Risk Management Briefing

Net contribution clauses 2008

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Introduction

Owing to the English common law legal principle of joint liability, and the courts' approach to causation of loss, it is quite possible that a consultant might only be 30% responsible for a claimant's loss and yet have to pay 100% of the damages. Net contribution clauses, which aim to limit a consultant's liability for damages to a fair proportion based on its responsibility for the loss, are often put forward as a solution. In order to appreciate their significance this *Briefing* examines the background to and role of such clauses.

The legal background

The principle was demonstrated in the first instance judgment of West v Finlay in 2014, in which a net contribution clause was held not to be effective to reduce the architect's liability in that case. As discussed later in this Briefing, the judgment was over-ruled by the Court of Appeal on the grounds that the judge at first instance had been wrong to find that the net contribution clause was not effective. However, if there been no net contribution clause in the architect's appointment, there would have been no grounds, on this basis, to appeal against the first instance judgment that the architect was liable to pay 100% of the damages, notwithstanding that the contractor was responsible for a substantial proportion of the losses.

The problem in practice

Say, as an example, a claimant engages a consultant and a contractor and the consultant has a duty to inspect the workmanship of the contractor. The claimant suffers loss or damage as a

result of the contractor's bad workmanship and it is also held that the consultant negligently failed to identify this bad workmanship. Common sense would suggest that each party would be separately liable to the claimant for part of the loss or damage.

In fact, the contractor and consultant is each 100% liable to the claimant …

In short, there are two causes of the loss or damage in question; with the consultant being liable for one cause (negligent site inspection) and the contractor being liable for the other (the bad workmanship). Note that the claimant is not entitled to recover more than 100% of its damages. Thus, if it is paid 100% of the damages by the consultant, it cannot then seek to recover the same or any amount from the contractor, even though the contractor is also liable.

… but they can claim contribution from each other

The consultant and contractor can, however, make a claim against each other for contribution under the Civil Liability (Contribution) Act 1978, so that, if the consultant does pay 100% of the damages to the claimant, it can seek a contribution from the contractor. The court can take into account such factors as degree of fault and extent of causation, but only insofar as these are relevant to the claim for contribution. What often happens in practice is that the claimant sues both the consultant and contractor and the court apportions liability between them. An example where the principles used to assess apportionment are usefully set out is *Carillion JM Limited v Phi Group Ltd* [2011].

The right to claim contribution may not be sufficient

In our example, if the contractor cannot pay its apportioned share, the consultant will have to pay the full amount. All this is really saying is that ***the right to claim contribution, as with the right to claim anything else, is only as good as the financial standing of the person against whom one is making the claim.***

Thus, as explained in the example above of bad workmanship by the contractor and negligent site inspection by the consultant, if say 30% is apportioned to the consultant and 70% apportioned to the contractor but the contractor cannot pay (perhaps because it is insolvent or because it does not have an insurance policy that covers the relevant categories of loss), the consultant will have to pay the full amount. This does not mean that, as a result of the contractor's insolvency, the consultant's liability to the claimant increases from 30% to 100%. The consultant is 100% liable to the claimant anyway. The effect of the contractor's insolvency is that the consultant cannot make good its right to recover a 70% contribution from the contractor.

There are other potential limitations on a claim under the 1978 Act:

1. The consultant can only claim contribution from the contractor if the contractor is also *liable to the claimant*. It may be that, while the contractor, as well as the consultant, have been responsible for the loss or damage in question, the contractor is not liable to the claimant, because, for example, there is no contract between the claimant and the contractor. This can arise where the consultant's liability to the claimant arises out of a collateral warranty given by the consultant, but the contractor has not given a warranty.

2. The contractor might not be liable to the claimant where the liability for the loss or damage in question is excluded under the terms of the contract between the claimant and contractor. An example of this occurred in the case of *Cooperative Retail Services Ltd v Taylor Young Partnership* (2002). Here the building works were damaged by a fire, due to defective workmanship that had not been discovered by the consultants while inspecting. The owners sued the consultants, who claimed contribution from the contractor. The claim for contribution failed, as the court held that the contractor's liability for this type of damage was excluded under the terms of the JCT contract.

3. Also, the consultant will not be able to claim contribution from the contractor unless the contractor is liable in respect of *the same loss or damage* as the consultant. The courts have construed the expression quite narrowly.
Thus, while for all practical purposes the losses suffered by the claimant due to the breach of duty of the consultant may seem to be the same as those due to the breach of duty of the contractor, if it is not technically the same loss or damage, the claim for contribution will fail.

4. It should also be noted that even if a claim for contribution is successful, it is likely that not all the costs in bringing the claim will be recoverable.

A net contribution clause aims to deal with these kinds of problems

The purpose of a net contribution clause in a contract therefore is to overcome the kinds of difficulties described above for the party seeking to rely on a right to contribution. A net contribution clause aims to limit the liability of the consultant to the amount which would be apportioned to that party by a court.

Under a net contribution clause it is important to state two assumptions, and these are that any third party responsible for the same loss or damage is:
(i) also contractually liable to the other party to the contract, and
(ii) has paid its fair share to the other party – ie the share that would be apportioned to it under the 1978 Act if both were sued together.

Thus, in a contract between the consultant and the claimant, the effect of a net contribution clause is that the contractor would be deemed to be contractually liable to the claimant and to have paid to the claimant the proportion of the damages that would be apportioned to the contractor on an apportionment between the consultant and contractor if the claimant had sued both consultant and contractor, leaving the consultant only having to pay the balance.

Net contribution clauses are now to be found in most of the standard forms of appointment and collateral warranties. For example, the appointment forms of the RIBA, RICA and ACE include net contribution clauses that set out the assumptions listed above.

Net contribution clauses in practice

There are potential problems, however, with net contribution clauses. The wording varies, and ***each clause must be considered on its merits.*** In any given case, the court is likely to be

concerned about how it determines the amount that would be apportioned to a party which is not before the court. Also, the effect of a net contribution clause is to limit the liability of the party relying on it, by the amount that would be apportioned to the third party. This means that it may be open to challenge under the Unfair Contract Terms Act 1977 (UCTA) or, in the case of a consumer, the Consumer Rights Act 2015.

A few cases concerning such clauses have been heard by the courts, where in general the clauses proved to be effective. For example, in *Langstane Housing Association Ltd v Riverside Construction Aberdeen Ltd* (2009) a net contribution clause was considered not to be unfair for the purposes of UCTA. In *West v Ian Finlay & Associates* (2014*)* a claim for negligence was brought successfully against architects in relation to renovation work to a residential property, but where the main contractor had become insolvent. The Court of Appeal found the net contribution clause in the architects' appointment to be effective in reducing the liability to a reasonable proportion of the losses.

However, despite these successes, the consultant should ensure that the wording of all clauses is checked, especially if in a non-standard document.

Allocation of risk

As a risk management tool, therefore, consultants often include a net contribution clause in their appointments or collateral warranties. A net contribution clause should not, however, be considered an alternative to a financial cap on liability. The consultant's share of the liability to a claimant may still exceed the level of its professional indemnity insurance, which will be particularly relevant given the Consultant's potential liability for repair of defective workmanship in the absence of the contractor. Caps are discussed in the Briefing 'Managing liability through financial caps' published by the CIC in 2015

This *Risk Management Briefing* is for general guidance only and legal advice should be sought to cover any particular situation.

This briefing was edited by Professor Sarah Lupton, Lupton Stellakis in conjunction with the CIC Liability Panel.
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