It is common in construction projects for contractors, sub-contractors and consultants to be asked to provide collateral warranties and/or letters of reliance/assignments to parties other than the main client. In this article we consider the scope of such liability to third parties and, also, the extent to which it can be limited in contractual documentation.

The ability to limit your liability to third parties will often mirror or be dependent on the extent of any limitations of liability set out in the contract with the original client. It follows that, when drafting terms of appointment, care should be taken to ensure your liability is as limited as possible. In particular:

1. The contract should expressly prohibit assignment. It should also exclude third party rights under the Contracts (Rights of Third Parties) Act 1999. Whilst most standard construction contracts will include such a restriction, it is always sensible to double check that it is there.

2. Include a cap on liability – this is acceptable, so long as it satisfies the criteria of ‘reasonableness’ under the Unfair Contract Terms Act 1997. It should be in respect of “all such claims” as opposed to “each and every claim”. You should note that the level of professional indemnity cover you hold is not, in itself, a limit on your liability.

3. Include a net contribution clause to protect...
you in circumstances where there are other parties who are also liable to the client. Such a clause ensures that you are not left responsible for the entire sum claimed, and that liability can be shared out between the various parties involved.

4. Include an exclusion for indirect and consequential losses. This will ensure that you are not responsible for losses that are too far removed from the services provided.

5. Restrict the time limit for all claims to a period of six years from the date of the delivery of services/a report.

A carefully drafted appointment or contract, including the provisions referred to above, will provide strong grounds on which to challenge any third party claims that may later develop.

**Collateral Warranties**

Breaches of contract can cause loss to many parties in a construction project. There is, however, usually no direct contractual link between you and third parties such as project funders, purchasers or future tenants. Collateral warranties create that otherwise non-existent link by creating a separate contract between you and the third party.

Whilst it would, of course, always be preferable to avoid providing collateral warranties, this often will not be possible. It is therefore sensible when agreeing terms of appointment to limit the obligation to provide collateral warranties to only closely defined groups, such as the first purchaser or the first tenant and to resist wording that requires a collateral warranty to be provided to “any party with an interest”. It is also prudent to agree a cap on the total number of collateral warranties the terms of appointment oblige you to provide, and the number of times those warranties can be assigned to others.

When agreeing the terms of a collateral warranty, you should take care to ensure that its obligations mirror, and do not go beyond, the terms of your main contract with the client. A collateral warranty will generally include a “no greater duty” or “equivalent rights of defence” clause, which confirms the parties’ intention that the liability under the collateral warranty should be no greater than the duty you assumed under the main contract with your client. This fundamental principle was confirmed by the court in *Swansea Stadium v City & County of Swansea* [2019] and the Scottish Court of Session in *British Overseas Bank Nominees Ltd v Stewart Milne Group Ltd* [2019]. If a collateral warranty is drafted as a bespoke document, or if a standard form is amended, care should be taken to ensure that the “no greater duty” wording is included.

Bearing in mind the stand alone status of a collateral warranty, its content should be considered as closely as the terms of the original terms of appointment.

You should also bear in mind the issue of time-bar, or limitation, which has recently been considered by the courts in the cases...
of Swansea Stadium v City & County of Swansea [2019] and British Overseas Bank Nominees Ltd v Stewart Milne Group Ltd [2018]. In the Swansea case it was held that the limitation period ran from the date of the original building contract, not the date on which the collateral warranty was granted. This was reinforced by the Court of Session in British Overseas Bank.

For the avoidance of any doubt, you may wish to ensure that there is an express clause included in the collateral warranty stating that no actions or proceedings shall be commenced after the expiry of six or twelve years (as appropriate) from the completion of the services provided.

Reports and third parties

Another area in relation to which liability to third parties may arise is the assignment of reports, originally prepared for the original client, to a third party (e.g. a developer purchasing the site from the original owner).

The question arises as to what extent that third party can rely on the content of your report. This issue was considered by the court in the case of BDW Trading Ltd v Integral Geotechnique (Wales) Ltd 2018. The judgment clarifies that any third party seeking to rely on your report will have to obtain a formal assignment “or other legal document” in order to do so. The court noted a significant distinction between “using” the report (in the sense of reading it and making decisions based on it) and “relying” on it in a legal sense. We reviewed the court’s decision in this case in LPA 68 to which you can refer for further detail as regards the background of the case. LPA 68 can be downloaded here.

The case is a good reminder of the commercial value of formal assignments of reports (or collateral warranties or letters of reliance) to third parties. When negotiating such transactions, proper consideration should be given to the significant extra risk that is being created in terms of potential liabilities and suitable remuneration for the risk assumed should be sought.

In the event of a formal assignment, how can you minimise your exposure to future claims from the third party assignee? It would be advisable to have a standard agreement to assign readily to hand, as requests to assign are often urgently made. A standard agreement should be carefully thought out and should include the following terms:

- Any further assignment of the report is absolutely prohibited.
- No proceedings or action can be brought after 6 years from the date of the report (not the date of the assignment).
- The adequacy of your performance in preparing the report shall be assessed by reference to standards prevailing at the time the report was prepared and the terms of the original appointment, not by contemporaneous standards/terms.
- No liability will arise from any changes to site conditions since the report was prepared.
- An express financial cap on liability.
An exclusion of liability for consequential losses.

Confirmation that any claim by the assignee will be subject to (1) any right of set off that you may have against the client, such as an unpaid invoice and (2) any defence you may have against the client, such as a cap or other limitations on liability contained in the original contract.

Finally, you should avoid any suggestion that the report is to be treated as if it had been originally prepared for the assignee. For this reason, requests to change the name of the client referred to in the report should be firmly resisted.

**Conclusion**

Whilst it is difficult to completely avoid potential liability to third parties involved in a construction project, recent case law suggests that the courts will be sympathetic to your position. The BDW Trading case confirms that a claim in respect of a report prepared for a client can be relied upon by a third party only where there is a formal assignment. Also, limits of liability, net contribution clauses and exclusion clauses have all been enforced by the courts of late. It is therefore worthwhile ensuring, first, that the main contract with the client limits liability insofar as possible: this will involve standing firm as regards reasonable limits of liability and the inclusion of net contribution clauses. Thereafter, all collateral warranties/assignments should echo, or enhance, those limitation of liability clauses.

Zita will be speaking at the half-day AGS Commercial Risks and How to Manage Them Conference which is taking place on Wednesday 22nd January 2020 at the Manchester Conference Centre in Manchester. For further information on the conference and to book your place to attend, please visit the AGS website or email ags@ags.org.uk.