



Technical Event Jointly Hosted by AACEI and Construction Management Guide



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PITFALLS & TIPS OF DEALING WITH SUBCONTRACT NOMINATION UNDER FIDIC & UAE CIVIL LAW

Speaker: Samer H. Skaik

BEng, MSc (W/D), PMP, MIEAust, ACI Arb

Email: samer@cmguide.org

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AGENDA



The use of provisional sums for nomination

Why to nominate?

Nomination Risks

Contractual & legal frameworks

Necessary amendments in main & subcontract conditions.

Procedures of subcontract nomination

Rights & Obligation of NSCs.

Objection to nomination by main contractor

Dealing with the Default of Nominated Subcontractors

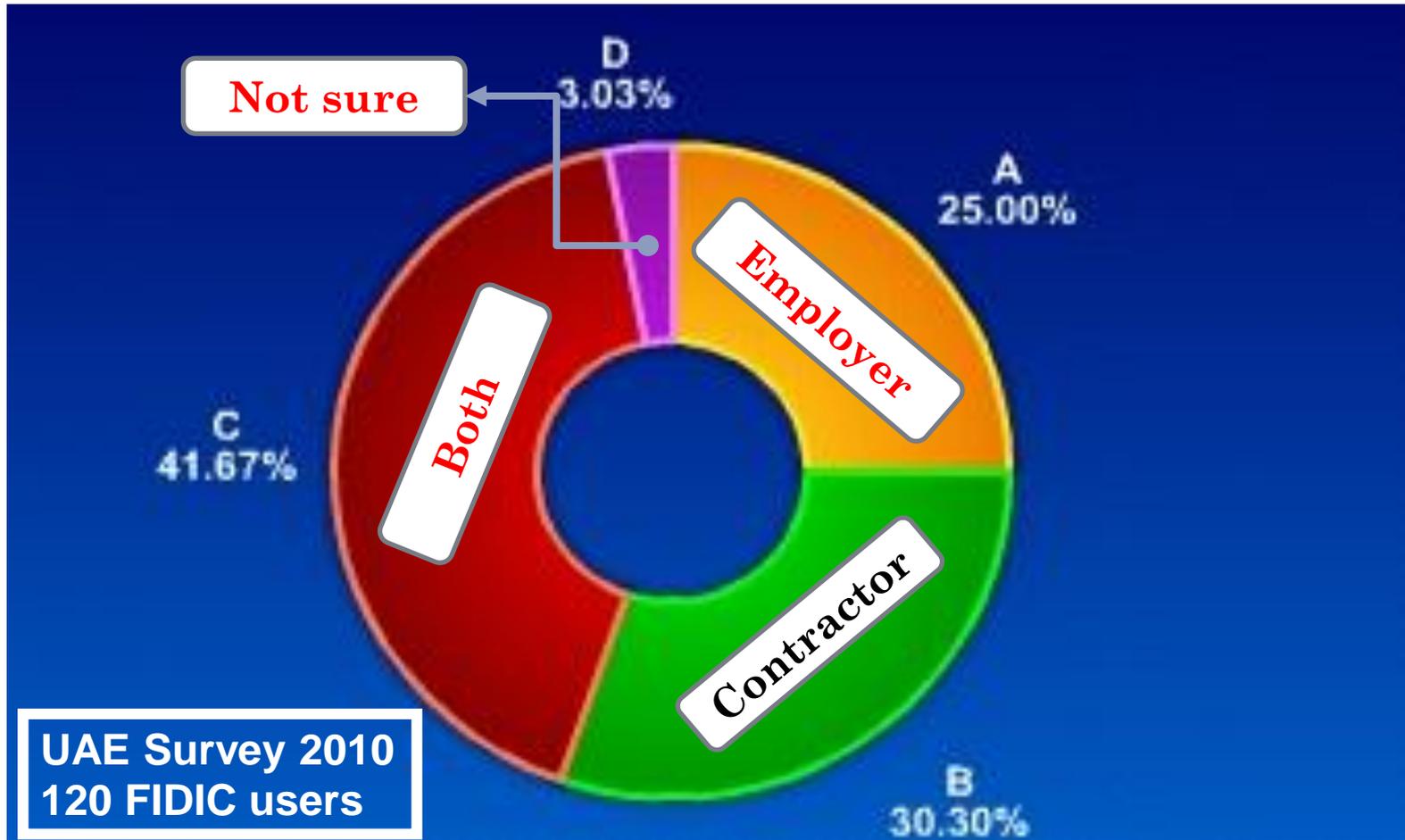
Termination and Re-nomination of NSCs.

Case studies of repetitive nomination problems in the UAE

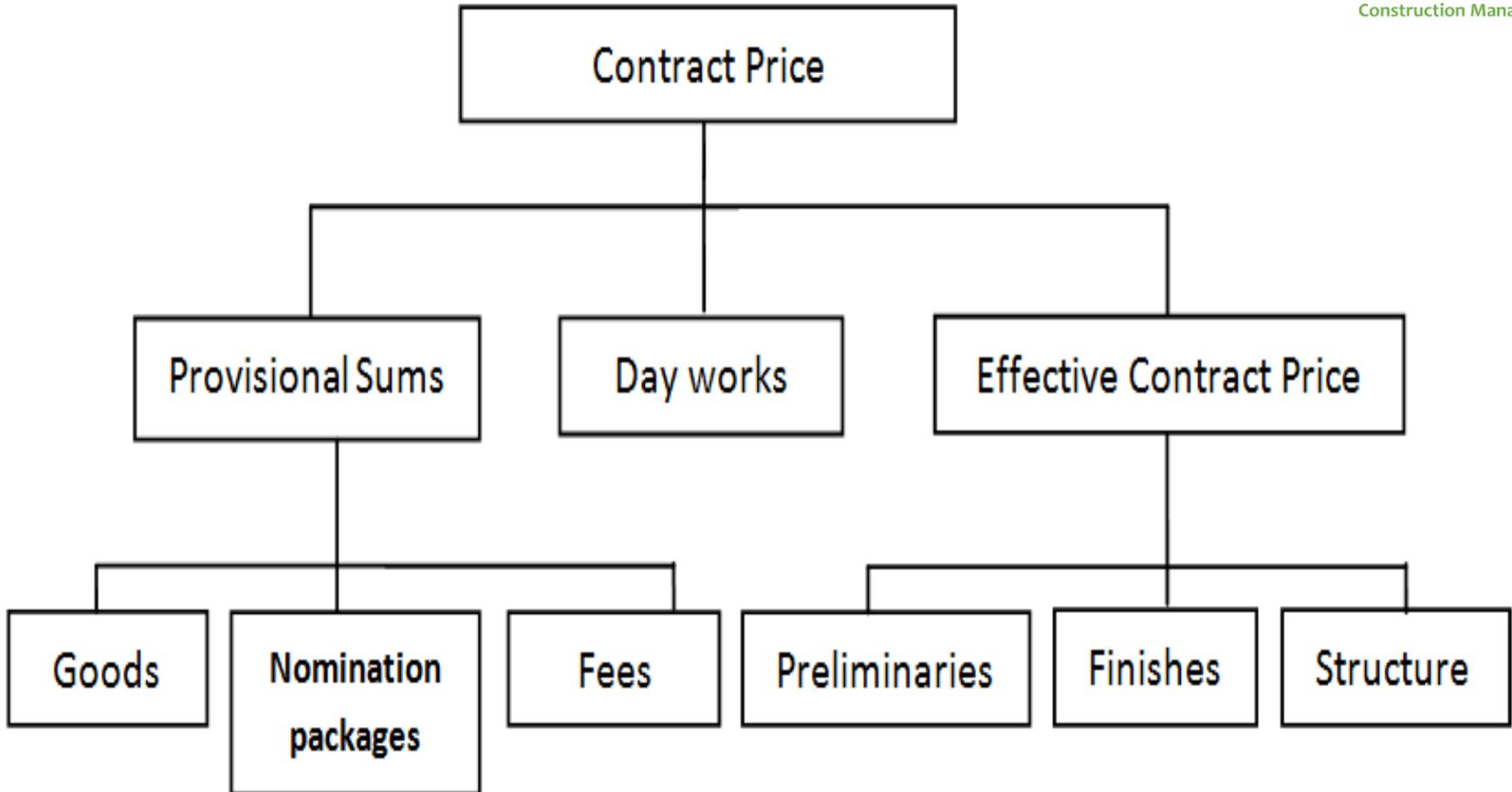
How to Improve Nomination Practice



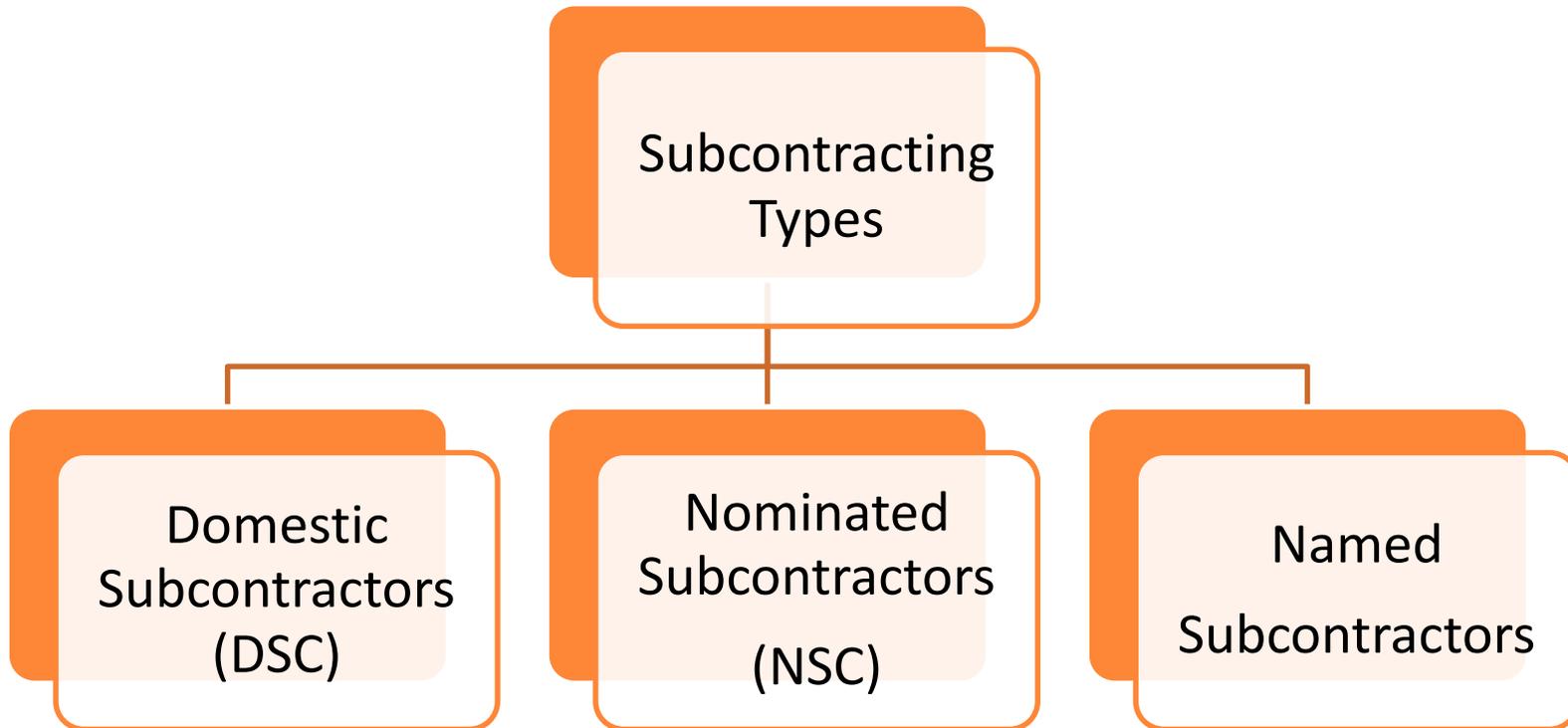
WHO IS LIABLE FOR NSC DEFAULT?



THE USE OF PROVISIONAL SUMS



TYPES OF SUBCONTRACTORS



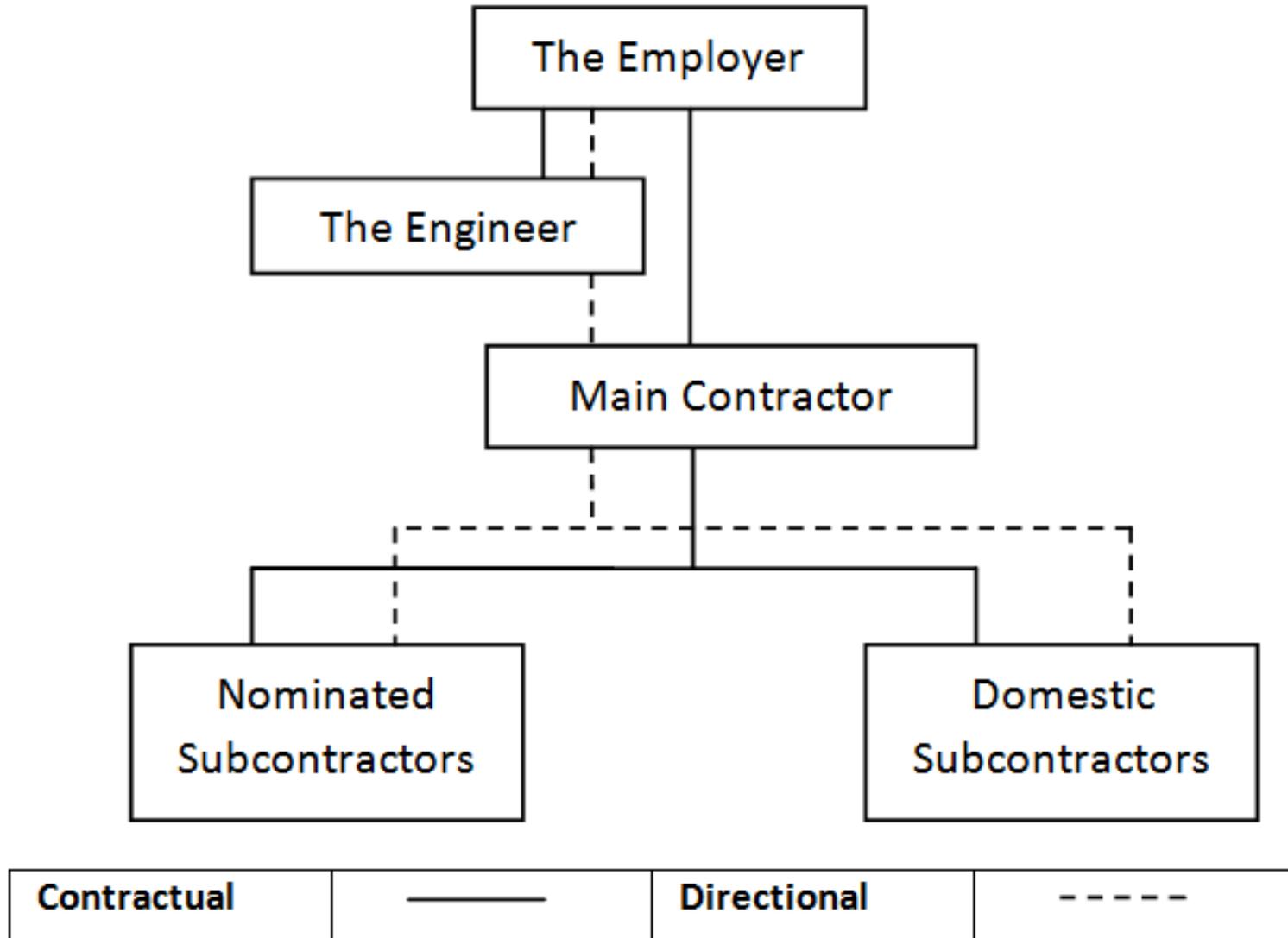
DEFINITION OF NOMINATED SUBCONTRACTORS



All specialists, merchants, tradesmen and others executing any work or supplying any goods, materials, Plant or services for which Provisional Sums are included in the Contract, who may have been or be nominated or selected or approved by the Employer or the Engineer, and all persons to whom by virtue of the provisions of the Contract the Contractor is required to subcontract shall, in the execution of such work or the supply of such goods, materials, Plant or services, be deemed to be subcontractors to the Contractor and are referred to in this Contract as "nominated Subcontractors".

Clause 59.1 – FIDIC 1987

Arrangement of subcontractors in the project organization



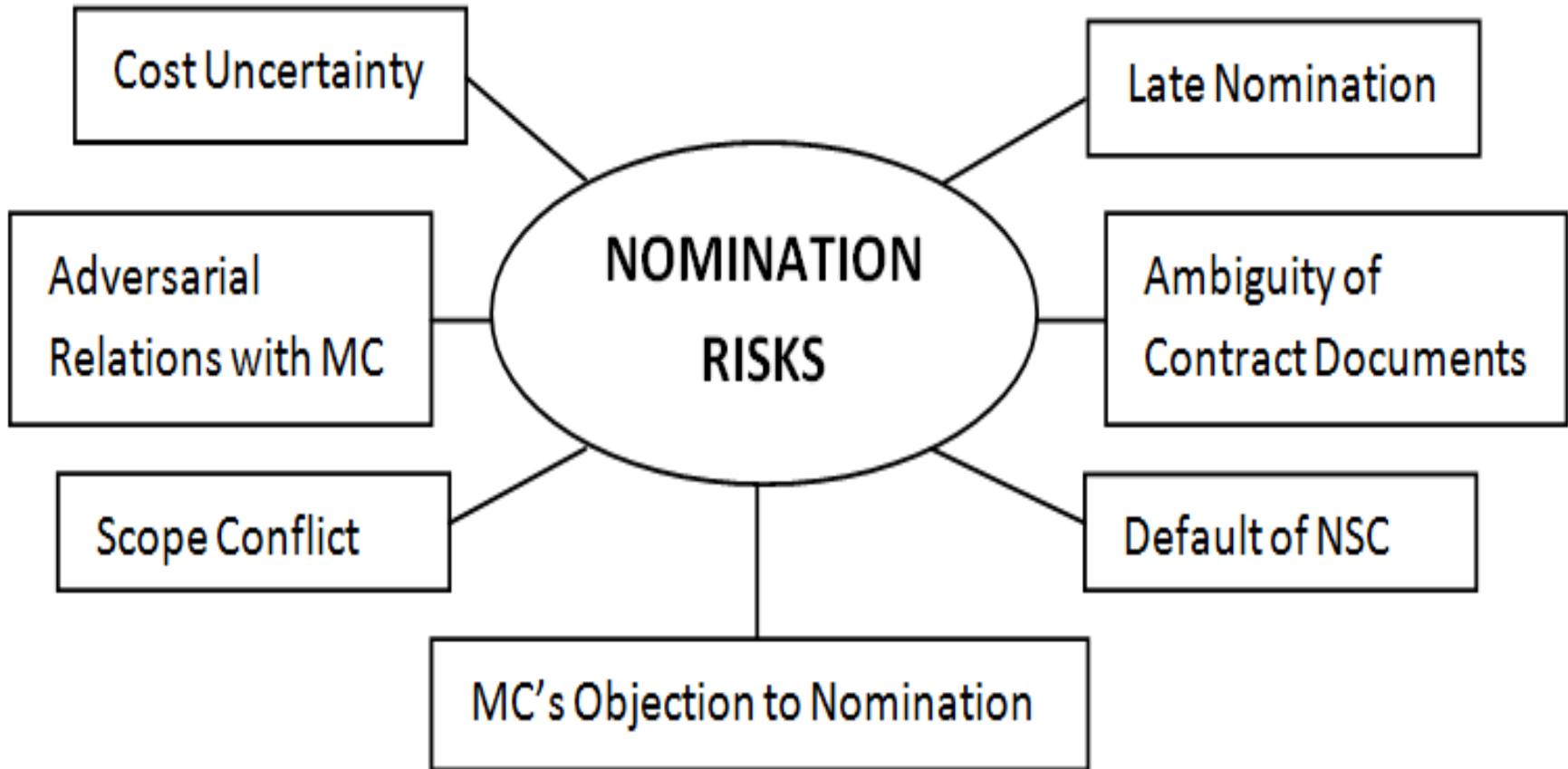
REASONS AND BENEFITS OF SUBCONTRACT NOMINATION



1. Starting construction with incomplete design
2. Better control over the project budget
3. The use of Employer's sister/preferred companies
4. Quality requirements
5. Design constraints.
6. Shortening the Main Contract tendering submission
7. Reducing estimation risks of the main contractor.
8. NSC enjoys the advantages of direct payment and less impact of fluctuations of prices.



NOMINATION RISKS



NOMINATION UNDER STANDARD FORMS OF CONTRACT



- **FIDIC 4th edition 1987** includes nomination provision (clause 59)
- **FIDIC Red Book 1999** retained nomination provision (clause 5) without significant changes.
- **FIDIC Yellow Book 1999** includes nomination under clause 13 (Variations)
- **ICE 7th edition** relatively includes the best written and detailed nomination provisions.
- **JCT 2005** and **NEC forms** don't allow for nomination due to inherent risks and tendency to move to collaborative approach.

INTRODUCING NOMINATION IN BESPOKE MAIN CONTRACTS



Essential clauses are required to cover:

1. Reasonable objection to nomination
2. Reasonable proof of payments
3. Direct payment to sub-contractors
4. Detailed "Set-off" rules
5. Design liability
6. The main contract and subcontract conditions **must** be compatible.

CONTRACTUAL FRAMEWORK OF NOMINATION UNDER FIDIC



- The only contractual relationship arrangement in nomination is between the MC and the NSC.
- There is no privity of contract between a client and a NSC.
- Once the MC & NSC sign the subcontract agreement, the MC shall be liable towards the default of NSCs and NSC will be treated as a DSC.

CONTRACTUAL FRAMEWORK OF NOMINATION UNDER FIDIC



- The NSC shall stop all types of communication with the Employer once appointed by MC.
- The only advantage for NSC is the protection that the Employer **shall** (1987)/**may** (1999) give for **direct payment** if the Contractor fails to pay the due amount to NSC.
Criticism: *In case of the MC's insolvency, the NSC will get unfair preference over creditors where his due amount will be put aside by the trustee or liquidator to comply with the direct payment provision.*

LEGAL FRAMEWORK OF NOMINATION UNDER UAE CIVIL LAW



- There is a common misconception that MCs do not share the same legal relationship with the NSCs as they would with their own selected subcontractors.

Article 890 of the UAE civil law states that: “1) A contractor may entrust the performance of the whole or part of the work to another contractor unless he is prevented from so doing by a condition of the contract, or unless the nature of the work requires that he do it in person 2) The first contractor shall remain liable as towards the employer”.

- This article is deemed to include NSCs as affirmed by previous Supreme Court judgments in the UAE.

LEGAL FRAMEWORK OF NOMINATION UNDER UAE CIVIL LAW



Article 891 states that: *“A subcontractor shall have no claims against the employer for anything one to him from the main contractor unless if assigned to the employer”*.

- NSCs can't claim due payments directly from the Employer unless there is a proper assignment of right by the MC with the Employer.
- a subcontractor has no right against an employer and all rights and liabilities in relation to the subcontract works will be a matter between the contractor and his subcontractor.
- An employer may request NSCs to provide a direct warranty to the employer

NOMINATION UNDER COMMON LAW



- The common law rule of privity of contract prevents a third party to sue for damages on a contract in which he is not a party.
- This rule has led to the emerge of the **collateral warranty**: *“An agreement between a subcontractor and the client in which the subcontractor undertakes to the client that he will perform all his obligations contained in his subcontract with the main contractor”*.
- With collateral warranty, the client creates a direct contract with the NSC who is acting as a third party to the main contract.
- Such warranty usually states a nominal amount of money that will be due to the client in case of the default of the NSC.

FIDIC STANDARD FORMS OF SUBCONTRACT



- FIDIC Conditions of Subcontract 1994 (compatible with FIDIC, 4th edition, 1987)
- FIDIC Conditions of Subcontract New Edition 2011 (compatible with FIDIC Red Book 1999)
- **Mandatory Amendments** in Subcontract particular conditions to be used for NSCs

“Where the type, circumstances, or locality of the subcontract works necessitate additional clauses or sub-clause (for example, when the subcontractor has been nominated by the Employer). Forward, FIDIC 2011

1. Indemnities to MC
2. Design Liability
3. Direct Payment By Employer.

NECESSARY AMENDMENTS TO FIDIC STANDARD SUBCONTRACT



➤ Indemnity to MC

Nominated Subcontractors; Objection to Nomination

59.2 The Contractor shall not be required by the Employer or the Engineer, or be deemed to be under any obligation, to employ any nominated Subcontractors against whom the Contractor may raise reasonable objection, or who declines to enter into a subcontract with the Contractor containing provisions:

(a) that in respect of the work, goods, materials, Plant or services the subject of the subcontract, the nominated Subcontractor will undertake towards the Contractor such obligations and liabilities as will enable the Contractor to discharge his own obligations and liabilities towards the Employer under the terms of the Contract and will save harmless and indemnify the Contractor from and against the same and from all claims, proceeding, damages, costs, charges and expenses whatsoever arising out of or in connection therewith, or arising out of or in connection with any failure to perform such obligations or to fulfil such liabilities, and

Necessary amendments to FIDIC standard subcontract



➤ Design Liability

Design Requirements to be Expressly Stated

59.3 If in connection with any Provisional Sum the services to be provided included any matter of design or specification of any part of the Permanent Works or of any Plant to be incorporated therein, such requirement shall be expressly stated in the Contract and shall be included in any nominated Subcontract. The nominated Subcontract shall specify that the nominated Subcontractor providing such services will save harmless and indemnify the Contractor from and against the same and from all claims, proceedings, damages, costs, charges and expenses whatsoever arising out of or in connection with any failure to perform such obligations or to fulfil such liabilities.

NECESSARY AMENDMENTS TO FIDIC STANDARD SUBCONTRACT



➤ Direct Payment By Employer

Certification of Payments to Nominated Subcontractors

59.5 Before issuing, under Clause 60, any certificate, which includes any payment in respect of work done or goods, materials, Plant or services supplied by any nominated Subcontractor, the Engineer shall be entitled to demand from the Contractor reasonable proof that all payments, less retentions, included in previous certificates in respect of the work or goods, materials, Plant or services of such nominated Subcontractor have been paid or discharged by the Contractor. If the Contractor fails to supply such proof then, unless the Contractor:

(a) satisfies the Engineer in writing that he has reasonable cause for withholding or refusing to make such payments, and

(b) produces to the Engineer reasonable proof that he has so informed such nominated Subcontractor in writing, the Employer shall be entitled to pay to such nominated Subcontractor direct, upon the certificate of the Engineer, all payments, less retentions, provided for in the nominated Subcontract, which the Contractor has failed to make to such nominated Subcontractor and to deduct by way of set-off the amount so paid by the Employer from any sums due or to become due from the Employer to the Contractor.

NECESSARY AMENDMENTS TO FIDIC STANDARD SUBCONTRACT



➤ Direct Payment By Employer

Example of proposed amendment by FIDIC

CLAUSE 16

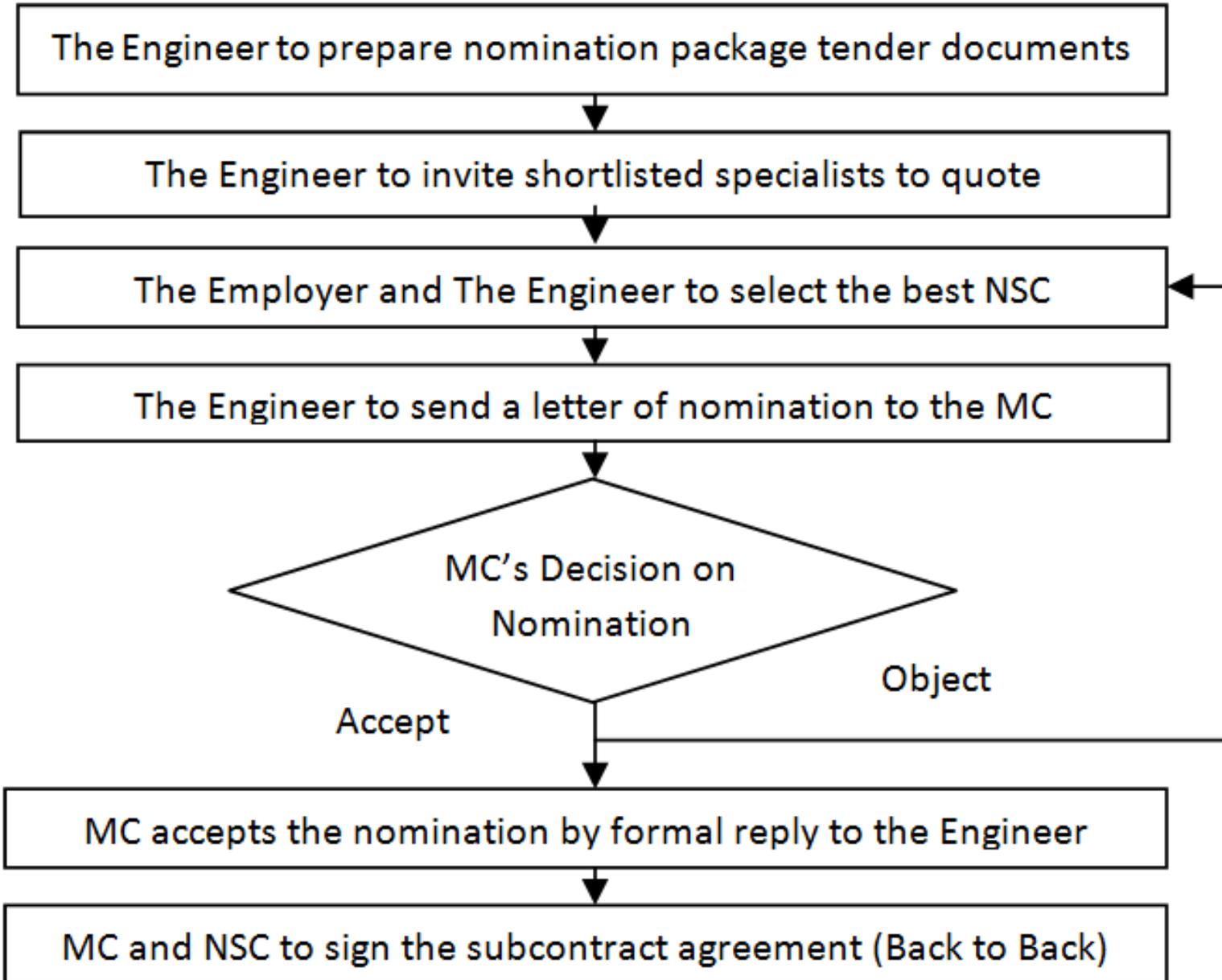
If payments have to be made to a nominated Subcontractor, an additional Sub-Clause should be added.

EXAMPLE SUB-CLAUSE

**Direct Payment
to Nominated
Subcontractor** **16.7**

Subject to the terms of Sub-Clause 59.5 of the Conditions of Main Contract, the Subcontractor shall be entitled to be paid by the Employer direct, upon certificate of the Engineer, all payments, less retentions, provided for in the Subcontract, which the Contractor has failed to make to the Subcontractor.

FIDIC NOMINATION PROCEDURES



CONTRACTOR'S OBJECTION OF NOMINATION UNDER FIDIC



- MC can refuse the nomination if he has reasonable grounds.

- Main Contractor may not employ a NSC:
 - against whom he has reasonable objection; or
 - who refuses to enter into a subcontract which:
 - a) is back-to-back with the main contract; and
 - b) indemnifies MC in respect of NSC's breaches.

- These rights of veto are crucial for MC to use.

POSSIBLE SCENARIOS AFTER MC OBJECTION



The Engineer/Employer can:

1. Seek to negotiate more favorable subcontract terms with the NSC.
2. Appoint the NSC and indemnify the contractor for any default
3. Nominate alternative subcontractor
4. Vary the work
5. Omit nominated subcontract works
6. Instruct the contractor to secure subcontractor from his choice
7. Invite the contractor to carry out the work himself

AMBIGUITIES IN FIDIC NOMINATION PROVISIONS



1. FIDIC does not have well detailed provisions for subcontract nomination in terms of procedures.
2. liabilities of parties and allocation of risks associated with nomination is not well addressed.
3. The liability for the delay or failure of entering into subcontract agreement after the issuance of nomination letter is not determined, hence debatable.
4. The consideration of incurred delays in the project prior to nomination is challenging.

AMBIGUITIES IN FIDIC NOMINATION PROVISIONS



5. FIDIC Red Book states that NSC should save the MC harmless from any damages or losses resulting from NSC failure, however it doesn't define a limit of such compensation.
6. The extent of liquidated damages in case of the sole responsibility of the NSC about delays is undefined.
7. The termination and re-nomination procedures and liabilities against the defaulted NSC are not clear.

DEFAULT OF NOMINATED SUBCONTRACTORS



- Dealing with the default of the NSC is quite different and complicated due to the involvement of the Employer in any corrective action.
- NSC defaults include delays, poor performance, repudiation and bankruptcy.
- Defective works of the NSC may cause claims by another subcontractor against the MC. In such case, the MC can pass the liability of the claim on the NSC.
- The performance security and the retention amount are two winning cards in the custody of the MC.

CRITICAL RAISED QUESTIONS ONCE NSC DEFAULT OCCURS:



- Who shall compensate Contractor/Employer for losses?
- How shall MC proceed with NSC termination?
- Who is liable for re-nomination?
- Who is liable for the delay period of re-nomination?
- Who is liable for the difference in subcontract cost?

PITFALLS OF SUBCONTRACT NOMINATION UNDER FIDIC



- Wrongful nomination tendering process.
- Late nomination and Default of NSCs.
- MC's Objection of nomination.
- Lack of procedures and ambiguity of nomination provisions.
- Lack of Procedures of Termination and re-nomination of NSC.
- Undefined scope of NSCs in the main contract.
- No limitation of delay damages liability in NSC contract.
- Lack of consideration of incurred delays prior to nomination.
- In case of MC insolvency, NSCs get unfair preference over creditors due to the direct payment provision.

CASE STUDIES: PROJECT A: DEFAULT OF NSCs



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- Twin towers in Jebel Ali, FIDIC 1987, AED 150 M
- Pool subcontractor was nominated and accepted by the MC.
- Pool NSCs got bankrupt while critical pool works was ongoing.
- MC served a notice to Engineer cc Employer about the NSC default requesting re-nomination.
- Employer refused to re-nominate stating this is a contractor's risk and it is the Contractor's sole responsibility to complete the works by him or other DSCs.
- MC position: No express provision under FIDIC addressing this risk.
- Debating and disputing the issue for 2 months, project got delayed and the contractor was held liable.

CASE STUDIES: PROJECT B: LIMITATION OF DELAY DAMAGES



- Mixed use development, Almamzar, Dubai, FIDIC 1987, AED 180 M
- The First lift subcontractor was nominated by the Employer.
- Nomination documents limit the LDs to 10% of the subcontract
- MC objects the nomination of NSCs referring to clause 59.2 (a) which does not limit the liability of NSCs.
- Employer's position: Any NSC can't accept such illogical condition.
- Disputing the issue for a month, the Employer finally agreed with the MC to accept the nomination with a waiver from Employer re imposing LDs more than those accepted by NSCs.

CASE STUDIES: PROJECT C: DESIGN BY NSCs



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- Super tall building, Dubai Marina, FIDIC 1987, AED 500 M
- The BOQ includes a PS for supply & installation of Façade system.
- Façade subcontractor was nominated by the Employer where the scope includes Façade design.
- MC objects nomination as his scope doesn't include design.
- Employer's position: it is common practice to get Façade designed by a specialist.
- Disputing the issue for 3 months, the Employer finally appointed NSC directly for design scope, and amended nomination documents to waive the contractor from any design scope and design liability.

TIPS OF IMPROVING SUBCONTRACT NOMINATION.



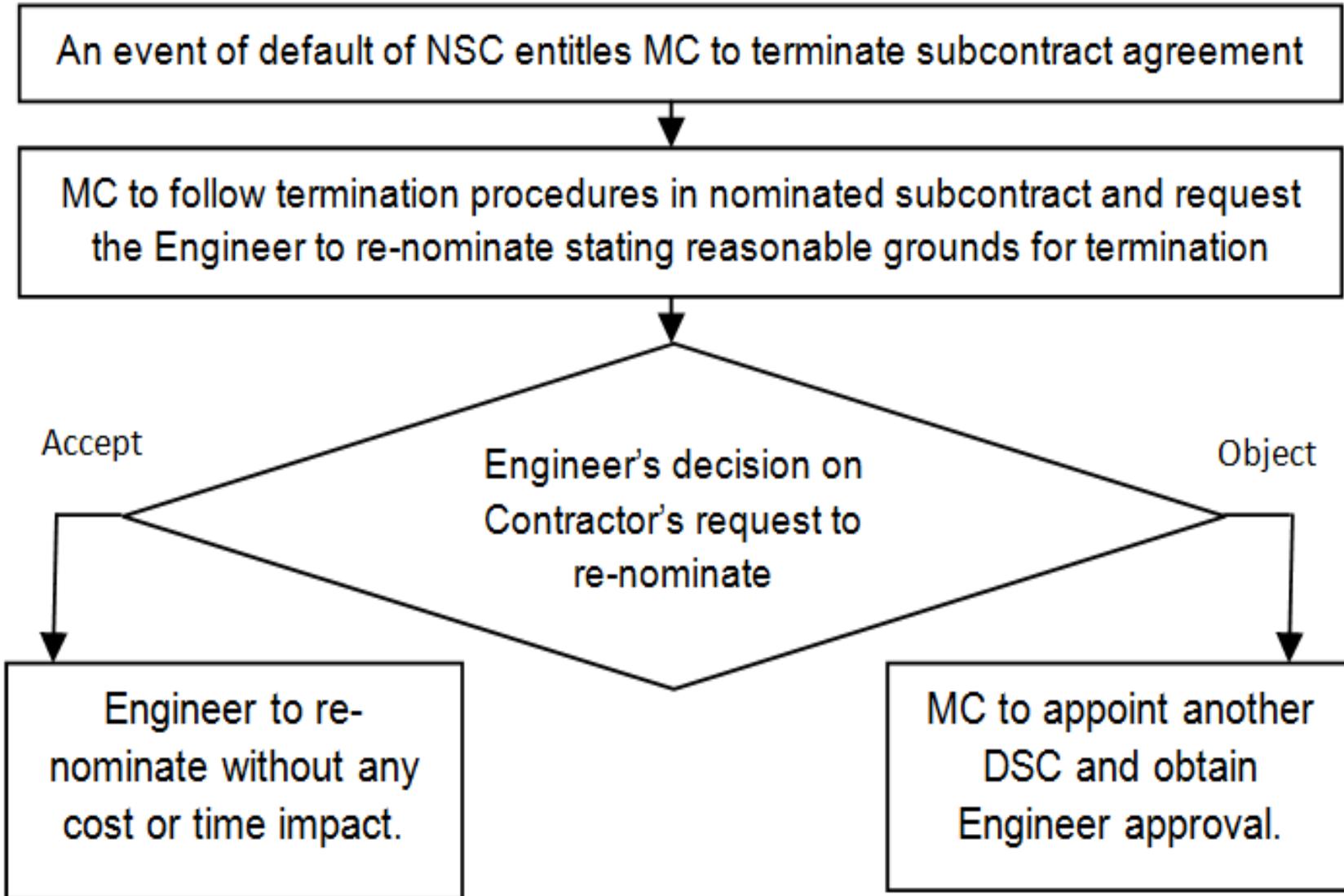
- Amendment in main contract PII to cover (proportional delay damages, default of NSCs & consequences, etc..)
- Define all provisional sums allocated for nomination.
- Define NSC design requirements in the Main contract.
- Use compatible and well drafted main contract and subcontract conditions
- Employers to get collateral warranties from questionable NSCs
- Prepare well coordinated nomination packages.
- Involve main contractors early in nomination process.
- Educate and train construction professionals

TIPS OF IMPROVING SUBCONTRACT NOMINATION.



- Nominate the best subcontractors only
- Maximize the use of named subcontractors.
- Minimize nomination packages for easy control
- Use the Assignment of Rights if applicable
- Use Novation as an alternative to nomination

PROPOSED TERMINATION PROCEDURES OF NSC





Questions & Answers

