

Net Contribution Clauses in Construction Contracts - Are they fair and reasonable?

Briefing note

September 2009



Ask any Construction Specialist for their thoughts on net contribution clauses in construction contracts and you can guarantee a heated response.

Questions abound – are they fair and reasonable; are they standard practice or unusual; are they subject to the Unfair Contract Terms Act. In essence, are they even enforceable?

The purpose of a net contribution clause, or proportional liability clause as it is otherwise known, is to overcome the general common law principle of “joint and several” liability.

Net contribution clauses have become increasingly popular in recent years as professional indemnity insurers continue to look at innovative ways to limit or exclude the liability of their insured.

For example, where a client appoints a consultant, the client may be asked to accept a net

contribution clause in the appointment and/or in any collateral warranties which the consultant may be obliged to provide in favour of a third party beneficiary such as a funder, purchaser or tenant .

The main problem for the client / beneficiary is that the risk of insolvency of any other party who might be liable is passed back to the client / beneficiary.

They in turn are then unable to rely on the common law position of “joint and several liability” due to the inclusion of a net contribution clause. And therein lies the controversy.

How do net contribution clauses work?

Where liability arises under the appointment, rather than two consultants being jointly and severally liable to the client / beneficiary, they will only be liable to the extent it is “just and equitable” which, in the absence of agreement, will be decided by

the court.

Take for example a building that suffers substantial damage leading the employer to seek compensation for his losses.

If two consultants (for example, an Architect and an Engineer) were “jointly and severally” responsible for the same loss, it is the client’s decision as to whether it pursues one or both consultants.

If, for example, the Architect is insolvent, the client is likely to pursue the Engineer for all of its loss.

It is a decision for the Engineer as to whether it seeks a contribution from the Architect. However, if the Architect is insolvent, the Engineer may find that it is unable to recover a contribution from the Architect.

In contrast, if the Architect and the Engineer had the a net contribution clause in their appointment, they would only be



HUGH JAMES

liable to the extent it is “just and equitable”. This means that the client would have to pursue both the Architect and the Engineer in order to recover all of its loss.

If the Architect is insolvent, there may be little or no prospect of the client recovering that element of its loss. In this example, the client would only be able to recover from the Engineer to the extent it is “just and equitable”.

If the Architect and Engineer were each responsible for 50% of the client’s loss, the client could only recover 50% from the Engineer and the other 50% from the insolvent Architect may not be recoverable.

This reverses the common law position that where the client suffers loss, he may seek damages from all or any of those parties who might be liable.

Consultants often include these clauses as part of their standard terms and conditions or they often ask that such a clause is included where the client proposes the form of appointment.

The inclusion of such a clause can reduce their professional liability insurance premiums significantly.

Consultants often argue that they should not have to bear the risk of the client contracting with other consultants, who in the event of insolvency effectively pass a “joint

and several” liability onto them.

The same logic applies where one consultant has cover for “each and every claim” and another consultant has “aggregate” cover which may have been expended during a period of insurance due to a poor claims record.

Clients argue that they should not have to bear the risk of not being able to recover 100% of their losses and that the common law position of joint and several liability should apply.

What is the current position?

Until recently, these clauses remained untested by the courts – a sign perhaps of the industry’s reluctance to put them to the test.

However, the recent Scottish case of *Langstane Housing Association v Riverside Construction (Aberdeen) Ltd [2009]* has offered some guidance on the subject.

Although this case turned on its facts, the court indicated that there was nothing unusual about the type of clause.

Clauses were drafted by professional bodies and were in wide use. It was also suggested that the employer would be able to insure against the risk of unrecoverable losses from insolvent parties.

This seems to point towards a failure of an argument that a net contribution clause is unduly unfair and should be struck out under the Unfair Contract Terms Act, where the client is an experienced developer.

In such cases, the client often dictates the terms of the appointment and it is the consultant that requests any amendments such as a net contribution clause.

In the majority of cases, the Unfair Contract Terms Act argument is unlikely to be relevant.

Where do we go from here?

Whilst Langstane hasn’t answered questions about the enforceability of net contribution clauses definitively, it does seem that the courts are satisfied that such clauses meet the requisite tests to be fair and reasonable.

Whilst the clauses are still up for negotiation, clients need to be aware that where such clauses are included in appointments and collateral warranties, they risk being able to recover only proportional parts of any losses.

Whilst it may be possible to obtain insurance to cover these potential shortfalls this will obviously come at a cost.



For more information, contact:

Ioan Prydderch Partner, Head of Construction, Energy and Projects

ioan.prydderch@hughjames.com