

Nominated and domestic subcontractor construction essay



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Chapter 2

Introduction

According to C. Gray and R. Flanagan 1989 over ninety percent of construction activities are now subcontracted on the majority of contracts, which leaves the main contractor with a mere ten percent of the project to physically construct. These figures suggest that the success of a project largely depends on the performance of its subcontractors.

Although the main contractor has only ten percent of the project to construct he is responsible for the full one hundred percent of the completed works. It is then logical for a main contractor to concentrate the majority of their efforts on the greater percentage of the project i. e. the subcontracting packages.

It is fair to assume that both main contractor and subcontractor share the same aims on a project, which are to:

Complete their work to a high quality

Complete their work on time

Make a profit on their work

Like all companies in business, the highest placed aim of the above three for both a subcontractor and main contractor is to make a profit.

As main contractors have realised that the greatest potential for cost saving lies with subcontractors, the prevalence of unfair contract conditions, dutch

auctioning and other onerous practices has increased. (J. Matthews, A. Tyler, A. Thorpe 1996). In fact, many main contractors exploit subcontractors mainly to shift liability risks, resulting in a reliance on complete contracts rather than cooperative relationships. (Per Erik Eriksson, 2007)

This can place a huge strain on the subcontractor/main contractor relationship which means subcontractors find themselves relying on the integrity of main contractors and client professional advisors to ensure fair play. (B. Power, Subcontractors Woes)

In this chapter the author will look at the two different types of subcontractors operating in the Irish construction industry, why the industry subcontracts and the common abuse situations that subcontracting firms in Ireland experience.

What is a Subcontractor?

A subcontractor is a person or a company hired by a general contractor to perform part of the work of a construction job. Generally the subcontractor will either relieve the main contractor of part of the building work, or will be able to perform work at lower expense or at a greater skill level than the general contractor could.

(www.wisegeek.com)

Most of the packages on a project assigned to a subcontractor are that which require a person of specialised training to complete to an acceptable level, such as plumber, electrician or carpenter.

Some of the products and materials being used in today's construction projects come with a clause, stating that the product must be installed and signed off by a qualified individual before use and/or for the supplier to stand by their guarantee on the product.

In most cases subcontractors attempt to form a good working relationship with several main contractors; this increases their chances of winning subcontract packages and decreases the likelihood of contractual disputes, but the main contractor would not employ the subcontractor as a regular employee in most cases.

The Difference between a Nominated and Domestic Subcontractor

There are two types of subcontractor that operate in the Irish construction industry, which as follows:

Domestic Subcontractor

Nominated Subcontractor

The domestic subcontractor is chosen by the main contractor to carry out a package of the site works (e. g. mechanical & electrical installation). They then enter into a contract only between themselves and the main contractor. Neither the client's consultants (e. g. Architect & Quantity Surveyor) nor the client themselves can influence the appointment or the conditions, although most main contracts carry a provision for the approval of a domestic subcontractor by the client.

Nomination is the process by which the employer (client) nominates, selects or approves who will perform a subcontract or specialist trade role (nominated subcontractor). The nominated subcontractor then enters into a subcontract with the main contractor. It is a means for the employer to retain some control over the selection of specialist contractor or supplier without necessarily becoming directly involved in detailed contractual arrangements with the specialist.

Nomination is used because there are benefits for the employer in using the system. The key benefit for the employer is control over the choice of, and performance required from the nominated subcontractor. Above all, the employer reserves to itself the choice of subcontractor.

Another benefit is the potential for reduced procurement times. Some specialist subcontract work requires a longer lead time than the construction programme would allow - such work must be started before main contractor has been chosen. Nomination allows for continuity when a specialist subcontractor has been selected before the main contractor is in place.

(www1.fidic.org)

The greatest difference between these two types of subcontractor is the manner in which they are selected to do a job and the terms and conditions of employment they work under.

As it is generally accepted that the subcontractor is bottom of the food chain in the construction sector, i. e. the client pays the main contractor first, who then pays the subcontractor. The best way for a sub-contractor to move

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themselves up the food chain is to have themselves appointed as a nominated subcontractor. As a nominated subcontractor, they are entitled to demand payment from the employer (client) if the main contractor does not pay them.

(www.liquidation.ie)

2. 3 Why does the Irish Construction Industry Subcontract?

Outsourcing (subcontracting) originally started thousands of years ago.

When societies began to form, individuals began to develop specialized skills. Certain tasks were given to these individuals, and thus outsourcing was born. Although outsourcing began thousands of years ago, it rose in popularity during the Industrial Revolution of the 18th and 19th centuries.

During this time, business owners began realizing the power of doing more in the time that they have. They tried to outsource certain parts of their production to other outside firms. (www.life123.com)

The three main reasons for the use of subcontractors in today's industry are as follows:

Numerical flexibility of the workforce

Risk and liability transfer

Greater degree of specialisation

2. 3. 1 Numerical Flexibility of the Workforce

The Irish construction industry is considered a small industry on the world stage with an estimated 130, 000 people directly employed in March of 2010

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compared to that of leading construction industries such as the United States, China and the United Arab Emirates whose construction industries directly employ millions. It is therefore illogical for construction companies within Ireland to supply all the material and directly employ specialised staff to construct the varying and challenging designs of today's projects.

R. Morton 2002 believes subcontractors are hired for the following reason:

In an industry where work was so uncertain and when obtained, so varied, it was difficult for any contractor to guarantee permanent employment for large groups of tradesmen; they could and did take on and lay off workers, as they were required. But the tradesmen themselves were more likely to find constant work by subcontracting work from several different main contractors; and they could also continue to do smaller jobs themselves independently.

2. 3. 2 Risk and Liability Transfer

Sir Michael Latham considered that “ no construction project is risk free”.

Risk can be managed, minimised, shared, transferred or accepted. It cannot be ignored. (Construction the Team, 1994)

Subcontracts can be seen to offer a main contractor a method of risk transfer and minimisation for both the financial risk and production risk of a project package.

F. Giordano and R. Pawlowski state that most construction agreements contain provisions allocating the risk for claims arising from the contracted work. Owners, general contractors and developers (“ Contractors”) typically

require their subcontractors both to indemnify the contractors for claims arising from the work and to provide the contractors with insurance coverage for related liabilities.

2. 3. 3 Greater Degree of Specialisation

In today's construction market quality now stands alongside price as the major factors in a client awarded a contract to a main contractor. Unless a construction company can guarantee its clients a quality product, it can now no longer compete effectively in the modern construction market. Crucial to the delivery of such quality products is the quality of processes that produce the product. (F. Harris & R. McCaffer 2006)

As I was mentioned in section 2. 2 (What is a Subcontractor), a subcontractor can generally perform part of the building work at a greater skill level than the main contractor could. This is due to the subcontractor's familiarity to the job, materials and working conditions they operate with on a week in week out basis.

In an article by Adnan Enshassi 2008, he believes the large involvement of subcontractors in the construction industry can be attributed to the shift from traditional craft base, to a greater reliance on increasingly sophisticated technology based products. This results in the main contractor concentrating their management rather than employing direct labour to undertake the work.

Forms of Subcontract

The success of a project can depend to a great extent on the levels of communication and cooperation between the parties involved in the project. The building contract acts a framework, outlining relationships between the parties and their duties towards each other.

According to John Adriaanse (2007) a variety of factors make a building contract different from most other types of contract. These include the length of the project, its complexity, its size and fact that the price agreed and the amount of work done may change as it proceeds.

It is these variances in a contract that generally lead to conflict between a main contractor and subcontractor in the Irish construction industry.

J. Alfs (April 1st 2004) believes the key to a good relationship between the general contractor and its subcontractors lies in the steps taken before the project starts. The most important step in the preparation process is having a well written, comprehensive subcontractor agreement. The subcontract should be specific enough that it serves as the final word on potential areas of dispute.

Although the aim of the subcontract is to prevent potential disputes and ensure fair working circumstances for both main contractor and subcontractor, it is often felt that some subcontracts fails to do this as they are open to manipulation by the main contractor.

In a later article Alfs goes on to comment “ Unfortunately, as a subcontractor, you not always have the ability to have much say in the form

of subcontract agreement adopted by the general contractor. Depending on economic and market conditions, general contractors may have the ability to tell subcontractors who want to renegotiate agreement terms to “ take it or leave it”. This is the reality of the market place.” (J. Alfs, June 1st 2004)

In the Irish construction industry there are three main types of subcontract that are commonly used:

Standard Form of Subcontract

Non-Standard or Amended Form of Subcontract

Oral Subcontract

2. 4. 1 Standard Form of Subcontract

Standard form contracts are pre-prepared contracts where all the terms have already been set. The contracts are normally printed so that there are only a few blank spaces left to fill in, such as names and signatures.

Standard contracts may contain a multitude of terms and can be pages long, or can be straightforward documents which are simply designed to name the parties to an agreement along with dates, subject matter and any special requirements. (www. innovation. gov. au)

The standard forms of subcontract that exist within the Irish construction are generally well understood within the industry, and case law has developed to interpret many of the clauses. It is common that once a contract has commenced that an employer or main contractor decides to vary the plans.

The standard form of contract provide for procedures on how such “Variations” should be valued.

The most common standard form of subcontract use in Ireland is the RIAI (Royal Institute of Architects of Ireland) standard form subcontract, which is used in conjunction with the RIAI form of main contract.

The use of standard form construction contracts has a number of advantages for the various parties that participate in the construction process, including the speed at which tender documents can be produced. (www. mcmullan.net)

R. Thomas (1993) gives three reasons as to why standard forms of contract should be used in construction contracts. Firstly, it will have been prepared having regard to the nature of the work to be undertaken. Secondly, practitioners in the industry are more comfortable using standard form of contract with which they are familiar and which is usually capable of interpretation by reference to readily available text books and case law. Thirdly, they are often drafted and agreed by recognised bodies representing all sides of the industry which will be affected by them.

Although these are considered the fairest of the subcontracts in the industry there is still a feeling among subcontractors that they don't go far enough to protect them from contractual bullying.

The standard agreements for subcontracts are often poorly drafted and weighted heavily in favour of the main contractor. (B. Power, Subcontractors Woes). It is felt that they can be often used as an attempt to limit liability for

damages, losses or delays by the party presenting the standard form agreement, who is usually the bigger and stronger party in the contract.

(www.innovation.gov.au)

2. 4. 2 Non-Standard or Amended Form of Subcontract

Standard forms of subcontract are often further amended heavily in favour of the main contractor or worse still, the main contractor will insist on using his own form of subcontract. (B. Power, Subcontractors Woes) Such amendments are usually introduced either by means of Special Conditions of Contract (often contained in the Preliminaries section of the Bills of Quantities) or by correspondence exchanged between the parties at the time of tender or negotiation of the contract.(www.mcmullan.net)

These difficulties are highlighted when the economic climate turns cold and life within the industry gets harder. Subcontractors often find they do not have proper legal protection against sharp practice to deal with these difficulties. (B. Power, Subcontractors Woes)

Uncertainty as to the meanings of contract terms reduces the effectiveness of project management as resources need to be channelled into discussions about the division of responsibility within the project. Ultimately, uncertainty may lead to conflict. Conflict leads to expenditure on legal services.

Imprecise contract provisions produce a risk that third parties (lawyers, expert witnesses, arbitrators) will become entitled to a slice of the cake that the parties thought they were going to divide up between themselves. (John UFF & A. Martin Odams)

2. 4. 3 Oral Subcontract