

# What Do I Do When a Subcontractor Doesn't Perform?

## In a Nutshell

Builders need to manage both the “front-end” and “back-end” of works performed by subcontractors so that builders can take appropriate steps if a subcontractor performs defective work or fails to finish a job.

## Front End

1. **Ensure that written subcontracts are entered into before subcontractors commence on site** - with time sensitive jobs there can be a temptation to engage subcontractors without a written subcontract. Lack of a written subcontract can prove to be a major headache for a builder if there is a later problem with a subcontractor.
2. **Follow your purchase order procedures** – For time sensitive rectification works, site supervisors may be tempted to procure rectification works by way of an “extra over” on existing unrelated purchase orders. Costs of those works can prove to be difficult to identify at a later stage.
3. **Subcontracts** – You should consider maintaining a suite of subcontracts within your business that will allow the following issues to be addressed when a subcontractor is engaged –
  - a. The term of the subcontract, scope of works (with provision for how the scope is to be varied), program of works and the timing for significant milestones.
  - b. Warranties and indemnities that are to be provided by the subcontractor. You should ensure that any warranties and indemnities are back-to-back with the head contract where appropriate.
  - c. The statutory warranties implied by the Home Building Act 1989 are set out in the subcontract. Amendments to the Home Building Act 1989 which commenced on 1 March 2015 confirm that statutory warranties are implied into subcontracts entered into from that date, however, it is arguable that statutory warranties are also implied into subcontracts for residential building work entered into before 1 March 2015. Where subcontracts relate to residential building work in the construction of new strata buildings, 1 March 2015 amendments to the way the date of completion of residential building work is calculated in the Home Building Act 1989 operate to align the commencement of subcontractors’ warranty periods with the commencement of a head contractor’s warranty periods; namely, from the issuance of an occupation certificate.
  - d. Requiring a subcontractor have in place adequate insurances before they commence work on site.

- e. The appointment of a Subcontract Superintendent for the subcontract works.
- f. The mechanism for quality control and acceptance of the completion of subcontract works.
- g. Whether a defects liability period will apply. Any defects liability period under the head contract should be taken into account.
- h. The form of retention sums, how those retention sums are to be applied and when retention sums are to be returned.
- i. Inclusion of a mechanism allowing for the head contractor to elect whether rectification works are performed by the subcontractor, or the costs of rectification works are to be set off against amounts due to the subcontractor.
- j. How disputes are to be resolved under the subcontract. It may be helpful for disputes to be resolved by reference to an independent expert, either appointed by agreement or by an alternative dispute resolution organisation such as the Institute of Arbitrators & Mediators (“IAMA”). Consideration should be given to the dispute resolution procedure and whether the parties will agree to be bound by the decision of the independent expert.
- k. Liquidated damages as appropriate to the project should be considered especially in view of any liquidated damages that may become due under the head contract.
- l. The inclusion of a termination clause, with steps for issuing a notice of substantial breach and show cause notice and the time to respond.

**4. Back to back subcontracts** – Generally, it is important that any standard form subcontracts that are used by your business are back-to-back with head contracts, so that where possible, any risks that have been assumed by you under a head contract are passed down the line to subcontractors. While carefully drafted subcontracts may provide protection for risks assumed by a builder under the head contract, you may remain liable in negligence for a breach of any duty of care owed by you, such as a failure to supervise and so still be liable for a % of the damage caused by your subcontractors.

**5. Contracting out of the Civil Liability Act and Indemnities** – Be aware that if your Head Contract contains clauses stating that you have either contracted out of the Civil Liability Act 2002 or are contractually liable for the acts or omissions of your subcontractors then you will be liable for the acts of your subcontractors, in which case you need to –

- a. Ensure that your insurance policies cover this additional liability for your subcontractors.
- b. Maximize your ability to recover from your subcontractors any liability imposed upon you under the Head Contract by following the steps recommended above in relation to those subcontracts.
- c. Be aware that the best subcontracts in the world may not be of much assistance if your subcontractor goes broke or into liquidation, therefore the financial standing and track record of your subcontractor is also a very important consideration, as a cheap price from a fly-by-night subcontractor may cost you a lot in the end if that subcontractor is not around 6 months later when problems arise leaving you to carry the cost alone.

## Back End

1. **Collection of evidence** – There are some simple techniques that can be executed to protect your business in the event of a failure by a subcontractor to comply with the terms of their engagement, as follows:
  - a. **A picture paints a thousand words** – clear photographs of any incomplete works or defective works can be invaluable when directing a subcontractor to return to rectify defective or incomplete works or recovering costs of rectifying such works.
  - b. **Investigate and record** – Consider implementing procedures for defective or incomplete works to be investigated and recorded. Standard form report sheets which record time/date of inspection, name of staff member who has inspected and a brief description of the issue should be considered.
  
2. **Notice of breach** – Where a subcontractor has failed to complete works, seek legal advice on whether it is appropriate to issue a notice of substantial breach or show cause notice. If work remains uncompleted, you should seek advice on whether to terminate the contract and seek damages, or enforce specific performance of the contract.
  
3. **Breach of subcontractor statutory warranties** – In the case of a breach of subcontractor statutory warranties pursuant to the Home Building Act 1989 where a subcontract is entered into on and from 1 March 2015:
  - a. Reasonable efforts must be made by the builder seeking to enforce the subcontractor statutory warranties to ensure written notice is given to the responsible subcontractor within 6 months after the breach of the subcontractor’s statutory warranty becoming apparent.
  - b. A builder still in control of a building site must not unreasonably refuse the subcontractor access to the residential building work concerned as may be required to rectify the breach.

These duties do not apply where a subcontract is entered into before 1 March 2015, however, it is prudent to notify subcontractors of defective works in a timely manner and where practicable provide an opportunity to rectify defective works.
  
4. **Record all communications with subcontractors in relation to defective or unfinished work** – Keep on file all letters of demand, evidence of defective or unfinished work set to subcontractors, responses from subcontractors, and invitations to subcontractors to inspect defective or unfinished works prior to those works being rectified or completed.
  
5. **Documentation in support of backcharges** – Where unfinished works or defective works need to be completed by the head contractor and a backcharge is issued to the subcontractor pursuant to a “set-off” clause it is important to comply strictly with the terms of the subcontract relating to “set offs” and

backcharges and retain all purchase orders, contracts, tax invoices and receipts for costs related to completion of unfinished works or rectification of defective works.

6. **Consider commencing debt recovery proceedings** – A backcharge will be inappropriate if there are no amounts to set-off against the costs that you wish to recover from the subcontractor. In those circumstances you should consider seeking advice on pursuing debt recovery proceedings. Your contract administration procedures and evidence of the unfinished work/defective work will then become vital to your prospects of success in any such debt recovery proceedings.
  
7. **Final note on “corporate memory”**– Finally, like all memories a corporation’s memory is not infallible. One of the issues that companies can struggle with is where employees leave and there is no “paper trail” to allow disputes to be resolved, or even in some case for disputes to be appropriately identified. Setting up your business processes and seeking legal advice or advice from independent experts at the critical points during a dispute can help to alleviate this problem.

**Prepared by Bannermans Lawyers  
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T: (02) 9929 0226                      M: 0403 738 996                      ABN: 61 649 876 437  
E: [dbannerman@bannermans.com.au](mailto:dbannerman@bannermans.com.au)                      W: [www.bannermans.com.au](http://www.bannermans.com.au)  
P: PO Box 514                      NORTH SYDNEY NSW 2059                      AUSTRALIA