CITY OF LONDON LAW SOCIETY CONSTRUCTION COMMITTEE

STANDARD FORM OF NOVATION AGREEMENT

NOTES FOR GUIDANCE

1. Introduction

With the increasing popularity of the 'design & build' approach to construction procurement in commercial developments in and around the City of London, the practice of the novation of contracts and consultancy appointments has also grown significantly.

In the context of 'design & build' procurement, the building contractor is typically required to take responsibility for the entire design, even where some of the earlier phases of the design work were carried out by the developer's own design team (architect, engineers etc.). In order to provide the building contractor with some support in this wide-ranging assumption of responsibility, it has become common practice for the developer to "novate" the appointments of his design team to the building contract. Thus, if a design problem were subsequently to emerge in respect of any pre-novation design carried out by the consultants, the building contractor will be able to pursue the developer's consultants for their liability for the problem (if any) through the terms of their appointments.

The benefits of novation, however, go beyond merely facilitating the transfer of legal risks. The novation of the developer's design team also permits consistency to be maintained in the design process, preserving their project-knowledge and enabling the same designers to work with the contractor in terms of realizing the original design concepts. It also avoids the need

for the contractor to have to enter into new full-scale consultancy agreements with his design consultants.

Despite the frequency in which novation is used in the context of 'design & build' projects, there is currently no recognized standard form of novation agreement. As a result, the use of numerous bespoke forms proliferates. The absence of a standard form of novation agreement has become particularly apparent with the publication of the JCT Major Project Form of building contract ('MPF'). This standard form of contract anticipates the use of a novation agreement. However, no form of novation agreement is enclosed with the MPF building contract nor is one available from the JCT.

In these circumstances, to meet this need, the City of London Law Society Construction Committee has prepared a simple form of novation agreement which can be used.

2. Who to Novate?

As described above, in the context of construction contracts, the typical use of the novation agreement is to transfer the obligations of the design consultants from the developer to the building contractor in order to support his assumption of overall design liability and to maintain consistency in the team of design consultants. As a result, this should normally require the novation of the appointments of each of the developer's design consultants; the architect, the structural engineer and the building services engineer being the principal likely parties. There may be others, however, such as geotechnical engineers responsible for ground investigations etc.

3. When to Novate?

One reason why developers use novation is that they wish to retain some control over the design process, at least in the initial stages. Otherwise, it would be legally simpler to leave the building contractor to appoint the design consultants himself. Also, it is typical for the developer to have engaged the design team prior to the selection and engagement of the building contractor.

There is no hard and fast rule as to when novation should take place. Commonly, this takes place in or around RIBA Design Stage D (Scheme Design) or Stage E (Detail Design) and once planning permissions have been obtained. It is also natural and appropriate for the novation of the consultants' appointments to take place at the same time as the completion of the building contract (since, from that time, the design & build contractor will assume liability for the complete design).

4. The Post-Novation Developer/Consultant Legal Relationship

As a matter of general law, reflected by the approach adopted by the CLLS standard form, novation involves the termination of the consultants' obligations to the developer and the assumption by the consultants of the same obligations to the building contractor (especially the obligations which were owed/performed/discharged by the consultant to the developer *before* the novation).

In practice, developers sometimes seek to retain certain obligations from the consultant (such as the ability to issue instructions to them). However, in order to preserve legal and practical clarity, this is not recommended as good practice. The novation should ideally mark a clean break between the end of the consultants' engagement by the developer and their re-engagement by the building contractor. It may be legitimate, however, for the developer to receive copies of notifications and reports issued by the novated consultants to the contractor, such as when they consider that the works are reaching practical completion. These are matters which should be addressed in the lists of services contained in the consultants' appointments, not in the novation agreement itself. See also 5(i) and (ii) below.

5. The CLLS Standard Form of Novation Agreement

The CLLS standard form of novation agreement is intended to be a simple document which is adaptable for use in respect of a variety of different contexts and with the various forms of standard form and bespoke consultancy agreements which exist in the marketplace.

Consequently, its primary aim is to accomplish the termination of the consultant's responsibilities to the developer and the assumption of those responsibilities to the building contractor. As a practical matter, it is also provided that the parties accept that the consultant's fees have been paid up to the date of novation. This seeks to ensure that the building contractor can take over the consultant's appointment from a neutral position as regards consultancy fees. The contractor will, of course, assume responsibilities for the remainder of the consultant's fees as and when they become due under the terms of the underlying appointment.

Consistent with the intent for this standard document to be simple, it does not include some other additional provisions which have commonly been included within construction novation agreements. The two most significant and frequently arising additional provisions are:

(i) A Warranty Back to the Employer

In a commercial development, the consultants will normally be required to provide collateral warranties to certain third parties (typically funders, purchasers and tenants) in respect of the consultant's duties under the appointment. After the novation, the developer will no longer have the benefit of the consultant's obligations and, legally, he becomes merely another third party who is interested in the performance of the consultant's duties. In recognition of this, the developer might expect to receive a collateral warranty from the consultant after the novation has taken place.

Previously, the 'warranty back' to the developer has commonly been included in the novation agreement; with the aim to use one document to cover both purposes. However, in the **Blyth** case, discussed below, the judge appeared to cast doubt on the effectiveness of the novation agreement because it included residual rights for the developer; it was felt in that case that this cast doubt on whether the agreement was properly a novation agreement at all. In order to avoid any such possible criticism, the CLLS standard form does not include a 'warranty back'. Accordingly, if the developer requires a warranty (as is likely), it is suggested that this should be contained in a separate warranty agreement.

(ii) "Step-In" Rights for the Employer

As described above, once the consultants' appointments are novated, then the contractor has assumed the role of 'client' in place of the developer. However, there are circumstances in which the developer might want to regain direct control over the consultants' appointments. This especially applies in the event of the termination of the building contract (eg. if the contractor were to become insolvent during the works).

To accommodate this, it has been frequent practice for the developer to include 'step-in' rights in the novation agreement by which, in the event of the termination of the building contract, the developer may regain his rights directly to instruct the consultants (although, in doing so, he must also re-assume the obligation to pay their fees).

However, as referred to above in relation to the 'warranty back', after the judgment in **Blyth**, it is important to maintain the clarity of the novation agreement. Consequently, it is suggested that it would be more appropriate to include any step-in rights for the developer in a separate consultant/developer warranty agreement.

6. Blyth & Blyth v Carillion

The practice of novating the appointments of design consultants was thrown into uncertainty as a result of the judgement in **Blyth & Blyth Ltd v Carillion Construction Ltd (2001) 79 Con LR 142** (Outer House, Court of Session).

Without referring in detail to the facts and matters of this particular case, there were a number of significant points in the judgment which are of general application to novation agreements and are important to note. These are as follows:-

(i) There was some argument over whether or not the 'novation agreement' in the case actually provided for a novation or an assignment. It is legally debateable as to whether novation and assignment are mutually exclusive concepts, although more orthodox opinion is that the two concepts are separate and distinct. The CLLS form of novation agreement seeks to avoid any such confusion by avoiding the use of the word "assignment" and by providing for an orthodox novation in which the initial contract between the consultant and the developer is discharged and is replaced by a new agreement (albeit on the same terms) between the consultant and the contractor.

(ii) Related to this, another factor which was judged to have confused the 'novation' agreement in **Blyth** was the attempt to reserve ongoing post-novation rights for the developer in the novation agreement. These ongoing residual rights were seen as inconsistent with normal legal concepts of novation. Whether or not there is any such inconsistency is legally debateable. However, to avoid any possible contention over this, the CLLS novation agreement has removed any other such reservation of rights by the developer (as discussed above in relation to the 'warranty back' and 'step-in rights').

(iii) One particular feature in the **Blyth** case was that some of the pre-novation duties carried out by the consultant simply would not have made any sense if they were regarded as having been performed for the contractor. For example, the judge referred to the consultant's services to assist the developer in the selection and appointment of the contractor. Consequently, the judge had some difficulty in interpreting the novation so that any or all pre-novation duties were to be interpreted now as having been performed for the contractor. As a result of this, it was held that the contractor did not have the benefit of the consultant's pre-novation duties in his own right; he was merely the 'creditor' of any losses which the developer may have suffered for the negligent performance of such pre-novation duties.

The result of this was that, whilst there may have been a breach of obligations owed to the original employer, the contractor was still limited by the *employer's* measure of loss (which was minimal, whereas the contractor's loss was significant). The CLLS standard form of novation agreement seeks to address this particular 'measure of loss' issue specifically (see Clause 1.5) to allow the contractor to claim for *his own* losses if and where these can be shown to have been the result of the consultant's negligent performance of any pre or post-novation duties, subject always to any particular limitations of liability which might exist in the underlying consultancy agreement. This should be acceptable to a consultant where it has always been clear that the consultancy agreement will be novated – eg. where the original consultancy appointment attaches the form of novation agreement and expressly provides for novation to the contractor. In this situation, the contractor's losses could be said to

have been in the "contemplation of the parties" when the appointment was entered into (*per* the test of remoteness of loss in **Hadley v Baxendale**). The position might be more problematic for a consultant where the original consultancy appointment did not appear to contemplate any novation at all – eg. an appointment based upon 'traditional' construction appointment which is subsequently changed to 'design & build' procurement with novation. In such circumstances it could arguably be unreasonable to expect the consultant to be liable to the contractor post-novation for losses incurred by the contractor which the consultant could not have reasonably contemplated when the original appointment was entered into.

In any event, however, in view of the lessons learned from the **Blyth** case, it is very important for the parties to consider carefully the list of services in the appointment so as to exclude specific reference to services which cannot possibly be regarded as having been novated to the contractor. This means that the individual consultancy appointment must be reviewed and amended accordingly. The CLLS form of novation agreement has been drafted on the assumption that any such problem items have been removed from the list of services.

Disclaimer and Interpretation

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use of the standard form and/or this Guidance Note or for any error or omission contained in the standard form and/or this Guidance Note.

This Guidance Note does not form part of the standard form of novation agreement and shall not affect the interpretation thereof.

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