

SUBCONTRACTING - SOME GUIDELINES

This note sets out some guidelines relating to subcontracting. They apply whether you are the subcontractor or are intending to appoint a subcontractor.

They pick up some key points - they are not intended to be comprehensive, or a substitute for legal advice on any particular arrangement or contract.

1. What is a subcontract?

- 1.1 A subcontract is a separate contract entered into by A under which A agrees with B (the subcontractor) that B will perform some or all of A's obligations under a main contract. The main contract stays in place and in force.
- 1.2 A generally remains liable for the performance of the main contract, with the result that A is liable to the other party to the main contract for any default in performance by B. Equally, the other contracting party to the main contract is not usually entitled to sue B for breach of contract, as there is no direct contract between them.
- 1.3 Subcontracting should be distinguished from novation (where B steps into A's shoes and A falls out of the picture) and assignment (where A transfers the benefit of the main contract to B).

2. Can you be/use a subcontractor?

- 2.1 Does the main contract contain a clause prohibiting subcontracting? If so A will need to liaise with the commissioner to remove that clause or gain express consent to the subcontracting it proposes.
- 2.2 Do B's objects allow it to undertake the subcontracting it intends ie do the activities fit the organisation?

3. What do you need to know before you draw up a contract?

- 3.1 Exactly what is B to take on? All of the services under the main contract or just a part of them? Who will do the rest - A or another subcontractor(s)?
- 3.2 A will need to think about what information B will require in order to carry out the subcontracted services fully. But A will also need to consider its own commercially sensitive information (such as pricing) and any confidentiality obligations.
- 3.3 B will want to know as much as possible about the main contract so that it can see how its services fit in, practically and commercially.
- 3.4 Both A and B will need to make sure that the subcontracting is financially attractive to them.

4. **Do you even need to draw up a contract?**

- 4.1 A contract under English law requires (broadly) an offer which is accepted, a passing of some "consideration" (usually services, goods or obligations in exchange for money), an intention to create a legally binding contract and certainty of terms. A contract does not have to be in writing or signed for the courts to enforce it.
- 4.2 Great care needs to be taken with exchanges of letters and emails, and documents like tender submissions, heads of terms, letters of intent, partnership agreements etc - any of these could create legally binding contracts when you do not wish them to.
- 4.3 When you do want to create a legally binding contract, you should make sure it is in writing, it covers all the things you want it to cover, it is signed by all parties (by someone who has the authority to sign contracts for them) and that it is dated.

5. **"Back to backing" the main contract**

- 5.1 A will want the subcontract to expressly incorporate the terms of the main contract insofar as they are consistent with the subcontract. This is to ensure that B's duties to A are "back-to-back" with A's duties under the main contract.
- 5.2 However, it is not always easy to get this right in the drafting - sometimes it is more complex than just repeating or referring to main contract clauses. Care and thought are required!
- 5.3 In the absence of express incorporation, where B agrees to carry out work "based on" the main contract terms, this does not necessarily bring into the subcontract by implication all relevant terms of the main contract. Also, if B has knowledge of the main contract terms that is not always enough to prove that s/he has agreed to be bound by them. It is always best to be clear in the wording.
- 5.4 B may object to straight "back to backing". The subcontract is a document to be negotiated between A and B, and B may feel that A should have negotiated harder on the terms of the main contract, and may push for a better deal for himself than A obtained with the main contractor. For example, A might have agreed to "comply with all relevant laws", but B may prefer to have the subcontract say "use reasonable endeavours to comply with all relevant laws in all material respects". This boils down to the relative bargaining powers of the parties. A will much prefer the straight back to back approach as this way s/he passes down all his/her obligations to B.
- 5.5 Conversely, A might try to make the subcontract terms tighter than the main contract. For example, if the main contract obliges A to use

reasonable endeavours to do something, A might draft the subcontract so that B is absolutely required to do the thing, without any reference to reasonable endeavours. Another example is payment times - A might get paid within say 14 days of invoicing under the main contract, but might try to make B wait 30 days from invoice in the subcontract. B should ask to see a copy of the main contract so s/he can check for these things and object if s/he wishes.

6. Common clauses you might (or might not!) want to include

The subcontract is a commercial contract like any other and should contain the usual clauses. There are additional considerations too, such as those set out below.

6.1 Commencement date

The commencement date for the services should be stated. The contract can be dated before or even after the commencement date for the services. Before is preferable!

The term ie the duration of the subcontract should also be stated. This should fit in with (ie generally either be the same as or less than) the main contract.

6.2 The Services

The subcontract should refer to the main contract and should detail the scope of the subcontracted obligations clearly. Both A and B need to be clear as to what B is to do, where, in what manner and by when.

Any specifications, project plans or similar documents appearing in or referred to in the main contract need to be repeated or referred to in the subcontract.

If A is required to carry out services in a certain way eg “with all reasonable care, skill and diligence” or “to the standards to be expected from a competent service provider” or “in accordance with all laws, industry guidelines and best practice”, s/he will want to ensure that the subcontract requires B to perform to at least the same standard.

6.3 Payment

The subcontract should be clear on payments: how much is to be paid to the subcontract, does the subcontractor have to invoice or are there automatic periodic payments, what supporting evidence is to be provided to back up claims for payment, is interest due on late payments etc. All this can and usually should reflect the main contract - but beware of A trying to gain better payment terms for him/herself under the subcontract than those s/he has negotiated under the main contract.

If the main contract allows the main contractor to suspend or clawback payments, A will want the subcontract to do likewise. B would prefer that suspension or clawback is only allowed under the subcontract where the suspension or clawback under the main contract is B's fault.

6.4 Invoicing

A and B need to make sure their cash flows work. A will seek to say that s/he only has to pay B when A has been paid by the main contractor. Again, B will say this should only apply where a default by B has caused A to be paid late by the main contractor.

6.5 Liability

Generally, the subcontract is a separate contract that does not affect the position of the parties to the main contract. There is no direct contract between the main contractor and B - A is always between them. The main contract will almost certainly hold A responsible for the services provided by B, so A will want to impose strict obligations on B as to the quality of the services B supplies.

The main contract may place a monetary limit on A's liability to the main contractor. B will want to include a similar limit (relative to the scope of its obligations if the subcontract is only for part of the main contract). A may resist this. There is nothing to stop B requesting a limit on his/her liability to A even if A has not limited his/her liability to the main contractor.

6.6 Indemnities

A may require B to indemnify him/her against any losses arising from the subcontracted work. B may resist this on the basis that his/her contract is with A, and s/he is not concerned with the terms of the main contract.

The indemnities requested generally cover the performance by B of the subcontracted services and situations where the acts of B cause A to suffer a loss - either by causing A to be in breach of the main contract or with respect to a third party. B might have to accept some indemnities, but s/he should take care - A has the benefit and the (usually greater) financial reward of the main contract, and for that s/he must accept some risk.

6.7 Termination

A will want to reflect the main contract termination provisions and also include rights to terminate the subcontract if:

- the main contract terminates for any reason,

- B fails to perform to the required standard or otherwise breaches the subcontract,
- B's actions cause A to be in breach of the main contract,
- B becomes insolvent,
- B undergoes a change of control or management (possibly),
- on the giving of notice by A to B, even where there is no default

B will want to include similar rights, and particularly a right to terminate if A fails to make the required payments under the subcontract.

If there are specific triggers or notice periods set out in the main contract, these should be reflected. For example if the main contractor can terminate the main contract on three months' notice, A will need to make sure s/he can terminate the subcontract on three months' notice, or possibly less to allow time for the notice to be sent etc.

6.8 Employees

At the start or end of a contract or a subcontract, it is possible for the Transfer of Undertakings (Protection of Employment) Regulations 2006 to operate to automatically transfer employees from A to B, vice versa, or from A or B to the main contractor or a new service provider. It is a complex area and any clauses in the subcontract which deal with this must be carefully considered. Particularly beware of anything that looks like an indemnity (see above)!

6.9 Sub subcontracting and assignment

If B intends to sub-subcontract, s/he must make sure that the terms of the subcontract allow this. S/He might also look for the ability to assign his/her subcontract to another person.

If sub-subcontracting is intended, all of these guidelines will apply equally to the sub-subcontracting arrangements.

6.10 Performance monitoring

Where the main contract obliges A to feed information back to the main contractor, A needs to make sure the subcontract passes those obligations to B. Similarly, the subcontract may need to allow A or even the main contractor to audit or performance monitor B. B needs to take care with these clauses, and not let them be too onerous in terms of management time - and also in terms of payment deductions, suspensions or clawback.

6.11 Variations

If the main contract allows the main contractor to vary the terms without the agreement of A, A must seek to include a similar power for A in the subcontract with B - otherwise A could end up with a subcontract that doesn't fit with the main contract.

6.12 "No Partnership" clause

Both A and B will want to see a clause stating that their relationship is one of contractor and subcontractor, not agency or partnership.

6.13 Rights of Third Parties

Contracts usually have a clause in which states that no third parties (ie people or bodies which are not parties to the contract) have any rights to enforce it. Which fits in with the notes above relating to liability. A may seek to alter this standard clause to allow the main contractor to step in to enforce the subcontract as against B. B should resist this on the basis that only A should have rights against him/her under the subcontract.

6.14 Miscellaneous clauses

It is in the interests of both A and B to ensure that standard clauses like "Notices", "Law and Jurisdiction" and "Force Majeure" all reflect and fit with the main contract.

Other usual clauses such as those dealing with intellectual property, data protection or confidentiality should also reflect the main contract, but may need a little more thought to make them fit in a fair and appropriate way.

A dispute resolution clause might need to refer to the main contractor and A and B all working together to resolve disputes which involve all three of them - if so A may have to agree to procure the main contractor's co-operation.

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