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Practice Information Note

CIC BUILT ENVIRONMENT PROFESSIONS TOGETHER

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Managing liability through financial caps and time-barring clauses (Scottish Edition)

The CIC (Construction Industry Council) recently prepared a Risk Management Briefing on this topic. At the request of the RIAS, this has been kilted into a Scottish Edition. Our thanks go to David Wedderburn of RIAS Contracts Committee. This note supercedes N1750.

All construction professionals and especially architects, are concerned about unlimited liability in matters of negligence and competence.

It is quite in order to negotiate an appropriate level of cover with your client and ultimately, of course, to refuse to undertake a commission if you feel the conditions imposed by a client are too onerous. The paper below gives some guidance on when, why and how to put an agreed financial cap on your liability.

CIC Risk Management Briefing

The CIC Risk Management Briefing was compiled by Beale & Co on 19/02/2015 and kilted for Scotland by David Wedderburn.

Introduction

Every well-run business must manage the risks that it faces and there are many ways in which this can be done. Consultants protect themselves against the financial consequences of being sued with professional indemnity (PI) insurance. However, the insurance market may harden and consultants may be faced with increased premiums and excesses. There may also be restrictions on the cover available. Consultants may therefore find themselves underinsured or uninsured in the event of a claim. As a result consultants cannot simply rely on their PI insurance; they must actively manage liability through other means.

Although liability cannot be excluded or restricted in relation to damages for death or personal injury arising from negligence (Note, the decision in Allen Fabrications Ltd v ASD Ltd shows that whilst it is not possible to limit liability for death or personal injury arising from negligence, it is possible for a party in a chain to limit liability in respect of an indemnity for another party's breach; the relevant liability in such a case is not directly the injury.), parties to a contract can agree to limit almost any other liability that they may incur to each other, e.g. for breach of contract or negligence. This can be done in a variety of ways. One method – now accepted by many clients – is to agree a figure (a financial cap), beyond which the consultant will not be liable.

Recovery from a limited company or limited liability partnership is limited to its insurance cover and the assets of the company or LLP; even in the case of an individual or partnership, recovery is in practice similarly limited - no individual or partner has unlimited funds. A cap therefore gives clients as well as consultants a degree of certainty they would not otherwise have.

Whenever practicable, the cap should be discussed and specifically agreed with the other party. This is discussed further below, see Agreeing a cap.

Any limitation of liability will have to satisfy the test of 'reasonableness' under the Unfair Contract Terms Act 1977 ('UCTA'). What is reasonable depends on the circumstances of each case. UCTA is discussed in more detail below. The Unfair Terms in Consumer Contracts Regulations 1999 ("UTCCR") will also be relevant if the other contracting party is a consumer, although consideration of UTCCR is outside the scope of this briefing paper.

Great care needs to be taken in drafting clauses capping liability. In the event of a dispute over the application of the clause, any limitation of liability will be construed against the person seeking to rely on it. Legal advice should therefore be sought on the wording of the clause itself.

Some guidance is also given below on the related issue of limitation periods for the bringing of claims and contractual time-bars.

How does a financial cap work?

A financial cap on liability in a contract (for example, a consultant's appointment) operates to limit the damages payable by the consultant to the client under the appointment to the agreed amount. The scope of the cap depends on the terms of the contract and usually follows one of these options:

o The cap might apply to each and every claim so that each claim could be to the full value of the limit, for example: The liability of the Consultant under or in connection with this Agreement shall be limited to £X in respect of each and every claim.

o It might be drafted so that it applies on an aggregated basis. Here claims would be 'grouped' according to the particular event that caused the loss/damage, for example: The liability of the Consultant for any claim or series of claims arising out of the same occurrence or series of occurrences shall not exceed the sum of £X.

o It might apply as a total limit in which case, regardless of how many claims arose from the event that caused the loss/damage, the consultant's liability would not exceed the figure stated. This option offers the greatest certainty in relation to potential exposure. For example: The total liability of the Consultant under or in connection with this Agreement shall not exceed £X.

The total potential liability under a project needs to be taken into account. For example, a tenant collateral warranty might include a cap of, say, £250,000 in respect of all claims; but if a consultant has given warranties to three tenants, each one would be able to recover up to £250,000. Moreover, if all three tenants were able to recover as a result of the same act of negligence, this might constitute one claim under the consultant's PI policy and one limit of indemnity would apply.

Some limits of liability will expressly state that they cover claims both by the client and the beneficiaries of collateral warranties or third party rights. For example, clause 3-17 of the CIC Conditions expressly limits liability in the aggregate to the Client and "Interested Parties" (the parties identified as having the benefit of third party rights).

PI insurance v financial caps

A financial cap is not the same as the limit of indemnity under a consultant's PI policy. However, the indemnity limit of a PI policy will be one of the relevant considerations in deciding on the financial cap on liability (see below). The policy will have a limit on the amount insurers will pay. Once this limit is reached, no further payments will be made by the insurer. In contrast, where a contract does not incorporate a cap and the consultant is sued for an amount which exceeds the amount recoverable under his insurance, this will expose the firm to uninsured loss. Because consultants generally have few assets beyond the PI insurance they carry, a claim in excess of the available insurance could be the end of the firm. For this reason, and because of the restrictions placed on insurance cover, it is in the consultant's interests to seek a cap. From a client's point of view, moreover, a claim against an over-exposed consultant may well be worthless.

UCTA

As explained, it is not possible to exclude or restrict liability for death or personal injury resulting from negligence (section 2(1)). With regard to most other claims: "a person cannot so exclude or restrict his liability for negligence except insofar as the term or notice satisfies the requirement of reasonableness" (section 2(2)). This applies independently of any standard terms and whether or not one party deals as a consumer.

The requirement of reasonableness is: "that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made" (section 11(1)).

It is important therefore, that in determining the amount of a cap, the circumstances at the time the contract is made are considered. Where a person seeks to restrict his liability to a specified sum of money (a cap), regard shall be had to: "the resources which he could expect to be available to him for the purpose of meeting the liability; and… how far it was open to him to cover himself by insurance" (section 11(4)).

Application of UCTA in Scotland

UCTA comes in three parts with Part I, (Section 1-14) applying to England, Wales & Northern Ireland only, and Part II, (Sections 15-25) applying to Scotland only. The sections, from Part I, quoted above, have their Scottish counterparts, which are similar but not identical. Thus section 16(1)(a) voids any attempt to exclude liability for death or personal injury like section 2(1) and section 16(1)(b) has a similar 'reasonableness test' to that in section 2(2). In addition section 24(1), in relation to the fair and reasonableness test, is in similar terms to section 11(1) and section 24(3) has similar wording to section 11(4) regarding matters to be considered when fixing a financial cap on liability. Because of the similarity of wording and the differences in the volume of litigation within the two jurisdictions, cases on these matters arising in England & Wales are often considered persuasive in the Scottish Courts but it should always be remembered that the provisions are different and are enforced under different legal systems (some English cases may turn of specialities of English law not applicable under Scots law) and so care should be taken when trying to apply the reasoning in an English case to similar circumstances arising under Scots law.

Agreeing a cap

As explained, where possible, any proposed cap should be drawn to the attention of the other party to the contract. Preferably it should be discussed and specifically agreed. If this is done, it is much more difficult for the other party to successfully challenge the cap in court. In the case of a contract of appointment, the consultant should explain to the client how the cap will operate and how it is calculated; these discussions should then be recorded in detail (preferably in a letter).
In the case of a collateral warranty, the negotiations may be with the client rather than the beneficiary of the warranty; however, the cap should still be discussed, and the discussion recorded. Where repeat work is undertaken for the same client, any cap should be negotiated and agreed for each commission. Records of the discussion as well as any correspondence should be retained, particularly where the other party is not legally represented. It is helpful to include a note of how the cap was calculated.

How do you calculate a reasonable cap?

There is no simple answer or formula. It is sometimes suggested that a multiple of the fee is appropriate. However, each project has to be looked at on its merits. A number of factors should be taken into account, for example:

- the likely nature and extent of the risks of the project, having regard to its size, complexity etc;
- an assessment of the damages that would be payable in the event of a claim in negligence (e.g. the cost of repeating the work/construction costs);
- the resources that the consultant could be expected to have available to meet any liability;
- any previous dealings between the parties; and
- the amount and cover available to the consultant under his PI policy.

Case law application

The case law cited below shows that the enforceability of a limit of liability clause very much depends on the facts of the case, often turning on such matters as the bargaining power of the parties and whether or not the cap has been drawn to the client's attention and specifically negotiated**.**

The case of *James Moores v Yakeley Associates Ltd* helpfully illustrates what is a 'reasonable' cap. James Moores employed Yakeley Associates as architects, and their contract (on the terms of the RIBA Standard Form of Agreement 1992), included a cap of £250,000. The architects' fee was 8.5% of the construction cost, subject to a minimum of £19,125 and assuming a construction cost of £225,000.

The court held that the cap on the architects' liability was reasonable on the basis that:

- Both the client and his solicitor were aware of the existence of the clause imposing the cap and both had said that they were happy with the proposed agreement.
- The cap was not an arbitrary figure. It was based on the architects' assessment of the likely cost of the works. The judge accepted that it was a reasonable figure: 'It would take some quite exceptional circumstance, beyond the reasonable contemplation of the parties, to give rise to a liability for damages in a sum greater than the total estimated cost of the project itself'.
- The client had accepted in giving evidence that if the cap was roughly sufficient to cover the total building cost, that would be 'fair enough'.
- The cap was more than ten times the amount of the architects' fee.
- The client was in a stronger bargaining position than the architects; not only was there a recession and architects were chasing work, but the client was not in any hurry to enter into the contract and had a solicitor to protect his interests in negotiations.
- A comparison of the parties' resources showed that the architects had little, whereas the client was very wealthy.

The judge said that he was obliged to have regard to how far it was open to the architects to cover themselves by insurance. In this case, the architects had in place insurance of £500,000 which was in excess of the cap but was not determinative. He accepted the architects' explanation that the figure of £250,000 was considered reasonable having regard to the estimated cost of the project. In any event, they were concerned that they ought to leave some allowance in case they had to meet legal costs.

A contrast can be made with the case of *St Albans City and District Council v International Computers Ltd* where a cap on ICL's liability of £100,000 was not considered reasonable. ICL were engaged to write and operate a computer program to calculate the level of community charge; due to an error in the system, the council suffered losses estimated at over £1 million. There was no evidence to show that it was fair and reasonable to limit liability to £100,000. The court also had regard to the fact that ICL had liability insurance cover of £50 million.

Ampleforth Abbey Trust v Turner and Townsend Project Management Ltd also demonstrates the factors which should be considered in negotiating limits of liability. T&T's liability was limited to the amount of its fees (£111,321) but the court refused to enforce this limit on the basis that:

- **T&T's appointment required it to take out PI insurance with a limit of indemnity of £10 million** and upholding the limit of liability would render the greater part of the protection provided by this insurance **illusory**. It is therefore important that any limit of liability is considered in light of the insurance requirements under an appointment. Obligations to "take out" PI insurance should be resisted as it suggests that the insurance will be taken out specifically for the purpose of that project, whereas this is rarely the case. Wording such as that used in clause F8.1 of the ACE Agreement 1, which requires the Consultant to maintain sufficient insurance "to cover the Consultant's liabilities under this Agreement" can reduce the risk of inconsistency; and

- **T&T did not draw the Trust's attention to the limit of liability when providing the Trust with the appointment.** This was T&T's third appointment for the Trust and the previous appointments did not contain a limit of liability. The Trust had assumed that the previous terms would simply "roll over" and had not closely reviewed the appointment.

Further guidance on the enforceability of limits of liability was provided in Elvanite Full Circle v AMEC Environmental (2013). Although the court rejected Elvanite's claim on the merits, it went on to state that, had Elvanite's claim been made out, a limit of liability to the extent of AMEC's fees (or £50,000, whichever is less) would have been reasonable on the basis that:

- the appointment was between **two sizeable commercial entities** and there was no evidence that AMEC had taken unfair advantage of Elvanite;

- there was no "stark discrepancy" between the limit of liability and any PI insurance requirement, as in the Ampleforth case; and

- Elvanite had generally understood the terms of the Appointment.

The contract also reduced the limitation period in which a party could bring a claim to less than the 6 years imposed by statute. In considering this clause the Court referred to Inframatrix Investments Ltd v Dean Construction Ltd (2012) in recognizing that, as a matter of principle "the parties to a contract can vary the statutory six year limitation period".

This case underlines the importance of ensuring that a limit of liability is considered in light of any PI insurance requirement in the Appointment and of drawing the client's attention to any such limit of liability. It also recognises that, in principle, a term limiting the time in which a claim must be brought to less than the common law six years would be enforceable.

Finally, SABIC UK Petrochemicals Ltd v Punj Lloyd Ltd provides a reminder that caps on liability are construed against those seeking to rely on them. The limit of liability in this case was phrased in the following terms: 'the aggregate liability of the Contractor under or in connection with the Contract (whether or not as a result of the Contractor's negligence and whether in contract, tort, or otherwise at law)…shall not exceed 20%…of the sum of the Contract Price plus or minus the value of any Variations …'.

The Court held, albeit obiter, that the parties did not intend the cap to apply to the costs incurred by SABIC in completing the works following termination of the contract. This was in spite of the wide and typical wording seeking to limit aggregate liability “under or in connection with the Contract”. In addition (again obiter), it was concluded that monies paid under bonds (Advance Payment Guarantee and Performance Guarantee) should be deducted before the 20% cap on liability is applied. This is a reminder of the need to clearly denote in a limitation of liability clause what is to be included or excluded from the limitation.

Liability caps in sub-consultancy appointments

Care should be taken when negotiating sub-consultancy appointments. If a cap on a sub-consultant’s liability is agreed where there is no liability cap, or a higher liability cap, in the main appointment, this could result in the consultant being unable to recover from the sub-consultant the full extent of any liability incurred under the main appointment, notwithstanding that it may have been incurred as a result of the sub-consultant’s negligence or default. In these circumstances, the difference between the consultant’s liability and the amount recoverable from the sub-consultant may not be recoverable under the terms of the consultant’s professional indemnity insurance cover. Consultants should accordingly seek appropriate advice from their brokers before agreeing any liability cap in a sub-consultancy appointment, particularly if there is no cap, or a higher cap, in the main appointment.

Third party claims

Liability in relation to claims made by third parties (e.g. end users or adjoining owners) cannot be excluded or restricted in the absence of a contract between them (subject to the point below). In such a case therefore the consultant’s liability to third parties is unlimited, even where the liability to the client has been capped.

Where a consultant enters into a collateral warranty with a third party, the consultant’s liability to the third party can be limited. Standard forms of warranty – such as the CIC consultant warranties – limit the consultant’s liability to the costs of repair and include a net contribution clause; some forms of warranty also impose a financial cap on the damages recoverable or, more commonly, include a provision enabling the Consultant to rely upon any limit or exclusion of liability in the Appointment and to raise equivalent rights of defence as it would have against the client under the Appointment.

If a third party has been given the right to enforce a term of a contract between a consultant and a client under the Contracts (Third Party Rights) Act 1999 (“C(TPR)A’) (or in Scotland, where the C(TPR)A does not apply, under the Third Party Rights (Jus Quaesitum Tertio (‘JQT’)) arising under the common law), the parties to the contract can limit the liability to the third party, in the same way that liability can be limited in a warranty. If it is anticipated that third party claims might exceed an agreed cap, in appropriate circumstances, the consultant may wish to seek an indemnity from the client. Because a JQT arises under the Scots common law it would be advisable for the Consultant to seek legal advice if they wish to rely on, or limit, any such rights.

Contractual Limitation Periods

Consultants may also seek to limit the period during which they can be pursued by their client (or in a collateral warranty, the beneficiary) by means of a clause imposing a time-bar on claims. Although the contractual limitation period is commonly 12 or 6 years from practical completion, if possible it should be linked to the date on which the services were last performed/terminated. In addition, it is important that any time-barring clause enables the consultant to rely on any shorter statutory limitation periods and therefore it is common for any contractual time-bar to refer to “such earlier date as may be prescribed by law” (under the Scots law of prescription any rights or obligations which have, by statute, prescribed cease to exist regardless of whether or not the contractual time bar has expired – see note on Scots law of prescription below).

The limitation period or time-bar is particularly important in considering any collateral warranty, as in some circumstances liability under the collateral warranty may last longer than under the underlying appointment. For example, if a collateral warranty is to be executed as a deed, but the underlying appointment is a “simple contract”, liability under the collateral warranty could last longer than under the appointment, unless an express time-barring clause is included in the collateral warranty which is consistent with that under the appointment (see note below regarding Scots law on prescription, where form of execution of contract alone, does not affect prescriptive periods). Some professional indemnity insurance policies exclude cover for any collateral warranty which gives rise to longer lasting liability than the appointment and therefore it is important that the limitation period under any collateral warranty is considered very carefully.

Brief Note on Statutory Prescription under Scots Law (for more detailed advice seek Legal Guidance)

The approach of the law of Scotland relative to time bars is different to that of England. In England the statutory time bar is by way of limitation, which is a procedural bar whereby, after a certain period, remedies are no longer available even if the right or obligation still subsists, whilst in Scotland the statutory time bar (other than claims in relation to: person injury or wrongful death; Proceeds of Crime Act; and Consumer Protection Act) is by way of prescription whereby, after a certain period, the right or obligation is extinguished. The relevant Scottish law is the Prescription and Limitation (Scotland) Act 1973 (‘P&L(S)A’). Under P&L(S)A there is a short 5-year prescriptive period running, in relation to the obligation to make reparation (principally damages for breach of contract or for negligence), from when the wronged party was, or ought, with reasonable diligence, to have been aware of the loss flowing from that wrong (in the case of building defects the loss normally only occurs when there is physical damage). The starting point of this short prescriptive period can, therefore, be postponed, especially in relation to building defects although a recent Supreme Court decision has held that awareness (or deemed awareness) of the damage alone is sufficient to start time running. There is therefore a 20-year longstop, which starts running as soon as the loss, arising from the wrong, occurs regardless of whether or not the wronged party is aware of the loss (however, in relation to building defects, loss has been interpreted to require physical damage and thus even the start of the 20-year longstop can be delayed). The English limitation periods of 6 and 12 years therefore have no relevance under Scots law nor does the manner of execution of a contract affect the prescriptive periods applicable for rights and obligations arising under that contract. However it is possible under Scots law for the parties to agree to a contractual time bar but, whilst such a contractual time bar, properly drafted, can shorten the period of liability, it cannot extend the statutory prescriptive periods as once a right or obligation has prescribed it ceases to exist.

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

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This Risk Management Briefing is available at www.cic.org.uk/liability

26 Store Street
London WC1E 7BT