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Insights

THE BLACK HOLES OF NO LOSS ARGUMENTS

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SUMMARY

In Pegasus v Ernst & Young the advice from Mr Justice Mann was that:

“Whatever the metaphysician may say, the law says that the loss flowing can and should still be treated as a loss of the assignor which the assignee can recover. Black holes are to be (as all black holes should be) avoided where possible.”

So what are these black holes we need to avoid? In our universe, this arises because only a party to the contract can make a claim and the party to whom a contract is assigned cannot recover more than the original party. This was considered in detail by the House of Lords in Linden Gardens Trust v Lenesta Sludge Disposals and two exceptions were identified to the general rule, in order to prevent a party avoiding liability on the basis of a no loss argument.

SOME CONSTRUCTION EXAMPLES

If successful, a defence based on a no loss argument can be very effective. In construction, there are often a number of parties involved in a project and the longer duration of such projects means they are more likely to change over time. This is why there have been a number of construction disputes involving these issues and here are a few examples to consider.

In another House of Lords case, Alfred McAlpine v Panatown, the employer under the contract was a separate entity to the one that owned the land. The contractor’s no loss defence succeeded because the land owner had the benefit of a duty of care (a collateral warranty) and it was held this meant a remedy existed and the exceptions therefore did not apply.

In Technotrade v Larkstore, a site investigation report was prepared for a sloping site in Kent for residential development. It had no prohibition on assignment and a copy of the report was provided when the land was sold by the land owner to a developer. The report was incorporated into the construction contract by the developer and a landslip then caused damage, following which the land owner assigned the benefit of the report to the developer, who sued the surveying company

who prepared the report. The Court of Appeal rejected the "no loss" argument, holding that what was assigned was the cause of action, not the loss, and that:

> "The remedy in damages for breach of contract is not limited to the loss that could have been proved at the date when the breach occurred and the cause of action first arose."

In Riva Properties Ltd v Foster + Partners Ltd the contract with the architect was made by a company that did not own the land. The appointment permitted assignment and provided for collateral warranties to be given to the land owner, but this was never done. The architect's attempt to rely on Panatown failed, as the TCC held that it did not apply if parties contemplated future arrangements but never operated them such that an alternative remedy for the land owner did not exist.

THE LATEST EXAMPLE

The same issues came before the Scottish Courts in SRB Civil Engineering UK v Ramboll. The background here was that a main contractor entered into a design and build contract for up-grading works to Junction 1A of the M9 at the Queensferry Crossing. It sub-contracted design services to Ramboll, but following a corporate restructure the main contractor, the new main contractor entity and the employer entered into a formal novation agreement to effect a change of main contractor.

When design defects were identified that led to substantial remedial costs, the new contractor sought to claim damages from Ramboll, who argued that the original main contractor suffered no loss because it was released from any liability under the novation agreement.

Not surprisingly, this argument did not succeed. It was held that under the novation, the obligations of the original main contractor had been transferred, not extinguished, and the new entity was liable as if it had always carried out the works. The novation agreement was found to be a form of delegation, which meant the loss pre-novation was the same as the original contractor's loss would have been if there was no novation. The new entity's right to pursue the claim was based on a valid assignment and the point was made that in terms of quantifying the loss, there is no practical difference in the amount of the loss suffered by the original contractor and the new entity, and the new entity was liable to the employer as if it had always been the contractor.

IS IT POSSIBLE TO AVOID SUCH ARGUMENTS?

Assignment and novations can be tricky. In a similar context, involving a collateral warranty, in Orchard Plaza Management v Balfour Beatty, the contractor resisted a claim under a collateral warranty on the basis that it had been assigned and the damages were limited to what the original assignor could have claimed. The argument failed as the warranty contained a "no loss" clause that specifically addressed and prevented such arguments.

So while we will probably still see such arguments being raised, and even succeed in certain circumstances, parties need to be aware that this is an issue and, if possible, address it as part of the overall contractual arrangements.

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