CONSTRUCTION FOCUS

Construction focus: When a collateral warranty is a construction contract

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> ***It was held that, for a warranty to be a construction contract, it must be an agreement for the carrying out of construction operations, meaning it must relate to the performance of works rather than just the quality of work.***

In the recent case of *Abbey Healthcare (Mill Hill) Ltd v Simply Construct (UK) LLP* [2022], the Court of Appeal confirmed that a collateral warranty can be a construction contract under s104 of the Housing Grants, Construction and Regeneration Act 1996. The decision meant that the parties had the right to refer a dispute under a collateral warranty to adjudication, bringing about additional certainty following the case of *Parkwood Leisure Ltd v Laing O'Rourke Wales and West Ltd* [2013].

The case

Sapphire Building Services Limited engaged Simply Construct (UK) LLP by a contract dated 29 June 2015 to carry out the construction of the Aarandale Manor care home. Practical completion was achieved on 10 October 2016. By a novation agreement dated 14 June 2017, Sapphire transferred all of its rights and obligations under the building contract to Toppan Holdings Limited. Toppan granted a long lease to Abbey Healthcare (Mill Hill) Ltd on 12 August 2017 and on 23 September 2020, some years after the works were completed, Simply Construct entered into a collateral warranty in favour of Abbey.

Toppan discovered fire safety defects and notified Simply Construct of the defects in August 2018. It then engaged a third party to carry out remedial works after Simply Construct failed to comply with its remedial obligations, which achieved practical completion on 14 February 2020. Both Toppan and Abbey commenced adjudications in parallel to recover the costs of the remedial works. The same adjudicator was appointed in respect of both disputes. The adjudicator awarded Toppan £1,067,247.15 and Abbey £908,495.98, which Simply Construct did not pay.

Toppan sought summary judgment to enforce the adjudicator's decision and the court ruled in its favour. In the Abbey adjudication and enforcement, Simply Construct argued that the collateral warranty fell outside of the scope of the Construction Act and, therefore, Abbey did not have the right to refer the dispute to adjudication. This gave rise to the question of whether the collateral warranty could be a construction contract within the meaning of s104, which would give the parties the right to refer the dispute to adjudication.

At first instance, the court found that as the collateral warranty was executed after the works were carried out and given that the latent defects had been remedied, it was not a contract for the carrying out of construction operations as required by s104. Rather, it was a warranty as to 'a past state of affairs having reached a certain level, quality or standard'.

The Court of Appeal overturned this decision, determining that a construction contract within the meaning of s104 can be interpreted broadly to include subsidiary agreements, including collateral warranties. Coulson LJ noted that the intention of s104 was to 'cast the net of the Construction Act as widely as possible'. Coulson LJ considered three key issues to determine whether a collateral warranty could be a construction contract within the meaning of s104:

Issue 1: Can a collateral warranty ever be a construction contract as defined by Section 104?

Coulson LJ held that the answer to this question was yes; however, there should be no assumption that all collateral warranties will fall within the scope of the Construction Act because the wording of the collateral warranty will be determinative.

Section 104 defines a construction contract as an agreement for:

- the carrying out of construction operations;
- arranging for the carrying out of construction operations by others; and
- providing his own labour, or the labour of others, for the carrying out of construction operations.

It was held that, for a warranty to be a construction contract, it must be an agreement for the carrying out of construction operations, meaning it must relate to the performance of works rather than just the quality of work. Therefore, a warranty that a contractor was carrying out and would continue to carry out construction operations will likely fall within the scope of s104, whereas a warranty which did not recognise or regulate the carrying out of any future work, being more akin to a product guarantee, would likely fall outside of the scope of s104.

Coulson LJ commented that the potential for the beneficiary to bring a claim for specific performance under a collateral warranty is indicative of a contract for construction operations. It was also commented that the absence of detailed payment and remuneration provisions, as per s109 of the Construction Act, did not prevent a collateral warranty falling within the scope of s104.

Coulson LJ recognised that one of the aims of the Construction Act was to provide an effective dispute resolution system. Both Toppan and Abbey commenced adjudications relating to the same fire safety defects arising from the performance of the same construction operations. Enabling both claims to be dealt with by the same adjudicator aligns with the purpose of the Construction Act by ensuring 'consistency in approach and outcome'. Nevertheless, it was noted that the procedural advantage of allowing for adjudication should not affect the meaning of s104 or justify a strained interpretation of it.

Issue 2: Did the terms of the Abbey collateral warranty make it a construction contract as defined by Section 104?

In the Abbey collateral warranty, Simply Construct warranted that it:

> *… has performed and will continue to perform diligently its obligations under the contract.*

Coulson LJ held:

> *… [this was] a warranty of both past and future performance of the construction operations. Simply Construct were warranting that, not only have they carried out the construction operations in accordance with the building contract, but they will continue so to carry out the construction operations in the future. That is an ongoing promise for the future, of the kind to which I have already referred. As a matter of common sense, therefore, it seems to me that that is "an agreement for the carrying out of construction operations". It is not a warranty limited to the standard to be achieved; neither is it a warranty limited to a past or fixed situation. It is a warranty as to future performance. It is that that differentiates the [warranty] from a product guarantee.*

In contrast, in his dissenting judgment, Stuart-Smith LJ considered that too much reliance has been placed upon the reference to past and future performance. He commented that the wording in the Abbey warranty neither says nor implies that Simply Construct is assuming a direct obligation to carry out the works for Abbey.

Issue 3: Did the date on which the Abbey collateral warranty was executed make any difference?

In the first instance decision, it was held that, as there were no future works to be carried out at the time the warranty was signed (it was actually signed some years after practical completion), it was a warranty of a state of affairs akin to a product guarantee, and did not therefore fall within the scope of s104. Coulson LJ held that the time of execution was of little relevance to its categorisation under s104 because it was retrospective in effect. The collateral warranty made a promise to the standard of past work and to the future carrying out of work to the same standard. Thus, any delay between the completion of the works and the execution of a warranty does not matter where the collateral warranty contains future-facing obligations and is retrospective in effect.

Coulson LJ noted that if the date of execution did matter, it would result in considerable uncertainty as it would mean that two collateral warranties signed at different times would be treated differently despite being drafted on exactly the same terms. Ultimately, this would encourage contractors not to sign collateral warranties until after they had completed construction operations in order to avoid the implication of the Scheme and avoid being the subject of a claim in adjudication.

Practical implications

The decision in *Abbey* both confirms and clarifies the interpretation of s104 given in the decision in *Parkwood*. In *Parkwood*, Akenhead J concluded that a collateral warranty that included the phrase 'warrants, acknowledges and undertakes' could be considered a construction contract, explaining that (i) 'warrants' depicts a state of affairs, (ii) 'acknowledges' confirms something, and (iii) 'undertakes' is an obligation to do something.

As is clear from the decision in *Abbey*, simply removing references to 'undertakes' within a collateral warranty, which most evidently captures forward facing obligations, is not sufficient to bring a collateral warranty outside of the scope of s104 in the context of standard collateral warranty drafting. Warrantors should be especially careful in considering the drafting that they agree if they do not wish for adjudication to be applicable. Conversely, those acting for the beneficiaries of collateral warranties should consider the wording in both the Parkway and Abbey collateral warranties and would be well advised to incorporate all three of the words expanded upon by Akenhead J in *Parkway*, particularly 'undertakes'.

The wording of the Abbey collateral warranty is market standard drafting. In the absence of substantial drafting changes which are widely replicated throughout the industry the decision in *Abbey* will confer a substantial benefit on recipients of collateral warranties, such as funders, purchasers and tenants, by offering a quicker and cost-effective method of dispute resolution. It follows that in moving forward, parties may wish to consider whether they want to specify that the Scheme applies or include express drafting to align the adjudication procedure with the underlying primary document.

With regard to the prospect of industry-wide drafting changes to avoid collateral warranties falling within s104, Coulson LJ's comments in a footnote in Abbey are perhaps telling:

> *… I am aware that, shortly after Parkwood was decided, there were one or two articles in the Construction Law Journal expressing some surprise at the outcome. The principal points made in those articles are all considered in this judgment. However, Parkwood was decided almost a decade ago, and there has been no subsequent decision in which it has been doubted or criticised in any way. The construction industry, known for picking up on any TCC decision that it regards as anomalous, can therefore be taken to have broadly accepted the result.*

Assuming that the industry has indeed accepted the impact of both *Parkway* and *Abbey*, one would hope that following the decision in *Abbey* we will not see contractors, consultants and sub-contractors refusing to provide collateral warranties or substantially renegotiating their terms.

If parties want to avoid adjudication altogether, then providing third-party rights pursuant to the Contract (Rights of Third Parties Act) 1999 may be the solution. Unless a further decision is handed down in relation to *Hurley Palmer Flatt Ltd v Barclays Bank Plc* [2014], a third party will not have the right to adjudicate under their third-party rights unless such right is expressly granted in the third-party right schedule. In due course, it may be that

the inability to adjudicate in relation to third-party rights may make their use less attractive when compared to collateral warranties.

Cases Referenced

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

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