Determination of Employment under the Standard Forms of Contract for Construction Works

by Arthur T. Ginnings, FIArb, MBIM, (Fellow)

This article is the substance of a lecture given to the West of England Branch on 6th October, 1977.

First of all let us spend a few moments in talking about the Grounds for Determination and, in doing so, I am going to talk primarily against the background of the JCT Contract. I am well aware that there are marginal matters in which other Forms of Contract may differ from the provisions of the JCT but all we can attempt to do here is to talk about general principles. If we can get some general principles clear, or clearer, between us we can go away and apply those principles to particular types of contract and to particular situations and circumstances.

So, the grounds for the determination of the Contractor's employment may broadly come under two main headings – the first which I may describe as culpable behaviour or non-performance by a Contractor and the second financial disability.

We are all pretty familiar with these things and I feel sure I am only telling you things that you already know. However, we are going to refresh our memories and I will just touch briefly upon the sort of things which the JCT Contract prescribes as grounds for determination.

If the Contractor, for example, suspends execution of the Works without reasonable cause, or the Contractor fails to proceed regularly and diligently, or the Contractor refuses or neglects to comply with Superintending Officer's instructions – with no disrespect to the Architects present, because we are trying to cover other forms of contract in which (regrettably, should I say?) Architects are not mentioned at all. Then, the Contractor may have his employment determined because he ignores the prohibition clause about assigning his contract. If he does so without performing the obligations upon him, that can be a ground for determination.

I think those are the main grounds, under the JCT Contract at least, on which a Contractor runs the risk of having his employment determined. I say he runs the risk because the eventual decision about determination in those circumstances is for the Employer to take.

Before I come on to the question of financial disability, I should mention that under the Local Authority version of the JCT Contract there is a further ground for determination, that is, if the Contractor offers or makes any corrupt payment in connection with that particular job or his business generally. Now, I don't know, but I believe that what is most in our minds at this time is the second broad group of happenings which I have referred to as the Contractor being in financial disability. First of all, it is stated that if certain things happen (which I will refer to collectively as Acts of Bankruptcy) then the Contractor's employment is automatically determined. Not the contract itself. Something that most of us will have had cause to be well aware of is the fact that determination of the Contractor's *employment* is not the same thing as determining or rescinding the contract itself. The contract still stands and governs what happens from that point onwards. So much for the Contractor's side of the contract – being things which the Contractor may have done or failed to do, which put him at risk in respect of having his employment determined.

But, equally, it is not unknown for the Employer, the other party to the contract, to also mis-perform and certain things are prescribed as grounds on which the Contractor can take the initiative about determining his own employment in those circumstances. First of all, if the Employer fails to honour a payment certificate within the time prescribed. Once-upon-a-time, a *payment* certificate was the only certificate referred to in the (pre-1963) Contract, but since the 1963 Contract has been with us we know that there are fourteen or so different sorts of certificate that the SO is required to issue in certain circumstances. This is dealing particularly with a payment certificate, but if the Employer interferes with or obstructs the issue of *any* certificate then that is potentially grounds for determination.

Then, although through no fault of anybody, if the Works are suspended for at least the period mentioned in the Contract because the Works have been damaged

by the effect of one of the happenings for which provision is made in the insurance clauses of the Contract then, again, there is an option which the Contractor can exercise to determine his employment in those circumstances.

There is a special provision in the ICE Contract which governs access to the site of undesirable persons, or any persons not authorised to be there, and there is this other ground for determination if the Contractor ignores any instructions issued with respect to the admission to site of any particular person or persons. I just throw that in as one of these extra matters which one finds in Forms of Contract other than 'the JCT.'

Back to the perils you know, such things as *force majeure* (I hope somebody will one day define what *force majeure* really is and what it is not). Then, too, all the other perils of fire, storm, tempest, flood, lightning and all the things that aircraft might drop upon us. These are grounds for the Contractor's option to determine and, likewise, the Contractor can determine if the Employer commits an act of bankruptcy, although I hasten to add that that provision does not appear in the Local Authorities Form. It is assumed, presumably, that a Local Authority cannot go bankrupt, although things I have read recently about New York begin to make me wonder even about that. There is no similar provision either in the GC/Wks/1 Contract because, I suppose, if the Employer goes bankrupt under that Contract we have *all* 'had it'. Then, too, the Contractor has the option of determining his employment if the Works are affected by those same perils when the Works are being insured by the Employer. I think that those comments touch upon the main grounds for determination as far as the Main Contractor is concerned.

If we now reflect those considerations into the Contractor/Sub-Contractor relationship it is perhaps enough to say at this point that all Nominated Sub-Contracts are automatically determined upon the determination of the (Main) Contractor's employment. There are other features of the Contractor/Sub-Contractor relationship but I am doing a rather hasty review of the situation just to stimulate your own thinking and so that you can come back on things that you might particularly wish to go into further.

The Procedure for Determination is also spelled out fairly closely in the wording of the Contract. In the case of the Contractor's default for what I call 'non-performance', it is important to follow very closely the procedure laid down. As we know, after the usual sort of less-formal letter writing and telephoning, there has to be a solemn-warning type of communication sent by Recorded Delivery specifying the default, and if that default continues for fourteen days thereafter, then the Employer may decide to send a further Recorded Delivery notice determining the Contractor's employment. The first recorded communication is from the Superintending Officer; the final one is from the Employer, although, if the SO is acting as the Employer's agent, the Contractor could not avoid service of such a notice if it was in fact sent by the SO. Obviously, however, it is best for the Employer to do this in his own name.

Those periods vary in other contractual relationships and in the JCT General Contract you will have noticed that after the warning notice has been sent there has to be a further period of ten days before the Employer can exercise his option to terminate. In the relationship between Sub-Contractor and Main Contractor the period appears to be ten days instead of fourteen days and then no further time. Other Forms of Contract seem to follow that one-stage system rather than the two-stage system. The 'Blue' Sub-Contract Form and the ICE Conditions all seem to prescribe that, after the warning notice period expires, that's it.

As I have already mentioned, when we are talking of financial disability, there is no time-span involved because upon the occurrence of any one of the matters referred to – which I classify generally as an act of bankruptcy – the Contractor's employment is determined automatically. There are, of course, practical difficulties in deciding exactly when an act of bankruptcy has occurred and I propose to deal a little more deeply with that presently.

If the determination is the other way round then, again, the Contractor sends a notice by Recorded Delivery to the Employer or to the Superintending Officer and the same thing happens in reverse but the rights and responsibilities of the parties are different according as to who has been sacked by whom.

We will now go on to talk about the consequences of determination and, I suppose, this is where we are often perplexed in trying to reconcile conflicting provisions in the contract and in the general law. If we deal with what the contract prescribes (and in most of these things I see a balance of sympathetic reaction throughout the major Forms of Contract) first of all the Employer is given the right to engage others to carry out the works which are left unfinished by the old Contractor and he (the Employer) or the new Contractor – and I'll talk about 'old' and 'new' Contractors now to distinguish them – can go on the site and take possession of everything that is there. Of course, one has to set up some kind of policing of the site and, in practice, this may present some problems because, obviously, everybody who feels that they can salvage something will try to do so and may be acting improperly in the circumstances when they do it.

If the determination arises out of non-performance or mis-performance then the Contractor can be required to assign his sub-contracts and his arrangements with his suppliers but not in the case of his financial disabilities. The question that causes so much discussion is the one of direct payment to Sub-Contractors in these circumstances. The Contract provides quite clearly that the Employer may pay Sub-Contractors for any goods or services supplied before or after the date of determination, that is stipulated quite clearly in Clause 25, sub-clause (3) and it is there specifically stated that such powers are in addition to those powers in Clause 27, sub-clause (c) for paying direct when the Contractor defaults in paying Sub-Contractors out of interim payments made by the Employer. Furthermore, in certain cases, this provision may be reinforced by Part B of the Standard Agreement commonly known as the 'Employer/Sub-Contractor Agreement 1973'.

There is strong reason for doubting whether that course is always wise and I would be very interested to know if any of you have met this problem and how you have dealt with it, because there does seem to be the possibility that there is a conflict between some of the provisions of the Contract and the general law of bankruptcy.

As and when required to do so, the Contractor has to remove his redundant plant and equipment from the site but he is not allowed to remove it until he is instructed to do so and if he doesn't remove when directed (may-be he no longer has the capacity for doing so) then the Employer can sell off those redundant items, holding the proceeds as a balance to the credit of the Contractor and accounting for that at the end of the day when the accounting is done for the total situation. As you would expect, there is a provision that any extra costs which the Employer suffers because of the determination can be levied against the old Contractor and those costs will include not only the extra cost of employing a new Contractor but, I am quite sure that you would agree with me when I say that they should include the extra fees payable to the Consultants for the amount of extra advice and services that they have to give in such circumstances.

Whilst all this is happening the Employer does not have to pay any further money to the old Contractor. This is an obvious common-sense position to take up, but the Contract specifically provides that that shall be so, so that immediately the determination is effected no further monies are payable by the Employer until the whole mess financially has been tidied up – and that won't be until after the Works have been completed by the new Contractor under whatever arrangement will have been made for that purpose. But, when the Works have been completed then there has to be a very careful and proper detailed statement of accounts prepared which will indicate the value of the work actually done by the old Contractor less the extra costs arising and showing what, if any, balance might still be due to the old Contractor, otherwise there may be a debt that is not recoverable, except in the bankruptcy. And those, broadly, are the Consequences of Determination when the Contractor has defaulted.

When the boot is on the other foot, so to speak, the Contractor is calling the tune rather than the Employer and under these circumstances the Contractor can remove all items from the site, the ownership of which has not yet passed to the Employer. So also he could remove his huts, his plant, etc, the ownership of which would never pass to the Employer. He could also remove materials on site, which the Employer had not yet paid for and, furthermore, the Contract provides that the Contractor has a lien even on those materials and goods which the Employer may have paid for – until such time as his position has been clarified. Having said that, the Contractor is entitled to be paid for all work that he has actually completed (or even only begun) in accordance with the normal rules for measuring and valuing the Works and, in addition, he would be paid the direct loss or expense which he incurs under the normal Contract provisions; he is also paid for any materials and goods on the site which are left there and he has to be paid for any extra costs of removing himself from the site and any other direct loss or expense directly related to the fact of the determination.

Those are again broadly some of the highlights of the Consequences of Determination. The fact that many people will have many headaches is perhaps another consequence for which the Contract can make no provision.

Let me now turn to what I call Additional Matters related to Insolvency. I was interested, and expect some of you were also, to find that in the September 1977 edition of the IQS Journal, there is a comprehensive feature on this subject, reporting papers read by two Accountants and one Quantity Surveyor is South Africa. Although some of the terms used and some of the statutory instruments referred to are not applicable here, it is most interesting to find that the general principles in South Africa run in parallel lines to those here. I would commend you to read that feature and particularly the paper by the quantity surveyor contributor, Mr. D. O. Norman, because it does set out the total picture that emerges from the financial disabilities of Contractors and others in the construction industry.

It is well known that construction has been the field for many bankruptcies. In 'Building' of 12th August, 1977 there was a table under a feature headed by the apparently unusual headline 'Construction Insolvencies Down'. I think that's about as comforting as when they tell us that inflation is down, or coming down. What they really mean is the *rate* of inflation is flattening off but it is still going up. It is no surprise to any of us, I believe, to be confronted with figures which remind us that on the average it seems, during 1975 and 1976 there were something like 200 to 250 bankruptcies in the construction industry every quarter and that no doubt accounts for the fact that here and there some of you may have been involved.

Now, as I said earlier, it is all very well to have a Contract. It is very necessary that we should, and there was a stage in my younger experience, when I made the mistake of thinking that the Contract was everything. Now, of course, like most of you, I relise that it is not. In this and in most other civilised countries people live under a system of law. In this country we live mainly under what we call 'common law'. In other countries (Scotland, for example, and certain continental countries) they live under a more codified state of law. We have this general background of common law and in parallel with it, or alongside it there is also Statute Law.

"These are interim accounts. The final account is a mirage which recedes as we approach it."

All these features of our society – Common Law, Statute Law, Case Law – have a relevance upon the way we live, the way we do things, the way we behave, the way we get punished when we don't behave. I should also mention Criminal Law because it could be relevant in certain bankruptcy situations.

Now, just to give us a broad idea of the sort of thing I was referring to when I said that the Contract provisions might in some respects need to be tested against the general law, the following are instruments which have a relevance upon a bankruptcy situation:—

The Bankruptcy Act, 1914.
The Deeds of Arrangement Act, 1914.
The Land Charges Act, 1914.
The Bankruptcy Rules – starting in 1915 and amended up to and including 1965.
The Law of Property Act, 1925.
The Land Registration Act, 1925.
The Bankruptcy (Amendment) Act, 1926.
The Companies Act, 1948.
The County Courts Act, 1959.

That's just a selection as summarised in a little book, called "Bankruptcy Law" – (M. and E. Handbooks). This series of handbooks – M. and E. Handbooks – is a very useful potted accumulation of important data under many different subjects. This happens to be the one on Bankruptcy Law and I am indebted to it for most of the things that I am saying about general matters.

Confusion may arise sometimes between the terms "Bankruptcy Act" and "An Act of Bankruptcy". An Act of Bankruptcy is what we have been already mentioning, and includes these definitions within the Bankruptcy Act: The assignment of property for the benefit of creditors, the fraudulent conveyance of property, the creation of fraudulent preference, departure from the United Kingdom with intent to thwart creditors or, being abroad, failing to return. The (potential) bankrupt may stay away from his base or, if he is at his base, he may refuse to come out – you can imagine him nailing up the door and refusing to talk to his creditors. Or, he has his goods seized by legal process, or he faces up to his position and he files his own declaration of inability to pay debts, or he submits a petition against himself, or he fails to respond to a bankruptcy notice which has been initiated by one or more creditors, or if he gives notice to one or more creditors that he intends to suspend payment. All these things are defined as an Act of Bankruptcy. That is what we talk about in the context of the Contract but, once we are in the field of law – and I am not a lawyer – there are many provisions which are not spelled out in the Contract. In particular, in connection with direct payments to Sub-Contractors, although it may be quite right and proper and safe for an Employer to pay a Sub-Contractor those monies which, having been previously certified and included in a payment certificate to the (Main) Contractor have not been passed on, there is a big questionmark over whether he is wise to pay monies in respect of work not previously included in a payment certificate. If in doubt, say or do 'nowt' but if any of you are braver than that please tell us so that we can go and advise our clients similarly. It seems to be the general view that there may well be a conflict between the law and the contract. It is dangerous to try to create preferential treatment of one creditor against another and the risk is that the Employer, having paid the Sub-Contractor direct, may find himself facing a demand by the Receiver or Liquidator for that amount of money – which could mean double payment or, at least, double payment of some of it.

I will now conclude my remarks by running down what I visualise as the order of events when something like a bankruptcy situation is emerging. The first thing that happens, usually, is some kind of rumour on the proverbial grapevine. There is no smoke without fire, they say, but I suppose it is not unknown for a Contractor to be pushed over the edge because of the prairie fire of rumour that suddenly gathers momentum and, before he knows where he is everybody is clamping down and tightening up and his cash flow which is already a little precarious becomes completely non-existent. So, the first thing to be done is to check the source of any information and to test the validity of it – taking care not to be responsible for passing on any ill-founded rumour.

If a Receiver or a Receiver-and-Manager or a Liquidator has been appointed then it is wise to try and get in touch with him and check the precise position in the financial sphere and, at the same time, to check the position on the site and take what steps may be necessary to prevent any improper removals therefrom. Above all, I suggest, the professionals should keep a low profile until the facts are established beyond doubt. In the meantime it is important to contact the Employer and get his instructions. Depending upon what sort of a person or organisation the Employer is he will either take over matters or will leave the professionals to advise him and to take action as may be necessary. At that stage it will be important to begin to think of how to go ahead with arrangements for continuing the work as soon as it is clear to do so, to re-insure the Works (if necessary) and to initiate any special measures that are required for the safety or the security of the Works. The vexed question of direct payment to Sub-Contractors will certainly crop up at that stage. There will also have to be discussions with the other Consultants and, in particular, the Quantity Surveyor will be involved in making records of what has been done on the site. No doubt photographs would be taken to supplement the other records made and there would be discussions between the Consultants about the position generally and, in particular, how to get the Works re-started and eventually completed.

Then, under the general heading of Instructions to the old Contractor (or defaulting Contractor) he would need to be instructed on the matters that we have already been ventilating about closing the site, not removing any materials or equipment, any security or safety measures he is required to take. The question of safeguarding site records and site documents is, I think, important because if everything suddenly stops and everybody gets the sack overnight there could be chaos about retrieving site records, including the Contractor's site records which are of some importance to the professionals involved; and any arrangement for assigning of Sub-contracts will be dealt with at that stage.

Of course, the old Contractor may be completely unable to do anything and in those circumstances all the things that I have been talking about in connection with the site would have to be dealt with through another Contractor even though it might be a temporary Contractor brought in just to do those things which are essential to be done at that point of time. If there is a

Clerk of Works on the site he will be very much involved as 'employer's agent on site' and might even (metaphorically) wear a new helmet with those words on it in order to prevent those things happening which ought not to happen at that time.

As soon as possible one should check with the Receiver/Manager as to what his intentions are with regard to the Contractor's future. Hopefully, when a Receiver/Manager is appointed the idea is to steer the concern through its stormy waters with a view to coming out at the other end to the best advantage of the creditors. Alternatively, that best advantage might be best served by shutting the whole thing down as quickly as possible, or by trying to keep it going and maybe selling off the enterprise as a going concern. Naturally, one would want to know as quickly as possible what the Receiver/Manager's intentions are in those matters.

In parallel with all this, the Quantity Surveyor should be preparing a document on which a new contract could be based with another Contractor, and that document will need to be such as meets the circumstances of the particular case. The questions arise – 'How do we employ or on what basis do we employ a new Contractor? Do we go out to competitive tender or do we try to negotiate?'. The policy for tendering for the completion Contract, as I might call it, has to be also discussed and agreed with the Employer. A New Contractor is brought in, if necessary, under the usual arrangements for starting a job, albeit he is starting a job that has already been half completed. The assignment of sub-contracts to the new Contractor could be dealt with at that time and arrangements made for removal and disposal of the redundant items left by the old Contractor. The certifying of the Works under the headings of old Contractor and new Contractor will be dealt with in due course as may be appropriate.

APPENDIX: CHECK-LIST

Determination of Contractor's Employment and related action by Superintending Officer and others.

TYPICAL SEQUENCE OF EVENTS

1 (i): Information received that Contractor is in financial difficulty and/or has committed an 'act of bankruptcy'.
- *(a)* Check source/validity of information – taking care not to pass on what may be false rumour
- *(b)* If appointed, check precise position with Receiver or Receiver/Manager or Liquidator
- *(c)* Check position on site and take (provisional) steps to prevent improper removals
- *(d)* Keep low profile until facts are established.

1(ii): Contractor's employment determined because of 'non-performance'.

2: Advise Employer and get his instructions.
- *(a)* Discuss/recommend what to do about:—
  - (1) liaison with Receiver (or other such official appointed by the Court);
  - (2) safety and security measures;
  - (3) completing the Works;
  - (4) direct payment to sub-contractors;
  - (5) re-insurance of the Works.
- *(b)* Discuss/agree who takes any or all action arising from *(a)*.

3: Inform QS and other Consultants.
- *(a)* Discuss/agree nature/scope of essential measures/works to make Works safe and secure
- *(b)* Agree how and by whom such measures are implemented
- *(c)* Arrange for photographic and other records of site conditions
- *(d)* Discuss procedure for getting the Works completed.

4: Issue the necessary instructions to the defaulting Contractor
Eg: Closure of Site
Non-removal of materials or plant/equipment required for the Works
Safety/security measures
Safeguarding of site documents/records
Assignment of sub-contracts

5: Issue instructions to another Contractor to execute any essential safety/security measures.

6: Inform Clerk of Works.
Ensure adequate control over entry upon and/or removal from site of persons and vehicles.

7: Check with Receiver/Manager his intentions with regard to Contractor's future.
If practicable, arrange for Contractor's employment to be reinstated.

8: If necessary, instruct QS to prepare tender documents for completion of Works.

9: Discuss/advise Employer re tender policy for completion.
- *(a)* Competitive
- *(b)* Negotiated.

10: Arrange for new Contractor to re-commence site works.

11: Formalise assignment of sub-contracts to new Contractor.

12: Arrange for removal/disposal of plant/equipment of 'old' Contractor as/when no longer required.

13: Certify value of work etc, by 'old' Contractor – subject to set-off in respect of extra costs incurred by Employer.