Court of Appeal solves collateral warranty adjudication riddle

By Matthew Taylor, Christopher Hallam, Aidan Steensma and Lauren Ryan

A Court of Appeal decision last week has overturned a TCC decision concerning the right to adjudicate under collateral warranties. The Court's decision confirms the potential for collateral warranties to fall within the Construction Act and the statutory adjudication regime, whilst noting that the drafting of any given warranty will remain important. The date of execution of a collateral warranty and whether it post-dates the completion of construction work is no longer likely to be of much, if any, relevance.

Collateral warranties and the Construction Act

The Housing Grants Construction and Regeneration Act 1998 (as amended) (the "**Construction Act**") applies to "construction contracts", defined as being (among other things) a contract for the carrying out of construction operations. One of the consequences of a contract falling within this definition is that the mandatory adjudication provisions of the Act will apply. These require the contract to provide a right for the parties to adjudicate "*at any time*". If the contract does not provide such a right, the adjudication provisions of the Scheme for Construction Contracts are implied.

Up until now, the only case which had considered whether collateral warranties fell within the definition of a "construction contract" was *Parkwood Leisure v Laing O'Rourke*. The collateral warranty in that case was executed part way through the works and provided that the contractor "*warrants, acknowledges and*

undertakes that it has carried out and shall carry out and complete the Works in accordance with the Contract." The court in that case emphasised the promissory nature of the word "undertakes" and found that the collateral warranty amounted to a contract for the carrying out of construction operations.

The *Parkwood* case and the potential for beneficiaries under a collateral warranty to benefit from the adjudication provisions of the Construction Act mark an important point of distinction between collateral warranties and third-party rights granted under the Contracts (Rights of Third Parties) Act 1999. In *Hurley Palmer Flatt v Barclays Bank*, the TCC found that the beneficiaries of third-party rights under a construction contract could not take advantage of the adjudication provisions in the construction contract, whether they be express or implied by the Construction Act. A separate right of adjudication would need to be agreed in favour of the third-party, which is rarely done.

Abbey Healthcare (Mill Hill Limited) v Simply Construct (UK) LLP: a recap

The appeal in this case arose out of a claim by Abbey (a tenant) to recover losses from Simply (a contractor) in respect of fire safety defects at a care home. Abbey brought adjudication proceedings against Simply pursuant to a collateral warranty and obtained a successful adjudication decision. The collateral warranty provided (among other things) that:

"The Contractor warrants that (a) the Contractor has performed and will continue to perform diligently its obligations under the Contract; (b) in carrying out and completing the Works the Contractor has exercised and will continue to exercise … reasonable skill care and diligence …"

A summary judgment application was made by Abbey to enforce the adjudication decision. However, it was refused by the TCC on the basis that the collateral warranty did not meet the definition of a "construction contract" under the Construction Act. Strong emphasis was placed on the timing of the execution of the collateral warranty and that it had been signed approximately 4 years after practical completion. The court also noted that, unlike in *Parkwood*, the warranty did not use the term "undertake".

The court concluded that the collateral warranty was no more than a warranty of a past state of affairs and could not realistically be held to be a contract "*for the carrying out of construction operations*". For a more detailed review of the TCC's decision, please see our earlier Law-Now here.

The Court of Appeal

The Court of Appeal, in a split judgment, has now overturned the TCC's decision. The Court of Appeal considered the matter in three parts as follows:

1. Simply asked the Court of Appeal to find that ***Parkwood*** was wrongly decided and that parasitic agreements such as collateral warranties could not in principle be "construction contracts" under the Construction Act. Simply contended that the definition should be confined to the principal contract under which work was carried out (i.e. the Building Contract). This submission was rejected by all members of the Court and ***Parkwood*** was confirmed to be good law. The Court found that the definition of "construction contract" is to be given a broad interpretation and that there was no objection in principle to there being more than one construction contract in relation to a given subject matter. Everything depended on an interpretation of the agreement in question and whether it was a contract "***for the carrying out of construction operations***". A collateral warranty which only warrants a past state of affairs is unlikely to be a "construction contract" whereas one which addresses the future carrying out of construction work is more likely to be a construction contract.

2. The Court split over how the collateral warranty in this case was to be interpreted. The minority judge, Lord Justice Stuart-Smith, considered the absence of the term "undertake" to be of crucial importance. In his view, a clause which warranted that construction work would be carried out is conceptually distinct from a clause which promised to carry out that work. The latter would be a contract "for" construction work, whereas the former would only be an agreement to be liable if the construction work was not carried out. Lord Justice Coulson adopted a much broader approach, focusing on the fact that the warranty referred to the future carrying out of construction work. He considered any differentiation between the terms "warrant" and "undertakes" as "***hair-splitting***". Lord Justice Peter Jackson had more sympathy for

the distinction between these two terms but found that limb (a) of the warranty wording quoted above was sufficiently strong to give rise to a primary obligation to carry out construction operations.

3. Simply also sought to uphold the TCC's reasoning based on the execution date of the collateral warranty. In this regard, all members of the Court agreed that the fact that the collateral warranty in question was executed at a time when the works were completed was of little relevance to its categorisation under the Construction Act. If the warranty was otherwise to be interpreted as containing a promise for the carrying out of construction obligations, execution post-dating the work would simply mean that the warranty was to be given retrospective effect.

Conclusion and implications

The Court of Appeal's decision restores clarity in this area of the law and will be welcomed by many construction industry participants, including typical beneficiaries under collateral warranties such funders, landlords and tenants. The decision not only clarifies the necessary criteria for a "construction contract" under the Construction Act, but confirms that statutory adjudication rights can apply more broadly, thus extending the benefits of a quicker and cheaper form of dispute resolution.

The Court of Appeal's decision supports the reservations expressed in our earlier Law-Now as to the correctness of the TCC's decision in light of the doctrine of retrospectivity. The recommendation in our earlier Law-Now that employers and beneficiaries include all three of the terms "acknowledge", "warrant" and "undertake" in their collateral warranties is also reinforced by the Court of Appeal's decision. The different approaches to the interpretation of the term "warrant" taken by each member of the Court of Appeal opens the door for further disputes to arise in the future if this word only is used.

In confirming the correctness of the *Parkwood* decision and the ability in principle for collateral warranties to be subject to the mandatory adjudication regime under the Construction Act, the Court of Appeal's decision is likely to highlight the advantage that collateral warranties have over third-party rights in this regard. Whether this inhibits the take up of third-party rights as an alternative to collateral warranties remains to be seen.

References

Parkwood Leisure Ltd v Laing O'Rourke Wales and West Ltd [2013] EWHC 2665
Hurley Palmer Flatt Ltd v Barclays Bank PLC [2014] EWHC 3042 (TCC)
Abbey Healthcare (Mill Hill Limited) v Simply Construct (UK) LLP [2022] EWCA Civ 823

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