

‘The characteristics of construction contracts that are shared with, and distinctive from, other commercial supply contracts’.

Introduction

In order to determine the shared and distinctive characteristics of these two contract types, it is firstly essential to distinguish what constitutes a construction contract. Once this has been established, the terms of typical contracts from each type can be compared to determine where similarities and differences exist. The comparison will first examine the express terms of three standard forms of construction contract¹ with those of typical commercial supply contracts. Subsequently the implied terms of these two contract types will be compared.

Definition of a Construction Contract

The *Housing Grants, Construction and Regeneration Act 1996*², provides a statutory definition of a construction contract; in summary this comprises:

- The carrying out of construction operations or arranging or providing labour for the carrying out of construction operations (construction operations are described within the statute³)
- To do architectural, design or surveying work or advice on building, engineering, interior or exterior decoration or on the laying-out of landscape in relation to construction work.

Express Terms

Construction contracts are commonly executed utilising one of the standard forms such as those published by NEC⁴, JCT⁵ and ICE⁶. Other commercial supply contracts tend to contain standard express terms adapted to suit the circumstances of the particular agreement. In order to compare these two types of contract with clarity, it is necessary to examine them under a number of sub-headings.

Performance Obligations

The contractor’s general obligations under a construction contract are to carryout and complete the defined works.

¹ NEC3 , JCT 2005 , ICE 7th Edition

² Section 104

³ Section 105

⁴ New Engineering Contract

⁵ Joint Contracts Tribunal

⁶ Institute of Civil Engineers

Under the NEC3 form of contract, the contractor's responsibilities additionally include in clause 2; to employ each person named in the Contract Data, to co-operate with Others in obtaining and providing information and sharing the Work Area and engaging Subcontractors on terms agreed by the Project Manager.

Section 2 of the JCT 2009 form of contract contains contractor's obligations regarding materials, workmanship, discrepancies, divergences, fees, royalties and patent rights, design work, unfixed materials, adjustment of completion date, practical completion, lateness, liquidated damages and partial possession.

The main performance obligation placed on the employer, is payment of sums due. However additionally, the employer is required to allow access to the site⁷ and take over the works upon completion⁸.

Under other commercial supply contracts, the supplier's general performance obligations are similar to those of a construction contract supplier; the general obligation is to supply the goods or perform the services described in the contract. Dependant on the contract's particular circumstances, additional obligations may be included in the contract with relation to personnel, time, delivery, testing, etc. The employer or purchaser has an obligation to pay for the goods or services supplied.

One of the major differences in the characteristics of these two types of contract, with regards to performance, is in the method of payment. Other commercial supply contracts generally call for payment upon issue of invoice, either when the goods have been supplied or when the service has been performed. Often no payment is due unless the supply side of the bargain is totally complete. Interim payments can be identified in non construction contracts; however there may be requirements for repayment should termination of the contract occur prior to completion.

The case of *Sumpter v Hedges*⁹, which co-incidentally related to construction work, is an example of how payment (when the contract is not made under the terms of a standard construction form) can be withheld until performance on the supplier side is complete. *Sumpter* abandoned a contract to build two houses and stables part way through. It was held that as the contract did not entitle the builder to part payment, no payment was due.

⁷ NEC3 33.1, JCT 2005 2.4, ICE 7th Edition 42,

⁸ NEC3 35, JCT 2005 2.30, ICE 7th Edition 48

⁹ 1898 1 QB 673

Due to the long term nature of construction projects, terms within the main standard forms of construction contract allow for interim payments. In the NEC3 form¹⁰ the price of work done to date and all other payments due is assessed at agreed intervals and payment made within three weeks unless agreed otherwise. Similarly the JCT 2005 form¹¹ states that valuations are to be assessed at intervals to be agreed and will include work properly executed, site materials and agreed off site materials. The ICE 2003 form¹² stipulates that the contractor should issue a statement at monthly intervals giving the estimated contract value of the permanent works completed to date and an estimate of all other amounts due under the contract.

Contract Documents

Although other commercial supply contracts often refer to other documents which are to be included within the agreement, the complexity and uniqueness of construction projects almost always requires further definition by way of drawings, specifications, programmes, method statements, form or articles of agreement, etc.

Construction projects by their nature usually produce a product that is required to last a long time. For this reason construction contracts are usually executed as deeds, which increase the limitation period from six years for a simple contract¹³ to 12 years¹⁴. The importance of the form or articles of agreement is to ensure that the contract is made under deed. Conversely, the supplied product or service in other commercial contracts is frequently adequately covered by the limitation period of a simple contract¹⁵.

Every construction site will have conditions specific to its particular location. Contractors often rely upon the employer's site investigation report or state a particular method when calculating their price for carrying out the works. If this report is incorrect or the defined method proves impossible to follow, it may be possible to seek remedy for any losses if the relevant documents are bound into the contract.

In *Yorkshire Water v Sir Alfred McAlpine*¹⁶ the contractor issued a method statement identifying the direction in which they were going to construct a tunnel. The method statement formed part of the contract. When it proved impossible to construct the tunnel in the direction specified, *McAlpine* suffered delay and financial loss. The court

¹⁰ Core clause 5

¹¹ Section 4

¹² Clause 60

¹³ Limitation Act 1980 Section 5

¹⁴ Limitation Act 1980 Section 8

¹⁵ 6 years

¹⁶ 1985 32 B.L.R. 114

held that the contractor was obliged to follow his method statement and as the contract excluded completing the works where impossible, damages were awarded:

“Save insofar as it is legally or physically impossible the Contractor shall construct and complete the Works in strict accordance with the Contract...”¹⁷

Variations

Unlike most other commercial supply contracts, the final product of a construction contract is very rarely fully defined at formation due to the practicalities of the design process. If there are no express terms allowing a contract to be varied, the contractor is not bound to carry out extra work and the employer could be in breach of the contract if elements of the works are omitted. Although some other commercial contracts, particularly those that span a long period of time such as those involving distribution and loans, include variation clauses¹⁸ allowing price adjustment for example, the scale of variation in construction contract is usually greater

Whether a contractor is entitled to receive extra payment for variations will depend on how the contract works have been defined (assuming that there are express variation terms). If the description of the works is very broad, a variation would have to be similarly broad. In *Sharpe v San Paulo Railway Co.*¹⁹ the plaintiff contracted to construct a railway from terminus to terminus. The court held that subsequent design changes were included in the contract works.

In *Williams v Roffey*²⁰, the court held that even though the scope of the works had not changed, a promise by the employer to incentivise the contractor for timely completion would be enforceable, as consideration existed in the form of a benefit to the contract.

Certificates

The issue of certificates by an independent third party, which acknowledge events and give decisions, is largely a process unique to construction contracts. The role of certifier is usually filled by the Architect or Engineer.

In *Hickman and Co. v Roberts*²¹ the contract provided that the decision of the architect regarding payment due to the contractor was to be final. The contractor claimed that he was owed certain sums but the architect failed to issue a certificate in his favour. When challenged by the contractor the architect's reply was that his clients would not allow it:

¹⁷ ICE form of contract, Clause 13(1)

¹⁸ In the NEC3 form of contract variations are Compensation Events.

¹⁹ 1873 L.R.8 Ch. App 597

²⁰ 1991 1 Q.B. 1

²¹ 1913 AC 229

"in the face of their instructions to me I cannot issue a certificate whatever my own private opinion in the matter". The House of Lords held that he had improperly allowed the owners to influence him; the owners could not rely on the absence of a certificate as a reason not to pay the contractor.

One of the primary functions of certificates is to periodically quantify interim payments. Amounts certified can be however, subject to set-off by the employer. In *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*²² the contractor had refused to pay out the full certified amount of a progress payment to its subcontractor and had withheld funds on the basis of additional costs due to subcontractor's delay and poor workmanship. The question was whether the contractor had the right to set-off claims it may have had arising out of the subcontractor's breach of contract. The House of Lords held that the employer was justified in using set-off, however it is necessary to examine the particular contract in every case to determine whether the parties' common law and equitable rights of set-off and counterclaim have been explicitly excluded.

The status of certificates in construction contracts was confirmed in two cases, *Lubenham v South Pembroke D.C.*²³ and *Rupert Morgan Building Services v Jervis*²⁴. In the former case, despite the Architect wrongly deducting liquidated damages from an interim certificate, the court held that the certificate was effective. In the latter case, the Court of Appeal held that the employer had no right to resist payment of the amount certified by the Architect without the issuance of a withholding notice that complied with the Housing Grants, Construction and Regeneration Act 1996²⁵.

Contract Administrator

Although other commercial supply contracts often make provision for an administrator, it is only in construction contracts that the role includes the issuing of certificates, ordering variations and issuing instructions and drawings. This role has traditionally been carried out by an Architect or Engineer and more recently by a Project Manager or Construction Manager. Engaged by the employer and sometimes acting as their agent, the administrator nevertheless must carry out some roles acting fairly and impartially.

“...under a building contract the architect has to discharge a large number of functions, both great and small, which call for the exercise of his skilled professional judgment. He must throughout retain his independence in exercising that judgment ... it is the position of independence and skill that

²² 1974 AC 689

²³ 1986 33 B.L.R. 39

²⁴ 2004 B.L.R. 18

²⁵ Section 111

affords the parties the proper safeguards and not the imposition of rules requiring something in the nature of a hearing”.²⁶

Lord Hoffmann however observed that

“...the architect is the agent of the employer. He is a professional man but can hardly be called independent. One would not readily assume that the contractor would submit himself to be bound by his decisions subject only to a challenge on the grounds of bad faith or excess of power. It must be said that there are instances in the nineteenth century and the early part of this one in which contracts were construed as doing precisely this ... But the notion of what amounted to a conflict of interest was not then as well understood as it is now ... today one should require very clear words before construing a contract as giving an architect such powers”²⁷

Implied Terms

The implied terms of contracts can be divided into three categories; those imposed by courts, custom or statute. Some implied terms will apply equally to construction contracts and other commercial supply contracts however this depends on the circumstances of the agreement. The custom of not charging for tendering for construction projects was highlighted in *William Lacey v Davis*²⁸, however this term would equally be implied in many other commercial contracts. An example of the courts implying terms can be found in the case of *Liverpool CC v Irvin*²⁹ where it was held that there was an implied term for the Council to maintain the common areas of the flats. The *Defective Premises Act 1972* implies terms into contracts for provision of dwellings, that they are “fit for habitation”, however the statutes that most commonly imply terms on both construction and other commercial supply contracts are the *Sale of Goods Act 1979* and the *Supply of Goods and Services Act 1982*. The 1982 Act is more pertinent to construction as it specifically refers to services as well as goods. This Act codified what was previously Common Law.

A statute that implies terms solely on construction projects is the *Housing Grants, Construction and Regeneration Act 1996*. The terms implied are:

- The right to refer disputes to adjudication (section 108)
- the right to interim, periodic or stage payments (section 109);
- the payer must give the payee early communication of the amount he has paid or proposes to pay (section 110(2));

²⁶ Megarry J. *London Borough of Hounslow v Twickenham Garden Developments Ltd* [1971] 1 Ch. 233

²⁷ *Beaufort Developments Ltd v Gilbert Ash NI Ltd* [1999] AC 266

²⁸ 1957 1 W.L.R.932

²⁹ 1977 A.C. 239

- the payer may not withhold money for the sum due unless he has given an effective withholding notice to the payee (section 111);
- the payee may suspend performance where a sum due is not paid in full by the final date for payment (section 112);
- prohibiting pay-when-paid clauses which link payment to payments received by the payer under a separate contract (section 113).

The courts in *Young & Marten v McManus Childs* considered whether construction contracts contain implied warranties in respect of defective materials and goods. It was held that, even if there was no reliance on the skill of the sub contractor in the selection, that would not prevent the contract being subject to an implied term that the material supplied must be of merchantable quality.

In practice, contracts (construction or for other commercial supply) will have an implied limit to the extent of variations permissible albeit that they may contain terms that state that no variation will vitiate it. In *Thorn v London Corporation*³⁰, which concerned a contract for the reconstruction of Blackfriars Bridge, the court held that the varied work was so different from that expected, that it constituted a new contract.

There are implied terms that will apply almost exclusively to construction contracts. The law has long recognised that some of a contract administrator's tasks during a project require them to act fairly when deciding matters between the employer and the contractor. This was underlined in *Sutcliffe v Thackrah*³¹, where the House of Lords acknowledged that a professional consultant had an implied duty to act impartially when deciding questions between its client and the contractor. This means acting independently, honestly, fairly and without bias.

In *LB Merton v Leach Ltd*³² it was held there was an implied term that the Employer would not hinder or prevent the contractor from carrying out its obligations in accordance with the terms of the contract and from executing the work in a regular and orderly manner. The implied obligation by the building owner extends to those things which the Architect has to do, such as the issue of correct and timely information.

Conclusion

Construction contracts have similarities with and differences from other commercial supply contracts. The differences stem from the uniqueness of the construction process.

³⁰ 1876 1 App. Cas. 120

³¹ 1974 AC 727

³² 1985 32BLR 51

No other industry combines the characteristics of individuality of works, lengthy period of execution, longevity of product, site specificity, connectivity with other infrastructure, high levels of change post contract formation, multi party delivery team and design responsibility split amongst many consultants. It is for these reasons that construction contracts have developed terms, through case law, custom and statute, which are suited to their environment. These terms have largely manifested themselves in the standard forms of contract so widely used today in the construction industry.

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