BirkettLong

Construction Law

news and advice from Birkett Long

Spring 2011

Limiting Liabilities in Contracts

Often, one of the most contentious points when negotiating a contract is whether clauses should be included which limit a party's liability, should that party breach the contract. These are known as "limitation clauses".

Often, such clauses try to restrict liability by identifying the types of losses for which the party in breach will not be liable. The most popular phrase is to say the party will not be liable for "indirect and/or consequential loss". The courts have held that indirect and consequential losses are in fact the same thing.

However, it is often misunderstood what losses these words would exclude. The problem stems from the fact that some losses may be either direct or indirect depending on the circumstances. It is usually assumed that these words would restrict the losses that can be claimed to simply the physical damage caused by a breach and that the clause would exclude loss of profits and other economic losses, but that is not normally the case.

Direct losses are losses arising naturally in the ordinary course of things from the breach. Those losses are foreseeable and therefore recoverable which would, in a business situation, include loss of profit, other unlimited economic losses and damage to reputation or goodwill, as well as the cost of repairing the physical damage.

The losses that are excluded by such a clause are only those which would arise from a special circumstance of the case. If the party that breaches the contract was aware of those special circumstances at the time the contract was made, then even indirect losses are foreseeable and recoverable. If the party that breached the contract was not aware of the special circumstances then the losses would probably be too remote and not recoverable.

As this is the case, limitation clauses should be drafted very carefully. They will also be subject to a reasonableness test and that will depend on how they have been negotiated.

Furthermore, it has been held recently that if you simply include in the clause a list of some of the liabilities that could be included in indirect or consequential loss, you could still be liable for them. Therefore, if the clause states that the party in breach will not be liable for any "indirect or consequential loss (including, but not limited to, loss of goodwill, loss of business, loss of anticipated profits or savings and all other pure economic loss)" then a party would still be liable for all of these losses if they are direct rather than indirect. The court held that those losses were only excluded when they were indirect rather than direct losses.

There are a number of ways around such clauses, including listing the types of loss for which you would be liable. It is also possible to put a monetary limit on such losses.

If you require any assistance in drafting limitation clauses, please do not hesitate to contact Peter Allen on 01245 453813 or peter.allen@birkettlong.co.uk

Changes to the Construction Act 1996

As you are probably aware, there are a number of changes that are going to be made to the Construction Act 1996. We have covered the likely changes in a number of our previous newsletters.

The Act of Parliament making the changes was passed at the end of 2009, however a new scheme for construction contracts had to be approved before the Act could take effect. That is now likely to take place in October 2011. Once the scheme has been finalised, we will confirm all of the changes to the Act and how they may affect you.

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Adjudication and Tolent Clauses

When the construction sections of the Housing Grants Construction and Regeneration Act 1996 were introduced in 1998, subcontractors gained the right to refer disputes to adjudication with very little risk to themselves. They had the risk that they would lose but they would not have to pay the costs of the other party. Furthermore, if they were not substantial companies, they might even avoid paying the adjudicator's fees. In that situation, the successful party would end up paying their own legal costs and the adjudicator's fees.

To avoid this situation and, in truth, to try to put off subcontractors from referring disputes to adjudication, many large companies introduced clauses into their contracts that meant that the party referring a dispute to adjudication would be liable to pay all of the costs of the adjudication, including the adjudicator's fees and the legal costs of the responding party. As in most circumstances the adjudication would be started by the subcontractor claiming for monies due to it from the contractor, this meant that the subcontractor was going to end up paying the cost.

If the subcontractor had a claim of £30,000 it might be that it would be uneconomic to refer the dispute to adjudication because even if it won the whole of its claim, the costs it would have to pay would exceed the amount awarded to it. Unfortunately, such clauses were held to be valid in the case of Bridgeway Construction Limited v Tolent Construction Limited and hence the expression "Tolent clauses" came into existence in 2000.

This remained the position until 2010 when the point was challenged once more in the courts. In this case, it was held that Tolent clauses conflict with Section 108 of the Act and therefore they would be unenforceable and would be replaced by the Scheme for Construction Contracts.

Subcontractors should therefore no longer fear such clauses and should feel free to refer disputes to adjudication once more, knowing that they will not be liable for the other party's costs, whether unsuccessful or not.

Introducing David Rayner

David Rayner recently joined Birkett Long from Blake Lapthorn in Southampton.

He joins us as a partner in the Commercial Property Department where he deals with both real estate and environmental law. David's specialities include building contracts, appointments and warranty matters on behalf of commercial development clients as well as advising lenders on taking security over development agreements and approving warranty deeds for their protection. He also has an interest in environmental law and has delivered lectures to the Sustainable Construction Network on issues including CRC and green leases.

David has been identified as a leading individual of both real estate and environmental law by Chambers & Partners.

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