

Back-to-back contracting safe?

STUART JORDAN analyses the pitfalls of taking the easy way to drafting back-to-back contracts.

WE RETURN this month to one of our regular themes: contracting practices which are thought of as risk-free but which are not. 'Back-to-back' contracting is practised everywhere but it is particularly popular in the Middle East and can take some extreme forms.

As with most construction terms, back-to-back contracting does not have a single accepted definition. This is about approaches to subcontracting and we begin as always with a statement of the obvious: Main contractors (general works contractors) will almost always subcontract the whole or the greater part of the works.

In doing so they will, of course, seek to set up those subcontracts in such a way that they collectively support the main contractor in the delivery of its main contract obligations.

So, in all subcontracting, there is a basic objective of passing down main contract obligations to subcontractors, and this will logically require alignment of the subcontracts to the main contract. In other words, there will always be subcontract features which mirror main contracts.

The question is: how best to achieve



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Jordan ... care with contracts.

this alignment?

Many contractors conclude that the safest and simplest way is to make the subcontracts exactly the same as the main contracts; by incorporating the main contract into each subcontract and saying "Comply with that". This is back-to-back contracting in its simplest form and it is easy to see the attraction: If the main contract is entirely recreated at subcontract level then, in theory, there is no risk of the contractor falling into holes by failing to procure subcontractor obligations which will fulfil his own main contract obligations.

If the contractor is in breach under the main contract, then there must be a corresponding remedy under one or more subcontracts.

Plus the drafting is easy. The basic method is to provide that the main contract conditions are to be read as subcontract conditions but substituting the references to the parties: The contractor for the employer and the subcontractor for the contractor. It looks good. What can go wrong?

Well, a lot can go wrong, and most of

this stems from the fact that a subcontract is fundamentally not the same as a main contract.

As an aside, there are fewer problems where the main contractor subcontracts the whole of the works in one subcontract, which is common in the Gulf although it still has pitfalls.

In the more traditional situation of dividing the works into many subcontracts, it has to be recognised that certain functions of main contracts and subcontracts simply do not translate into each other. For instance, subcontractors generally do not:

- Take possession of the site;
- Identify the need for, and obtain, consents;
- Insure the works;
- Interact with the employer's contract administrators;
- Escalate disputes with the employer's nominated people and enter into main contract formal disputes resolution process;
- Provide health, safety, welfare and site security resources; or
- Handle, or be responsible for, whole-works events such as completion, taking over, performance testing and certification.

In these and other areas, it does not make legal or commercial sense to place subcontractors in the same position as the main contractor, even if the subcontractor is willing to agree to it.

To deal with this basic mismatch, a back-to-back subcontract will modify the incorporation of the main contract terms. We have all seen the familiar words; for instance, providing that the main contract terms shall apply "only insofar as they are relevant to the subcontract works" or the main contract shall take precedence "where the main contract is inconsistent with the subcontract". This leaves room for a lot of uncertainty and dispute, for instance, about the meaning of relevance and inconsistency: Is a main contract term always relevant if it is about the works? Is

this meant as a common-sense exclusion of things which plainly shouldn't apply in subcontracts, such as the above list? Is it meant only to fill the gaps where an essential point is entirely missing from the subcontract?

Whatever words are chosen to bring legal sense to the subcontract as a separate agreement, this has to be done with care as this is the crucial provision in back-to-back contracting.

As well as this, good practice would be to make sure that the subcontract contains essential terms which align with the main contract but are not the same.

One example is notice periods: If the main contract requires notices to be given to the employer within a fixed period, there is no sense in repeating that period in the subcontract as it will leave the main contractor in breach or – in the case of time bars – without a valid claim in the event of delay and disruption.

Other issues might arise in the subcontract without any corresponding main contract term being triggered. For instance, subcontractor claims for time extensions should logically be different from



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those available to main contractors. The most obvious difference is that contractor acts of breach or prevention (including failure by other subcontractors) are simple culpable delay for the purposes of the main contract but should be grounds for extensions of time in the subcontract.

This brings us to a particular diffi-

culty: The combination of back-to-back contracting with conditional payment ('pay-when-paid') provisions or wider 'equivalent project relief' under which subcontractors' entitlement to payment for work done – or extensions of time and additional sums for delay and disruption – are dependent on the main contractor having received the equivalent benefit in the main contract.

Pay-when-paid is unlawful in many countries but is widespread in the Gulf. Of course, it is not inherently unworkable but it can create poor incentives for main contractors, who might not be keen to make those claims and press them assiduously.

Back-to-back contracting has sense to it but it needs to be done carefully to avoid unforeseen outcomes.

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