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Collateral warranties and the right to adjudicate – a turning point

Collateral warranties are used as a supporting document to a primary contract where an agreement needs to be put in place with a third party outside the primary contract. Architects, contractors, or sub-contractors may need to warrant to a funder, tenant or purchaser that they have fulfilled their duties under a building contract.

Collateral warranties often contain obligations that affect the consultant or contractor, such as using specific materials or carrying out work in a professional, workmanlike manner.

On 9 July 2024, the Supreme Court gave judgment in a case which raised the question of whether the beneficiary of a collateral warranty had the right to refer disputes arising from the warranty to adjudication.

How quickly things can change…

Since 2013 and the decision by Mr Justice Atkinhead in the case of *Parkwood Leisure Ltd v Laing O'Rourke Wales and West Ltd,* it has been generally accepted that the standard wording used in collateral warranties have resulted in the warranty being a 'construction contract'. Within the meaning of section 104 (1)(a) of the Housing Grants, Construction Act 1996 (the 'HGCRA'), parties to a collateral warranty had the statutory right to refer their disputes to adjudication at any time[1] (section 108 of the HGCRA) .

Collateral warranties were not automatically construed as a 'construction contract' for the purposes of the HGCRA, but the wording in the *Parkwood* collateral warranty was the same as that used in the majority of instances. As a result, the construction industry has operated on the basis that parties to a collateral warranty had the right to refer disputes to adjudication.

Following the Supreme Court's decision in *Abby Healthcare (Mill Hill) Ltd v Augusta 2008 LLP (formerly Simple Construct (UK) LLP*, that status quo has been reversed. It is therefore highly likely that your collateral warranty is no longer a 'construction contract' for the purposes of the HGCRA and that you no longer have a statutory right to refer disputes to adjudication. The tables have, quite literally, been overturned!

What has happened?

The Supreme Court were tasked with considering a collateral warranty which contained the following wording:

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"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 all the reasonable skill care and diligence to be expected of a properly qualified competent and experienced contractor experienced in carrying out and completing works of a similar nature, value complexity and timescale to the Works;"

Similar terms are the core obligations in virtually every collateral warranty.

When this case was in the Court of Appeal, Coulson LJ considered the Contractor's ongoing obligation to "*continue to perform diligently its obligations under the Contract*" differentiated the collateral warranty from a "*simple promise or guarantee in respect of a past state of affairs*" which would not be a contract for carrying out construction operations pursuant to Section 104(1). The collateral warranty however, because of the obligation to continue to carry out and perform its obligations under the building contract "*is a promise which regulates (at least in part) the ongoing carrying out of construction operations*" and therefore a contract for carrying out of construction operations and with Section 104(1).

The leading Judgment in the Supreme Court was given by Lord Hamblen (with whom the other Lords agree). Lord Hamblen considered that in order to determine if the collateral warranty was or was not a construction contract for the purposes of Section 104 was necessary to consider the purpose of the collateral warranty and in this respect he was of the opinion that:

"…it is difficult to see how the object or purpose of a collateral warranty is the carrying out of construction operations. The main object or purpose of such a warranty is to afford a right of action on respect of defectively carried out construction work, not the carrying out of such work.

Whether or not the carrying out of construction operations has to be the main object or purpose of the agreement, it must surely be necessary for the agreement to give rise to the carrying out of such operations. A collateral warranty that merely promises to the beneficiary that the construction operations undertaken under the building contract will be performed does not do so…"
"…There is no promise to carry out any construction operations for the beneficiary; merely a promise to the beneficiary that the construction operations to be carried out for someone else under the building contract will be performed."

As a consequence, the Supreme Court decided that *"… a collateral warranty will not be an agreement "for" the carrying out of construction operations for the purposes of section 104(1) if it merely promises to perform obligations owed to someone else under the building contract*"

Given that this is the core obligation of a collateral warranty it is difficult to see how the

standard collateral warranties used in the construction industry will in future be considered construction contracts for the purpose of section 104. Certainly existing collateral warranties are very unlikely to be considered construction contracts for the purpose of section 104.

The Supreme Court did not however rule out the possibility of a collateral warranty coming within the ambit of section 104, but it needed to contain *"…a separate or distinct obligation to carry out construction operations for the beneficiary* [of the warranty]*; not one merely derivative and reflective of obligations owed under the building contract*."

Conclusions

The Supreme Court did not discount the possibility of collateral warranties being 'construction contracts' for the purpose of section 104 of the HGCRA. However, depending on the purpose of the warranty, it is unlikely that beneficiaries will willing to take the risk of relying on the Court's interpretation of the drafting. We are therefore likely to see express adjudication provisions inserted into warranties as was frequently the case before the decision in *Parkwood*. They will of course be contractual adjudications rather than statutory adjudications and therefore need to contain (or refer to) all the necessary terms of the adjudication process and jurisdiction of the adjudicator, etc.

So what happens now if your collateral warranty does not contain explicit adjudication provisions?

If you wish to pursue a right to action under the warranty, you will likely need to do this through court proceedings or arbitration (if an arbitration clause is included) to enforce your rights. Keep in mind that this can result in additional costs and delays.

If you would like more information on the impact of this ruling, please get in touch with Matt Needham-Lang, Director, Construction mneedham-laing@lawstep.co.uk