IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: WAKI, NAMBUYE & MAKHANDIA, JJ.A)

CIVIL APPEAL NO. 111 OF 2010

BETWEEN

ZENITH STEEL FABRICATORS LIMITED..APPELLANT

AND

CONTINENTAL BUILDERS LIMITED......................................1ST RESPONDENT

ELTEX (EPZ) LIMITED..2ND RESPONDENT

(An appeal from the Judgment and Decree of the High Court of Kenya at Nairobi (Kasango, J) dated 16th March, 2006

in

H. C. C. C. No. 641 of 1998)

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JUDGMENT OF THE COURT

What is the true meaning of a nominated **Sub-contractor** in the building construction industry? Who between the **Employer** and the main **Contractor** is bound to pay the sub-contractor? Was there privity of contract between the parties? These and other peripheral issues arise for our consideration in this appeal.

Twenty four years ago in 1994, the 2nd respondent, Eltex (EPZ) Ltd **(Employer)**, commenced the construction of a garment spinning factory **(the project)** at the EPZ processing zone in Athi River. The main contractor for the project was the 1st respondent, Continental Builders Ltd **(Contractor)**. But there was no formal contract signed between the two. On 12th July, 1994, the appellant **(Sub contractor)** was appointed by the contractor as the sub-contractor for steel and roofing works at the agreed sum of Sh.20,500,000. Again there was no formal contract signed between the two. From letters exchanged between them, payments on the project were made to the contractor by the employer, and the contractor in turn paid the sub contractor.

All was well in the first few months but the project began to stall in September 1994 due to delays in payment for purchase of materials. The subcontractor blamed the contractor while the contractor blamed the employer. At some point in December 1994, the sub contractor complained directly to the employer but the latter retorted that it had no direct agreement with the former. The sub contractor reverted to the contractor and demanded the balance of payments for works completed. They had been paid all but Sh.4,283,320 of the agreed contract sum and additional works.

When the payment was not forthcoming, the sub contractor sued the contractor on 26th October, 1998. The basis of the suit was a letter dated 1st December, 1994 sent by the contractor to the sub contractor stating as follows:

> ***"SPINNING FACTORY AT E.P.Z. – ATHIRIVER** We refer to your letter dated 30 November 1994 Please take note of the following:*
>
> ***1. You are our Nominated Sub-Contractor for Structural Steel Works, Roofing and Ceiling works all as agreed and discussed directly with the client.***
>
> ***2. We are not responsible for any design, detail or acquisition of any materials of your part of the works.***

3. At a pre-contract meeting held at the Client's offices in your presence, it was agreed by all present that payments would be affected to the Main Contractor including your sub-contract pro-rata amount as follows;

Advance payment 15% of Contract Sum

Monthly payments 15% of Contract Sum for Six months

Whilst we fully agree with your predicament regarding the issue of payments, we are in no position to assist you unless the Client is willing to issue additional payment for your use as stipulated in your letter.

Yours faithfully,

for CONTINENTAL BUILDERS LTD".

It was further pleaded that the contractor had failed, refused or neglected to pay the balance despite the subcontractor having completed the works.

The contractor filed a defence to the claim denying any contractual obligation to settle the debt and asserting that it was the employer who had appointed both and who was obligated to pay for the entire project. The contractor was only a conduit for the payments due to the subcontractor but had not received the sum claimed from the employer. As an alternative defence, the contractor pleaded that the claim was exaggerated as it included retention sums which were not due; and that the work done by the subcontractor was substandard, hence refusal by the employer to pay the balance. The contractor further applied for, and was granted leave to serve a third party notice on the employer, which it did, seeking indemnity or contribution, should the subcontractor's claim be successful.

In its defence, the employer denied entering into any contract with the subcontractor or appointing the contractor as its agent for payments due to the subcontractor. It only admitted having entered into an agreement with the contractor but denied any privity of contract between it and the subcontractor. It denied liability for payment of any money either to the contractor or the subcontractor asserting that it had fully paid the contractor and had nothing to indemnify or contribute towards the claim made by the subcontractor.

For some reason which is not clear from the proceedings, the suit took some years before it landed on **Mwera, J.** (as he then was) who partly heard the subcontractor's one witness in 2003. **Kasango, J.** took over in 2005, heard the cross examination of the witness and fully heard the contractor's one witness. The employer tendered no evidence and judgment was delivered on 16th March, 2006. Upon considering the evidence, largely documentary, the learned Judge made findings that the subcontractor did not enter into a subcontract agreement with the contractor but was nominated by the employer; that the terms discerned from correspondence on record were that the subcontractor was to perform its duties in co-operation with the contractor; that payment to the subcontractor was the responsibility of the employer; that the subcontractor could only be paid by the contractor if and when the money was received from the employer; that there was no contractual obligation on the part of the contractor to pay the subcontractor; that the relief claimed by the subcontractor against the contractor had no merit; and that the employer cannot be called upon to indemnify the contractor since there was no liability found against the contractor. The suit was dismissed with costs to the contractor and the employer.

Aggrieved by those findings, the subcontractor filed this appeal four years later, which, again for unclear reasons, has taken eight years to hear! Six grounds are put forward in the memorandum of appeal, but learned counsel for the subcontractor, **Mr. Rimui** appearing with **Mr. H. Shah,** both instructed by M/s Mohamed Madhani & Company Advocates, urged them as three issues in their written submissions which were briefly highlighted orally. The issues are:

(i) Whether there existed a contract between the sub contractor and the contractor.

(ii) Whether the subcontractor was to be paid by the contractor or the employer.

(iii) Whether the contractor breached the terms of the contract by failing to pay the subcontractor.

On the first issue, counsel observed that there was no formal contract signed between the employer and the contractor or between the contractor and the subcontractor. He submitted, however, that a clear contract can be inferred from the parties' conduct and the letters they exchanged. One such letter dated 12th July, 1994 addressed to the sub contractor by the contractor, in his view, firmed up the appointment of the subcontractor by the contractor as the *'nominated subcontractor'* for specific works in the project. Other letters followed confirming the same position and spelling out terms of payment by the contractor. It was erroneous therefore, he submitted, for the trial court to find that there was no privity of contract between the contractor and the subcontractor on the basis that payments to the subcontractor were made by the employer.

Citing the case of ***Agricultural Finance Corporation vs Lengetia Limited & Jack Mwangi [1985] eKLR,*** he submitted that:

"As a general rule a contract affects only the parties to it, and cannot be enforced by or against a person who is not a party, even if the contract is made for his benefit and purports to give him the right to sue or to make him liable upon it. The fact that a person who is a stranger to the consideration of a contract stands in such near relationship to the party from whom the consideration proceeds that he may be considered a party to the consideration does not entitle him to sue upon the contract."

Counsel further wondered why, if any privity of contract was intended between the employer and the subcontractor, there was no collateral agreement signed. There was also no basis for the finding that the contractor was a mere conduit for the payments made to the subcontractor.

Such finding, in his view, would make the contractor a mere agent and fly in the face of the principle that both the employer and the contractor are principals. He cited the case of ***Hampton vs Glamorgan County Council*** ***(1917) A. C. 13*** for that principle.

On the 2nd issue, counsel started by defining a *"nominated subcontractor"* as one who has been nominated, selected or approved by the employer but whose obligations lie with the main contractor. For this definition he relied on two publications: the international **"FIDIC Conditions of contract for works of civil engineering construction", 4th Edition 1987**, and the local **"Agreement and conditions of contract for building works"** published by the Joint Building Council, Kenya with the sanction of the Architectural Association of Kenya and the Kenya Association of Building and Civil Engineering Contractors. According to both publications, the contractor has no right, without the consent of the employer, to assign the contract or any part of it to a subcontractor, and in any event, the employer is not rendered liable to any nominated subcontractor, even if the employer plays any part in the nomination. In this case, counsel observed, it was the contractor who expressly in its letter dated 12th July, 1994 nominated the sub contractor. In sum, concluded counsel, the trial court got the meaning of a nominated subcontractor all wrong, and inevitably came to the wrong conclusions.

As for payments, counsel submitted that it was the responsibility of the contractor who always paid the subcontractor. He referred to the same publications above which contain provisions for payments and make it clear that the duty to pay the subcontractor lies with the main contractor and not the employer. The employer would only be called upon to pay the subcontractor where the contractor has failed to pay but then deduct the payment from the money due to the contractor. He cited the book on **"Construction Contracts Law and Management",** 3rd Edition, by John Murdoch & Will Hughes, where the authors state:

> ***"In general, the fact of nomination makes no difference to the basic principle...that a subcontractor's payment rights are contained in the subcontract and are therefore exercisable only against the main contractor..."***

In line with this principle, counsel observed, the employer in its letter dated 8th December 1994, correctly declined to make direct payments to the subcontractor.

Finally on the 3rd issue, counsel submitted that there was no denial that the sum claimed by the subcontractor was due. The argument was who between the contractor and the employer should pay it. There was evidence to show that it was the contractor who persuaded the subcontractor to complete its part of the contract despite the outstanding payments, and it was therefore the contractor's obligation to ensure that the subcontractor did not suffer. He cited the case of ***Steadman vs Steadman*** ***(1976) AC 536,540*** stating thus:

> ***"If one party to an agreement stands by and lets the other party incur expense or prejudice his position on the faith of the agreement being valid he will not then be allowed to turn around and assert that the agreement is unenforceable."***

In conclusion, counsel urged that it would be unconscionable and inequitable to leave the sub contractor without a remedy, especially when it was contended and not denied that the contractor had been paid fully for the project. The money ought to be paid with interest at commercial rates from the date of filing suit, to the date of decree.

In response, learned counsel for the contractor **Mr. James Ochieng Oduol** instructed by M/s Ochieng, Onyango, Kibet & Ohaga Advocates, filed written submissions which were orally highlighted. Lack of a formal contract between the parties was conceded and therefore the terms of their relationship were to be inferred from their conduct and exchange of letters. According to counsel, the terms of the subcontract are contained in the letters dated 12th July, 1994 and 1st December, 1994 which make it clear that the contractor was a mere conduit in channeling payments made to the subcontractor by the employer who recommended and nominated it. The contractor faithfully made all payments received and there is no claim for any amount received but not remitted. In his view, the only issue before this court should be who had the obligation to pay the subcontractor and whether the subcontractor proved any breach of contract.

Relying on the **Building Contract Dictionary**, 3rd Edition, counsel defined a *'nominated subcontractor'* as *"generally, a subcontractor named by the employer.."* and '*nomination*' as *"the naming of a person or firm to undertake a part of the work or to supply goods. Such nomination is done by the employer."* Accordingly, submitted counsel, the contractor was only a link between the employer and the subcontractor in respect of the works the subcontractor was responsible for. That is how payments were also channeled, and there was no obligation on the contractor to pay before receiving the money from the employer. This position, in his submission, was mutually understood by all the parties. The position, in his view, was fortified by an exchange of several letters between the subcontractor and the employer which conveyed the intention of the parties to create a legal relationship between themselves. The intention was also manifested by the surrender of the employer's VAT exemption certificate to assist the subcontractor in the procurement of raw materials. In sum, there was a mutual agreement and understanding that the subcontractor was to be paid by the employer through the contractor, and the subcontractor is estopped from asserting otherwise. By accepting that mode of payment, the subcontractor must also be held to have waived or forborne any right to claim directly from the contractor.

As for breach, counsel was emphatic that in the absence of any contractual obligation on the part of the contractor as demonstrated, no breach could arise. Any cause of action against the contractor would only have arisen if the contractor failed to remit monies received from the employer but that was not pleaded in the suit or proved in evidence.

Finally for the employer, learned counsel **Mr. Alfred Nyairo** instructed by M/s Nyairo & Company, relied on the written submissions which he briefly highlighted. His position was clear that there was no case pleaded by the subcontractor against the employer and no reply was made to the defence it filed denying liability. There was also no evidence tendered to show that the employer owed any money to the contractor. According to the employer, it had an agreement with the contractor on the entire project for which it was to pay in excess of Sh.80 million, and there is no claim from the contractor that the contractual sum was not paid to it.

Counsel further observed that the nomination of the subcontractor was made by the contractor in its letter dated 12th July, 1994. The employer was not privy to that contract. How the payments were to be made was a matter between the two, and it is clear from the record

that the payments were always made by the contractor. In counsel's submission, the case pleaded by the subcontractor was not proved, hence the proper dismissal of the suit, with costs following the event.

We have considered the appeal in the manner of a retrial in order to arrive at our own conclusions of fact and law in terms of ***Rule 29*** of the ***Court of Appeal Rules***. As always, we must accord due respect to, and not lightly differ from, the findings of the trial court which had the added advantage of seeing and hearing the witnesses.

Nevertheless, this Court has stated time and again that it will interfere with such findings if they are based on no evidence, or the judge is shown demonstrably to have acted on wrong principles in reaching them. See ***Jabane vs Olenja [1986] KLR 661***. Indeed, an appellate court is not bound to accept the factual findings of a trial court if it appears either that it has clearly failed on some material point to take account of particular circumstances or probabilities material to an estimate of the evidence, or if the impression based on the demeanour of a witness is inconsistent with the evidence in the case generally. See ***Mwangi vs Wambugu [1984] KLR 453.***

In our assessment, the three issues stated in the opening paragraph of this judgment stand out for our determination. The first is the true meaning of a ***'nominated subcontractor'*** in the context of the building construction industry. It is this definition that will unlock the determination of the second issue, who between the employer and the main contractor is bound to pay the sub-contractor; and the third issue, whether there was privity of contract between the employer and the subcontractor. We shall consider them together.

Both the trial court and the contractor in this case relied on the **Building Contract Dictionary**, 3rd Edition, which defines *'nominated subcontractor'* as:

> ***"Generally, a subcontractor named by the employer.."***

and **'*Nomination*'** as:

> ***"In general, the naming of a person or firm to undertake a particular task or office. In building contracts, nomination refers to the naming of a person or firm to undertake a part of the work or to supply goods. Such nomination is done by the employer."***

That definition was extrapolated in the judgment to mean that since the nomination is the responsibility of the employer, liability for payments to the subcontractor lay with the employer. For several reasons, we respectfully differ with the trial court on the application of that definition.

As the dictionary itself states, the definition is general. We may add it is also shallow as it does not elaborate on the legal relationship between the employer and the subcontractor after nomination. We are persuaded that the publications cited above by the subcontractor carry, not only the correct definitions, but also the appropriate application of the principle. It is instructive that there was no attempt by any of the other parties to dismiss or distinguish the definitions as applied in those publications.

FIDIC is the International Federation of Consulting Engineers charged with promoting and implementing the consulting engineering industry's strategic goals and to disseminate information and resources of interest to its members. Among its objectives, it publishes international standard forms of contracts for works and numerous other documents and guidelines for the industry. Its international acceptance cannot thus be doubted. The **FIDIC Digest on 'contractual relationships, responsibilities and claims',** by John Sawyer, cited by the appellant defines '***Nominated contractors'*** as:

> ***"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".***

The FIDIC terms also provide that the employer is not liable to the subcontractor's payment even where he has made the nomination. Similarly, the standard agreement published by the Joint Building Council of Kenya provides the definition in *Clause 31*, thus:

> ***"31.0 NOMINATED SUB-CONTRACTORS***
>
> ***31.1 The following provisions shall apply where prime cost sums are included in the contract bills or arise as a result of Architect's instructions given in regard to the expenditure of provisional sums in respect of persons to be nominated by the Architect to supply and fix or install materials or goods or to carry out work.***
>
> ***31.2 Such sums shall be expended in favour of such persons as the Architect shall instruct, with the consent of the Employer, and all specialists or others who are nominated by the Architect are hereby declared to be sub-contractors employed by the Contractor, and are referred to in these conditions as 'nominated sub-contractors'.***
>
> ***31.3 The Architect shall not nominate any person as a sub-contractor against whom the Contractor shall make reasonable objection.***
>
> ***31.4 The nominated sub-contractor shall carry out and complete the sub-contract works in every respect to the reasonable satisfaction of the Contractor and of the Architect and in conformity with all the reasonable directions and requirements of the Contractor".***

[Emphasis added]

In the treatise **"Construction Contracts Law and Management", (supra),** the authors provide further elaboration on such clauses and state that the legal rights of subcontractors are predominantly against the main contractor, particularly on payments.

The terms will normally be spelt out in the relevant sub-contracts. As a general principle, the authors state:

> ***"the lack of a direct contractual link between an employer and a subcontractor or supplier means that the employer is not liable to pay the subcontractor directly....the fact of nomination makes no difference to the basic principle that a subcontractor's payment rights are contained in the subcontract and are therefore exercisable only against the main contractor."***

This is stated as a general principle because there is nothing to prevent an employer from expressly taking up the responsibility of paying the subcontractor.

Which leads us to the big question, what were the terms of the subcontract?

It is conceded all round that there were no formal contracts signed either between the employer and the contractor or between the contractor and the sub contractor. An express contract would have spelt out and resolved the thorny issue that stands out here

- who was responsible for payments due to the subcontractor? But the parties appear to have taken a conscious risk since none of them was a novice in carrying out works of such magnitude as the project here. They have opened themselves to the application of general principles and inferences made on their working relationship from their conduct and written correspondence.

The basic letter relied on to found the contract between the contractor and subcontractor is dated **12th July, 1994**, and states as follows:-

> ***"Zenith Steel Fabricators Ltd***
>
> ***P O Box 18314***
>
> ***Nairobi***
>
> ***Attn. Mr. A. T. Biviji***
>
> ***Dear Sir,***
>
> ***GARMENT FACTORY AT E.P.Z. - ATHI RIVER***
>
> ***We have been appointed as Main Contractors on the above project as letter of offer from the Clients dated 11 July 1994 and accordingly, we hereby appoint you as nominated Sub-Contractors for Steelwork and Roofing work as per your quotation dated 29 June 1994 amounting to Ksh.20,500,000 excluding V.A.T. and Duties.***
>
> ***We will submit our programme of works shortly for your planning but please ensure that all design and detailing of reinforced concrete works is forwarded to us in good time to avoid any delays. This is more so for foundations and reinforced concrete framework initially.***
>
> ***Please also arrange to provide us with insurance to cover your sub-contract works or alternatively you are invited to share the cost pro-rata of our insurance to cover the entire contract. Also ensure that all plant and equipment for your use should have a separate insurance cover should you so require.***
>
> ***We will forward advance payment as set out in your letter and agreed by the Clients once we receive the same from them.***
>
> ***Yours faithfully***
>
> ***for CONTINENTAL BUILDERS LTD***
>
> ***Signed***
>
> ***J. S. ROOPRA". [Emphasis added]***

This is augmented by the subsequent letter dated 1st December, 1994 which was reproduced earlier.

It is clear from the letter of 12th July, 1994, as contended by the subcontractor, that it is the contractor who nominated the subcontractor and even agreed on the amount payable to it. The second letter dated 1st December, 1994 came as a response to complaints raised by the subcontractor and it reiterates the nomination and mode of payment. When the subcontractor attempted to demand direct payments from the

employer, their contractual relationship was explained in a Fax message dated 8th December, 1994 as follows:-

> ***"PLEASE KINDLY NOTE THAT OUR MAIN CONTRACTORS ARE Ms CONTINENTAL BUILDERS LTD AND THAT YOU ARE A SUB-CONTRACTOR DIRECTLY CO-ORDINATING WITH THE MAIN CONTRACTOR. YOU THEREFORE SHOULD LIASE WITH THE MAIN CONTRACTOR IN RESPECT OF ALL PAYMENTS AND SITE WORK SCHEDULES. WE ARE NOT RESPONSIBLE FOR PAYMENT TO YOU DIRECTLY."***

The contractor maintained, and the trial court found, that it was only a conduit for payments due to the subcontractor from the employer. With respect, we find no basis for such finding. In the first place, if this was the intention of the parties, it would have been spelt out as is usually done in similar contracts. It is called the ***"pay when paid clause"***, and the rationale for it is given in the treatise (supra), thus:-

> ***"In the past, many sub-contracts contained a provision to the effect that the main contractor would become liable to pay the sub-contractor, not when the relevant sum was certified by the contract administrator, but only when the main contractor actually received the money from the employer. .... Provisions of this kind, known***
>
> ***as "pay when paid clauses", are inserted in sub-contracts for two main purposes. The first is to protect the main contractor's cash flow. This occurs because the main contractor will merely act as a channel of payment between the employer and the sub-contractor and will thus be in no danger of having to finance the sub-contractor's work. The second purpose, which is less obvious, is to make the sub-contractor carry the risk of the employer becoming insolvent. This will happen in circumstances where the employer's insolvency occurs after sub-contract work has been certified, but before the main contractor has been paid for it. Without a pay when paid clause, it is the main contractor who will bear the resulting loss, in the sense of having to pay the sub-contractor and then recoup whatever can be salvaged in the employer's liquidation. Under a pay when paid clause, by contrast, the main contractor need only pass on to the sub-contractor what can be recovered in the employer's liquidation, and even this will naturally be put first to meeting the main contractor's own claims".***

We must construe the absence of such provision against the contractor who drew up the letter founding the contract and who seeks protection under it.

We think we have said enough to satisfy ourselves that ordinarily, and in the absence of express provisions, a subcontractor, whether or not nominated by the employer, is responsible to the contractor and the contractor is responsible for the subcontractor's payments. As stated in the treatise (supra):-

> ***"As a basic principle, the lack of a direct contractual link between an employer and a subcontractor or supplier means that the employer is not liable to pay the sub-contractor directly for work done or materials supplied ...Although the terms of the main contract may lead to the conclusion that the employer is personally responsible for payments to sub-contractors, (Hobbs v Turner (1902) 18 TLR 235.) such an interpretation is extremely unusual. Most of the cases in which liability has been imposed have been ones in which the employer has entered into direct negotiations or dealings with a sub-contractor or supplier. (Smith v Rudhall (1862) 3 F & F 143). Even here, however, the courts are slow to reach the conclusion that any direct obligation has been assumed. In one case, Victorian Railway Commissioners v James L Williams Pty Ltd (1969) 44 ALJR 32 for example, where a main contractor was on the brink of liquidation, certain sub-contractors threatened to stop work. The employer then promised to 'ensure payment of all amounts outstanding' to the sub-contractors. However, it was held that even this did not create any legal obligation on the employer's part...".***

In this case, we are satisfied that the contractor appointed the subcontractor and was consequently liable for the payments due to it.

We are also satisfied that there was no privity of contract between the employer and the subcontractor, and in principle therefore, the subcontractor cannot claim directly from the employer. See the ***Agricultural Finance Corporation case (supra).***

Having so found, it only remains to declare that there is merit in this appeal which we allow. The judgment of the lower court is hereby set aside and substituted with an order for judgment against M/s Continental Builders Limited for the principal sum of **Sh.4,283,320/=**. The said sum shall bear interest at court rates from the date of filing suit until payment in full. The costs of the suit and of this appeal shall be borne by the 1st respondent.

Dated and delivered at Nairobi this 26th day of October, 2018.

P. N. WAKI

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JUDGE OF APPEAL

R. N. NAMBUYE

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JUDGE OF APPEAL

ASIKE-MAKHANDIA

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JUDGE OF APPEAL

I certify that this is a

true copy of the original.

DEPUTY REGISTRAR