

How far can you stretch liability under Collateral Warranties and what are the consequences for clients of the *Abbey Healthcare v Simply Construct* litigation?

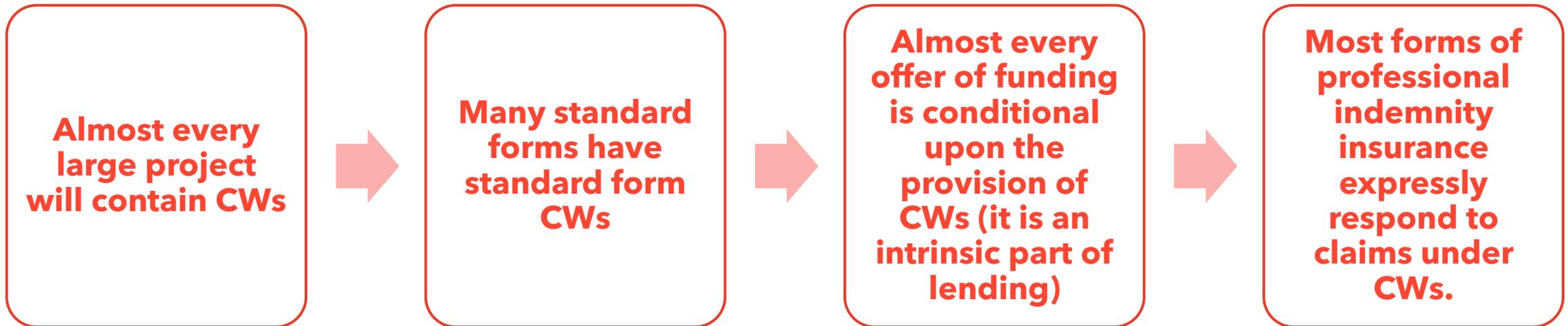
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Collateral Warranties: Spreading Risk

The aim of a collateral warranty is to provide a remedy in contract to a purchaser of property [and others] against a builder or designer for bad design or construction in order to compensate for the lack of a remedy in tort: *British Overseas Bank Nominees Ltd v Stewart Milne Group* [2020] PNLR 2 at [9]-[14].

A vitally important part of the fabric of the construction industry.



Adjudication: A Speedy Remedy

Primary purpose of the statutory scheme - delayed payment being used to put pressure on sub-contractors through speedy remedy:

"The twin purpose of [the HGCRA 1996] was to improve cashflow in the construction industry and to streamline its dispute resolution process. The former aim was achieved through mandatory provisions relating to interim payments, payment notices and the like, and the latter through a new, compulsory scheme of construction adjudication" (per Coulson LJ in *C Spencer Ltd v M W High Tech Projects UK Ltd* [2020] EWCA Civ 331)

Unintended consequence - speedy and *final* remedy for all substantive construction disputes; (see *Bresco Electrical Services v Michael J Lonsdale* [2020] UKSC 25 pars 14 and 15).

Advantage for the Beneficiaries of CWs: delay

- i. is costly in itself;**
- ii. is used as a weapon in negotiations;**
- iii. presents insolvency risks**
- iv. and can present insurance risks.**

The Issue: Are CWs Construction Contracts ?

Section 108 HGCRA 1996

108 A party to a construction contract has the right to refer a dispute arising under the contract for adjudication under a procedure complying with this section.....

Section 104 HGCRA 1996

104 Construction contracts.

(1) In this Part a 'construction contract' means an agreement with a person for any of the following–

(a) the carrying out of construction operations

Typical CW

The Contractor warrants that:

- i. the Contractor has performed and will continue to perform diligently its obligations under the Contract;**
- ii. the Contractor has exercised and will continue to exercise all the reasonable skill care and diligence.**

The Answer in Parkwood

Parkwood Leisure Ltd v Laing O'Rourke Wales and West Ltd [2013] EWHC 2665.

CW wording: The contractor warrants, acknowledges and undertakes thatit has carried out and shall carry out the works in accordance with the contract.

Akenhead J.

Clause 1(1) is not merely warranting or guaranteeing a past state of affairs. It is providing an undertaking that [the contractor] will actually carry out and complete the works. Completion of the works is not only important so far as time is concerned; it is also important because [the contractor] is undertaking that the works will be completed to a standard, quality and state of completeness called for by the contract.

Each case will depend on the wording of the CW:

A very strong pointer to that end will be whether or not the relevant contractor is undertaking to the beneficiary of the warranty to carry out such operations. A pointer against may be that all the works are completed and that the contractor is simply warranting a past state of affairs as reaching a certain level, quality or standard.

Abbey Healthcare v Augusta 2008 LLP (formerly Simply Construct (UK) LLP) [2024] UKSC 23

2015 Simply agrees to design and construct a care home; the Building Contract requires Simply to provide CWs to the Purchaser and the Tenant

June 2017 Toppan (the Purchaser) novated to the Building Contract and subsequently grants a lease to Abbey;

October 2020 Simply required to execute CW to Abbey, which commences adjudication;

July 2021 Martin Bowdery QC refuses enforcement: CW is not a construction contract on its particular wording.

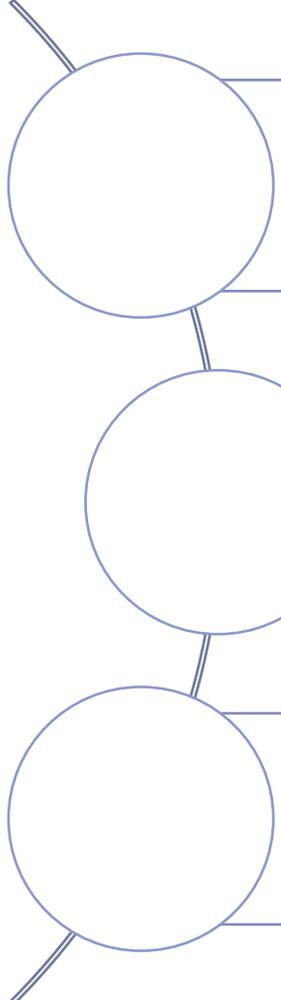
October 2016 PC;

August 2018 fire safety defects discovered;

Adjudicator awards damages to Abbey;

The Court of Appeal

CA allow the Appeal by a majority:



Coulson LJ: the warranty in this case regulates past and future building operations: it is not just a financial remedy; Parkwood was correctly decided; further, the statutory intent was that all disputes concerning the same facts could be dealt with by the same adjudicator; the word "for" in Section 104(1) is intended to have the meaning "in respect of";

Peter Jackson LJ: to come within Section 104(1) the object of the agreement must be the carrying out of construction operations; in this case there is a promise as to the performance of work and it does not matter that the contractor is carrying out the work to the instructions of someone other than the beneficiary;

Stuart-Smith LJ: the critical word is "for"; that implies a direct contractual obligation to carry out construction obligations; it is not sufficient that the contractor warrants its performance for someone else; Parkwood was concerned with different wording.

The Supreme Court (1) Section 104(1)

Section 104 (1) should be given its natural meaning and not a broader construction. In particular, the benefits of adjudication should not determine the inclusivity of 104(1).

"For" does not mean "in respect of": it indicates the object of an activity; the object or purpose of the agreement must be the carrying out of construction operations.

"...Will continue to perform" may be a promise to carry out works, but it is entirely derivative: *The contractor is not thereby promising anything that is not already promised to the employer under the Building Contract. It does not in itself give rise to any construction operation.*

The object of a collateral warranty is to afford a right of action for defective work. In practice the beneficiary has no control over the progress of construction operations and any such control might make the building contract unworkable.

(1) A collateral warranty will be an agreement "for ... the carrying out of construction operations" if it is an agreement by which the contractor undertakes a contractual obligation to the beneficiary to carry out construction operations which is separate and distinct from the contractor's obligation to do so under the building contract.

(2) A collateral warranty where the contractor is merely warranting its performance of obligations owed to the employer under the building contract, will not be an agreement "for" the carrying out of construction operations

The Supreme Court (2) Consequential Matters

The Court looks to the substantive intent of the Warranty, not its particular wording: *"Whether or not a collateral warranty comes within Section 104(1) should not depend upon fine distinctions in its wording: a far more principled and workable approach is for the dividing line to be between collateral warranties which merely replicate undertakings given in the building contract and those which give rise to separate or distinct undertakings for the carrying out of construction operations."*

The test will be whether the provider of the warranty agrees to carry out work for the beneficiary, something which is not achieved by promising that work will be carried out for the employer.

"Most" collateral warranties will not be construction contracts

***Parkwood* was wrongly decided. It proceeded on the erroneous footing that a contract "for" construction operations was a contract under which "A" promises "B" that "A" will carry out construction operations for "C".**

Could there ever be a CW which comes within 104(1) ?

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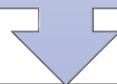
But what would that be ?

Abbey argued that the Building Contract provided it with construction rights: the right to carry out works and the right to access the Works. That was not enough. *"Whilst the Abbey Collateral Warranty may have entitled Abbey to enforce these rights, the rights do not involve or require the carrying out of construction operations by Simply and their existence cannot and does not transform that Warranty into a contract for the carrying out of such operations."*

A CW could only be a construction contract if it contains obligations to carry out substantive building works for the Beneficiary which are different to the building works to be carried out for the Employer.

Getting Around *Abbey* - (1) Step-in Rights in the CW

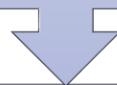
"Step-in rights" give a third party the ability to take the place of the Employer under the Building Contract if the Employer becomes insolvent.



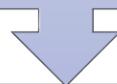
They almost always take the form of deemed assignment of the Employer's rights (and obligations) or a novation. There is almost always a provision of the Building Contract which requires the Contractor to refrain from terminating and to allow the Third Party (usually a funder) to "step in" to the shoes of the Employer. See for example Part 2 of Schedule 5 to the JCT Design and Build 2011.



Lord Hamblen was at pains to note that step-in rights are different to "normal" CW rights.



On the face of it a CW containing step-in rights passes the *Abbey* test, but does that mean that a funder who has not stepped in (but has a CW giving it the right to step-in) can adjudicate ?



Probably not. That would contradict the substantive intent approach taken in *Abbey*. A contingent right for construction operations is probably not a "construction contract". A construction contract only comes into being on deemed novation / assignment occurring at step-in.

Getting Around Abbey - (2) Third Party Rights within the Building Contract ?

Contracting parties can agree, within the Building Contract, to accord a third party, the rights to enforce a contract (under the Contracts (Rights of Third Parties) Act 1999. This is an important alternative to a CW.

See for example, Section 7 to the JCT Design and Build 2011.

Funders: "Where clause 7B is stated in Part 2 of the Contract Particulars to apply to a Funder, the employer may by notice to the Contractor confer Funder Rights on the Funder identified in the notice. Those rights shall vest in the Funder on the date of receipt by the Contractor of the Employer's notice"

Parts 1 and 2 of Schedule 5 set out the warranties - for funders: "The Contractor warrants that he has complied and will continue to comply with this Contract."

But are these rights enforceable in Adjudication ? Almost certainly not: the third party is not a "party to the construction contract" for the purposes of section 108; it merely has the right to enforce the terms; Hurley Palmer Flat Limited v Barclays Bank Plc [2014] EWHC 3042.

Getting Around Abbey – (3) Bespoke Adjudication Provisions

“Although Coulson LJ suggested that, despite that initial surprise, the construction industry may be taken to have broadly accepted [the result in Parkwood], the litigation history of the present case suggests otherwise. In any event, for the reasons set out above, there are both principled and practical grounds for overruling the decision and reverting to the position as it was generally understood to be before Parkwood. This allows parties to contract into the adjudication regime where this is seen as desirable but not to be fixed with an inability to contract out”

The parties can introduce a bespoke code - replicating those parts of the HGCRA 1996 they wish to include (see *Domsalla v Dyason* [2007] 112 Con LR 95 where the contract incorporated the adjudication provisions contained in the *JCT Minor Building Works 1998*), or they can simply incorporate the provisions of the HGCRA 1996 (see *RWE Npower Pc v Alstom Power Ltd* [2009] WL 5641217).

Advantages of incorporating the Scheme: simplicity and safety.

Advantages of bespoke provisions: adaptation to suit the Beneficiary (for example: more generous time provisions for more complex disputes; jurisdiction to hear more than one dispute; jurisdiction to award legal costs).

Whether CWs should all contain these provisions will depend upon commercial risk - probably more important that Beneficiaries can adjudicate against contractors than against the professional team.

Conclusions

Hard to see how any CW could ever be a "construction contract" following Abbey.

The existence of step-in rights will not change this.

Nor will third party rights in the Building Contract provide an adjudication remedy to the Beneficiary.

The only course of action open to third parties is to negotiate bespoke adjudication provisions.

Questions?

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