

Dealing with 'no loss' defences

STUART JORDAN* outlines some of the contract or collateral warranty terms that can be included in contracts as protection against "no loss" arguments that can arise in construction projects.

“NO Loss” arguments can arise in construction projects because of the way contracts are structured. If successful, these arguments can create a “black hole” in which no party can recover damages arising from a breach. Employers and project owners, therefore, seek protection in contract provisions – which was a feature in a recent court case.

A “no loss” defence can arise when the employer in a construction contract (or the client in a designer’s appointment) is not the owner of the project; or if an owner-employer transfers ownership of the built asset to another party on completion.

In normal circumstances, a contractor responsible for works defects would expect to have pay damages for losses arising from them, because they represent a breach of contract. However, if the employer is not the owner of the built asset, the contractor might raise a defence on the grounds that none of the loss and damage has been suffered by the employer. A contractor might also argue that the owner has not suffered losses of the type which was in the reasonable contemplation of the original parties as being potentially incurred by the employer.

Separately, when an employer transfers ownership of the built asset at completion, the employer’s benefit in the design and construction contracts is commonly assigned to the new owner. The conditions of that assignment often include a provision in terms that the contractor shall have no greater liability arising from the assignment than they would have had under the original (unassigned) contract; also, that the contractor has equivalent rights of defence to liability as against the assignee, as it had against the assignor. Again, if the owner seeks to rely on those assigned contracts, the contractor might agree that the claimant has suffered loss but the original employer has suffered no loss and, by reason of the above provisions, they will argue that the owner cannot recover anything more than the employer’s loss.

Similar arguments may arise in connection

with collateral warranties, in which contractors or consultants directly warrant to “interested third parties” (funders or prospective owners or lessees or users of the built asset) that they have complied, and will continue to comply, with their contractual obligations to the employer. Collateral warranties often contain the same “no greater liability” and “equivalent defences” provisions.

Common protections against such arguments include contract or collateral warranty terms to provide:

- A prohibition on the contractor arguing “no loss” on the basis that the claimant has suffered loss as an assignee and not as the original counterparty;
- A prohibition on the contractor arguing “no loss” on the basis that the type of loss suffered was not the same as would have been suffered by the original counterparty; and
- Qualifying the “no greater liability” and “equivalent rights of defence” provisions to acknowledge the above, that is, that the relevant assignment or collateral warranty may give rise to different types of loss suffered by parties other than the original counterparty.

The above-mentioned recent case contains several of these features. Here, Mansell Construction Services undertook to design and build a residential block for Coltham (Orchard), the owner. Later, the contractor (by then acquired by Balfour Beatty) gave a collateral warranty in favour of the project funders, AIB; and the owner granted a lease of the building to the management company Orchard Plaza Management Company Limited (Orchard).

Defects became apparent in 2015. Then, in 2017, the benefit of the collateral warranty was assigned twice: first by AIB to the owner, and then by the owner to Orchard. After the local government notified Orchard that the defects needed to be rem-

edied, Orchard claimed the cost from Balfour Beatty under the collateral warranty.

As part of its defence, Balfour Beatty argued that Orchard’s losses were not recoverable because the collateral warranty was given to a funder and Orchard’s losses were not the type of losses a funder would incur – that is, they were not in the parties’ contemplation on making the contract and were, therefore, too remote to be recoverable.

The collateral warranty, however, contained the following:

“The Contractor agrees with the Beneficiary not to contend or argue that any person to whom

the benefit of this Deed is assigned shall be precluded or prevented from recovering under this Deed any loss or damage resulting from any breach of this Deed by the Contractor by reason of the fact that such person is an assignee only or otherwise is not the original beneficiary or because the loss or damage suffered has been suffered by such person only and not by the original beneficiary, or because such loss is different to that which would have been suffered by the original beneficiary.”

The court struck out this part of Balfour Beatty’s defence, both because it decided that the type of losses actually incurred was in their contemplation at the time of contracting, and in any event because the above provision excluded that defence.

So, this provision passed this test. In truth, it was the remoteness part of it that was tested, rather than the anti-“no loss” part, but of course all similar provisions need to be assessed individually for potential challenge. ■

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Jordan ... a closer look at contract structure needed.