types: the hiring of people for employment and services, the hiring of movable or immovable things, and the hiring of works (such as construction works).<sup>2</sup>

The French Civil Code<sup>3</sup> provides the following:

‘There are three main kinds of hiring of industry and services: (a) The hiring of workers who enter the service of someone; (b) That of carriers, as well by land as by water, who undertake to carry persons or goods; (c) That of architects, contractors for work and technicians following research, estimates or contracts’.

While in the UK, a construction contract is defined as:

“An agreement for the carrying out of construction operations; arranging for the carrying out of construction operations by others, whether under sub-contract to him or otherwise; or providing his own labour, or the labour of others, for the carrying out of construction operations... includes an agreement to do architectural, design or surveying work or to provide advice on building, engineering, interior or exterior decoration or on the laying-out of landscape”<sup>4</sup>

## 2.3 Contractual Collaboration

HHJ Newey once described the extent of construction activities in the case of *Emson Eastern v EME Developments* by stating:<sup>5</sup>

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<sup>2</sup> Abd al-Rāziq al-Sanhūrī, Illustration on Civil Law (Egypt 1964, Dar Alnahda Alarabiyah) V7 Pt 1 Ch 1, 6

<sup>3</sup> Law No. 2004-164 of 2004, s. 1779

<sup>4</sup> Housing Grants, Construction and Regeneration Act 1996, s. 104

<sup>5</sup> (1991) 55 BLR 114, 125

“I think the most important background fact which I should keep in mind is that building construction is not like the manufacture of goods in a factory. The size of the project, site conditions, the use of many materials and the employment of various kinds of operatives make it virtually impossible to achieve the same degree of perfection that a manufacturer can. It must be a rare new building in which every screw and every brush of paint is absolutely correct”

The skeleton of a construction activity is further reflected in construction contracts; whether such contracts are main contracts, subcontracts or supply contracts, this will not change the fact that such contracts may relate to only one big or small project. Therefore, away from the standard legal doctrines regulating all such contracts, certain levels of contractual collaboration, as proposed by many, should be considered. This will be elaborated thoroughly in Chapter 3.

The attempt of project stakeholders to determine appropriate interlocking terms of two or more contracts depends on the legal skill of contract drafting. Collaboration among a group of contracts between main contractors and subcontractors would be considered back-to-back contracts.

Back-to-back contracts may not necessarily be made between a main contractor and a subcontractor but can involve multiple members of a single project when such members prefer to have a unified set of documents. For instance, this is often found in large multinational projects that may require the collaboration of multiple stakeholders of different capabilities. In such instances, drafting back-to-back documents is said to be a difficult task.<sup>6</sup>

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<sup>6</sup> P. Godwin & Others of Herbert Smith Freehills LLP ‘Back to Back Contracts’ (Lexology, April 2011) <<http://www.lexology.com/library/detail.aspx?g=d75e0cf3-eb8d-4ce5-b39a-13e7b9b4ec4e>> 02/11/2014

It is said that the methodology chosen to procure a project affects the level of collaboration between the project parties and the related agreement documents. This is more apparent in the traditional form of construction procurement, where this method serves the least levels of collaboration between main contractors and subcontractors. Other forms, such as the ICE and JCT standard forms, are said to be adversarial in terms of the level of collaboration, while the NEC and ECC forms work to serve cooperative relationships between the parties.<sup>7</sup>

The topic of this research is seen in a number of references by many scholars; many of these sources have touched particular points of discussion in the construction industry when it comes to the influences generated by the terms of main contracts over sub-contractual activities and vice versa. For example, some scholarly references have served general literature, while others have provided detailed studies in terms of particular issues, such as the impacts associated with back-to-back payments.<sup>8</sup>

The scholarly sources related to this topic depend very much on a doctrine that is respected and recognized by both common and civil law systems: the doctrine of privity of contracts, which is the rule that “a contract cannot confer rights nor impose obligations arising under it on any person except the parties to it”. This rule is held in common law systems in cases like *Price v Easton*<sup>9</sup> and *Tweddle v Atkinson*,<sup>10</sup> which were both directly linked with the principle of consideration. In both cases, claimants sued parties that were

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<sup>7</sup> O. A. Akintan & R. Morledge ‘Improving the Collaboration between Main Contractors and Subcontractors within Traditional Construction Procurement’ (2013) Journal of Construction Engineering, Hindawi Publishing, 8-9 <<http://downloads.hindawi.com/journals/jcen/2013/281236.pdf>> 14/10/2014

<sup>8</sup> See Mahmoud Fathi Bader ‘Impact of 'Back to Back' Payment Clause on the Cash Flow of Subcontractor in the UAE’ (MSc Thesis, British University in Dubai, 2013) <<http://bspace.buid.ac.ae/handle/1234/507>> 12/10/2014

<sup>9</sup> [1833] 110 ER 518

<sup>10</sup> [1861] EWHC QB J57

strangers to a disputed agreement; both cases were rejected, setting the doctrine of privity.

This doctrine is also recognized in civil law systems, such as in the UAE. It was previously held by the Dubai Cassation Court,<sup>11</sup> and it is provided under Article 252 of the UAE Civil Transaction Code (CTC) that:<sup>12</sup>

“A contract may not impose an obligation upon a third party but it may vest a right in him”

Furthermore, one of the most important scholarly sources written about the topic of this dissertation is the guidance directives proposed by FIDIC as part of its Conditions of Subcontract for Construction 2011.<sup>13</sup> The FIDIC Conditions of Subcontract for Construction 2011 provide standard terms for dealing with construction subcontract arrangements, particularly those that are based on the Conditions of Contract for Construction 1999<sup>14</sup> (FIDIC Red Book 1999). The FIDIC Conditions of Subcontract for Construction 2011 also brought some practice guidance for practitioners, giving alternative terms to some of the contract’s standard terms that are usually seen as sensitive in construction relationships. For example, Clause 20 [Notices, Subcontractor’s Claims and Disputes] of the FIDIC Conditions of Subcontract for Construction 2011 proposes some particular general terms in regard to a contractor’s claims and the formation of the Dispute Adjudication Board (DAB). Alternatives to the standard terms of Clause 20 are also proposed, although only on a trial basis, pending feedback from FIDIC users. FIDIC’s alternative terms are discussed in more detail under Chapters 3 and 4.

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<sup>11</sup> (2009) Dubai Cassation 96/2009 CA

<sup>12</sup> UAE Civil Transaction Code, Law No. 5-1985 amended by Law No. 1-1987

<sup>13</sup> Conditions of Subcontract for Construction for Building and Engineering Works Designed by the Employer, ISBN 978-2-88432-068-9, 1st Edition 2011

<sup>14</sup> FIDIC Red Book 1st Edition 1999, ISBN 2-88432-022-9

Many references do not seem to recognize the influence of subcontractors on most projects, despite the fact that subcontractors usually participate in more than 50% of projects and their contributions can reach up to 90% of the total project value.<sup>15</sup> It has further become a common practice in many parts of the world to have the main contractors act only as managers of subcontractors; the outcomes of most projects therefore rely majorly on subcontractors.<sup>16</sup> However, despite such high percentages in terms of a subcontractor's influence over a project, such influences are still not seen as major causes for delaying a project. This is observed as a result of numerous studies indicating that – on an international level – there are up to 73 different common causes for construction delays but only a few of them refer to the issue of collaboration of main and subcontract documents.<sup>17</sup>

The matter of contract collaboration was cited in the Latham Report 'Constructing the Team', as published by Sir Michael Latham in 1994. Sir Latham reported that:

“The most effective form of contract in modern conditions should include a wholly interrelated package of documents which clearly defines the roles and duties of all involved, and which is suitable for all types of project and for any procurement route”<sup>18</sup>

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<sup>15</sup> L. Yoke-Lian & Others, 'Review of Subcontracting Practice in Construction Industry' (August 2012) Vol. 4, No. 4, 1, IACSIT International Journal of Engineering and Technology <<http://www.ijetch.org/papers/406-P013.pdf>> 14/10/2014

<sup>16</sup> A. K. W. Ng & A. D. F. Price 'Assessing the Impact of Main Contractor's Site Co-ordination on Sub-Contractors' Performance in Hong Kong' (2005) Association of Researchers in Construction Management <[http://www.arcom.ac.uk/-docs/proceedings/ar2005-0191-0200\\_Ng\\_and\\_Price.pdf](http://www.arcom.ac.uk/-docs/proceedings/ar2005-0191-0200_Ng_and_Price.pdf)> 20/10/2014

<sup>17</sup> See M. Sambasivan & Y. Wen Soon 'Causes and Effects of Delays in Malaysian Construction Industry' (2007) International Journal of Project Management, 517-526 <<http://www.nosazimadares.ir/fanni/doclib7/causes%20and%20effects%20of%20delays%20in%20malaysian%20construction%20industry.pdf>> 20/10/2014

<sup>18</sup> Sir M. Latham, *Constructing the Team* (ISBN 0 11 752994 X, UK, HMSO, 1994) 37



It was concluded in the Latham Report that interrelated documentation clearly defining the roles of the parties and a complete family of interlocking contractual documents are very much a requirement in the UK construction industry, therefore coming to the conclusion that non-collaboration between project stakeholders would constitute problems in the face of the construction industry.

Sir Latham's report made reference to the payment procedures of the NEC form of contract, which at the time used to provide long payment periods to subcontractors – these could reach up to three months after the completion of their subcontract works. Sir Latham recommended that related payment durations must be modified in collaboration with clients, contractors and subcontractors, which should facilitate consent on a different timescale acceptable to all parties as part of an effort to propose cohesive main and subcontract documentations.

Shortly after the publication of the Latham Report, the Egan Report was published in 1998, containing the findings reported by the Construction Task Force set up by the UK's Deputy Prime Minister John Prescott and chaired by Sir John Egan. Similarly, it further concluded and recommended that integrated processes and teams are necessary in the construction industry and hence more-integrated project processes were advised. Sir Egan's approach, however, was founded more on the idea of ensuring the success of a project as a whole and improving the relationships between all parties, rather than being favourable to one or more members of a project, leading to the further development of the culture of Partnering and other innovative procurement methods. In this regard, Egan's report stated:

“The most successful enterprises do not fragment their operations – they work back from the customer's needs and focus on the product and the value it delivers to the customer. The process and the production team are then integrated to deliver value to the customer efficiently and eliminate waste in all its forms. The Task Force has looked for this concept in construction and sees the industry typically dealing with the project process as a series of sequential and largely

separate operations undertaken by individual designers, constructors and suppliers who have no stake in the long term success of the product and no commitment to it. Changing this culture is fundamental to increasing efficiency and quality in construction”<sup>19</sup>

Furthermore, some have highlighted the necessity for main contracts and subcontracts to be drafted on a back-to-back basis in terms of obligations, rights and liabilities. One example relates to the protection of a main contractor in events that give grounds for subcontractors to demand time extensions; as such events may not actually be the same events that give grounds for main contractors to submit similar demands to employers. This can have a consequence in terms of the main contractor paying liquidated damages to the employer, as well as paying the subcontractor any damages as a result of such delays, on which such liquidated damages from one side may not be recoverable from the subcontractor, leaving the main contractor responsible for paying more than one liability.<sup>20</sup>

## 2.4 Back-to-Back Contracts

It is often seen that main contractors fall into a common drafting mistake when they attempt to draft back-to-back contracts: they simply rename the titles of the parties in the main agreement to those associated with a subcontract. In other examples, the main contractor simply mentions in the sub-agreement that the terms of the main agreement are applicable between it and the subcontractor. In some jurisdictions, such simple references are not recognized by courts, as seen in the Scottish case of *Watson Building Services Ltd*

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<sup>19</sup> Sir J. Egan, *Rethinking Construction* (HMSO 1998) 13

<sup>20</sup> Z. Spyrou of Pinsent Masons ‘Sub-contracting – Risks and Opportunities’ (8/10/2010) *Construction Law Journal*, 21 8 Cons. Law 20.

*v Harrison*,<sup>21</sup> where the court refused to apply a condition laid out by the main contractor for making simple references to the terms of the main contract clauses.

It is said that the method of forming a back-to-back agreement as observed in the *Watson* dispute could be seen as attractive because it saves time and money, yet such an approach can result in ambiguity and can limit the main contractor's attempts to pass down risks to the subcontractor.<sup>22</sup>

Based on the above, some writers have condemned making simple references to main terms and conditions in a subcontract document because this approach may not necessarily serve the idea of collaboration between main and subcontract documents, as the scope of services under the main contract is usually different from that of a subcontract. Also, this approach may have a direct impact when it comes to the various notification periods that are found in standard agreements, such as the notification periods required to serve an extension of time demand starting from the moment of becoming aware of a related event. In many such instances, the main contractor may not even be aware of such events, unless the subcontractor notifies the main contractor of these events as per the subcontract. More importantly, if such notifications come from the subcontractor on the very last date of the notification period, this may not give sufficient time to the main contractor to make a similar notice to the employer, resulting in the subcontractor having to make a claim against the main contractor long before the employer or engineer can evaluate the extension request of the main contractor to the employer. Therefore, a simple reference between contractual documents would not achieve collaboration or compliance between the contractual documents. Instead, appropriate drafting should be observed in order to achieve such interlocking aims.<sup>23</sup>

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<sup>21</sup> [2001] SLT 846

<sup>22</sup> Spyrou (n 20) 13

<sup>23</sup> Ibid 22

Other writers have criticized the idea of back-to-back contracts because such contracts create problems of interpretation and may not achieve the effect intended in terms of project success or risk diversion as decided by main contractors and employers.<sup>24</sup>

Such mutual effects between main construction contracts and subcontracts may be determined by the differences or similarities between the contracts, as they can be majorly similar and in compliance with each other or they may well be completely different from each other in terms of prices, terms and penalties. The general understanding, however, is that certain levels of conformity should be provided between main and subcontract documents in order to achieve a successful project result. This notion has been pursued by construction industry professionals and has been recently developed by international module contracts such as the FIDIC Conditions of Subcontract for Construction 2011, PPC, SPC 2000 and the NEC 3 family of contracts.

## **2.5 Privity of Contracts**

In order to achieve an appropriate level of contractual conformity when dealing with interlocking sets of documents or back-to-back agreements, one major principle defines and limits the drafting process and further highlights the necessity of drafting skill, which is the principle of privity of contracts.

It is well established that a main construction contract is an agreement signed between the employer and the main contractor, while a subcontract agreement is made between a main contractor and their contractors. Under the general principles of common and civil laws, the principle of privity would apply, and this principle is a well-established one in the English common law system.<sup>25</sup>

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<sup>24</sup> J. Uff, *Construction Law* (ISBN 9781847037671, 10th Edition, Sweet & Maxwell 2009) Ch 10, 325

<sup>25</sup> *Dunlop Pneumatic Tyre Company Ltd v Selfridge & Co Ltd* [1915] AC 847

Sub-Clause 1.10 of the FIDIC Conditions of Subcontract for Construction 2011 provides:

“Nothing stated in the Subcontract shall be construed as creating any privity of contract between the Subcontractor and the Employer”

FIDIC has proposed that the clause mentioned above should be observed when dealing with FIDIC in different parts of the world because some laws impose joint liabilities and obligations among main contractors and employers to pay the dues of a subcontractor,<sup>26</sup> whereas the FIDIC guidance proposes that even though such statutory obligations exist, they should still not be construed as establishing any privity of contract between a subcontractor and an employer.

Subcontractors and employers in an ordinary construction project would normally not have direct contractual relationships with each other; an employer usually appoints a main contractor, and the main contractor then appoints its own single or multiple subcontractors. Each subcontractor may be specialized in a particular field of a related construction industry. This means that in any case of default or breach of agreement, the employer would not be able to sue the subcontractor directly for defaults associated with its performance, and equally the subcontractor would not be able to sue the employer for payment of the subcontractor's entitlement by the main contractor.<sup>27</sup>

The rules regulating construction arrangements in the UAE are generally provided in the CTC, which provides the general principles and rules of a construction contract, as well the rules of contracts in general. The law further covers subcontracting liability rules under Article 890, which provides:

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<sup>26</sup> French Subcontracting Law No 75/1334, s 12

<sup>27</sup> Nicholas Gould of Fenwick Elliott 'Subcontracts' (2011) 1  
<[http://www.fenwickelliott.com/files/nick\\_gould\\_-\\_subcontracts\\_paper\\_for\\_university\\_of\\_vienna.indd\\_.pdf](http://www.fenwickelliott.com/files/nick_gould_-_subcontracts_paper_for_university_of_vienna.indd_.pdf)> 21/8/2014

“(1) The contractor may entrust the performance of all or part of the work to another contractor unless a condition in the contract prohibits him from so doing, or unless the nature of the work is such as to require him to do it in person.

(2) The liability of the first contractor shall remain in place as against the employer”

From the above Article, it is clear that the liability of the subcontractor should rather be treated as a liability of a main contractor towards the employer, and it can also be seen that the law allows main contractors to appoint subcontractors without having to take permission from the employer as a default rule, unless expressed otherwise under the agreement or as per any surrounding circumstances prohibiting main contractors from appointing subcontractors. This is contrary to the rules seen in the FIDIC modules, which give the default rule that main contractors are not permitted to acquire assistance from subcontractors, unless agreed otherwise.<sup>28</sup>

The CTC further determines the idea of privity between those involved in a subcontract arrangement by prohibiting subcontractors from pursuing employers in regard to their contractual rights by stating under Article 891 the following:

“The second contractor may not make any claim against the employer for anything due to him from the first contractor unless he has made an assignment of it to him as against the employer”

From the above, it is clear that the law by default separates the relationship between employers and subcontractors. In other words, it separates the agreement between the employer and the main contractor from one side and between the subcontractor and the main contractor from the other side.

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<sup>28</sup> FIDIC Red Book 1999, s. 4.4

### 2.5.1 Exceptions to Privity Rules

#### a) Named and Nominated Subcontractors

The CTC is a general law dealing with construction contracts; hence, a number of questions are not explicitly answered under the CTC but are instead left to be dealt with under the general principles of civil laws and Islamic sharia.<sup>29</sup> For example, the CTC provides rules under Article 891 in terms of safeguarding the rights and liabilities of the construction employer against claims that may be raised by a subcontractor that is unknown to the employer, and equally provides further rules as per Article 890 in terms of safeguarding the rights and liabilities of a subcontractor against claims that may be raised by an employer that is equally unknown to the subcontractor.

Despite the rules and principles previously described, the judicial practice in Dubai holds some exceptions to the privity rule. This is apparent when answering the question of who appointed the subcontractor.

The Dubai Court of Cassation has held in a number of its judgments that mistakes, damages or delays caused by a subcontractor that is appointed by the employer would be the employer's liability, not the main contractor's.<sup>30</sup>

The rules set forth by the Dubai courts may not apply in situations where an employer or project engineer under an agreement is not authorized to nominate or name subcontractors but is only authorized to reject or approve subcontractors proposed by the main contractor. The main contractor here may still be liable for the works of his subcontractors, even if they were approved by the employer or engineer yet originally proposed by the main contractor. A practical example of such a situation can be found in

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<sup>29</sup> UAE Civil Transaction Code, s. 1

<sup>30</sup> (2008) Dubai Cassation 213/2008 & (2008) Dubai Cassation 266/2008

Clause 4.4(b) of the FIDIC Red and Yellow<sup>31</sup> Books 1999, as they differentiate between subcontractors that are named or nominated from those that are domestically appointed by the main contractor, even if they are approved by the employer or engineer first.

In terms of the liability of contractors for performance violations committed by subcontractors that are nominated by the employer, Section 5.2 of the FIDIC Red Book 1999 provides that the main contractor can object to a nomination of a subcontractor as long as the proposed subcontractor does not specify levels of indemnity in favour of the main contractor against any defected performance executed by the nominated subcontractor. The same right is given if the subcontracted works do not transfer the risk of defected performance from the main contractor to a nominated subcontractor. The objection situations described in Clause 5.2 of the FIDIC Red Book 1999 further suggest that a main contractor may still be liable towards the employer for the performance of a nominated subcontractor if the subcontract does not specify an indemnity clause against the liability of the main contractor.

FIDIC Clause 5.2 remains impractical in the eyes of UAE law, as previously described, whether the subcontract provides an indemnity clause in favour of the main contractor or not, as long as the main contractor is deemed to have previously had a chance to object to a certain nomination made by an employer. The reason for this rule refers back to Article 890(2) of the CTC, which provides for a strict liability against main contractors for the performance of their subcontractors, as even the previously described Dubai judicial precedents (which ruled that a main contractor shall not be held liable for the works of subcontractors named or nominated by the employer) have made the exception that a main contractor should not have been given ‘any chance’ to approve or reject a particular nomination as per the merits specified in these precedents. The example of FIDIC contracts seems to have given the main contractor such a clear chance.

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<sup>31</sup> FIDIC Conditions of Contract for Plant and Design-Build – 1st Edition, 1999



As for the nature of the relationship between a nominated subcontractor and the employer, this has not been expressed as a direct contractual relationship. The precedents issued by the Dubai courts referred to earlier seem to have been issued only on the basis of causation.<sup>32</sup>

English law strictly respected the privity rules and had no exceptions to the liability of the main contractor for the performance of a nominated subcontractor, at least not until the case of *Bickerton v. NW Hospital Board*,<sup>33</sup> which gave an exception in situations where a nominated subcontractor deliberately repudiates the contract. However, still, as a general rule, an employer does not share responsibility as a result of defects or delays committed or caused by a nominated subcontractor. This is said to have caused significant changes in UK standard forms of contract, such as JCT forms,<sup>34</sup> giving contractors the right to an extension of time for delays caused by the nominated specialist subcontractor or giving the right for reasonable objection to a nominated subcontractor.<sup>35</sup> These changes, however, are said to deprive the employer from remedy, save under any direct warranty.<sup>36</sup>

In the mentioned *Bickerton* case, it was held by the court that the employer would have a duty to re-nominate and pay for a new specialist subcontractor's account should the old one deliberately repudiate the contract. Yet interestingly, in the case of *Gloucestershire County Council v. Richardson*,<sup>37</sup> which refers to the matter of nominated suppliers, the main contractor found defects in pre-cast concrete columns supplied by a nominated

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<sup>32</sup> Professor A. Masadeh 'Vicarious Performance and Privity in Construction Contracts' (2014) International Construction Law Review, v 31, 108

<sup>33</sup> [1970] 1 WLR 607

<sup>34</sup> 1963 Edition, cl.23(g); JCT 80, cl.25.3.7

<sup>35</sup> J. Adriaanse, *Construction Contract Law* (UK ISBN 978-0-230-23044-6, 3rd Edition, Palgrave Macmillan 2010) 252

<sup>36</sup> Uff (n 24) 329

<sup>37</sup> [1969] 1 A.C. 480

supplier; the form of contract applied was RIBA 1939, which did not allow contractors to object to the choice of nominated supply contracts. It was held by the court that the main contractor would not be held liable for the defective supply and was therefore not in breach of contract.

## **b) Collateral Warranties**

Another exception to the contracts privity rules is found when establishing collateral warranties. A collateral warranty is a warranty given by a subcontractor directly to the employer undertaking to warrant the quality of goods or works.

In the leading case of *Shanklin Pier Limited v Detel Products Ltd*,<sup>38</sup> the claimant owned a pier that required maintenance and repainting. Detel Products (the paint supplier and subcontractor) warranted to the claimant that its products were suitable for the pier and further warranted that their paints would also ensure rust protection for a period of ten years. Shanklin (the employer) therefore trusted this warranty and appointed a main contractor to do the painting. The paint later failed to serve the requirements of the claimant, hence the claimant claimed for damages directly from the subcontractor (the defendant) and not from the main contractor because the warranty had not been issued by the main contractor and the main contractor did not actually make any comments on such warranties. This was despite the fact that the agreement for the purchase of the paint had been made between the main contractor and the subcontractor.

The judgment made by McNair J's reads:

“This case raises an interesting and comparatively novel question whether or not an enforceable warranty can arise as between parties other than parties to the main contract or the sale of the article in respect of which the warranty is alleged to have been given... I am satisfied that, if a direct contract of purchase and sale of

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<sup>38</sup> [1951] 2 KB 854

[the paint] had then been made between the plaintiffs and the defendants, the correct conclusion on the facts would have been that the defendants gave to the plaintiffs the warranties substantially in the form alleged in the statement of claim. In reaching this conclusion, I adopt the principles stated by Holt CJ in *Crosse v Gardner* and *Medina v Staughton* that an affirmation at the time of sale is a warranty provided it appear on evidence to have been so intended”

If, as is elementary, the consideration for the warranty in the usual case is the entering into of the main contract in relation to which the warranty is given, I see no reason why there may not be an enforceable warranty between A and B supported by the consideration that B should cause C to enter into a contract with A or that B should do some other act for the benefit of A.’

Collateral warranties are also permissible and enforceable under UAE law, based on the general principles of contracts and insurance.

### **c) Direct Payment**

Employer–subcontractor direct payment arrangements are not impliedly nor explicitly provided in UAE law. This arrangement is not recognized due to the privity of contracts rules. However, some standard forms of contract have provided direct payment arrangements in relation to nominated subcontractors but not as a first choice arrangement. By way of example, Clause 35.13 of JCT98, Clause 59(7) of ICE and Clause 5.4 [Evidence for Payment] of the FIDIC Red Book 1999 explain that an employer may request reasonable evidence from the main contractor that payment has been made to a nominated subcontractor under the contract and that this would be a requirement before a payment certificate can be issued to the main contractor.

It is said by some that such an undertaking is unnecessary, but others have argued that it will surely serve the interest of the employer in situations where the main contractor

becomes bankrupt, as the employer here will continue paying the specialized subcontractor in order to ensure continuation of the work pending the substitution of a general contractor, therefore reducing delays and damages. Greater delays and damages could be expected as a result of having specialized subcontractors suspend works due to the insolvency of the main contractor.<sup>39</sup>

In 1975, France introduced new laws designed to protect the rights of subcontractors, as well as a law that establishes direct payment obligations between employers and subcontractors under certain conditions.<sup>40</sup> The law provides that main contractors are under obligation to issue bank guarantees in favour of their subcontractors, guaranteeing payment for executing the subcontract works. Equally, employers are under obligation to ensure that their main contractors comply with this requirement, and failure by the employer to ensure these requirements would give the subcontractor the right to make a direct claim to both the employer and the main contractor jointly. The French Supreme Court recently extended the authority of these rules by considering them as part of the French public policy, even if the main contract or subcontract utilised laws other than French laws, as long as the works of such contracts or subcontracts are executed in France.<sup>41</sup>

#### **d) Payment Guarantees**

Due to the lack of a direct contractual relationship between an employer and a subcontractor, and as explained, a subcontractor may not make a direct claim to the employer for payment, and an employer could by virtue of contract have the option to deduct some of the entitlements of the main contractor in favour of the subcontractor if

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<sup>39</sup> Gould (n 27) 25

<sup>40</sup> Law No. 75-1334 issued on 31 December 1975

<sup>41</sup> (2007) French Court of Cassation, 06-14006

the main contractor fails to present evidence of payment. However, whether or not such options are available to the parties, the subcontractor may still request a guarantee from the employer ensuring such direct payment arrangements.

In UAE law, there are no special forms to conduct such guarantees, since a guarantee is considered an agreement establishing certain obligations upon a guarantor; however, in accordance with the UAE judicial system and practice, it is in the best interests of subcontractors to insist that such guarantees are established in writing.

In the UK, such guarantee agreements must be in writing to be recognized as valid guarantees. This was further confirmed in the case of *Actionstrength Ltd v International Glass Engineering IN.GL EN Spa*,<sup>42</sup> where it was decided that a verbal guarantee cannot be enforced for the reason that it does not comply with Section 4 of the Statute of Frauds 1677.

#### **e) Statutory Exceptions**

Some laws provide exceptions to the privity rules, such as the UK's Contracts (Rights of Third Parties) Act 1999, which rather regulates the exceptions that are already established under common law principles. It further stipulates that:

“A third party may enforce contract terms if it expressly states that the third party may enforce the term, or if the term purports to enforce a benefit on that third party”

Other laws have also been introduced providing certain exceptions to the rules of privity, such as the UK's Road Traffic Act 1988 and the UAE's Traffic Act 1995. Both laws confer rights to third parties to benefit from the comprehensive compulsory vehicle

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<sup>42</sup> [2003] BLR 207

insurance requirements; however, similar arrangements are often seen as being hybrid arrangements containing both elements of laws and contracts.

## 2.6 Incorporation of Main Contract Terms in Subcontracts

In most examples, the aim of contract incorporation is to achieve a back-to-back agreement. There are two methods of dealing with incorporation of terms in contracts:<sup>43</sup>

- 1- The first is by incorporating by reference all conditions of the main agreement with exception to particular parts of the main agreement that are directly excluded (these are usually confined to terms clearly not applicable to the subcontract, e.g. terms associated with money). This approach is seen by contractors as an easy way to conclude a back-to-back contract for the reason that this method is fast and cost-effective, yet a contract drafted using this method should be carefully observed because it may lead to disputes and difficulties.
- 2- The second approach is by drafting independent terms specifically tailored for the subcontract.

In English law, the incorporation of terms means the inclusion of terms of one contract in forming part of another contract. The English courts have judged many cases regarding this issue, and the collective set of English precedents forms the rules that are required to consider contract incorporation mechanisms as valid. These requirements can be summarized as follows:

- **Sufficient notice of the incorporated terms should be provided before or during the formation of the latter contract.**

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<sup>43</sup> Godwin et al. (n 6) 1

This was held in the case of *Olley v Marlborough Court Hotel*.<sup>44</sup> The claimant reserved accommodation in a hotel owned by the respondent. Inside the booked room was a notification providing that the hotel would not be responsible for any lost or stolen property unless the property was given to the administration to be deposited in a safe box. The claimant had her fur jacket stolen from her room; she later filed a case against the defendant claiming for damages. Due to the reservation contract being formed at the reception of the hotel before the plaintiff acquired the room, and as the notice of the term was made only after the making of the agreement, it was held that the notice (which was visible only after the room had been booked by the plaintiff) could not be considered an incorporated term with the booking agreement.

The English courts have further given an exception to the requirement of notice if any continuous past dealings took place between the parties. For instance, in *McCutcheon v. David MacBrayne Ltd*,<sup>45</sup> the court mentioned that the course of past dealings must be 'regular and consistent'; in *Henry Kendall Ltd v. William Lillico Ltd*,<sup>46</sup> it was ruled that a total of 100 similar agreements over a period of three years was considered a 'regular and consistent' course of transaction. In *Hollier v. Rambler Motors (AMC) Ltd*,<sup>47</sup> it was held that a total of four agreements over a period of five years was not considered a course of dealing.

- **The incorporated terms referred to must be found in a valid contract or a contract that is intended to be binding.**

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<sup>44</sup> [1949] 1 KB 532

<sup>45</sup> [1964] 1 WLR 125

<sup>46</sup> [1969] 2 AC 31

<sup>47</sup> [1972] 2 QB 71

In *Chapelton v. Barry Urban District Council*,<sup>48</sup> the claimant rented a deckchair from the defendant to use on the beach. The claimant was given two receipts that stated on the back of each that the defendant would not be responsible for any damages that may arise as a result of renting the chair. However, the chair was defective; it collapsed and caused injuries to the claimant, who later filed a claim against the defendant. In his defence, the defendant referred to the liability exclusion terms found on the back of the receipts. The court ruled that the terms found on the receipt could not release the defendant from liability for the reason that the receipts were not documents expected to be treated as contractual terms.

- **That ‘reasonable steps’ as described by courts should be followed by the party that requires the application of the incorporated term.**

This was explained in the case of *Parker v. South Eastern Railway Company*,<sup>49</sup> where the court held that it is not important for a party to read the incorporated term; however, a party should take ‘reasonable steps’ to bring the incorporated term to the attention of the other party. The case of *Thompson v. London, Midland and Scottish Railway Co Ltd*<sup>50</sup> illustrates this further where the claimant bought a train ticket that stated ‘see back’ on its front. The back stated that full terms and conditions could be found on the company timetables. The court ruled that the term was valid because ‘reasonable steps’ had been taken to bring it to the claimant’s awareness, even though the claimant proved to be illiterate.

The case of *J Spurling Ltd v. Bradshaw*<sup>51</sup> established what is known as the ‘red hand rule’, which Lord Denning describes as follows:

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<sup>48</sup> [1940] 1 KB 532

<sup>49</sup> [1877] 2 CPD 416

<sup>50</sup> [1930] 1 KB 41

<sup>51</sup> [1956] 1 WLR 461



“I quite agree that the more unreasonable a clause is, the greater the notice which must be given of it. Some clauses which I have seen would need to be printed in red ink on the face of the document with a red hand pointing to it before the notice could be held to be sufficient”

### **2.6.1 Incorporation by Reference**

Incorporation of reference or by reference is different from incorporation of terms. The first is more common in construction subcontracts, while the second means that a certain contract is referred to in another contract as being applicable alongside the first contract. If this is done properly, then the entire contract which is referred to would form part of the contract which made the reference.

Incorporation by reference can also be applied when the parties of a main construction contract make reference to an international standard contract, such as the FIDIC contracts. When incorporation by reference becomes necessary, then the text to be adopted must be clear in showing that the parties meant to incorporate the particular document (e.g. “The following documents shall be deemed to form and be read and construed as part of the contract...” ).<sup>52</sup>

### **2.6.2 Incorporation of Terms in UAE Law**

In the UAE, most of the examples found relate to arbitration clauses that were written in other agreements involving the same parties of a particular dispute. The examples taken from UAE law will therefore be examined on an analogical basis.

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<sup>52</sup> Dennis Brand ‘Incorporation of Reference’ Construction Week Online (2010) 1, <<http://www.constructionweekonline.com/article-9592-incorporation-of-reference/1/print/>> 30/10/2014

On the matter of making agreements by way of reference, the judgments of the UAE courts have been quite varied. For instance, it was once decided that an arbitration agreement is deemed to be concluded if the parties under a construction contract intended to have a FIDIC standard agreement be treated as complementary to their particular construction contract.<sup>53</sup>

In another example, an opposite ruling was decided in regard to making general reference to another contract containing an arbitration clause. It was held that it is not sufficient to establish an arbitration agreement if the particular arbitration term of that other contract is not explicitly referred to.<sup>54</sup> However, it has recently been confirmed by a Dubai Cassation Court ruling that a reference to an arbitration term can be made even if the arbitration clause is written on a non-contractual document, such as a bill of lading.<sup>55</sup>

On the other hand, UAE law indicates that incorporation of terms and incorporation by reference are permissible as per Article 132 of the CTC, which provides the following:

“An expression of intention may be made orally or in writing, and may be expressed in the past or present tense or in the imperative if the present time is intended or by an indication as is customary even if made by a person who is not speechless, or by an interchange of acts demonstrating the mutual consent or by adopting any other course in respect of which the circumstances leave no doubt that they demonstrate mutual consent”

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<sup>53</sup> (2002) Dubai Cassation 462/2002

<sup>54</sup> (2005) Dubai Cassation 174/2005

<sup>55</sup> R. Karrar-Lewsley & Z. Anani ‘Dubai Court of Cassation Judgment: Incorporation of Arbitral Clause by Reference in Bill of Lading’ Al Tamimi & Co (November 2013) 1, <<http://www.tamimi.com/en/magazine/law-update/section-5/november-4/dubai-court-of-cassation-judgment-incorporation-of-arbitral-clause-by-reference-in-bill-of-lading.html#sthash.VcngqK9z.dpuf>> 2/11/2014

## **Chapter 3 – Significant clauses of back-to-back subcontracts**

### **Introduction**

Special consideration needs to be given to the drafting and tendering process of a construction project, especially when drafting a back-to-back agreement. This consideration is mostly associated with the following issues:<sup>56</sup>

- 1- Conditional payment clauses
- 2- Liquidated damages
- 3- Deadlines
- 4- Dispute resolution

This dissertation examines and discusses the above issues alongside additional matters that are derived from these general issues. Furthermore, this discussion clarifies the different influences that may be enforced between project parties and contract documents as a result of the choices adopted upon having agreed on particular contractual terms, arrangements and procurement mechanisms.

### **3.1 Terms of Payment**

It is preferable to have the main construction agreement harmonized with its subcontract in order to avoid risks of contradicting terms between different construction parties within the same construction project.

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<sup>56</sup> Godwin et al. (n6) 2.

For example, when the employer demands to establish direct performance liability on the subcontractor, the subcontractor should equally demand that the employer be directly responsible for any claims of payment that may fail to be honoured by the main contractor. However, all such requirements are down to the skilful drafting abilities of the parties, which should not accidentally establish a direct contractual relationship between the employer and a subcontractor.

Clause 5.4 [Evidence of Payment] of the FIDIC Red Book 1999 provides for a proactive approach to be applied by the engineer in order to ensure that a nominated subcontractor is being paid. These measures are observed in the FIDIC Red Book standard rules requiring the main contractor to submit evidence of payment of the wages of the nominated subcontractor. The rules go further by giving the employer the authority to pay the nominated subcontractor directly should the main contractor fail to provide evidence proving the payment to the nominated subcontractor.

These FIDIC direct terms apply in relation to nominated subcontractors only, and they do not apply to subcontractors that are domestically appointed by the main contractor. The reason is because the employer is deemed to share a level of responsibility towards the rights of the subcontractor and would equally further share a level of liability towards the subcontractor's own performance liabilities only because such a subcontractor is in fact nominated or desired by the employer. By contrast, domestic subcontractors are not associated in any way with the employer's choices and desires.

UAE law adopts a slightly different approach from what is presented under the FIDIC contracts in terms of rights and liabilities regarding payments between employers and subcontractors. These differences can be summarized as follows:

- a) Clauses 5.3 and 5.4 of the FIDIC Red Book 1999 make it an obligation of the engineer and employer to ensure payment to a nominated subcontractor by the

main contractor or directly by the employer upon making the necessary deductions from the dues of the main contractor.

- b) While Article 891 of the UAE CTC prohibits subcontractors – whether named, domestic or nominated – from making any payment claims against employers, an exception to this rule is where the main contractor refers the subcontractor to the employer for payment.<sup>57</sup> It is presumed that this implies that the referral will mean that the subcontractor can be paid only by deducting from the pending dues of the main contractor where such dues are recognized by the employer at the time. This is because if the main contractor is not entitled to payments from the employer, then the rule laid out by UAE law may not be applicable.

It is worth mentioning that direct reference of incorporating the main contract terms within the subcontract terms often causes problems.<sup>58</sup> For instance, in the case of *Geary, Walker & Co. Ltd v. W Lawrence & Son*,<sup>59</sup> the parties agreed on similar terms of payment between the main contract and the subcontract, yet the value of retention under the main contract exceeded the amount payable to the subcontractor under the subcontract. The court held that the conditions of the main contract in regard to the payment terms were applicable, and the same was held in regard to the retention money. However, the court decided that payment should be made in the same proportion as the proportion of the subcontract amount to the main contract amount.

Clause 14.7 [Payment of Retention Money under the Subcontract] of the FIDIC Conditions of Subcontract for Construction 2011 seems to give a rule complying with the ruling in the *Walker* case. The guidelines also provide that the main contractor should pay to the subcontractor the retention money of the subcontract in the same portion that

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<sup>57</sup> (2001) Dubai Cassation 405/2001 and (2001) Dubai Cassation 428/2001

<sup>58</sup> Gould (n 27) 7

<sup>59</sup> (1986) HBC (4th Edition) Vol 2, Page 382 CA

applies to the retention money provided under the main contract (Clause 14.9 [Payment of Retention Money]).

By contrast, in UAE law, it is permissible for two parties to make reference to the terms regulating their relationship by pointing to terms described in another contract signed between other different parties, as long as the first parties are aware of the terms that are mentioned in the other contract. This is indicated in Article 132 of the UAE CTC. UAE law furthermore acknowledges making reference to the main construction terms and conditions under the subcontract. This can be seen in a number of cases concerning back-to-back terms that have been judged by the Dubai Cassation Court.<sup>60</sup>

### **3.2 Terms of Back-to-Back Payment Arrangements**

Back-to-back payment conditions (or pay when paid / pay when certified conditions) are conditions whereby a subcontractor accepts the risk of being paid by the main contractor only if the employer pays the main contractor or if the employer certifies payment to the main contractor.

Originally, the reason for back-to-back payment terms being considered in the construction field was to release the main contractor from the liability of making payment to the subcontractor until it had been first paid by the owner of the project. The effect of these terms was to allow the main contractor to transfer related payment risks to its subcontractors down the construction chain.

UAE judicial practice has established the rule that pay when paid and pay when certified clauses are valid, permissible and enforceable conditions<sup>61</sup> and that a subcontractor would not be entitled to payment unless the main contractor is paid or certified for payment first,

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<sup>60</sup> (2007) Dubai Cassation 240/2006

<sup>61</sup> *ibid*

whenever there are such agreements between the parties. The legal basis applied in the UAE refers to Articles 420 and 422 of the CTC, which states:

“a Condition is a future matter where the existence of a consequence or its non-existence depends upon the materialization of the Condition”

and:

“a suspended transaction is one that is restricted in an unfulfilled Condition or a future event and is one where its effects differ pending the formation of the Condition”

Back-to-back payment terms do contain some negative effects. The UK construction industry in particular has a long history of fighting such terms and describing them as unfair. The UK has suffered the negative consequences of such terms, especially in the 1980s and 1990s. As a consequence, these terms are now prohibited under Section 113 of the Housing Grants, Construction and Regeneration Act 1996, which provides that:

“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 or indirectly) a condition of payment by that third person, is insolvent”

It is not advisable for subcontractors to accept back-to-back payment terms because they contain a high risk of the subcontractor not being paid if a main contractor is not paid for any reason. A subcontractor should attempt to negotiate the removal of back-to-back payment terms under a proposed agreement. If this is not possible, then such back-to-back payment terms should at least be modified to become more feasible or to contain special exceptions. For example, a subcontractor could accept back-to-back payment terms under the following exceptions:

- a) Where the main contractor was not the cause of the employer or engineer refusing to pay or certify payment to the main contractor. Examples of this situation are

when a main contractor breaches its obligations towards the employer and the subcontractor had no association with the breach.

- b) Where the employer was refusing payment to the main contractor for no apparent reason, such as if there were no legitimate force majeure events preventing the employer from making payment to the main contractor.

The above proposals are considered in line with the UAE's public policy, which aims to apply the idea that contracts ought to be performed in good faith. In this regard, Article 246 of the UAE CTC provides that:

“a) The contract must be performed in accordance with its contents and in a manner consistent with the requirements of good faith.

b) The contract shall not be restricted to an obligation upon the contracting party to do that which is [expressly] contained in it but shall also embrace that which is appurtenant to it by virtue of the law, custom and the nature of the disposition”

Under the aforementioned drafting proposals, the typical back-to-back payment terms under UAE law and practice may not be applicable. Here, the subcontractor in both examples may claim from the main contractor all its entitled dues, even with the presence of a conditional back-to-back payment term. Considering the second proposal in particular, the subcontractor may insist on another associated condition based on Article 891 of the UAE CTC, which provides that a subcontractor shall not make direct claims against the employer unless the main contractor referred the subcontractor to the employer for payment. Therefore, it would additionally be preferable for a subcontractor to implement a condition in the subcontract allowing it to pursue the employer directly for its dues.



### 3.3 Terms of Variations and Related Claims

In FIDIC contracts, variations can be any alterations to permanent or temporary works. Variations may therefore include changes in quantities, standards, types, details, ordering and lengths of any works.<sup>62</sup> By contrast, under UAE law, the scope is limited to permanent works.<sup>63</sup>

Because projects depend on the objectives of the employers in terms of time, quality and costs, the instructions of variation orders could lead to many changes in construction periods and other related costs.<sup>64</sup>

An employer's variation in works may lead to the main contractor applying or requesting consequential variations from its subcontractors, turning such subcontractors into claimants towards a particular variation introduced under the main contract. Generally, the same liability principles would apply in terms of claims that originate from the main works.

Clause 13 of the FIDIC Red Book 1999 states the rules of variations [Variations and Adjustments]. However, complications may arise if the main construction agreement does not comply with the subcontract in terms of the methods used in pricing. This is seen more often when one of the contracts is a value-measured contract and the other is a lump-sum price agreement. In other words, the relationship between the employer and the main contractor may be based on a measured construction agreement, such as the FIDIC Red Book 1999, while the relationship between the main contractor and the subcontractor

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<sup>62</sup> Adriaanse (n 35) 205

<sup>63</sup> CTC s. 887 (2)

<sup>64</sup> O. A. Sunday 'Impact of Variation Orders on Public Construction Projects' Association of Researchers in Construction Management 26th Annual ARCOM Conference (2010) 101 <[www.arcom.ac.uk/-docs/proceedings/ar2010-0101-0110\\_Sunday.pdf](http://www.arcom.ac.uk/-docs/proceedings/ar2010-0101-0110_Sunday.pdf)> 20/4/2013>

could be based on a subcontract with a lump-sum payment arrangement, similar to the FIDIC Yellow Book 1999. In such instances, it is easier for the main contractor to agree with the employer on the values of variations, of which such values should be pre-determined under the main contract. Such agreement is not easy to reach under the subcontract in the given example for the reason that a variation in a lump-sum agreement would require the explicit consent of both parties before any changes could be applied. These are the rules in UAE law as well.

The legal basis of the above UAE rules can be traced back to Articles 886 and 887 of the CTC, which consecutively provide:

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“(1) If the contract has been made for a measured quantity on a per-unit basis and it appears during the work that it is necessary for the implementation of the agreed plan to exceed the estimated quantity by a significant amount, the contractor must immediately notify the employer thereof, stating the amount by which he expects the price to be increased. If he does not do so, he shall lose his right to recover the excess costs over the value of the measured quantity.

(2) If there is a gross excess in the quantity required to implement the plan, the employer shall be entitled to withdraw from the contract and to suspend the execution, but he must do so without delay and must pay the contractor the value of the works that he has completed, assessed in accordance with the conditions of the contract”

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“(1) If a contract of muqawala<sup>65</sup> has been made on the basis of an agreed plan against payment of a lump sum, the contractor may not require any increase in the payment required for the implementation of the plan.

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<sup>65</sup> A construction contract

(2) If there is any variation or addition to the plan with the consent of the employer, the agreement with the contractor shall be observed in connection with such variation or increase”

The FIDIC Conditions of Subcontract for Construction 2011 were issued in an attempt to harmonize the relationship between the FIDIC Red Book 1999 (in terms of the main construction works) and subcontracts. The FIDIC Conditions of Subcontract for Construction 2011 provide multiple hypothetical examples in its Guidance Chapter for the “Preparation of Particular Conditions of Subcontract” for most of its clauses. For instance, under the guidance associated with Clause 12 [Measurement and Evaluation], three possible scenarios are given on how the measurement relationship could be arranged between a main contractor and a subcontractor. The first scenario is applicable if the parties of a subcontract have agreed that the subcontractor would not take part in the measurement of the sub-contract works – not by actual measurement nor by records. The second scenario is where a subcontractor would not take part in the measurement of the subcontract works but would be permitted to participate wherever the subcontract works are going to be measured by records. The third scenario is where the manner of measurement of the sub-contract works is not going to be applied under the main contract

In an attempt to avoid discrepancies between main and subcontract documents, the FIDIC Conditions of Subcontract for Construction 2011 furthermore advise (in Clause 14.1 [Subcontract Price]) that choosing a lump-sum type of subcontract may be suitable if:

- (a) Tender documents contain sufficient information that is seen as complete for construction and for subcontract changes to be unexpected; and/or
- (b) If the main agreement is also a lump-sum contract.

### 3.4 Terms of Performance Security

Under the FIDIC Red Book 1999, the terms regarding performance security are stated in Clause 4.2 [Performance Security]. These terms are designed to ensure the proper performance of the main contractor's works towards its employer in regard to the permanent and temporary works of the project. Performance security is also a common arrangement applied in most construction contracts, whether they are based on FIDIC contracts or not. Such security should be valid during the construction period until the performance certificate is issued by the employer or engineer to the main contractor.

Under a subcontract arrangement, subcontract performance security may also be required between the main contractor and a subcontractor; it is presumed that such subcontract performance security should be valid during the whole period of the subcontract works and until the performance certificate under the main contract is issued.

The FIDIC Conditions of Subcontract for Construction 2011 propose that performance certificates of both the main works and the subcontract works should be issued on the same date if the difference in the completion dates between the main contract and the subcontract is not substantial. However, if the difference between such completion dates is substantial, then the subcontract performance security obligation may end at a date earlier than the date set or expected in the main contract.

Based on the above, it appears that the FIDIC conditions do not cover all the scenarios that may apply in situations where the difference between the completion date of a subcontract is substantially distant from the completion date of a main contract. It is clear that conflicting interests between the rights of a subcontractor, a main contractor and an employer are present, and the question remains as to the status of the performance security of a subcontract obligation when the completion dates are distant from each other. The FIDIC conditions appear to approach a policy that is more in favour of a subcontractor, and this may have already been established in the line of natural justice.

One possible proposal for a compromise solution is to have the main contractor issue the performance certificate to the subcontractor at a middle time falling between the completion date of subcontract works and the agreed completion date of the main contract works. This proposal, however, may not be seen as practical because the rights of a subcontractor in terms of the entitlement of the performance certificate are quite distant from the equivalent rights of a main contractor. Hence, one right could not be compromised at the price of the other. This may be the reason why the FIDIC conditions provide no guidance on this matter.

### **3.5 Terms of Programmes and Extensions of Time**

It is clear that a main construction contract certainly affects a subcontract in terms of time for completion and vice versa. It is further a standard rule that the date set and agreed for subcontractors to complete their works should not exceed the agreed date for completing the whole works of the main contract, otherwise delay damages may be incurred by the main contractor as per standard forms of agreements.

It is understood that damages caused should be compensated by the person causing them; this applies to both tortious damages and damages appearing as a result of performing or non-performing a contract. Examples of such damages include situations where the subcontractor fails to complete the works within the agreed time for completion, causing the main contractor to incur delay or liquidated damages on its part under the main construction contract.

The FIDIC Conditions of Subcontract for Construction 2011 provide under Clause 8.7 [Subcontract Damages for Delay] that the main contractor should be entitled to deduct all damages incurred as a result of the subcontractor breaching Clause 8.2 of the conditions, which led the main contractor to default on its part against Sub-Clause 8.7 [Time for Completion] of the FIDIC Red Book 1999.

Furthermore, the FIDIC Conditions of Subcontract for Construction 2011 require that the subcontractor's programme fully comply with the programme and reporting requirements of the main contract, as well as with Part A of Annex F of the contract, which sets the general acceptable standards for the subcontract programme.

Any delay in the subcontract programme by the subcontractor will cause further delays in the works of the main contract. Here, the main contractor should instruct the subcontractor to submit a revised programme to expedite the subcontract works by increasing working hours and/or increasing the number of personnel. The main contractor may furthermore deduct any costs incurred as a result of the revised programme.

In this sense, it was decided in the English case of *Martin Grant & Co Limited v. Sir Lindsay Parkinson & Co Limited*<sup>66</sup> that where the main contract programme is extended, this should lead to the automatic extension of the programme period of the subcontract.

### 3.6 Terms of Defects Notification Period

Sub-Clause 11.2 of the FIDIC Conditions of Subcontract for Construction 2011 warns the following:

“...if the Subcontract Works are to be taken-over by the Contractor before the Main Works are taken-over by the Employer in accordance with Sub-Clause 10.3 [Taking-Over by the Contractor] of the General Conditions, by virtue of this Sub-Clause the Subcontract Defects Notification Period may be significantly longer than the Defects Notification Period under the Main Contract”

Generally, the FIDIC subcontract terms seem to put more liability on the subcontractor for keeping it on a longer period of liability in terms of the defects notification period.

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<sup>66</sup> (1984) 29 BLR 31

This has reference to Clause 11.2 itself, which specifies that the subcontract defects notification period would start:

“from the date on which the whole of the Subcontract works have been taken-over under Clause 10 [Completion of and Taking-Over the Subcontract Works] to the date of expiry of the Defects Notification Period applicable to the Main Works or Section or part of the Main Works of which the whole of the Subcontract Works are part”

It is noted that the FIDIC guidelines take an approach that is not similar to the policies adopted regarding performance securities, but the FIDIC guidelines do reduce the liability of the subcontractor for expiring these securities starting from the date of completing the subcontract works, as long as the completion date is substantially distant from the one determined for the main construction works. However, regarding the defects notification period, the liability of the subcontractor is viewed as extended from what was originally intended.

The reasoning of FIDIC for the above may be related to reducing the liability of the subcontractor under the performance security scheme because the works of the subcontractor would then be deemed as fully performed ‘as a matter of fact’. Hence, any latent defects would not be relevant to discharge the liability of the subcontractor at the time when the terms of performance security come to an end.

### **3.7 Terms of Performance Certificates**

Under standard FIDIC contracts, the performance certificate is dependent on the date when the defects liability period comes to an end. The general rule requires that the date when a subcontractor becomes entitled to the performance certificate should be the same as when the main contractor is granted its performance certificate. However, complications may arise when a subcontractor’s date of completion of the work is

considerably earlier than the main contractor's date of completing the works. Here, it may not be appropriate to have the subcontractor incur unreasonably longer defects liability periods, which cause an unjustified delay in entitlement to the performance certificate under the FIDIC contract.

Despite the above general approaches, the FIDIC Conditions of Subcontract for Construction 2011 provide further guidance in this regard in Clause 11.3:

“If the date corresponding to the Subcontract Time for Completion is considerably earlier than the date corresponding to the Time for Completion under the Main Contract, such that it is not appropriate that the Subcontractor's obligations continue until the Contractor has fulfilled all his obligations under the Main Contract, then this Sub-Clause may be varied”

### **3.8 Terms of Decennial Liability**

The origins of the decennial liability statutory rule can be traced back to the French legal system. It is a statutory guarantee that secures the liability of both the contractor and the designing engineer for a period of ten years against any total or partial collapse of the constructed structure or the structural integrity of the project. This sort of guarantee is designed for the benefit of the owner and is provided under Article 880 of the UAE CTC.<sup>67</sup>

The rules of decennial liability were brought into French civil law as early as 1804. The French jurisprudence suggests that decennial liability is not a contractual or tortious

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<sup>67</sup> Decennial liability is also provided under Article 26 of Law No. 27/2007 Concerning Ownership of Jointly Owned Properties in the Emirate of Dubai



liability but rather a special rule that is not based on the general principles of laws and cannot be expanded or compared within the context of the principles of legal analogy.<sup>68</sup>

Under the general principles, decennial liability is a legal guarantee against a contractual violation caused by contractors and engineers, and it is aimed only in favour of the employer that is part of the main construction agreement. This type of security may therefore not be passed to third parties, such as subsequent purchasers of a building.<sup>69</sup>

In Egyptian law and jurisprudence, the idea of decennial liability is seen as a right *in rem* that cannot be separated from the structure and would therefore be transferable with it to the benefit of other subsequent purchasers of the building, allowing them to benefit from the guarantee.<sup>70</sup>

In UAE law, there is no decennial liability between the main contractor and a subcontractor. In accordance with Article 880 of the CTC, decennial liability applies only between the project employer, its direct contractors and the designing engineers and may not apply to other people that are not parties to a traditional construction contract.<sup>71</sup> Because the decennial liability guarantee does not apply between main contractors and subcontractors, this makes it necessary to have some sort of contractual guarantee (rather than a statutory one) between the main contractor and its subcontractor for defective subcontract works that may affect the overall integrity of the building during a main decennial liability period.

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<sup>68</sup> Maurice 1940 in *Civil Liability of Sub-Contractors in Civil Law (Comparative Study)*, R. Hammad (Egypt 1995 - Dar Alnahda Alarabiyah) Ch 120, 167

<sup>69</sup> (2004) Dubai Cassation 6/2004 CA; (2007) Dubai Cassation 150/2007 CA

<sup>70</sup> Sanhūrī (n 2) 111

<sup>71</sup> 150 (n 69)

It is therefore advisable for main contractors to have a decennial liability contractual warranty issued by the subcontractor in favour of the employer or subsequent purchasers. This warranty, however, should not start from the date of taking over the subcontract works but rather from the date of taking over the main works, covering the period from taking over the subcontract works until the date of taking over the main works. A general warranty can be agreed and applied between the main contractor and the subcontractor, covering any defects that may be caused by the subcontractor in the subcontract works.<sup>72</sup>

### **3.9 Effects of the Termination of the Main Contract**

The termination of the main contract for any reason would mean the termination of the subcontract. A notice should be served from the main contractor to the subcontractor, as per Clause 15.1 of the FIDIC Conditions of Subcontract for Construction 2011 – the same applies in situations of contractual releases or discharges of any of the main contract's parties from their obligations, as per Clause 19.7 [Release from Performance under the Law] of the FIDIC Red Book 1999, which includes situations of force majeure.

Clause 15.5 of the FIDIC's Red Book 1999 further sets rules for termination by the employer for convenience. These by default allow the main contractor to terminate the subcontract for reasons of convenience. Clause 15.1 of the FIDIC Conditions of Subcontract for Construction 2011 states that the main contractor may immediately and by notice terminate the subcontract whenever the main contract is terminated. Clause 15.3 (ii) in particular provides that if the main contract is terminated for convenience, then the subcontractor shall not be entitled to the payment of any loss or profit.

It is heavily argued that any such terminations should be performed in good faith, as when the main contractor enacts the right of terminating the subcontract for the reason that the main contract was terminated for the same convenience, this should observe

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<sup>72</sup> Masadeh (n 32)

elements of good faith without prejudicing the rights and entitlements of the subcontractor. In particular, subcontractors are entitled to certain compensation for loss and damages if the termination of the main contract came as a direct result of the main contractor. This means that if the termination of the main contract was on grounds caused by the main contractor, then the main contractor should not be permitted to rely on its own wrongdoing to terminate agreements with its subcontractors on the grounds of convenience.<sup>73</sup>

### **3.10 Terms of Subcontract Insurance**

Regarding the insurance by which a contractor or subcontractor arranges to provide coverage against specified losses, damages, illnesses or deaths and the other insurances covered by an employer (if any), the FIDIC Conditions of Subcontract for Construction 2011 propose that insurance coverage should not be duplicated through multiple policies issued by the main contractor or subcontractor.

In many instances under subcontracts, it is common for contractors to require to be added as ‘additionally insured’ parties under the insurance policies of their subcontractors, covering their liabilities towards the employer and other third parties in terms of works executed by the main contractors and their subcontractors. It should be noted that adding main contractors as additionally insured parties under the policies of subcontractors will not make them second insured parties, and the insurance provider would not indemnify the additionally insured parties unless a claim arose as a result of the works of the named insured. Therefore, having the main contractor designated as an additionally insured party as a way of pursuing any coverage for loss or liability is a mistake.

In the above example, it is observed that it may be the responsibility of the main contractor to insure some works, equipment or other items that are normally subject to

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<sup>73</sup> A. Gray ‘Termination for Convenience Clauses and Good Faith’ (2012) Journal of International Commercial Law and Technology, v. 7, Issue 3, JICLT, 260-275

insurance coverage. However, in many instances, the main contractor requires the subcontractor to have such items or works covered in subcontractors' insurance policies, as long as insurance coverage has already been established directly by the main contractor. The reason for this approach is because main contractors aim to avoid the risk of tainting their own insurance records and hence maintaining reduced insurance premiums.

### **3.11 Terms of Force Majeure Events**

Force majeure is defined under the FIDIC conditions as certain exceptional events or circumstances that were beyond the parties' control; that were not known to the parties before entering into the contract; that cannot be substantially attributed to the parties; and that could not reasonably have been avoided.

The FIDIC Red Book 1999 sets some examples describing force majeure events under Clause 19.1. UAE law has a different understanding of what constitutes force majeure,<sup>74</sup> as it emphasizes that force majeure events can only be described as public events. This causes some of the events described under the FIDIC conditions to not be considered force majeure events in UAE law. Furthermore, it causes them to be considered as mere contractual exemption clauses.

Whenever a force majeure event occurs in a subcontract relationship, the sub-contractual terms of force majeure along with general legal principles will apply. The terms of force majeure as laid out in the main contract should not be applicable in the absence of legal rules unless the subcontract terms have made a reference to the force majeure terms that are described under the main contract. A similar approach is adopted by the FIDIC Conditions of Subcontract for Construction 2011 in Sub-Clause 19.1, which provides that:

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<sup>74</sup> CTC, s. 249

“The Provisions of the Main Contract Clause 19 [Force Majeure] shall apply to the Subcontract”

When force majeure events occur between the main contractor and the subcontractor, the applicable legal or contractual rules will apply. This occurs even under UAE law, where public policy states that events are only considered as force majeure if they are public events. UAE law considers the fact that the subcontract is strictly limited between the main contractor and the subcontractor. The legal application would therefore pay no attention to any obligations existing between the main contractor and the employer if, for instance the force majeure event turned out to exist only between the main contractor and the subcontractor, not reaching the relationship between the main contractor and the employer.

For example, let us imagine a subcontractor performing both subcontract works and extracting the raw materials from a particular geographical area. If a war breaks out in this area, this would cause the subcontractor to have to extract raw materials from an alternative area, which may be more expensive in terms of extraction works and transportation. Here, the employer may not be aware of such unfortunate events, and the main contractor will not be excused under the main contract from rendering its obligations within the time, quality and prices previously agreed with the employer. On the other hand, the subcontractor would certainly be entitled as per FIDIC clauses and UAE law to a balancing remedy, such as reducing its obligations and/or increasing the price obligations of the main contractor towards the subcontractor.

The question is therefore: ‘will force majeure events occurring upon subcontractors’ liabilities towards the main contractor constitute a force majeure event between the main contractor and the employer?’ The answer would be ‘No’ because the force majeure event did not directly affect the main contractor. Hence, even though a force majeure event occurring for the subcontractor may legally or contractually increase the liabilities of the main contractor, this still does not change the obligations of the main contractor

towards the employer. The legal basis for this rule refers majorly to the principles of privity of contracts.

However, will the answer to the question above change if the subcontractor was nominated by the employer? Referring back to the liability of the subcontractor rules towards nominated subcontractors as held by the Dubai courts, would legal analogy here apply on serving the same principles on having the liability of the main contractor towards the employer be reduced or exempted as a result of force majeure events arising for the nominated subcontractor? The answer will perhaps still be 'No' because the subcontractor, whether domestic, named or nominated, would normally not have any hand in a force majeure event, unlike the events of defective construction or delays in performance.

## **Chapter 4 – Effects of Subcontract Dispute Resolution Mechanisms**

The dispute resolution mechanisms as agreed between the main contractor and the employer may not necessarily be similar to the mechanisms agreed between the main contractor and the subcontractor, considering that the works to be executed by the subcontractor in favour of the main contractor may constitute a very small portion of the overall main works, or perhaps it would be more appropriate to treat the subcontract works under dispute resolution mechanisms that are different from the ones adopted in the main document.

When it comes to arbitration in construction disputes, main contractors usually prefer to incorporate the same arbitration terms as agreed with their employers in their subcontract documents. The problem with this approach is that an arbitration dispute adopted between the main contractor and the subcontractor may be related to the same dispute as between the employer and the main contractor. Multiple arbitration tribunals may therefore be formed for the same issue and dispute, leading to the issuance of multiple arbitration awards that may or may not conform with one another. A subcontractor may be successful in its claim against the main contractor while the main contractor may not necessarily be successful in the same claim against the employer, and this is why the construction industry introduced the idea of tripartite arbitration.<sup>75</sup>

The FIDIC Conditions of Subcontract for Construction 2011 advise (as an alternative path to follow instead of its original terms) to remove all clauses related to DABs where a dispute or disagreement is associated with a simple, non-complex construction subcontract. The FIDIC conditions further advise two options for dealing with disputes or disagreements arising between main contractors and subcontractors and set two

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<sup>75</sup> Gould (n 27) 9

presumptions for them. The first presumption is associated with disputes that are not closely related to any existing or expected claim falling under the main contract. The second presumption is where the subcontract disputed works are closely associated with any of the main contract claims. Here, the FIDIC guidelines advise that any determination concluded by the engineer, any decision issued by a DAB formed under the main contract or any arbitral award issued under the main contract should be automatically binding on both the main contractor and the subcontractor under the subcontract.

Sub-Clause 20.6 [Subcontract Disputes] of the FIDIC's alternative proposals for subcontract conditions provides that within 14 days of giving a notice of a dispute, the contractor shall express its opinion on identifying the dispute as either a related claim or an unrelated claim, and the subcontractor may raise its objection against the said main contractor's opinion on determining the nature of the claim or dispute. This latter opinion will also determine how the dispute may be treated under the FIDIC guidelines as being either a related or an unrelated claim. The subcontractor's objection to the main contractor's determination shall be given within seven days from the date of receiving the main contractor's opinion, otherwise the main contractor's opinion in this regard shall be considered to be accepted by the subcontractor.

## **4.1 Related and Unrelated Claims**

FIDIC has therefore differentiated between related and unrelated claims. This distinction refers to whether a claim is related to a particular claim associated with the main contract or not. FIDIC has explained that where the parties have a disagreement as to whether a particular claim is related or not, the disagreement may be referred to a pre-arbitral referee under the ICC Rules. However, the FIDIC Conditions of Subcontract for Construction 2011 deal independently with unrelated claims, as seen in alternate Sub-Clause 20.3, which presents certain rules and timeframes as to how unrelated claims may



be settled privately between the contractor and the subcontractor without having to involve the main contract engineer or the employer in the process. The situation is different when it comes to solving related claims, as these require the main contractor to forward such claims to the main contract engineer to reach an arrangement in fulfilling the claim, as seen in the rules of alternate Sub-Clause 20.4 of the FIDIC Conditions of Subcontract for Construction 2011.

Unrelated disputes and claims can follow and be associated with independent dispute resolution mechanisms to be agreed between the parties of a subcontract. Unrelated disputes will be subject to the ordinary dispute adjudication rules followed by the ordinary agreed arbitration rules if any, while related disputes under the alternative proposals can only be treated by the dispute resolution mechanisms that are identified under the main contract. FIDIC has further left it under the obligation of the main contractor to refer such related disputes to the DAB appointed under the main contract. This is due to complications of privity of contract, where the subcontractor may not directly be able to take action of a related dispute or to present arguments therein to be reviewed by the DAB members who are appointed solely by the members of the main contract.

For this reason, the main contractor shall and whenever possible involve the participation of the subcontractor in any meetings or discussions with the engineer in reaching any agreement concerning the subcontractor's claims that are considered as related to the main contract. However, if the subcontractor refuses or is not able to attend or participate in such discussions, then any determination made by the engineer or any agreement reached between the main contractor and the engineer may be subject to the approval of the subcontractor. The subcontractor may express dissatisfaction with such agreements and determinations within seven days from their dates, where such dissatisfaction expressions will be deemed as notice of a dispute.

However, it is provided that in the case of a subcontractor's claim that is related to additional payment demands, it shall be considered a condition precedent for such claim to fall under the liability of the main contractor only if it was actually settled by the employer towards the main contractor.

## **4.2 Alternative Mechanisms Associated with Related Claims**

As proposed by FIDIC, in a related dispute or claim, the main contractor shall forward the dispute to the DAB within the period stipulated under the subcontract, which may be 28 or 56 days (whichever is applicable). If the main contractor fails to take such action within the period stipulated under the subcontract agreement, then the dispute may be treated as an unrelated one, and the rules of unrelated claims will apply. This determination will later allow the subcontractor to pursue the main contractor directly under independent dispute resolution mechanisms without having to consider the restrictions mentioned earlier in disputes associated with related claims.

However, if the dispute is referred to the main contract DAB and is considered as a related one, then the main contractor will not only be acting for itself but also on behalf of the subcontractor and for the benefit of both subcontract parties. The main contractor shall further furnish any possible opportunity to allow the subcontractor to participate in the main contractor's written or oral submissions to the main contract DAB, adjudication strategy and choice of legal representation. The subcontractor shall equally fully cooperate with the main contractor and furnish it with all the information required to enable the main contractor to pursue adequately an appropriate and legitimate claim.

A subcontract related claim will affect the procedural rules of the DAB appointed under the main contract. For example, if the DAB members wish to extend the 84-day period to render a DAB decision, then the main contractor should not immediately approve such an extension without first consulting with the subcontractor. Equally, the main contractor

may not reach settlement with the employer in relation to a related claim without prior discussion with the subcontractor.

Once the main contract's DAB decision has been issued, the main contractor shall notify the subcontractor about this decision within seven days. In turn, within seven days from the date of receiving the said notification, the subcontractor may notify the main contractor of its dissatisfaction with the main contract DAB's decision. Otherwise, the DAB decision will be final and binding upon the parties of the subcontract, unless and until it is revised under settlement or an arbitral award, whenever such further mechanisms are reached.

If the subcontractor expresses its dissatisfaction with the main contract DAB's decision, then the main contractor shall also express its dissatisfaction with the DAB's decision under the ordinary procedures brought in the main contract agreement. Otherwise, should the main contractor not concur with the dissatisfaction of the subcontractor, should fail to forward and equally express its dissatisfaction with the DAB decision in a timely manner to prevent the decision from becoming final, or should fail to take any action on this matter, then the related dispute shall then be treated as an unrelated one.

The alternative proposals of the FIDIC Conditions of Subcontract for Construction 2011 have been expanded to include Clause 20.9 [Employer's Claims under the Subcontract], which was not inserted in the original contract's terms. This clause proposes the policy of the main contractor defending the rights or status of the subcontractor against claims of the employer that are related to the subcontractor's performance. Basically, many of the same assurances granted to the subcontractor under the main contractor's or the subcontractor's related claims are also provided in cases of the employer's related claims by the subcontractor being proactively involved in such related determinations.

## **Chapter 5 – Conclusions and Recommendations**

It is clear from a legal point of view that subcontracts are distinctly remote and separated from main construction agreements in terms of rights and obligation due to the well-established rule of privity of contracts, which is widely recognized under both common and civil law systems. The rule that ‘a contract cannot confer rights nor impose obligations arising under it on any person except the parties to it’ is seen as the default principle when dealing with any right or obligation of the parties of a construction project.

With time, business requirements and social awareness have made it necessary to provide certain exceptions to the rules of privity. The origins of such exceptions can be seen in the form of the contracts and statutory rules that have been implemented as a result of social requirements.

Despite the aforementioned distinctions between main and subcontract documents, and the emergence and spread of use of exceptions to the privity rules to further strengthen the protection of a particular party or parties of an agreement, a construction activity is seen from a technical point of view as a unique and complex type of activity that should not be treated like any other type of ordinary industrial practice. This uniqueness relies very much on understanding the relationship and influences between each of the construction parties, which may include the owner, the main contractor, the subcontractor and the supplier.

In this regard, the exceptions to the privity rules discussed may seem as if they were introduced solely to protect the rights of a particular group without considering the collective welfare of not only the project parties but also the future users of the project and other surrounding third parties. Perhaps this is where innovative and sustainable procurement methods could offer solutions: methods such as partnering, energy

performance contracting, public–private partnerships and performance information procurement systems.

It is further concluded that when looking at a construction project from both legal and technical points of view, it would be almost impossible to ignore the natural forces produced by all project parties and the exchanges performed among them before, during and after the project's construction phase. This is particularly true in relation to subcontractors that may be performing a large portion of a given project, as is usually seen in most construction works worldwide. Whether such works are small or big, local or international, one cannot treat the rights and obligations of each project member on an independent basis.

Based on these conclusions, and as suggested by many scholars and philosophers, each right and obligation of the contractor, subcontractor and owner should be, to some extent, interrelated, coherent and collaborated with one another in an attempt not only to serve the protection of one particular party but also to serve or improve the protection of the rights and obligations of all parties combined, including the welfare of the project itself.

Construction contract drafters, negotiators and those who are associated with construction activities and tendering processes, whether lawyers, engineers or employers, should consider interrelating some of the common general terms in main and subcontract documents, especially for projects that mainly rely on having a number of specialized subcontractors on board. It is recommended that consideration should be given to the common internationally recognized construction terms described in Chapters 3 and 4 of this dissertation: conditional payment clauses, liquidated damages, deadlines and dispute resolution mechanisms, as well as the sub-issues derived from these.

## **End of Dissertation**

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