

CLAIMS FOR LOSSES SUFFERED BY THIRD PARTIES IN CONSTRUCTION DISPUTES

by the Honourable Sir Rupert Jackson and Paul Sutherland Esq

A Report on the Meeting of the Society of Construction Law on 6th July 1999 at the Lloyd George Room, National Liberal Club, London

Report by John Denis-Smith of Keating Chambers

An extremely well attended meeting of the Society of Construction Lawyers on 6th July 1999 had the honour to be addressed by practitioners both at the Bar and on the Bench. Held in association with the Society of Construction Arbitrators. Anthony Speaight QC (whom John Burgess, Chairman of the SCL, thanked for his contribution to the Society during the past three years as a Council member) acted as Chairman, introducing the speakers: the Honourable Sir Rupert Jackson, an outstanding figure in the field of building law recently appointed to the Bench and Paul Sutherland of Two Crown Office Row, hand-picked by Sir Rupert as co-lecturer on the subject of “**Claims for Losses Suffered by Third Parties in Construction Disputes**”.

Sir Rupert gave a tour d'horizon of the development of the common law relating to recovery on behalf of third parties (a copy of which shall be circulated in due course). The Courts developed an exception to the general rule in contract that a party could recover only in respect of its own loss: a party could recover in respect of damage suffered by a third party to whom property in the goods in issue had passed where it was contemplated by the contracting parties that this would occur. That principle was applied in the field of building cases in St Martin's v McAlpine, in which Lord Griffiths suggested a broader principle that the contracting party should be able to recover on the basis that such damages would secure to it the benefit of the bargain it had made, a formulation considered but not adopted by the other Law Lords.

The doctrine was extended in cases such as Darlington v Wiltshier and Alfred McAlpine v Panatown in which the contracting party recovered damages despite never having owned the property in issue and despite the fact that there were contractual relations between the Defendant and third party. The Court of Appeal in Panatown further held that the principle suggested by Lord Griffiths in fact underlies the principle upon which the majority decision in St Martin's was based. Its decision is itself currently under appeal, but has in the meantime sparked off academic debate in favour of and against the Court's reasoning.

Paul Sutherland followed by exploring more recent case law and academic debate arising from Panatown. The Court of Appeal's decision was applied by HH Judge Thornton in John Harris Partnership v Groveworld Ltd (decided on the 3rd March 1999 and reported in the April edition of CILL). Four points arise from the Groveworld case:

- (i) the principle set out in Panatown was held to be applicable to all contracts for services
- (ii) it applies where the third party was not an owner of the property in question at all: thus it might be possible for recovery to be made on behalf of a high street lender.
- (iii) the third party need not itself be in the parties' contemplation at the time the contract was made. It sufficed for the type of third party to be in contemplation; the principle might therefore apply to the later purchaser of a property.
- (iv) as to the potential for double recovery, in Panatown liability was owed both to the Claimant and to the owner under a Duty of Care Deed. There was perhaps scope for comparison with the position of parties held to assume a responsibility in tort to parties with whom they were not in contract.

Reviewing the current academic debate, Mr Sutherland focused on two issues, the first being whether recovery in respect of a third party's loss was in the nature of a penalty. Norman Palmer and Professor Tolhurst have suggested that it would be, since such recovery would be neither in respect of the Claimant's own actual loss nor based upon a genuine pre-estimate of such loss ("Compensatory and extra-compensatory damages: Linden Gardens and Lord Griffiths' Principle": Journal of Contract Law). By contrast Professor Treitel argued (in the Law Quarterly Review) that penalties were defined as operating "in terrorem": an agreement to compensate losses suffered by a third party would not fall into that category. Judicial authority on penalties does not appear yet to have considered this issue but it may be that the rule against penalties would not be held to have been breached, for the Claimant would not recover more than its actual loss as it would be liable to account to the third party. Moreover, if one applies Lord Griffiths' principle, the problem would not arise at all, since the whole loss would be considered that of the Claimant in any case.

Concern has been expressed as to the uncertainty posed by the scope of the principle post Panatown. The Court of Appeal justified its decision on the basis that the right of abatement under the contract indicated that the parties contemplated that accounts would be settled so as to allow the employer to recover in respect of defective work. Yet, as Professor Treitel points out, a claim in abatement would be limited to the contract sum: Groveworld recovered more.

Mr Sutherland commented that the danger of "indiscriminate liability to an indeterminate class" was posed by the provision in the Contract (Rights of Third Parties) Bill concerning a term which "purports to confer a benefit" on a third Party. This provision has indeed been (unsuccessfully) challenged during the Bill's passage through the House of Lords.

The speakers' contributions precipitated a lively debate during which Mr Justice Jackson suggested, in response to a question from Professor Philip Capper, that an oddity of the decisions after St Martin's was that less emphasis had been placed on the principle explained by Lord Browne-Wilkinson that the Claimant would not be able to recover if the third Party was able to do so itself. In later cases, the Claimant succeeded despite the fact that the third Party had been able to secure itself the right to sue directly: in his view the Contract (Rights of Third Parties) Bill provided the sensible way to cure the potential unfairness arising from the principles of contract law, to mitigate which the common law exception had developed.

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