

Back to basics:

key legal principles behind professional indemnity claims in construction and engineering projects

1. THE BASIS OF THE OBLIGATION: CONTRACT VS COMMON LAW

Key principle	Contract	Common law
Where the obligations are set out	In the contract.	Built up through case law. No requirement for a contract.
Limitation periods	Time runs from the breach of contract. Six years for a contract signed under hand; 12 years for a deed.	Six years from date damage is suffered (although there are some exceptions). Three from actual or imputed knowledge of certain factors.
Pure economic loss	Recoverable, unless specifically excluded under the contract.	Only recoverable if there is a "special relationship" between the parties (see for example the "Spartan Steel" case).
Remoteness	Losses must be within the contemplation of the parties at the time of formation of the contract. Direct and indirect losses are different (see Hadley v Baxendale).	Losses must have been reasonably foreseeable by the defendant at the time the duty was breached ("The Wagon Mound" test).
Quantification of loss	To put the claimant in position it would have been in had the contract been performed – useful for claimants in "good bargain" cases.	To put the claimant in position it would have been in had the tort not been committed - useful for claimants in "bad bargain" cases.

Tip: Parties can have "concurrent liability", where they owe each other obligations under both a contract and at common law.

2. CONTRACTUAL "STANDARD OF CARE" ... AND WHAT IT ACTUALLY MEANS

Reasonable Skill and Care:

A professional agrees to carry out its work using reasonable skill and care. Objective test: the "man on the Clapham omnibus", or the "Bolam" test for professional liability. Normally covered by insurance policies, but be careful of inadvertently agreeing to a higher standard without insurers' approval.

Fit for Purpose:

A professional can expressly agree that their work product will be fit for the purpose required. For example, an architect agreeing their drawings will be suitable for a specific use - and if they are not, then the architect will be liable – regardless of whether he was negligent, the reason for the unsuitability or whether it was someone else's fault. Often not covered by insurance policies. Can be excluded or limited by contract.

Strict Liability:

Similar to fitness for purpose. For example, an architect agreeing their drawings will be entirely accurate - and if they are not, then the architect will be liable – regardless of whether he was negligent, the reason for the error, the impact of someone else, or any damage actually caused to the claimant.

Tip: Check the insurance policy and appointment are back to back.

3. TRANSFERRING OBLIGATIONS

Assignment:

- Transfers the benefit of a contract.
- Requires the consent of just the parties to the assignment.
- Legal assignment: Best practice. Must be in writing, absolute and on notice.
- Equitable assignment: Transfers just the equitable ownership. Can be verbal and does not require notice.

Novation:

- Transfers both the benefit and burden of the contract.
- Extinguishes one contract and replaces it with a new contract on the same terms but between different parties.
- Requires the consent of all the parties.
- Best practice is to use a formal Novation Agreement.

Tip: Think carefully about what obligations need to be transferred.

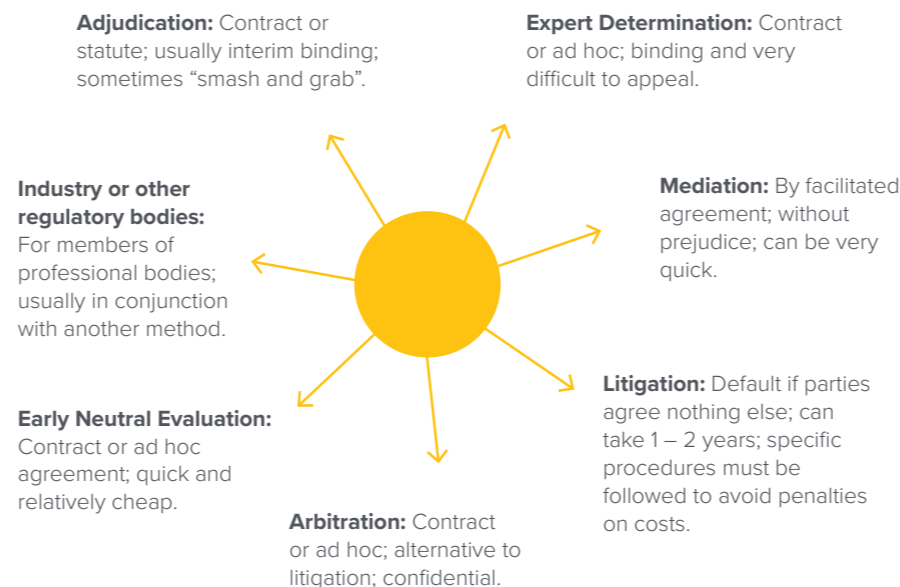
4. REDUCE THE RISK

If in doubt, take legal advice to ensure you are not exposed to unnecessary risks. For example, always check:

- The contractual chain: are contracts up and down the chain back to back? If not, you may get caught out.
- The contracts and your insurance policy: are they back to back? For example, standard of care.
- Net contribution clauses: limits a party's liability, when two or more parties to a construction project are liable for the same loss or damage, to the amount for which it is responsible as would be apportioned to that party by a court.
- Caps on liability: for example by reference to the professional consultant's PI insurance.
- Limitation periods: have the periods provided by the Limitation Act 1980 been amended?
- Exclusion clauses: are certain types of losses excluded? For example, consequential losses or anything excluded under the PI policy.

Tip: The lowest price is not always the best option. Check if the price is lower for a reason.

5. MAIN DISPUTE RESOLUTION FORUMS



Tip: Earlier is always better. If disputes arise, get advice quickly to keep all your options open.

6. ANY QUESTIONS?

For more in depth knowledge, see our "back to basics" booklet or contact us:



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