CONSTRUCTION : BULLETIN

Net Contribution Clauses
Are They Enforceable?

Defective construction work is often more than one party's fault. English law allows the employer to pursue any or all of the parties responsible for a defect, regardless of the extent to which they contributed to it. If the employer chooses to pursue just one party, that party can face a claim for damages representing 100% of the employer's loss, even if that party is not 100% to blame. The party who has been sued then has to pursue the other responsible parties for a contribution to the damages he has had to pay. This can be extremely problematic if the other responsible parties are insolvent or uninsured.

A net contribution clause ("NCC") is a type of limitation of liability clause which protects contracting parties (normally consultants) from being pursued for losses they did not cause. A NCC generally stipulates that where two or more parties are liable for the same loss or damage, the liability of each party will be limited to the amount that it would be fair and reasonable for them to pay, bearing in mind their responsibility for the loss.

The recent case of ***West v Ian Finlay and Associates*** provides helpful guidance to those using NCCs.

Background

Mr and Mrs West engaged Ian Finlay and Associates ("IFA") as architect in relation to the refurbishment of their home. IFA's appointment included a NCC which stated:

"Our liability for loss or damage will be limited to the amount that is reasonable for us to pay in relation to the contractual responsibilities of other consultants, contractors and specialists appointed by you."

Mr and Mrs West appointed a main contractor to carry out most of the work. They also directly appointed a number of specialist contractors to provide discrete elements such as balustrades and wooden flooring.

The refurbishment works turned out to be significantly defective and Mr and Mrs West had to move out of the property whilst remedial works were carried out. The main contractor became insolvent, so Mr and Mrs West pursued IFA, alleging that IFA had failed to advise them properly and failed to notice the defects.

Mr and Mrs West claimed around £800k from IFA in respect of the costs of dealing with the defects and subsequent consequential losses.

The High Court Case

The court decided that IFA had been negligent by failing to notice the poor quality of the works. The court then considered whether IFA could rely on the NCC to limit its exposure to damages.

Although the court considered the NCC was enforceable in principle, it also considered that there was more than one interpretation of the NCC. In the circumstances, the words "*other consultants, contractors and specialists*" could mean either (1) everyone Mr and Mrs West entered into a contract with, except IFA, or (2) the various specialist contractors or suppliers whom Mr and Mrs West entered into direct contracts with outside the main building contract.

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Since there was doubt about the meaning of the NCC, and given that Mr and Mrs West had contracted with IFA as consumers, the Unfair Terms in Consumer Contracts Regulations 1999 ("UTCCR") applied. This required the court to interpret the NCC in the way which was most favourable to Mr and Mrs West.

The most favourable interpretation was the second one (i.e. the NCC referred to specialist contractors but not to the main contractor). Accordingly, IFA could not rely on the NCC to avoid paying damages for losses caused by the main contractor. What's more, IFA could not recover those losses from the main contractor because the main contractor was insolvent.

IFA appealed the court's decision.

The Court of Appeal Decision

In the Court of Appeal, IFA argued that the high court had failed to adopt the ordinary and natural meaning of the words in the NCC.

The Court of Appeal agreed with IFA. The Court of Appeal's view was that the wording of the NCC was crystal clear. There was no limitation on the words "*other consultants, contractors, and specialists appointed*", so they must be taken to mean all parties falling within those categories, including the main contractor. Although the Court of Appeal judges accepted that the high court judge was entitled to look at the factual background of the case, they did not think the background (i.e. the contracting arrangements adopted by Mr and Mrs West) should lead to a conclusion that the NCC used the wrong wording.

Since the NCC was clear and unambiguous, there was no need for the judge to have resorted to the UTCCR to determine how the NCC should be interpreted.

Mr and Mrs West then argued that the NCC was unfair pursuant to either the UTCCR or the Unfair Contract Terms Act 1977 ("UCTA"). Although the two pieces of legislation are different (UTCCR is aimed at consumer contracts and UCTA is aimed at business contracts), similar considerations apply to them both.

Although the Court of Appeal judges recognised that the NCC did benefit IFA and impose a disadvantage on Mr and Mrs West in terms of transferring the risk of contractor insolvency onto them, they nevertheless rejected the argument that the NCC was unfair under either UTCCR or UCTA. Their reasoning was that:

- The imbalance the NCC created between the parties was not significant because the RIBA standard forms include NCCs and a NCC is not unusual in a commercial contract.
- Although IFA had recommended the main contractor, it was Mr and Mrs West who ultimately took the decision to appoint the main contractor. Mr West had a banking background and would have appreciated the importance of the main contractor's financial stability.
- The parties had equal bargaining power.
- Mr and Mrs West were not forced to accept the NCC. It had been open to them to renegotiate the NCC or appoint a different architect.
- Mr and Mrs West were undoubtedly aware of the existence of the NCC as it was placed prominently in the appointment.
- There was nothing to indicate that the NCC was contrary to good faith.

IFA therefore won the appeal and was entitled to benefit from the NCC.

Analysis

This judgment confirms that NCCs, even if poorly drafted, are likely to be enforced and that arguments of unfairness are unlikely to succeed.

Interestingly, even though the Court of Appeal found the NCC to be reasonable, it did point out that it was not clear from the drafting that the effect of the NCC would be to push the risk of contractor insolvency from IFA onto Mr and Mrs West. Indeed, the NCC's use of the word "reasonable" rather diverted attention away from the potentially serious consequences of the clause. However, the Court of Appeal also said that IFA had not intended to trap or deceive Mr and Mrs West.

It is true that conventionally drafted NCCs, including those used in the RIBA and ACE standard forms, are not expressed in a way which makes the full impact of the NCC clear. To minimise the risk of arguments about unfairness, consultants may wish to consider more clearly explaining to their clients (particularly consumers) how a NCC operates. However, there is of course a risk that if the effect of the NCC is clearly explained, the client is much less likely to accept to it!

It is also noteworthy that the Court of Appeal stated "*we doubt whether any lawyer advising a commercial party to a building contract would be likely to object to such a term or press for its deletion*", seemingly suggesting that NCCs should be seen as the commercially fair and acceptable standard. In our experience, this is not the case. The inclusion of a NCC in a consultant appointment is often a hotly contested issue, with neither the client nor the consultant wishing to bear the risk of the other parties involved with the project becoming insolvent. It remains to be seen whether the Court of Appeal's apparent endorsement of NCCs will be seized upon by consultants as justification for their inclusion in appointments.

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