Risk Management Briefing

Liability to third parties for reports

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A consultant prepares a report in connection with a property or a project for a client. The report is passed to a third party who relies on it in some way. In what circumstances could the consultant become liable to the third party for any deficiencies in the preparation of the report?

This Risk Management Briefing considers three situations which could give rise to potential liability, namely:

- the client assigns to the third party the benefit of the client's contract with the consultant (the contract);
- the consultant incurs a liability to the third party in tort; or
- the consultant agrees to be liable to the third party.

This Risk Management Briefing includes example disclaimer wording and other guidance on some of the steps that consultants can take to reduce the risk of third party claims. The guidance may also be relevant in situations where a consultant is asked to issue a certificate in relation to completed work where the certificate contains assurances as to quality.

1. The client assigns the benefit of the client's contract with the consultant to a third party

Unless assignment is prohibited in the contract (which can be done), normally the client would be free at any time to assign the benefit of the contract to a third party. Any such assignment would usually take place when the client sells or transfers its interest in the project to the third party, but it could take place some time later. If the contract requires the consultant's consent to the assignment, that must be sought and given for the assignment to be effective.

The assignment would give the third party any rights that the client may have against the consultant under the contract. Provided that the consultant has been given notice of the assignment, the third party would be entitled to sue the consultant in its own name for any breach of the contract committed by the consultant.

The effect of the assignment is to give the third party the same rights under the contract as the client would have had – no more and no less. Thus, the consultant should be in no worse position, by virtue of the assignment, if faced with a claim for breach of contract, than it would have been in without the assignment. The claim will simply be brought by the third party instead of the client. The same defences will be available as if the claim had been brought by the client. The statutory limitation period will run from the same date – i.e. the date of the alleged breach of contract.

The damages recoverable by the third party would probably be no more than those that would have been recoverable by the client. Questions may arise if the third party is in a different business to the client or has a different interest in the project in question, and therefore might incur losses of a kind that would not have been suffered by the client. The third party would probably not be entitled to recover for such losses against the consultant, under the assignment.

However, assignment of a cause of action most commonly takes place when the third party is taking over (or has taken over) the client's interest. As such any losses that the third party suffers as a result of the consultant's breach of contract are likely to be of the same kind that would have been suffered by the client and therefore recoverable from the consultant.

In July 2006, the Court of Appeal in *Technotrade Ltd v Larkstore Ltd*. rejected the argument that an assignee in these circumstances cannot recover substantial damages at all, on the ground that the assignor will have suffered no loss.

2. The consultant incurs a liability to the third party in tort

The consultant may incur a liability to the third party in tort, independently of its contract with the client.

The circumstances in which a person giving professional advice may incur liability to a person with whom it does not have a contract have been considered by the courts on many occasions. Some of the leading cases were reviewed by the Court of Appeal in 2005 in the case of *Precis (521) plc v William M Mercer Ltd*. This case concerned a report prepared for a company which was later sent to some prospective buyers of the company's shares. The court held that, in the particular circumstances of that case, the makers of the report did not owe a duty to the prospective buyers.

It is not possible to state definitively the circumstances in which the consultant would be held to have owed a duty in tort to the third party. Key considerations are likely to include:

- the relationship between the consultant and the third party (e.g. if the relationship is a direct one, sometimes termed 'akin to contract');

- the precise circumstances in which the report was prepared and in which it was sent to the third party;

- the extent to which and the purposes for which the third party relied on the report;

- the extent to which the consultant knew of this reliance and had agreed to it or should have anticipated it; and

- whether, taking all such considerations into account, the consultant could be said to have assumed responsibility to the third party for any deficiencies in the report due to negligence on the part of the consultant.

A duty will not necessarily arise simply because the report is passed to the third party. However, if the consultant agrees to a request that the report be passed to the third party, it may, depending on all the circumstances, be difficult for the consultant to show that it did not know or anticipate that the third party would rely on it, and this might indicate an assumption of responsibility by the consultant to the third party

Disclaimer

It may be possible to prevent liability in tort arising by means of a disclaimer.

The following words in a valuation report on commercial properties prevented liability from arising, where the interest of the party to whom liability was alleged to be owed was unknown to the valuer:

This report is for the private and confidential use of the clients for whom the report is undertaken and should not be reproduced in whole or in part or relied upon by third parties for any use whatsoever without the express authority of the surveyors.[1]

The appropriate wording of a disclaimer may depend on the circumstances. In some situations, it may not be feasible to attempt to prevent the report being shown to other parties, but a disclaimer along the following lines may help to prevent liability to any such party arising:

This report has been prepared by [consultant] on behalf of [client] in connection with [project] at [site] and takes into account their particular instructions and requirements. It is not intended for and should not be relied on by any third party and no responsibility is undertaken to any third party.

Or –

[The consultant] accepts no duty or responsibility (including in negligence) to any party other than [original client] and disclaims all liability of any nature whatsoever to any such party in respect of this report.

A disclaimer should be reiterated to the client and if possible to the third party direct.

In the event of a claim, the consultant may be required to show that any disclaimer of liability was reasonable under the Unfair Contract Terms Act. In *Barclays Bank PLC v Grant Thornton UK LLP*[2] accountants prepared non-statutory audit reports for Von Essen Hotels

[1] This wording comes from *Omega Trust Company Ltd v Wright Son & Pepper* [1996] EWCA Civ 1233, (17 December 1996), Court of Appeal.

[2] [2015] EWHC 320 (Comm); see also the case of *Galliford Try v Mott MacDonald* [2008] EWHC 1570 (TCC), where a disclaimers on an engineer's drawings were found to be effective in preventing a liability in tort.

Limited, part of a hotel group (VEH). The reports contained disclaimer clauses on the first page which stated that the report was prepared solely for the company's director and that:

"To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's director… for our audit work, for this report, or for the opinion we have formed."

The disclaimer was found to be effective against the bank that had been sent the reports by VEH, and also to be 'reasonable' in respect of the Unfair Contracts Terms Act 1977 (Under section 2 of the Act, liability for negligence cannot be excluded or limited unless the requirement of reasonableness). In this particular case the clause was clear and the parties were experienced commercial entities. However, it should be noted that the courts will look at the facts in each case, and in some circumstances may take a different view as to what is reasonable.

3. The consultant agrees to be liable to a third party

Often, in circumstances where the report includes such a disclaimer, or otherwise, the consultant may be asked to allow a third party to rely on its report. For example, prior to committing to the purchase of a site for development, the purchaser may wish to rely on the consultant's site investigation report, condition survey or such other report. In practice the most common scenarios are:

- the client asks the consultant to 're-address' its report to the third party;
- the client asks the consultant to 'assign the benefit of' its report to the third party
- the client asks the consultant to 'confirm that the consultant owes a duty of care to the third party in respect of the report'; and
- the third party asks the consultant to 'confirm that the third party can rely on a report prepared earlier for the client'.

In these circumstances, the consultant may be asked to remove the disclaimer from its report and/or enter into a contract with the third party, usually by means of a collateral warranty or 'letter of reliance'. The consultant may be asked to agree this in its contract with the client or may be asked to do so later.

The consultant does not of course have to agree to such a request but may be willing to do so for commercial reasons. However, it should bear in mind that it may incur liability to the third party for losses for which it would not have been liable to its client and that the liability may not be subject to any limitations contained in the contract with its client.

Therefore, if the consultant is willing in principle or under commercial pressure to accept liability to the third party, appropriate terms, including sensible limitations of liability, should be sought – for example, there could be a limit on the types/amount of losses recoverable and/or a limit on the period of time for which the consultant could be liable. The collateral warranty or 'letter of reliance' should also include a provision stating that the liability of the consultant to the third party shall not be greater or of any longer duration than the consultant's liability to the client under the relevant contract. Such provisions may also limit

(or exclude) any liability to the client arising by either of the other ways described above – ie by assignment of the benefit of the contract with the client or in tort.

Note that if the operation of the Contracts (Rights of Third Parties) Act 1999 is not excluded in the contract and there is a term in the contract with the client that purports to be for the benefit of the third party – for example, a term that allows the report to be shown to and relied on by the third party – it may be able to bring a claim against the consultant under the Act.

This Risk Management Briefing is for information only, and insurance or legal advice should be taken to cover your particular circumstances.

This briefing was prepared by the CIC Liability Panel, chaired by Professor Sarah Lupton.

It is available at www.cic.org.uk

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