GILES DIXON SOLICITORS

Collateral Warranties and Adjudication.

The Court of Appeal decided last month that a collateral warranty can be a "construction contract" for the purposes of the Housing Grants, (Construction & Regeneration) Act. So, a claim under a collateral warranty can be referred to adjudication. The case was Abbey Healthcare (Mill Hill) Ltd. v Simply Construct (UK) LLP.

The facts

In this case, the circumstances surrounding the collateral warranty were somewhat unusual. Simply Construct was the contractor for a care home, appointed by Sapphire Building Services. The building contract began in May 2015 and practical completion was in October 2016. In 2017 Sapphire sold the property and novated the building contract to Toppan Holdings Ltd. and Toppan granted a long lease of the care home to Abbey Healthcare. Defects were found in 2018 and, as Simply Construct failed to do any remedial work, Toppan and Abbey Healthcare shared the cost. Abbey Healthcare's lease required Abbey to claim under its collateral warranty from the builder for any defective work.

The building contract provided for Simply Construct to give a collateral warranty to Abbey Healthcare and when they did not sign it, Toppan applied to the court for specific performance of that obligation and in 2020 the collateral warranty was executed.

The collateral warranty was in a fairly standard form and included wording that Simply Construct "has performed and will continue to perform diligently its obligations under the contract."

The claims

Each of Toppan and Abbey Healthcare then brought a claim against Simply Construct for the cost of the remedial works that they had paid and the same adjudicator was appointed for each of the disputes. The adjudicator awarded just over £1 million to Toppan, and £908,000 to Abbey Healthcare.

Simply Construct failed to pay, so both Toppan and Abbey Healthcare applied to the court to enforce their awards. Simply Construct argued that the collateral warranty agreement was not a construction contract and so the adjudicator had no jurisdiction to decide the dispute. The judge agreed with Simply Construct that the collateral warranty deed was not a construction contract within the meaning of the Act. He also noted that the collateral warranty was only signed after all the works, including the remedial works, had been caried out.

The Court of Appeal's Judgment

Abbey Healthcare appealed and, by a majority of two to one, the Court of Appeal decided that a collateral warranty could be a "construction contract" within the meaning of the Act and, therefore, could be subject to adjudication. The Court allowed the appeal and awarded summary judgment to Abbey Healthcare for the amount awarded by the adjudicator.

Coulson LJ gave the leading judgment and held that, on a broad interpretation of Section 104 of the Act, a collateral warranty can be a contract 'for construction operations' and so capable of being

referred to adjudication. He said that 'a warranty that the contractor was carrying out and would continue to carry out construction operations (to a specified standard) may well be a "contract for the carrying out of construction operations" in accordance with s.104(1) of the Act' On the other hand, a warranty that said "We completed these works two years ago and we warrant that they were completed in all respects on accordance with the building contract" is more akin to a product guarantee and so not a construction contract.

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S.104(1) of the Act says a construction contract includes an agreement with a person for
"(a)the carrying out of construction operations;
(b)arranging for the carrying out of construction operations by others, whether under sub-contract to him or otherwise."

The judge also mentioned s.104(5) of the Act which refers to where 'an agreement relates to construction operations'.

He also referred to the aim of the Act as being to improve the dispute resolution mechanism available to those involved in construction disputes. And since the factual issues for both the beneficiary of a collateral warranty and the developer are essentially the same, it makes sense to have the same adjudicator appointed to decide those disputes, thus saving time and money. And he said that although a collateral warranty may only include a nominal payment arrangement, that does not prevent it from being a construction contract.

In his minority judgment, Stuart Smith LJ said that when a person (A) warrants to someone (B) that they will perform their obligations to a third person (C), that does not create an obligation on A to perform those obligations for B. It merely means if A fails to perform it contract with C, then it is in breach of its warranty to B. He also saw no reason for a 'broad' interpretation of s.104 of the Act.

This judgment of the Court of Appeal reaffirms and expands on the other case dealing with this issue, Parkwood Leisure Ltd v Laing O'Rourke, in 2013. There the court decided that the wording of the collateral warranty, under which the contractor gave an undertaking as well as a warranty, then it could be treated as a construction contract.

Comment

This decision is potentially important for the construction industry. It clarifies the status of a collateral warranty as a 'construction contract' within the meaning of the Act.

For the beneficiary of a collateral warranty, it enables them to have a claim against the contractor or consultant dealt with by an adjudicator, even if the collateral warranty is executed after the works have been completed.

Also, it raises the question as to whether a third party rights schedule and other project related agreements could be treated as a 'construction contract.'

For contractors and consultants, and, in particular, their insurers, it may be time for a rethink on both the extent of the risk that they should take on by signing collateral warranty agreements with multiple third parties and the terms of those collateral warranties.

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