WARRANTY WOES – WHEN CAN YOU ADJUDICATE UNDER A COLLATERAL WARRANTY?

CONSTRUCTION

Mr Justice Akenhead, in the recent Technology and Construction Court decision of *Parkwood Leisure Limited v Laing O'Rourke Wales & West Limited*, has looked at the issue of whether a collateral warranty can be a "*construction contract*" for the purposes of the Housing Grants, Construction and Regeneration Act 1996 (the "Construction Act"). This is the first time that the point has been considered by the Courts and the judgment will have important implications for all parties who negotiate and enter into collateral warranties, whether on the side of the warrantor or the beneficiary.

THE FACTS

A contractor was engaged to design and build a new swimming pool complex in Cardiff. Before completion of the works, a collateral warranty was executed in favour of the tenant who would operate the facility. A dispute subsequently arose over the alleged defective design and installation of air handling units in the complex. The tenant sought confirmation from the Court that the warranty constituted a construction contract, which would allow it to pursue adjudication proceedings against the contractor.

Akenhead J's decision revolved around three concepts:

1. statutory interpretation;
2. construction of the warranty; and
3. timing.

STATUTORY INTERPRETATION

Section 104 of the Construction Act defines a construction contract as an agreement "*for…the carrying out of construction operations*". However, the Court had not previously looked at whether a collateral warranty would fall within this definition. Whilst the Construction Act provides guidance on what "*construction operations*" are, the judge noted there is little or nothing in the act which illuminates what constitutes an agreement for the carrying out of such operations.

Given this lack of guidance, Akenhead J suggested that it was necessary to look at the precise terms of the contract in each case and to apply the usual principles of contractual interpretation. Where one party "*agrees to carry out and complete construction operations*", it will be a construction contract.

CONSTRUCTION OF THE WARRANTY

The collateral warranty in question stated 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 judge looked at each of the verbs "*warrants, acknowledges and undertakes*" as having a different meaning – the contractor was *acknowledging* the completed work, *undertaking* to carry out and complete the outstanding work and *warranting* that past and future work and design had been and would be performed in accordance with the underlying building contract.

The most important of these in the judge's eyes was the contractor's undertaking to carry out and complete the remaining works. The judge decided that this was an agreement to carry out construction operations and that, therefore, the warranty was a construction contract which fell within the Construction Act.

TIMING

Akenhead J underlined that not all collateral warranties will be construction contracts and that the precise wording of the agreement must be considered together with the surrounding circumstances. However, the judge was clearly particularly influenced by the timing of the warranty, which had been executed before Practical Completion of the works. The agreement, therefore, partly related to future works and fitted more comfortably as a prospective contract "*for the carrying out of construction operations*".

In light of this judgment, if a contractor or consultant is agreeing by way of a collateral warranty to carry out uncompleted works in the future, it will be a "*very strong pointer*" that the collateral warranty is a construction contract. By contrast, where the works are already completed and a warranty merely guarantees a past state of affairs, a construction contract is unlikely to arise.

This analysis may produce surprising results. For example, commentators have already highlighted that, in multi-let properties, the rights of tenants could differ depending on whether their collateral warranties are executed before or after Practical Completion. Those executed before may be deemed construction contracts and so the tenant will have the right to adjudicate, whereas those executed after will not.

WHAT ARE THE CONSEQUENCES?

The most significant consequence of the decision is that, given the right circumstances, the beneficiary of a collateral warranty may now bring adjudication proceedings against the warrantor – so funders, purchasers and tenants might potentially bring adjudication proceedings against contractors or the professional team in a construction project. This affords them the benefit of a fast decision on a "pay now, argue later" basis.

It is important that both parties to the collateral warranty keep this in mind – for the beneficiary, it will be another tactical arrow to their bow, whilst warrantors will not want to be put at a disadvantage by being ambushed by an adjudication referral. However, given that each case will turn on the specific wording of the collateral warranty in question, challenges to jurisdiction by the responding party may well be common.

Contractors and consultants should ensure that they negotiate the contents of collateral warranties carefully if they wish to prevent them falling within the Construction Act. The warrantor should be careful merely to warrant the standard of the completed works and to avoid any wording that could be construed as an undertaking or agreement to carry out and complete outstanding works.

It is also possible that this decision will encourage more parties to use the Contracts (Rights of Third Parties) Act 1999 (the "Rights of Third Parties Act"). A third party is unlikely to be able to adjudicate where they obtain their rights via the Rights of Third Parties Act, unless this right is expressly granted – only "*a party to a construction contract*" has the right to adjudicate under section 108 of the Construction Act and section 7(4) of the Rights of Third Parties Act prevents third parties from being deemed to be such a "*party*". This may make use of the Rights of Third Parties Act preferable to reliance on collateral warranties as far as contractors and consultants are concerned.

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