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The JCT Contract In a Cold Climate

**Adam Constable
Keating Chambers**

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A. Introduction

History of the JCT forms

- Standard form of building contract has been in use since at least the end of the nineteenth century (*Clemence v Clarke* (1880) HBC (4th Edn), Vol. 2 p.54 (referred to in Keating, para 19-002))
- Various versions of the JCT form (under its current 'JCT' name, as well as earlier versions released as 'RIBA' forms) have been released. Editions of the contract date from 1909, 1931, 1939, 1963, 1980, 1998, and 2005.
- The JCT contract has, in some form or other, therefore lasted over 100 years, encompassing two world wars, and the economically 'cold climates' of the 1930s, mid-1970s, early 1980s and early 1990s.
- Most recent JCT suite introduced in 2005, with the provisions largely representing continuity with provisions of JCT 1998.
- Presentation focuses on those Clauses of JCT 2005 (by reference to the Standard Building Contract) that will be of particular relevance to construction contract parties faced with cash-flow and other financial difficulties in the course of a project as a result of the current recession, namely: (i) determination of the contract; (ii) insolvency; (iii) advance payments; and (iv) dispute resolution.

B. The Impact of Recession on the Construction Industry

Gloomy construction industry news stories have become very familiar over the past year. The following statistics outline why construction industry professionals need to think carefully about how robust their contracts are in the event that one of the parties to the contract are faced with financial difficulties:

- Experts believe that in 2008, over 100,000 construction jobs were lost, with an estimated 300,000 jobs to go over the course of the recession (Royal Institution of Chartered Surveyors).
- Pricewaterhouse Coopers estimate that in the course of 2008, over 2,000 construction firms became insolvent.
- In the *Independent*, 21 October 2008, it was estimated that the construction industry accounted for 21 per cent of all insolvencies in the UK.

How do these factors impact upon the contractual dealings of construction industry players? In short, parties become more concerned with the provisions relating to money and the extent of their obligations. Contractors need to ensure they have sufficient finances. Both parties need to be able to minimise their losses in the event of the other parties' default or insolvency. Finally, where a dispute arises, both parties may adopt more aggressive tactics over money. Therefore the following provisions are relevant:

- The provisions on determination in the contract detailing how, in what circumstances, and how quickly a party can end the contract in the face of default by the other party.
- Where there is an increased likelihood of contractors or employers going insolvent, the provisions of the contract detailing what happens in such circumstances gain heightened significance.
- Where the project runs into difficulties, and is stopped part-completed, the question of ownership of the materials used becomes important, as they may be of considerable value to one or all parties.
- Where cash-flow becomes an issue in the course of a project – for example where a contractor needs to purchase materials to complete the job before he has received payment for that job – the provisions in the contract regarding

the circumstances in which advance payments can be made also become highly relevant.

- If a contractor is struggling to balance the books, it is inevitable that they will fight hard over any disputed sums in a contract. This can lead to protracted and increasingly bitter litigation. The provisions of the contract relating to dispute resolution will therefore be highly relevant to the success with which the parties are able to remedy the dispute without incurring high litigation costs.

C. **Determination**

Provisions on determination in Clause 8 of the JCT Standard Contract are split between determination by the contractor and by the employer. Provisions dealing with determination for insolvency are addressed in the next section of this presentation.

The important House of Lords judgments in *Reinwood v L Brown & Sons* [2008] UKHL 12, [2008] 1 W.L.R. 696, and *Meville Dundas Ltd (in Receivership) v George Wimpey Ltd* [2007] UKHL 18; [2007] 1 W.L.R. 1136 which related to the payment and determination provisions of JCT Standard Form of Building Contract 1998 and the 1996 Act are the subject of the separate paper. This section will focus specifically on the determination clauses of the JCT contract.

Determination by the Employer

Clauses 8.4 – 8.8 of the JCT set out the provisions whereby the employer can determine the contract. The main grounds for determination for default by the contractor are listed in Clause 8.4, including where the contractor:

- Wholly or substantially suspends the carrying out of the work before completion without a reasonable cause (Clause 8.4.1.1);

- Fails to proceed regularly and diligently with the works (Clause 8.4.1.2);
- Refuses or neglects to remove defective work after written notice and the Works are materially affected (Clause 8.4.1.3);
- Fails to comply with clauses restricting sub-letting, assignment, or dealing with named subcontractors (Clause 8.4.1.4); and
- Fails to comply with CDM Regulations (Clause 8.4.1.5).

In order to terminate on any of these grounds:

- The architect must first serve a notice by special or recorded (or actual) delivery specifying the default (8.4.1).
- Contractor has 14 days from receipt of the notice in which to remedy the default.
- If the Contractor “*continues a specified default for 14 days from receipt of the notice under Clause 8.4.1, the Employer may on, or within 10 days from, the expiry of that 14 day period by a further notice to the Contractor terminate the Contractor’s employment*” (Clause 8.4.2)
- The architect is not empowered to send actual notice of termination.
- If the contractor remedies default or the employer does not issue a termination notice under Clause 8.4.2 but the same default is later repeated, employer is entitled to serve notice of termination without a further default notice (Clause 8.4.3).

Care must be taken before the employer seeks to determine the contract under these Clauses, since any error may result in a finding of repudiation and the employer may be liable in damages to the contractor.

Termination by the Contractor

Termination by the contractor may be effected under Clause 8.9 where the employer:

- *“Does not pay by the final date for payment the amount properly due to the Contractor in respect of any certificate...”* (Clause 8.9.1.1)
- *“interferes with or obstructs the issue of any certificate due under this Contract”* (Clause 8.9.1.2)
- suspends the works owing to specific instructions or impediment, prevention or default (Clause 8.9.2).

As with termination by the employer, before issuing the termination notice, the contractor must send a notice to the employer specifying the default, with a 14-day notice period before the termination may be effected.

These provisions provide the Contractor with a valuable weapon in the event of non-payment by the contractor. However, requiring the Contractor to issue two notices, and the 14 day period before termination can be effected, may in some instances lead to solvency issues.

Termination by Either Party

Clause 8.11 of the JCT provides that either party may terminate the contract for force majeure; damage to the Works by a specified peril; instructions issued in regard to the correction of discrepancies, variations or postponement of work where this resulted from negligence or default of statutory undertaker; civil commotion or terrorism; or exercise of statutory power by the UK Government.

Consequences of Termination

Where the Contractor’s employment is terminated by the Employer (Clause 8.7):

- The employer may take, and the contractor must give up possession of the site;
- The employer may employ and pay others to complete the works;
- Provisions concerning the payment or release of retention to the contractor cease to apply, meaning that employer need make no further payments to the contractor until the works are completed and defects rectified;
- A reasonable time after the Works are complete and the defects rectified, an account must be drawn up stating:
 - (i) The amount of loss and/or expense caused to the employer by the termination, including the cost of having the work completed by others;
 - (ii) The amount already paid to the contractor;
 - (iii) The amount which would have been payable for the Works in accordance with the contract.

Where the contractor terminates, the parties' key rights and duties are as follows (Clause 8.9):

- Clauses requiring payment or release of retention to the contractor cease to apply;
- The Contractor must prepare an account as soon as reasonably practical setting out:
 - (i) The total value of the Works at termination;
 - (ii) Any sum ascertained under the loss and/or expense claim;
 - (iii) The reasonable cost of removal of its property from site;

- (iv) The cost of materials properly ordered for the Works for which the contractor has already paid or is legally bound to pay;
- (v) Any direct loss and/or damage caused to the contractor by the termination after taking into account amounts already paid under the contract.

While termination provisions allow parties an escape from contractual obligations in certain circumstances, should not be entered into lightly. Termination expensive therefore advice/consideration of costs involved required, including costs of obtaining alternative contractors.

If termination found to be unjustified, it can have significant cost consequences. Under Clause 8.2.1, “*Notice of termination...shall not be given unreasonably or vexatiously...*” If so given, the notice is void and consequences flow from that. The authorities concerning this clause were considered in the first instance decision in *Reinwood Ltd v L Brown & Sons Ltd* [2007] BLR 10 (reversed on other grounds on appeal) – See the separate paper in relation to this.

Insolvency

Insolvency of Contractor

Definition of insolvency set out in Clause 8.1.: “*a Party is Insolvent if:*

1. *He enters into an arrangement, compromise or composition in satisfaction of his debts...*
2. *Without a declaration of solvency, he passes a resolution or makes a determination that he be wound up; or*
3. *He has a winding up order or bankruptcy order made against him; or*
4. *He has appointed to him an administrator or administrative receiver; or*

5. *He is the subject of any analogous arrangement, event or proceedings in any other jurisdiction...*”

Contractor must inform the employer immediately if it becomes involved in any of the matters set out in clause 8.1.

Clause 8.5 provides that:

1. *If the Contractor is Insolvent, the Employer may at any time by notice to the Contractor terminate the Contractor’s employment under this Contract.*
2. *The Contractor shall immediately inform the Employer in writing if he makes any proposal, gives notice of any meeting or becomes the subject of any proceedings or appointment relating to any matters referred to in Clause 8.1.*
3. *As from the date the Contractor becomes Insolvent, whether or not the Employer has given such notice of termination:*
 - a. *The provisions of clauses 8.7.4, 8.7.5, and 8.8 shall apply as if such notice had been given and the other provisions of this Contract which require any further payment or any release of Retention shall cease to apply;*
 - b. *The Contractor’s obligations under clauses 2.1 and 2.2 to carry out and complete the Works and the design of the Contractor’s Designed Portion shall be suspended; and*
 - c. *The Employer may take reasonable measures to ensure that the site, the Works and Site Materials are adequately protected and that such*

Site Materials are retained on site, the Contractor shall allow and shall not hinder or delay the taking of those measures.

This marks a change from earlier JCT contracts – Contractor’s employment no longer automatically determined. Instead the employer has discretion under Clause 8.5.1 to give notice to terminate. This is an important change, since it is often to benefit of all concerned for Contractor’s trustee in bankruptcy to complete the Contract.

Clause 8.5.3 is also important as it means that following Contractor’s Insolvency, some changes automatically occur from date of insolvency (whether or not a notice of termination has been issued): (i) the payment regime ceases to apply; (ii) the Contractor’s obligation to carry out the Works is suspended; and (iii) the Employer is entitled to secure the Site.

The consequences of determination for insolvency are the same as those for determination generally, contained in Clause 8.7.

Insolvency of Employer

Clause 8.10 sets out the contractor’s rights upon employer insolvency:

- 1. If the Employer is Insolvent, the Contractor may by notice to the Employer terminate the Contractor’s employment under this Contract;*
- 2. The Employer shall immediately inform the Contractor in writing if he makes any proposal, gives notice of any meeting or becomes the subject of any proceedings or appointment relating to any of the matters referred to in clause 8.1;*
- 3. As from the date the Employer becomes Insolvent, the Contractor’s obligations under clauses 2.1 and 2.2 to carry out and complete the Works and the design of the Contractor’s Designed Portion shall be suspended.*

D. Ownership of Materials

JCT Standard Form Clause 2.24 provides that:

“Unfixed materials and goods delivered to, placed on or adjacent to the Works and intended for them shall not be removed except for use on the Works unless the Architect/Contract Administrator has consented in writing to such removal, such consent not to be unreasonably delayed or withheld.”

This provision creates a lien in favour of the Employer even before certification of the Works. In *Archivent v Strathclyde Regional Council* [1984] 27 BLR 98 the claimants sold materials to the main contractors. The contract of sale contained a retention of title clause. The value of the materials was contained in an Interim Certificate which was paid by the defendant employers. The main contractors became insolvent and could not pay the claimants. The court held that the main contractors had conferred good title on the employers under section 25(1) of the Sale of Goods Act 1979. The court rejected the claimant’s argument that under the 1963 Form’s precursor to Clause 2.24, the main contractors never came into possession of the materials but held them for the employers. The clause was to be interpreted as giving the main contractors possession of the materials prior to delivery to the employers.

Clause 2.24 continues on to provide that:

“Where the value of such materials or goods has in accordance with clause 4.10 [Amounts due in Interim Certificates] and 4.16 [Ascertainment of Gross Valuation] been included in any Interim Certificate under which the amount properly due to the Contractor had been paid by the Employer, such materials and goods shall become the property of the Employer, but subject to Insurance Option B or C (if applicable), the Contractor shall remain responsible for loss or damage to them.”

The intention of this clause is that property in materials and goods should pass to the employer upon payment of the Certificate which includes the value of such

materials and goods. Both before and after Certification, the risk remains with the Contractor.

As regards off site materials and goods:

- Clause 4.17 provides that the amount stipulated as payable by the Employer to the Contractor in the Interim Certificate shall include the value of any Listed Items before their delivery to or adjacent to the Works provided that (1) the Listed Items are in accordance with the contract; (2) reasonable proof has been provided that the Contractor owns the property and the correct insurance is in place; (3) the Listed Items are clearly marked and set aside from other materials as for the Employer and destined for the Works; (4) the Contractor has complied from a surety approved by the Employer with any contractual requirements as to a bond in favour of the Employer.

- Clause 2.25 provides that when their value *“has in accordance with clause 4.17 been included in any Interim Certificate under which the amount properly due to the Contractor has been paid by the Employer, those items shall become the property of the Employer and thereafter the Contractor shall not, except for use upon the Works, remove or cause or permit them to be moved or removed from the premises where they are. The Contractor shall be responsible for any loss or damage to them and for the costs of their storage, handling and insurance until they are delivered to and placed on or adjacent to the Works.”*

Thus, where the Employer is prepared to pay for the materials needed for inclusion of the materials needed for the Works prior to their Delivery – a provision which could bring valuable cash-flow to the Contractor – then this must be stated in a list attached to the Contract Bills. The Contractor is then entitled to be paid for these items subject to the fulfilment of the conditions set out in Clause 4.17 above which offer protection for the Employer against the Contractor’s insolvency.

E. Advance Payments

JCT Standard Form Clause 4.8 provides for advance payments:

“the advance payment shall be paid to the Contractor on the date and reimbursed to the Employer on the terms stated in the Contract Particulars. Provided that where the Contract Particulars state that an advance payment bond is required, such payment shall only be made if the Contractor has provided to the Employer a bond...from a surety approved by the Employer.”

This optional provision allows the employer to pay a sum to the contractor on a date stated in the Contract Particulars. The idea is that the sum will be paid early, in order to assist the contractor to finance the project. The contractor must reimburse the employer in the amounts, and at the times, which the parties agree and state in the contract particulars. In these circumstances the contractor is required to give a bond, usually in the form reproduced at Schedule 6 to the Contract.

In the current financial climate, Contractors may find it advantageous to insert such provisions into their agreement, in order to ensure they have sufficient finances at the start of the project to obtain all necessary resources.

F. Dispute Resolution

Perhaps the most significant changes in the JCT 2005 contract are the alterations to the familiar JCT dispute resolution procedure.

Arbitration vs Litigation

Article 9 of the JCT Articles of Agreement states that *“...the English courts shall have jurisdiction over any dispute or difference between the Parties which arises out of or in connection with this Contract.”*

Arbitration still exists as an option for parties to disputes under Article 8, but in order for the arbitration rules to apply, an express entry must be made in the Contractual Particulars. This is in contrast to the 1998 JCT standard contract, where arbitration was the default dispute resolution option. Under the 2005 version, the default is litigation.

This provision may find favour with parties in the current recession. The prevailing view now seems to be that domestic arbitrations are increasingly costly, while litigation in the TCC is quicker and more cost effective. It remains to be seen, however, how many parties do make the express choice of arbitration to resolve their disputes.

The Framework Agreement and Partnering

JCT 2005 version also contains a new “Framework Agreement” which has Latham-esque undertones of partnering, collaboration and dispute-avoidance.

- The Framework Agreement is intended for use on large projects involving a number of co-operating parties.
- The intention is to build up a good working relationship long-term. Its advantages (and therefore probably the prospect of compliance) are unlikely to be felt in a one-off situation.
- The Framework Agreement requires a separate contract known as the “Underlying Contract” to exist between the parties – *i.e.* it is not a free standing agreement and does not regulate all the rights and obligations of the parties. It is intended as supplementary framework of “best practice” provisions.
- The Agreement is published in “Non-Binding” and “Binding” forms. Paragraph 19 the Guide makes clear that it is not intended that the Agreement will in any way affect the legal obligations of the Underlying

Contract. This gives rise to an obvious tension: the essentially adversarial nature of the parties' rights and responsibilities under the standard forms do not sit easily with the partnering style objectives of the Agreement.

- Clause 3.3 of both versions of the Agreement makes clear that in the case of dispute the Underlying Contract will prevail.
- Clause 6 (which deals with the legal status of the Agreement) provides that the Framework Agreement (even when Binding) is to have no "bearing" on the Underlying Contract in respect of its "formation, interpretation, application, administration, performance or enforceability." Clause 6.2 states that no tribunal including an adjudicator is to be influenced "in any way" by the Agreement.

These provisions are similar in ethos to the NEC3 contract, which is also aimed at facilitating a collaborative approach to construction projects.

However, when construction firms or employers are faced with financial difficulties, and are therefore determined to pay as little as possible for works or defects, it is doubted whether high-minded ideals such as collaboration will be upheld. This is because:

- (i) parties are likely to aggressively pursue disputes involving cash, given the scarcity of this resource; and
- (ii) the recession, and the resultant risk of insolvency, undermines the long-term, collaborative, goals of the partnering provisions. There is little incentive to collaborate with a view to promoting a prolonged mutually beneficial relationship if one side is facing imminent insolvency.

As such, it appears likely that the principles in the Framework Agreement, and indeed the NEC3 contract, could find less and less favour in the course of the recession. Instead, parties may welcome having recourse to a courtroom battle in order to obtain the damages or payment they believe to be due.

G. Conclusions

- Seems clear that the economic cold climate will last until well into next year at least.
- This creates significant risks for parties to construction contracts, with the vulnerability of contractors and employers to cash-flow difficulties and insolvency.
- These risks increase the importance of the provisions of the contract between the parties, especially in the four areas outlined above. Parties to construction projects should consider the following issues:
 - In relation to determination: What are the circumstances in which I can determine the contract? Is the process for doing so burdensome or overly time-consuming? What are the consequences of determining the contract in terms of costs? What is the risk of wrongly determining the contract?
 - In relation to insolvency: How am I protected against another party's insolvency? When am I considered to be 'insolvent'? Can the administrator continue the works? What happens to the site, to the payments, and to the works?
 - In relation to advance payments and payment for materials: Can I the contractor afford the sums required to get the work started or do I need an advance payment or to provide in the contract for the Employer to pay for the materials up-front?
 - In relation to dispute resolution: Is it better to opt for arbitration or litigation? Is there a prospect of a long-term relationship which might benefit from use of the Framework Agreement?