Consultants – navigate your novation

The growth of design and build has placed more risk on to consultants. Guest editor Andrew Croft of Beale and Company warns consultants to understand how to manage those risks from the outset of projects, especially when novated.

More and more projects are being procured on a design and build basis. Perhaps the main reason for this is that if things go wrong on a design and build project the employer can pursue the contractor alone, rather than having to spend time and money establishing the cause of any loss amongst those involved in the project.

Under a typical design and build contract the contractor takes on responsibility for the whole of the design, that is, both design carried out before and after tender. Despite reluctance from some contractors to assume this responsibility, employers are commonly using their bargaining power in the current market to impose design and build terms. The contractor is unlikely to accept this without contractual recourse against the consultants who carried out the original design and he therefore usually requires such consultants to be novated to him.

Novation brings additional risks and liability for consultants, in that the consultant could be liable for additional losses and/or different types of losses and these are not fully understood. The novation agreement and any collateral warranty which must be provided to the employer on novation often expose the consultant to liability to both the contractor and the employer in relation to the same services. Consultants therefore usually try to avoid novation, but this may not be commercially viable. If novation is required consultants should recognise the risks which novation inherently brings and manage these in negotiating the novation. What are these risks?

Novation – planning
Novation agreements usually follow one of two routes:

‘Ab initio’ novation
Ab initio, meaning ‘from the start’, treats the consultant as though it was always appointed by the contractor. In this respect, ab initio creates a fiction, as it does not recognise that the consultant was originally appointed by the employer. Consultants should try to avoid this fiction for the reasons stated below.

‘Switch’ novation
Switch more accurately reflects the reality of the situation and recognises that the consultant was originally appointed by the employer. It is not until execution of the novation agreement that the contractor’s appointment ‘switches’ from the employer to the contractor. Given that this more accurately reflects reality, consultants should look to achieve switch novation, where novation cannot be avoided.

Beware the fallacy of ab initio novation
The City of London Law Society (CLLS) Standard Form of Novation is an example of ab initio novation:

‘The Consultant undertakes to perform the Appointment and to be bound by its terms in every way as if the Contractor were, and had been from the inception, a party to the Appointment in lieu of the Employer.’

A central feature of ab initio novation is that the consultant is liable to the contractor for the pre-novation services. In addition, the consultant is usually required to provide a collateral warranty to the employer in relation to both the pre and post novation services and is therefore potentially liable to two different entities in relation to the same services.
One key risk of ab initio for the consultant is that the contractor’s interests in the pre-novation services may be very different to those of the employer, for whom those services were actually provided. For example, the employer is likely to want the best quality build whilst the contractor is more interested in its profit and value for money. This could mean that in carrying out the pre-novation services with the employer’s interests in mind, the consultant inadvertently breaches the post-novation appointment by acting against the interests of the contractor, who quite often has not even been appointed at the time. Further, if the consultant is aware when performing the pre-novation services that it will be novated to the contractor on an ab initio basis, this could result in a conflict of interests for the consultant, who is torn between satisfying the interests of the employer and those of the contractor. A big issue.

Switch drafting and the need for caution

The Construction Industry Council (CIC) Novation Agreement contains switch drafting as follows:

‘As from the date of this Agreement the Employer releases and discharges the Consultant from the further performance of the Consultant’s services and other obligations under the Appointment … In respect of those services and any other obligations to be performed under the Appointment that have yet to be performed by the Consultant … the Consultant agrees to perform those services and obligations … for the Contractor as if the Contractor were a party to the Appointment in place of the Employer …’

This is generally much more preferable for the party being novated than ab initio as it aims to reflect the reality of the situation – the consultant is not performing the services for the contractor until after it has been novated. Contractors and developers are accepting the CIC form, despite what some may tell you.

Nevertheless, even if a consultant is able to negotiate a switch form of novation it could still be exposed to additional risks. For example, a switch agreement may require the consultant to warrant to the contractor that it has carried out the pre-novation services in accordance with the appointment, thus having a similar effect to ‘ab initio’ in making the consultant contractually liable to the contractor for pre-novation services. Consultants should look out for this. The balance of risk in a novation agreement may also be altered by a ‘Blyth & Blyth’ clause. Blyth & Blyth Ltd v Carillion Construction Ltd (2001) 79 ConLR 142 (Scotland) suggested that a consultant may not be liable following novation for losses suffered by the contractor as a result of pre-novation services, if those losses could not have been suffered by the employer. Accordingly, many novation agreements expressly prevent the consultant from raising such a defence and seek to make the consultant liable to the contractor for losses which are specific to the contractor, and which may not have been in the consideration of the consultant when performing the pre-novation services for the employer. Consultants should avoid this for obvious reasons.

Other ways to soften the blow

As well as seeking to agree novation on the switch basis, the consultant should request the right to rely on the same rights of defence and upon any limitation of liability as it would have against a claim by the employer under the appointment. This should help the consultant to retain the same level of risk post-novation as it had pre-novation. For further protection a consultant should also request the inclusion of a clause stating that it will have no greater nor longer lasting liability to the contractor than it would have had to the employer. Consultants should also request a release of liability to the employer in respect of the services for which it will be liable to the contractor; the consultant should avoid being liable to two parties in respect of the same services. If the employer is being provided with a collateral warranty it should have no objections to such a release.

Final thoughts

Consultants should limit the employer’s rights to novate any appointment as much as possible, but novation is sometimes unavoidable. If novation is required it may expose the consultant to significant risks, so it is important that consultants understand how to manage these risks from the outset, rather than perhaps precluding themselves from being appointed on design and build projects or accepting novation without negotiating the risk to within acceptable confines.

Further, if novation is required under an appointment, the form of novation agreement should be considered very carefully by the consultant, in light of any collateral warranties which may be provided to the employer on novation, so as to ensure that it does not expose itself to unacceptable liabilities.