Drafting a Back-to-Back Contract: Issues and Considerations

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This article seeks to discuss the increasing scope and usage of agreements on back-to-back basis. Such agreements are majorly popular in construction industry for generally such projects require involvement of more than two parties at various levels for effective and efficient accomplishment of a particular task. While such agreements can prove to be extremely convenient, time-saving and cost-effective at one time, they can be equally problematic and create complex issues at a later stage as a result of poor drafting. The article discusses different approaches that one can adopt while drafting the like agreements. Also, the article throws light upon various clauses that might require careful consideration and appropriate phrasing before signing the agreement.

1. Concept

Contracts on back-to-back basis are increasingly becoming a common feature these days, especially in construction industry. Construction projects typically involve collaboration of three parties at different levels: employer, main-contractor and sub-contractor. The employer prefers to enter into only one contract or at least contracts with a single party which will act as the single point of responsibility regarding the project. However, in order to effectively complete the project in time the main-contractor has to enter into various sub-contracts with the sub-contractors. This is generally done by way of back-to-back agreements.

Back-to-back agreements refer to the duplication of terms and conditions in a contract at different levels of the project. It is necessary that the contractual rights and obligations at one level (initial contract between employer and the main contractor, this can be termed as ‘Level-I contract’ for avoiding ambiguities) of the project are included in agreements at lower levels also. This helps the main-contractor to pass his liabilities and obligations down the supply chain. While such clauses can prove to be extremely convenient, time-saving and cost-effective at one time, they can be equally problematic and create complex issues at a later stage as a result of poor drafting. Therefore, one needs to be extra-cautious while introducing such a clause in the tender agreements, MOUs, work orders, etc.

2. Design Draft

Drafting a scheme of Back-to-back contract is a task that requires careful consideration as to which specific terms shall be passed down the chain as a part of this arrangement. There are two methods for structuring a back-to-back contract, a ‘general obligation’ on main-contractor/ sub-contractor and a ‘specifically worded obligation’. These methods are better explained in the following paragraphs:

The back-to-back agreements can be created by:

(a) Incorporating by mentioning, all the provisions of the Level-I contract which are intended to be included, excluded or varied in lower level contract.

(b) Producing a stand-alone agreement specifically designed to accommodate provisions relating to a sub-contract.

The first method might seem very convenient to the parties as it definitely saves time and is cost effective. However, one need to keep in mind all that glitters is not gold. Adopting this approach without being vigilant enough can make you land in greater problems than it is intended to solve. The drafters are expected to be very alert while in the process as it can be intricate to identify every single clause in the Level-I contract that is relevant for lower levels and it ultimately calls for cross-referencing between

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contracts and it also necessitates that sub-contractors in the project have access to higher tier contracts which all the more pushes up the complexity in the chain.

For instance, if we incorporate a general clause providing that “all references in the main contract between the Employer” and “Main Contractor” are to be read in the subcontract as being references to the “Main Contractor” and “Subcontractor” respectively, this definitely appears to be tempting as it saves lot of time and money and at the same time allows the main-contractor to pass down his obligations to the sub-contractor. However, this may not be appropriate for every obligation and could result in rendering what should be an essential term of the contract either ineffective or subject to an interpretation that was never intended.  

In National Building Construction Corporation Ltd. v. Antia Electricals Pvt. Ltd, Hon’ble Delhi High Court held the back-to-back basis to be applicable to a provision of arbitration present in the main contract and thus applicable to sub-contract also. The court reasoned that since the provision has not been explicitly objected and excluded from the applicability of ‘back-to-back condition’ in the sub-contract, the same cannot be avoided at this stage. Thus, referring to this judgment it can be concluded that in such inclusive provisions “All major terms and conditions such as…..”, express exclusion is important and not express inclusion.

Moreover, the long and detailed main contract specifications can be futile for sub-contractors and it will be a tedious job for them to separate the relevant clauses from the irrelevant ones. It will also add up to the complexity in the circuit.

However, these issues to an extent can be managed by drafting of a suitable standalone contract for lower levels in the project i.e. main-contractor and sub-contractor [To avoid confusion, hereinafter referred as ‘Level-II contracts’]. An apparent benefit this approach offers is that while executing the Level-II contracts, the parties need not cross-refer the high-tier contracts i.e. Level-I contracts for every provision and clarification. They only have to adhere to the provisions of well drafted contract specifically designed to define the relationships of actual parties and there is no need to identify the relationship of two parties from a contract originally drafted for two other parties. On the other hand, one should know that drafting of standalone agreements are again not as easy as pie. Drafters need to remember that they are required to be considerable enough while doing the job but definitely, it cannot be denied the complexity can be reduced in this kind of approach.

Care therefore needs to be taken to ensure that all desired terms are effectively passed through, and a ‘walk-through’ approach should be taken for each term to see that it makes both commercial and legal sense and will have the intended result. Drafting an agreement such as this is indeed an intricate process that requires considerable amount of care and vigilant drafting so as to ensure the all correct terms, and only the correct terms are passed on the next levels and that they are phrased appropriately and that requirements, and in particular timings, are properly co-ordinated between the contracts at different levels.

3. Common issues while drafting typical back-to-back provisions

Irrespective of the type of drafting method that we opt for, there are several issues that creep in and it requires our considerable attention:

3.1. Terms of Payment

Care needs to be taken while introducing a general back-to-back clause in an agreement with respect to payment terms. Consider a situation where back-to-back provision includes ‘terms of payment’ as mentioned in the main-contract. Now, can that be read in order to suggest a “pay-when-paid” clause i.e. payment to the subcontractor under Level-II contract will be conditional upon the main contractor being paid by the employer under the Level-I contract. Such “pay-when-paid” clauses are not enforceable in

construction contracts under the laws of certain jurisdictions, including England and Wales and Singapore. Moreover, subcontractors generally refuse to give in to such clauses for they expect their payment as soon as they have rendered their services as per the subcontract notwithstanding the stage of the high-tier contract between main-contractor and the employer.

3.2. **Contractual deadlines**

Another notable requirement is that the deadlines in the subcontracts are coordinated with the deadlines of the main-contract. The drafters should ensure that the deadlines the sub-contract are of a bit shorter duration than those mentioned in the main contract so that there is time for inspection and corrections by the main contractor before the original deadline hits. Furthermore, these days companies have started resorting to another mode by instilling a provision of ‘completion certificate’ which is to be obtained by the sub-contractor and is supposed to be signed by both the main-contractor and employer. In that case, the provision has to be appropriately phrased.

3.3. **Dispute resolution**

One has to realize that under a contract on back-to-back basis, a dispute between the main contractor and the employer under Level-I contract will most probably inflict a corresponding dispute between the main contractor and the subcontractor under Level-II contract, and vice versa. Such disputes may include claims relating to defects and delays which go up and down the chain. While, the employer would seek an answer from the main-contractor, the main-contractor on the other hand would want to avoid Shouldering any such responsibility and put the blame upon his sub-contractor. The major concern of the drafters is that the main-contractor can be in a position where he is open to different judgments by two different tribunals constituted under different contracts with different parties at various levels in a project.

In order to avoid an intricate situation at a later stage, drafters should try an incorporate terms that may provide “the parties to agree to cooperate and assist each other to resolve the main contract dispute, and the subcontractor to agree to stay (put on hold) its dispute with the main contractor under the subcontract until the resolution of the main contract dispute”. Such provisions can help in better dispute resolution.

3.4. **Suspension and termination**

The drafters should explicitly provide in the sub-contract that in the event of a suspension or termination of the main contract, the sub-contract works will similarly be suspended or terminated. The parties may agree that in that event the sub-contractor will have no claim against the main contractor except where it was the main contractor’s breach of the main contract which gave rise to the suspension or termination.

Thus concluding that back-to-back contracts can be very effective in construction projects provided they are drafted with adequate care. There is for sure no one stop solution for various drawbacks associated with this scheme of back-to-back arrangements. As opined by Malcol Chin, “a ‘walk-through’ approach should be taken for each term to see that it makes both commercial and legal sense and will have the intended result”. The drafters/main contractors, in no case should aim at short-cutting the work load by putting a general clause thereby giving rise to future legal issues.

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