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BONDS, WARRANTIES, THIRD PARTY RIGHTS AND OBLIGATIONS TO PROCURE

CONSTRUCTION

NO ESCAPE

In *Liberty Mercian v Cuddy Group [2014]*, the Court has shown that it is prepared to exercise considerable (and surprising) discretion to ensure that absolute contractual obligations to provide a bond and collateral warranties are complied with.

As part of its contract with Liberty, Cuddy had agreed to provide a performance bond and procure collateral warranties in favour of Liberty from a sub-contractor, Quantum. However, Cuddy failed to perform either of these obligations before Liberty terminated the contract. Liberty applied to Court to force Cuddy to do so and Cuddy sought relief from its obligations, claiming it was now impossible to comply as:

- it had tried, but been unable to find a reputable institution willing to give a performance bond (despite conducting extensive searches); and
- Quantum had been liquidated so there was no value in providing the warranty.

The performance bond

The judge agreed that Cuddy had taken appropriate steps to obtain the performance bond, as it had instructed a broker who had made enquiries across the market. In all but one case, the broker had received negative responses. These ranged from outright rejections to more detailed responses noting that the institutions were unwilling to provide a bond in circumstances where:

- the contract had already been terminated and the works were nearly complete;
- the relevant Cuddy entity was non-trading and had no assets; and
- litigation was already in progress.

Cuddy had, however, found one institution, Evolution, which was prepared to offer a bond, subject to stringent terms: Cuddy would be required to pay the full cash equivalent of the bond amount (£420,000) to Evolution up front, along with an annual premium of 2 per cent a year. Evolution was an *"unrated"* company based in Gibraltar, and the terms of the bond differed from those stipulated in the contract.

In the circumstances, the judge was unwilling to order that Cuddy had to enter into such a performance bond, given that it was not a *"financially prudent"* solution.

However, rather than deciding that the obligation to provide a performance bond was impossible to perform and void, the judge ordered Cuddy to pay £420,000 into Court in lieu of the performance bond. The sum deposited could be used as security to contribute to any sums for which Cuddy was found liable to Liberty once the substantive issues of the case were decided.

The collateral warranties

The liquidator dissolving Quantum told Cuddy that Quantum had no professional indemnity insurance on which Liberty would be able to rely, rendering any collateral warranties worthless.

However, the Court also heard evidence that Quantum had held insurance (although the detail was not confirmed) and, in light of this, the judge could not rule out the possibility that the collateral warranties would be of value. The judge, therefore, ordered Cuddy to obtain the collateral warranties, despite the significant difficulties it would face in doing so from a liquidated company which had been removed from the Companies House register.

Conclusion

This case demonstrates that the Court will be very reluctant to allow a party to use its own delay in performing its obligations to provide security or collateral warranties as a reason to subsequently get out of those obligations by arguing that it has then become impossible to comply (which is to be welcomed). The decision has also set a high threshold for the test of when an obligation will be taken to be "impossible".

While this is a warning to contractors that there is, potentially, no escape from contractual obligations, and is some comfort to developers and employers, the length and likely cost of the litigation highlights the benefit of avoiding such a situation (and it remains highly doubtful that Cuddy will be able to actually get collateral warranties from its liquidated sub-contractor). Employers should enforce obligations regarding the provision of performance bonds and warranties at the earliest opportunity and consider making the supply of these documents a pre-condition to payment. Such clauses (combined with this judgment) should make contractors think twice about non-compliance.

THIRD PARTIES AND ADJUDICATION

In August 2013, the Technology and Construction Court confirmed that the recipient of a collateral warranty from a contractor may, in certain circumstances, use adjudication to resolve a dispute arising under that warranty.

We reviewed the decision in our October 2013 eBulletin and suggested that consultants and contractors may prefer to give third party rights rather than warranties (as we felt it unlikely that a recipient of those rights would be able to use adjudication to resolve a dispute).

Whilst we have not noticed any significant increase in the use of third party rights in the last year, a decision from the autumn came to the same conclusion about the right to adjudicate. Third party rights will not necessarily allow a third party the right to use adjudication to resolve their dispute.

The drafting and the dispute

The argument in *Hurley Palmer Flatt Ltd v Barclays Bank plc [2014]* revolved around the following third party rights clause in a consultant's appointment:

"any Affiliate with a direct interest in the Project shall be entitled to enforce the terms of this Agreement as "Client" always provided that the Consulting Engineer [Hurley Palmer Flatt Ltd] shall be entitled [to] rely on the equivalent defences in respect of such liability which it has against the Client".

The appointment also:

- clarified that, save as set out in the wording above, a third party did not have a right to enforce a term of the appointment; and
- relied on the statutory adjudication rules in the Scheme rather than bespoke drafting.

There was a dispute and Barclays Bank plc, an "Affiliate", sought to enforce its rights using adjudication. The consultant challenged Barclays' right to do so and the judge agreed – the notice of adjudication was ineffective and the adjudicator did not have jurisdiction to deal with the dispute.

The decision

The judge decided that the way in which the appointment was drafted meant that *"Affiliates"* had only been granted rights in relation to liability (i.e. the right to claim for breach) and not procedural rights (i.e. the right to use adjudication to bring a claim for breach). So, Barclays did not have the right to resolve the dispute via adjudication.

The judge also considered that:

- the rights granted were not conditional rights (i.e. they could be exercised other than via adjudication); and
- only a *"party to a construction contract"* has the right to adjudicate under section 108 of the Housing Grants, Construction and Regeneration Act 1996, and section 7(4) of the Contracts (Rights of Third Parties) Act 1999 prevents third parties from being deemed to be such "parties".

Conclusion

In light of this case, consultants and contractors wishing to minimise the risk of disputes with third party funders, purchasers and/or tenants being resolved through (potentially multiple) adjudication(s) may move towards the use of third party rights.

From an employer or developer's perspective, third party rights take less time and effort to put in place, and they now also have clarity over the availability of adjudication (the certainty of which should appeal to both givers and recipients of third party rights). Perhaps this will mean that the uptake of the use of third party rights will accelerate over the coming months.

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