The proposed reforms to the limitation of actions – the impact on the construction industry

Response by the City of London Law Society Construction Law Committee

Responses to the questions asked by the Ministry of Justice in its consultation paper – September 2009

The City of London Law Society

The City of London Law Society is the representative body of law firms with offices within the City of London. Nearly all of the top twenty UK law firms, by size and turnover, are members of the CLLS. The CLLS Construction Law Committee is made up of representatives of twenty three major City law firms. Committee members include many well known construction law practitioners acting for a wide variety of clients including employers, contractors, consultants and sub-contractors. Associate members of the committee include representatives from major contractors, insurers, employers and consultants. Members of the committee are familiar with the issues covered by proposed reforms to the limitation of actions and have first-hand experience of the operation of limitation periods in the construction industry.

We set out below our responses to the questions asked by the Ministry of Justice in its consultation paper on the impact of the proposed reforms to the limitation of actions on the construction industry.

Responses to the questions asked by the Ministry of Justice in its consultation paper

1. *"Question 1 – What effect will the changes recommended by the Law Commission have in general terms?"*

1.1 Proposed changes to the lengths of the current limitation periods

1.1.1 We agree with the Ministry of Justice's comment that construction disputes are usually of a contractual nature rather than tortious, but do not share the view (expressed by the Law Commission in its Report No. 270) that the current 6/12-year rule for contracts and deeds "creates needless complexity". Our view is that the additional period conferred by deeds is well understood and the main reason why construction contracts and consultants' appointments for most medium and large-scale projects are effected as deeds.

Accordingly, it is the Committee's view that, for such projects, the proposed reduction from the 12-year period for deeds would be a serious blow to the legitimate expectations of employers, developers, funders, purchasers and tenants. Also, given the greater propensity of deeds, this reduction would not be offset by the potential increase (from 6 years to 10 years) of the limitation period under simple contracts. Accordingly, there would be far more losers than winners among the innocent parties to contracts which have been breached,

1.1.2 The Committee's view is that the proposed 3-year period is potentially prejudicial to the innocent party where a contract has been breached, as under the current system such party would have a much longer period to assess the

optimum time to bring proceedings, taking account of its own and its counterparty's financial position. Under the proposed regime, there is the possibility of denial of justice or being disadvantaged if at the relevant time the claimant is not in a strong enough financial position to bring forward its claim or meet the expense of a pre-action protocol (which for high value and highly-complex claims can be significant).

1.1.3 The proposed 3-year primary period also seems to run counter to the Pre-Action Protocol for Construction and Engineering Disputes (in particular, the objective of encouraging parties to settle disputes without recourse to proceedings). It is thought that there could be an increase in the issue of protective applications to preserve claims (where the parties have been unable to agree standstill agreements) and also increased litigation over the date of knowledge starting date (see 2 below).

1.1.4 The proposed transitional arrangements, which will subsist for the first 12 years following the change in the law, will create additional complexity (as there will be additional variants) rather than simplify matters.

1.1.5 The Committee is not aware of any commercial business demand to rationalise contractual and tortious limitation periods and/or to change the lengths of contractual limitation periods. However, in the Committee's view, if the proposed 3-year primary period were extended to 6 years (at least), this would significantly mitigate the issues identified in this section of our response, but please see our comments at section 2 below. If the 3-year period were adopted, we would expect it to become common practice to seek to extend it.

1.2 Proposed change from a date of accrual to a date of knowledge

1.2.1 The Committee is concerned that this change will significantly increase the scope of litigation in construction disputes. The current system only rarely sees the date of accrual as an issue in litigation for contractual actions. The "constructive knowledge" and "significant" loss/damage/benefit constituents of the date of knowledge test are also likely to generate a great deal of litigation. Irrespective of its final formulation, it is easy to foresee scope for confusion, increased costs of legal advice and litigation over the 'date for knowledge' test in a construction context, with defendants routinely alleging that claimants had "knowledge" over three years prior to the proceedings.

1.2.2 There is scope for defaulting parties to seek to deluge counter-parties with information in a bid to start the primary limitation period earlier.

1.2.3 Third parties such as project funders may be concerned about the change in law and in particular, the possibility of "constructive knowledge". Monitoring

and information requirements may increase accordingly, adding to overall project expense.

1.2.4 Where a contract is assigned (or novated), which is common in the construction industry, the limitation period for the assignee's claims will depend on the assignor's date of knowledge. Assignees will therefore have to carry out extensive enquiries as to this knowledge prior to assignment. If the assignee is insolvent and/or has defaulted under the loan documentation, obtaining this knowledge is likely to be problematic. Although it may be possible to negotiate different starting dates for novations, this may make it more difficult to rescue developments that are in financial trouble and/or impact on the availability of finance for developments (as security assignments and the right to call for novations are standard practice).

1.2.5 Although the 'date of knowledge' proposal purports to offer additional time for the bringing of claims, this will not be the case where there are long chains of contractor liability (as is common in construction projects) if the date of knowledge occurs only shortly before the end of the 10 year long stop (whereas in such cases the current law provides an additional 2 years to bring claims under deeds). This could lead to indemnities being sought for matters which would ordinarily be catered for as ordinary contractual obligations, in order to have a 10 year long stop in respect of each new claim in a chain of indemnity claims. Commercial negotiations could therefore be prolonged.

1.2.6 Further timing difficulties may also arise in contracts where liability is typically limited by reference to other contracts (for example in guarantees, collateral warranties and third party rights provisions). These would need modification, again leading to difficulties in commercial negotiations.

1.2.7 Accordingly, the Committee believes that the proposed change to a date of knowledge test for contractual claims is likely to spawn increased pre-contract legal advice, increased litigation, increased contract administration and increased legal costs.

2. *"Question 2 – Will the net effect of the changes increase or decrease the cost of legal advice and proceedings?"*

It is considered that costs are likely to increase, as a result of drafting and negotiating changes to statutory limitation periods, advising clients on limitation periods at the contract drafting stage (in the short-term), defensive contract administration, drafting and negotiating standstill agreements, and increased litigation as a result of more protective applications being issued, fewer claims being settled without recourse to the Courts (by virtue of the reduction in the period of time for settling claims) and

disputes over the date of knowledge. Where there is a chain of contracts (a simple and common example being a development agreement, a main contract, sub-contracts, sub-sub-contracts and supply agreements), these problems will obviously be multiplied.

3. *"Question 3 – What effect will the express right to agree a limitation period have on the costs to business?"*

It will obviously add to the negotiation costs (both legal and management costs) and contractors, subcontractors and suppliers could, theoretically, increase their prices where their contracts are subject to longer limitation periods than those under the proposed reforms. However, for the reasons stated above, we consider it essential that parties retain the right to agree to extend limitation periods or revert to the status quo, without any agreement being subject to a reasonableness test.

4. *"Question 4 – What effect will the reforms have on the provision or cost of insurance in the construction sector?"*

4.1 It is difficult to evaluate the impact on insurance costs but the following factors may be relevant:

4.1.1 On any individual matter, only rarely will a party and/or its insurer know that the 3 year period has expired, so they will remain "on-cover" until the 10 year long-stop has expired.

4.1.2 Any benefit from the reduction in the long-stop period from 12 years to 10 years on deeds may be offset, to some extent, by the increase from 6 to 10 years on simple contracts.

4.1.3 As mentioned above, the combination of the three-year period and date of knowledge test may actually lead to an increase in litigation and therefore insurance costs.

4.1.4 The current economic climate and uncertainty over counterparty covenants may lead to an increased take-up of latent defects insurance in the UK (hitherto expensive), independent of these changes. We note that there is no proposal currently for compulsory decennial insurance as in some other European countries.

4.2 If the proposals envisage that there may be an increased loss of contractual entitlements through use of limitation defences then, of course, subject to the point made at 4.1 above, insurance costs should decrease over time. We do not however see such an artificial reduction in insurance costs as an objective that should be

sought, as such loss of contractual entitlements could be characterised as a denial of rights.

5. *"Question 5 – Please could you provide any other information regarding the effect of the reforms that you think would be helpful in assessing their overall impact."*

We are doubtful as to whether the potential impact of the proposed reforms is really capable of evaluation on a cost/benefit basis, given that there are so many variables involved. However, as indicated above, we believe that, in general, they are likely to be detrimental to claimants and result in greater cost.

6. *"Question 6 – Do you have any other comments to make regarding the impact of the proposed reforms?"*

6.1 The Committee is concerned that confusion caused by the proposals could lead to a reduction in non-UK parties choosing to contract using English Law. Choice of law for contracts is commonly debated by contracting parties (including occasionally for major projects in the UK) and uncertainty over such a basic issue is likely to be used as an argument in favour of other systems, particularly on projects having no obvious UK connection. Also, fewer contracts may specify England as the forum for the settlement of disputes (whether by Court proceedings or arbitration). Accordingly, there could be a reduction in the invisible earnings from using English-qualified lawyers for English law contracts and England as a disputes forum.

6.2 We are unclear as to the rationale for saddling the claimant with the burden of proof for the primary period. It is considered that it should always be for the defence to show that any limitation period has expired.

6.3 As mentioned above, we are not aware of any current demand for change in contractual limitation periods. If (as seems to be the case) the driving force behind the proposed changes is rooted in personal injury claims, we suggest that any changes could be so confined.

City of London Law Society Construction Law Committee,

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For further information please contact the Chairman of the Committee, Marc Hanson at Ashurst or David Metzger at Clifford Chance.