

Reliance Letters - Appreciate the value and consider the risks

Financial Markets - Spring
Legal Update

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Reliance Letters - Agenda

- What is a reliance letter?
- What are the main elements of a reliance letter?
- What are the alternatives?
- The main areas of debate from the issuer and beneficiary perspectives and likely points of negotiation
- What do we see in the current market



Reliance Letters - What is a reliance letter?

- Simply put, it is: *“a letter from one party to another party allowing them to rely on the contents of a report”*
- Reliance letters are customarily issued in respect of:
 - Legal due diligence reports; and
 - Consultant reports prepared by surveyors, valuers, environmental consultants, tax advisers etc.
- Regularly feature in financing transactions and construction and infrastructure projects
- Although reliance letters are nowadays provided in many transactions, they tend to be heavily negotiated

Reliance Letters - What is a reliance letter?

- Do reliance letters create a contract or do they simply extend a party's tortious duty of care/tortious liability? And, more importantly, does this matter?
- Yes it does, and given the choice between relying on a claim in tort or in contract, the latter would be preferable
- This is why:
 - The duty of care may be raised above the common law “duty to use reasonable skill and care”
 - The rights and remedies of the parties are often set out more clearly in a contract

Reliance Letters - What is a reliance letter?

- Parties are free to set out the damages that they are likely to suffer as a result of a breach of contract
- Party's ability to recover specific losses
- But a claim in tort may have the advantage that it affords a longer limitation period as cause of action accrues when the damage occurs
- Whether a reliance letter is a contract depends on its terms, so check the drafting carefully

Reliance Letters - What is a reliance letter?

- Normal rules of construction apply but generally a court is likely to find that a reliance letter is a contract
- A reliance letter can create contractual and tortious liabilities but in this case the scope of the duty of care will be limited to that taken contractually
- Through a reliance letter financiers/purchasers as beneficiaries try and secure every potential avenue for recovery of their funds

Reliance Letters - What is a reliance letter?

- How does it differ from a release letter?
- A release letter:
 - permits one party to disclose the report to another party and at the same time imposes confidentiality and non disclosure obligations to further third parties
 - excludes any liability of the report provider to the other party (i.e. due diligence report can be accessed on a non-reliance basis)

Reliance Letters – What are the main elements of a reliance letter?

- Beneficiaries of the reliance letter
- Performance of services subject to the scope of services and limitations normally included in the appointment letter and includes:
 - listing the surveys/reports to which the letter relates
 - mentioning the reason for the reliance (i.e. purchase, funding, etc.)
- Limitation of the timeliness of the report to the date provided with no duty to update beyond such date
- Limitation period for the reliance

Reliance Letters – What are the main elements of a reliance letter?

- Required levels of PI insurance cover and inclusion of aggregate financial limits
- Limitations or exclusions on the report provider's liability
- Right to assign the benefit of the reliance letter
- Licence to use and reproduce the contents of the surveys/reports
- Reliance letters for legal DDs will also include:
 - review of the material provided only
 - review limited to legal matters only (ie no commercial analysis)

Reliance Letters – What are the alternatives?

- In construction or engineering projects a buyer, a tenant or a financier may want a right to enforce certain terms of the contracts between the employer and the developer and the constructor
- Construction security may take the form of a collateral warranty or the granting of a right to a third party under a contract
- Construction security:
 - Deals with privity of contract
 - Provides direct recourse
 - Ensures no need to rely on a claim in tort

Reliance Letters – What are the alternatives?

- A collateral warranty is a contract under which a professional consultant or a building contractor warrants to a third party (such as a financier) that it has complied with its professional appointment or building contract
- A third party right allows a person who is not a party to a contract (a third party) to enforce the benefit of a term of that contract

Reliance Letters – What are the alternatives?

- Collateral warranties are used more often as:
 - market parties are more familiar with these contracts
 - effectiveness of third party rights not proven in the courts yet
 - easier to include step in rights for financier as collateral warranties usually include contractual rights and obligations on all parties to the contract (vs third party rights which only give rights)

Reliance Letters – main areas of debate and likely points of negotiation

- Disclosure
- Reliance
- Liability caps
- Carve outs from limitation of liability
- Limitation periods
- Restrictions on parties which may commence claims
- Application of T&Cs
- Proportionality

Reliance Letters – main areas of debate and likely points of negotiation: *Disclosure*

- Identify the addressees
- Disclosure on a non-reliance basis by the addressees is permitted:
 - to affiliates and officers, employees, auditors and professional advisers
 - to the extent required by law or regulation, or court order, requested by regulatory or supervisory body, rating agencies
 - prospective participants in primary syndication and in the secondary debt trading market

Reliance Letters – main areas of debate and likely points of negotiation: *Reliance*

- Restrict the recipients to a small and defined group
- The more people have access to DD reports on a reliance basis, the higher the likelihood for increased professional liability risks
- Also consider reputational risk
- Address reliance letters to legal entities by referring to the names of such entities or the capacity/role of such entities?
- Limit the entities that are entitled to rely on the DD reports or the scope of the facilities referred to in the addressee language

Reliance Letters – main areas of debate and likely points of negotiation: *Liability caps*

- The quantum of appropriate liability caps will be negotiated and agreed by the parties on a deal by deal basis
- Parties should take into account the nature of the client and the engagement, and the overall commercial risk and reward analysis
- Liability caps should be fair and reasonable
- Different liability caps depending on the type of loss/report
- Starting point for private equity transactions:
BVCA/accountancy firms 1998 MOU

Reliance Letters – main areas of debate and likely points of negotiation: *Carve outs from limitation of liability*

- Carve out for certain risks that the addressees deem appropriate for the report provider to bear without limitation
- With a few limited exceptions, there are no legal or professional barriers to report providers limiting their liability
- You cannot exclude or restrict liability for wilful default, fraud, dishonesty and negligence if it results in death or personal injury. In the Netherlands clauses attempting to limit or exclude gross negligence are generally prohibited
- Liability for indirect or consequential losses, such as loss of profit/revenue/business, can be excluded subject to clear interpretation and clause being deemed fair and reasonable

Reliance Letters – main areas of debate and likely points of negotiation: *Limitation periods*

- A limitation period is the period of time within which a party to a contract must bring a claim
- In England and Wales, limitation periods are imposed by statute, primarily the Limitation Act 1980
- The starting point is the day on which the cause of action accrues. 12 and 6 years are the prescribed statutory periods but parties may contractually agree to reduce
- In the Netherlands, limitation periods differ depending on the contract. This mainly depends on the applicable general conditions, legal regime or market practice

Reliance Letters – main areas of debate and likely points of negotiation: *Restrictions on parties which may commence claims*

- This is relevant in case of multiple addressees
- Each addressee will wish to preserve the flexibility to bring its own individual claim against the report provider
- Report providers instead will seek to restrict the parties that can commence claims for various reasons
- In case the report providers require an instructing group or majority lender vote prior to commencement of a claim, it is preferable to refer to parties who become lenders during primary syndication

Reliance Letters – main areas of debate and likely points of negotiation: *Application of T&Cs*

- Is it appropriate to extend the application of engagement T&Cs between report providers and their clients to third parties?
- Provisions which may need to be specifically disapplied *vis-à-vis* addressees other than the report providers' clients include payment of fees, costs and expenses, provision of information and indemnities
- But there are also provisions which third parties addressees may specifically seek to address in the reliance letter

Reliance Letters – main areas of debate and likely points of negotiation: *Proportionality*

- Proportionality provisions are negotiated on a case by case basis
- In England, the Civil Liability (Contribution) Act 1978 provides for tortfeasors to bear a degree of liability broadly proportional to their respective contributions taking into account what is just and equitable
- Thus generally separate contractual provisions are resisted
- If they are included, consider:
 - having regard to the contributory negligence of other addressees and responsibility of any other party

Reliance Letters – main areas of debate and likely points of negotiation: *Proportionality*

- referring to a determination made by a court of competent jurisdiction
- taking no account of liability caps agreed or imposed on the liability of any other party also bearing part of the responsibility

Reliance Letters – What do we see in the current market

THERE IS
NO MARKET STANDARD OR CUSTOMARY
APPROACH

BUT.....



Amsterdam
Brussels
Bristol
Dublin
Düsseldorf
Frankfurt
Lisbon *
London
Luxembourg
Madrid
Milan
Munich
Paris



Doha
Dubai
Jeddah **
Riyadh **



Beijing
Hong Kong
Shanghai
Singapore
Tokyo

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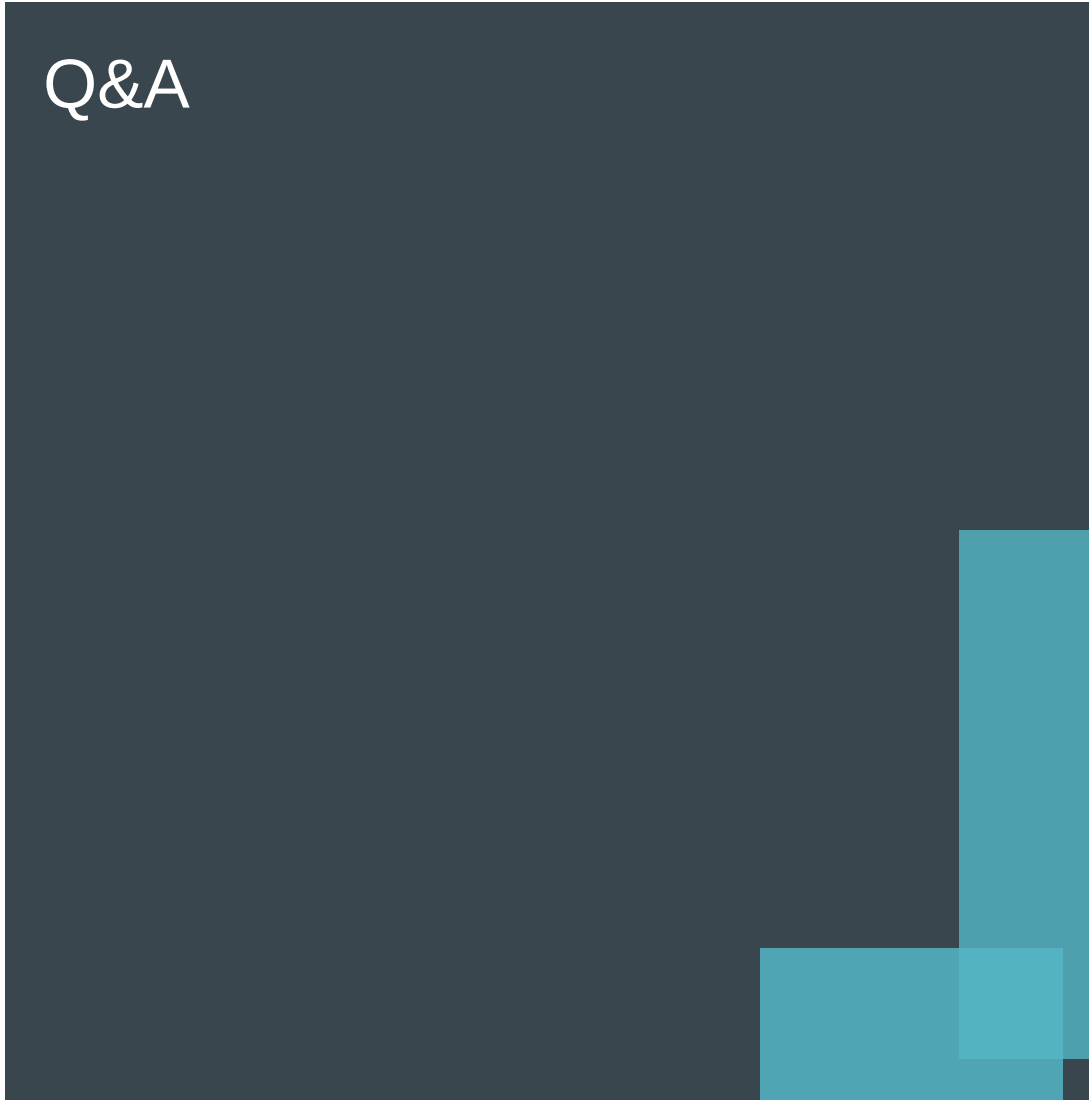


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