Risk Management Briefing

Novation of consultants' appointments

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Introduction

It is not unusual for a consultant to work on a project for an employer up to a certain stage, and then transfer to working for a design and build contractor taken on by the employer. Alternatively, the consultant may transfer to work for a new client who has taken over the project. The term 'novation' is often used in the construction industry to refer to such situations, i.e. where a consultant engaged by a building owner or developer (the client) to perform professional services is then engaged instead by a design and build contractor, or another developer or other organisation (the 'contractor/new client') on the same project.

There are generally considered to be two main methods of achieving this transfer, termed 'consultant switch' and 'novation ab initio'. Both are generally called novation agreements but their legal effect is very different.

The first is not a novation in the traditional sense. The agreement recognises the reality of the situation – that the consultant worked for the employer at the outset and then from a certain stage switched to working for the contractor/new client.

The second is based on the traditional form of novation, but creates the fiction that the consultant worked for the contractor/new client from the outset. The exact process for each method is as follows:

Consultant switch

The original appointment with the client is brought to an end and a new appointment is entered into with the contractor/new client. A supplementary agreement (a novation agreement) between all three parties is necessary to effect this change. The consultant will normally remain liable to the original client for any breach of duty under the earlier appointment, but will not be liable to the original client for any default in services performed

for the contractor/new client (unless a consultant–employer warranty is entered into). The consultant will be liable to the contractor/new client for services performed under the new appointment, and may accept liability to the contractor/new client for services performed for the client pre-novation.

The CIC publishes the CIC Novation Agreement – Switch 2021 (formerly published as the 2004 CIC Novation Agreement) for use in this situation.

Novation ab initio

The original appointment with the client is replaced by an appointment on identical terms between the consultant and the contractor/new client. A simpler (although less accurate) way of describing the process is that the contractor/new client will replace the client under the original appointment. The contractor/new client accepts all the obligations and liabilities that had formerly been the client's under the appointment, and the consultant's prior and future obligations/liabilities are now owed to the contractor/new client. The consultant will have no liability to the original client, including for any mistakes made earlier while working for it (unless a warranty is entered into).

The CIC publishes the CIC Novation Agreement – Ab initio 2018 for use in this situation.

From the consultant's point of view

Either process is complex, and needs to be handled carefully. A consultant originally appointed by a client is under no legal obligation to agree to being novated, unless this was agreed to and set out in the original appointment. Furthermore, there would be no obligation to accept any particular terms unless these had been set out or referenced in the appointment. Generally, the 'Switch' process is simpler and represents less risk to the consultant, however many clients prefer an ab-initio approach. The risks can be reduced by adopting the CIC standard terms. Bespoke terms should not be accepted without taking expert advice (see the section on Ad hoc provisions below).

Associated warranties

In engaging a contractor to design and build a project, an employer may sometimes have recourse against the contractor for all work done (including design work) by a novated consultant, both before and after the novation. This will depend on the exact terms of the construction contract. For example, the FIDIC Silver Book makes the contractor liable for all errors in information provided to it at tender stage, which would include information prepared by novated consultants. If this is the case, the client will not need a warranty from the consultant (although it may wish for one as an additional level of protection).

Similarly, if the appointment is being novated to a new client, such as another member of the client's group or another company which has acquired the client's interest in the project, the client should not need a warranty from the consultant.

However, a contractor's liability for design will depend on the terms of the design-build contract and, in some cases, it will be limited to design it undertakes post tender. In the JCT Design Build Contract, if used un-amended, the contractor is not liable for design contained in documents provided to the contractor at tender stage. In such cases the employer is likely to require a warranty from the novated consultant. Furthermore, even in situation where the employer has recourse against the contractor, it may also require a warranty as an added protective measure in the event, for example, that the contractor becomes bankrupt.

The CIC publishes warranties that may be useful in these situations

Switch: warranty from the consultant to the employer (the original client of the consultant):
In most cases the employer does not need a warranty from the consultant in respect of post-novation services, as the contractor will be liable to the employer for these services. If, however, the consultant agrees to give the employer such a warranty, an appropriate form would be the CIC Collateral Warranty Consultant – Employer: Switch (CIC/ConsWa/E/Switch).

Ab initio: warranty from the consultant to the employer (the original client of the consultant):
As above, a warranty may not be needed, as the contractor will be liable to the employer for the consultant's services. However, if a warranty to the client is required, the CIC Collateral Warranty Consultant – Employer (CIC/ConsWa/E), could be used. Alternatively, the appointment could provide that the client will be entitled to enforce the rights in a third party rights schedule following novation.

Important inclusions in the CIC novation agreements

Changes to services: Care needs to be taken so that the services to be performed by the consultant for the employer and for the contractor are properly recorded. If the consultant is, say, inspecting workmanship on behalf of the contractor its obligations will be slightly different from those it would have if the consultant was inspecting on behalf of the employer – it will not issue certificates, for example. There is a schedule attached to both the CIC Novation Agreements where the changes in the services (and fees, if any) can be recorded. A second schedule provides for any changes in the former client's obligations to be recorded.

'No Loss' argument: Under both the CIC Novation Agreements the consultant agrees that it will not argue that the contractor/new client has not suffered the loss being claimed on the basis that the client did not suffer a loss. The client will not, in fact, have suffered any loss as a result of a breach of duty by the consultant in preparing designs prior to novation if the client has passed the risk of all such losses to the contractor/new client. The CIC Novation Agreements, therefore, prohibit the consultant from raising this 'no loss' argument as a defence, thus allaying a concern that has sometimes been expressed about the possible effect of the 2001 Scottish case of *Blyth & Blyth Ltd v Carillion Construction Ltd*.

Net contribution clause: The CIC Novation Agreement – Switch (but not ab initio) contains, in addition to the above, a net contribution clause, providing protection to the consultant, which states that 'Without prejudice to any other exclusion or limitation of liability, damages, loss, expense or costs the consultant's liability shall be further limited to that proportion thereof as it would be just and equitable to require the consultant to pay having regard to the extent of the consultant's responsibility for the same…'

Limits on liability: Most ad hoc novation agreements do not contain a statement that prior to novation the consultant was acting solely on the instructions of the client in performing its obligations and taking into account the interests of the client. The new CIC forms include this statement to prevent the contractor/new client bringing claims against the consultant for failing to perform its pre-novation services in a way that benefited the contractor/new client, rather than the client.

Ad hoc provisions which create problems

Problems can be created by a number of other provisions which are frequently found in ad hoc versions of either type of novation agreement.
Examples of such provisions are:

1. Inclusion of 'retained services' whereby the consultant agrees to perform services for the original client post novation. This creates conflict of interest situations, as the interests of the original client and the contractor/new client are generally different, and is likely to be a breach of many consultants' professional Codes of Conduct. Additional drafting may be added to address the conflict, e.g. an acknowledgement by all parties that the consultant is instructed to act for both clients simultaneously, that both clients are aware of the consultant's obligations to the other and accept that the consultant may be obliged to inform both clients of information which could be adverse to the interests of either. Any such drafting should be reviewed by the Consultant's insurers / advisors.

2. An undertaking or warranty that the consultant owed a duty of care to the contractor/new client from the outset, or a direct warranty (e.g. 'the consultant warrants to the contractor/new client that the consultant has exercised reasonable skill, care and diligence in the performance of its duties under the appointment'). As commented above, this is not a warranty in the usual form, which is that, 'the consultant warrants that he has exercised reasonable skill and care in the performance of its duties to the employer under the appointment'. The difference is important. To reflect reality, the consultant should only warrant the obligations that were owed to the employer pre-novation: the consultant should not retrospectively create new obligations to the contractor/new client.

3. An acknowledgment or undertaking that the contractor has relied on the information and advice provided by the consultant to the employer – despite the fact that the information and advice was provided with the employer's interests in mind. Accepting this would mean the consultant was accepting a tortious obligation to the contractor/new client in respect of work done whilst its client was the employer.

4. An acknowledgement or undertaking that any losses suffered by the contractor/new client arising out of the services provided by the consultant for the employer were within the contemplation of the consultant at the date that the consultant first entered into a contract with the employer – even though at that stage the consultant may have had no idea who the contractor/new client would be. Again, in accepting this the consultant would be making itself vulnerable to claims for losses over and above those for which it would be liable to the original client.

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