



Welcome to the October edition of *Insight*, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

In this issue we provide practical tips for those who do not wish their warranties to be subject to statutory adjudication.

Insight

A collateral warranty; but not as we know it!

On 29 August 2013, the Technology and Construction Court handed down judgment in *Parkwood Leisure Limited v Laing O'Rourke Wales & West Limited* [2013] EWHC 2665, and considered for the first time whether a collateral warranty is a construction contract for the purposes of Part II of the Housing Grants, Construction and Regeneration Act 1996 (the "Act").

To the surprise of the construction industry (and its lawyers), the court confirmed that, depending on their precise wording and the circumstances, collateral warranties could be regarded as being construction contracts under the Act, in which case the beneficiary would be rendered eligible for statutory adjudication.

This twenty-eighth issue of *Insight* considers the ramifications of the decision for the construction industry, and also provides practical tips for those who do not wish their warranties to be subject to statutory adjudication.

Parkwood

The facts

Laing O'Rourke Wales & West Limited ("LOR") entered into a standard JCT Design and Build contract (the "Contract") in respect of a leisure facility in Cardiff. Before the works completed, LOR entered into a deed of warranty with the funder, first purchaser and mortgagee as required by Article 10 of the Contract, naming the tenant, Parkwood, as beneficiary.

The warranty provided:

"1 The Contractor warrants, acknowledges and undertakes that:-
1 it has carried out and shall carry out and complete the Works in accordance with the Contract;
2 ... it owes a duty of care to the Beneficiary in the carrying out of its duties and responsibilities in respect of the Works;
3 it has exercised and will continue to exercise all reasonable skill and care [in respect of the design] ...

...

7 it has complied and will continue to ... carry out its obligations under the Contract [including in terms of proceeding regularly and diligently]."

Following completion of the works almost a year later, LOR had failed to complete remedial works that Parkwood alleged it was contractually bound to undertake and Parkwood therefore sought to enforce the terms of the warranty. Parkwood wished to adjudicate its dispute with LOR and it therefore sought a declaration from the court that it was entitled to bring statutory adjudication proceedings against LOR on the basis that the warranty was a contract for construction operations caught by the Act.

The decision

In light of the wording of the warranty, the Judge held that it was a

construction contract for the carrying out of construction operations under the Act, even though it had been given retrospectively.

The recital confirmed that the Contract was for the design, carrying out and completion of the construction of a swimming pool development, and clause 1 of the warranty contained an obligation upon LOR to complete and carry out the works in accordance with the Contract with reasonable care and skill.

The key point about the warranty which swayed the Judge was the fact that it related in part to the execution and completion of works that were not yet complete, albeit LOR had already completed a significant proportion of the works and design. LOR's warranties were not therefore limited to a past state of affairs but, rather, they constituted a positive obligation upon LOR to carry out and complete future works to the standard, quality and state of completeness required by the Contract.

The Judge, however, made it clear that it does not automatically follow that all warranties will be regarded as being construction contracts under the Act: everything depends on the precise wording of the warranty and the surrounding background facts.

Ramifications of the decision

This decision is important because it challenges the 15-year status quo that warranties are not caught by the Act and are therefore not capable of being adjudicated. If the decision stands, there will be a number of ramifications for the construction industry.

For contractors, subcontractors and consultants

Those who provide warranties may face new adjudication claims by beneficiaries and contractors, subcontractors and consultants that had not previously been considered to be possible.



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For funders, tenants and purchasers

The decision will no doubt be welcomed by beneficiaries of warranties as adjudication may be seen as a more expeditious and cost-effective way to enforce the terms of a warranty than via court or arbitral proceedings.

For those commencing adjudication proceedings under a warranty

There will undoubtedly be an increase in jurisdictional challenges as parties will seek to establish as a preliminary point whether the warranty in question is a contract for construction operations, and is therefore capable of being adjudicated. Unless the parties agree to be bound by the adjudicator's decision as to whether the warranty is caught by the Act (which would be very unlikely as the issue is a brand new one), they will be left with a non-binding decision which may result in one or both parties refusing to participate in the adjudication any further, or a challenge on jurisdiction at a later date.

Practical tips if you do not wish your warranty to be subject to statutory adjudication

Draft with care

When preparing new warranties, consider the drafting of your warranty very carefully if you do not wish it to become subject to statutory adjudication. You should:

- Use the word "warrants" as opposed to "undertakes", as the latter suggests the existence of

a legal obligation that extends beyond that which would generally be seen in warranties.

- Draft your warranty along the lines of the JCT Purchaser/Tenant Warranty which does not contain an undertaking to carry out work, but instead warrants that the works will comply with the underlying contract with effect from practical completion.
- Try and contract out of the Act by using the Contracts (Rights of Third Parties) Act 1999, under which the third party beneficiary might not be regarded as being a party to the contract and might not therefore be able to enforce any rights under it in adjudication. A note of caution however: there is no authority on whether contracting out in this way would actually work and this approach is therefore high risk.

Think about timing

The wording of the warranty is important, but the timing of its execution is even more important. In *Parkwood*, the Judge suggested that any warranty given prior to practical completion should be treated as being a contract to carry out future works, as opposed to a warranty in respect of works that have already been carried out. If practical (and often it is not) you should therefore avoid executing a warranty until practical completion has been achieved as you will then only be warranting a state of affairs in respect of works that have already been carried out.

Conclusion

This is the first judicial authority as to whether warranties should be regarded as being construction contracts for the purposes of the Act. The Act itself is of very little use as it only provides an illustration of what

an agreement for the carrying out of construction contracts might include (and exclude). Notably, it does not say that warranties are not covered by the Act.

The Judge emphasised that there can be no doubt that the reference to a "contract" must mean a contract under English law. But what is difficult to reconcile about the decision is how a warranty can be regarded as being a construction contract (or at the very least a contract in the usual sense of the word) in circumstances where the beneficiary is not also the employer under the underlying contract; where the beneficiary would be unlikely to be able to exercise any control over the conduct of the works; and where consideration is not usually provided by the beneficiary of the warranty.

"If the decision stands, there will be a number of ramifications for the construction industry."

At the time of writing, it is not yet known whether the decision will be appealed to the Court of Appeal and so for the time being the decision stands, until and unless the Court of Appeal takes a different view.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston. lkingston@fenwickelliott.com. Tel +44 (0) 207 421 1986

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Fenwick Elliott LLP
Aldwych House
71-91 Aldwych
London WC2B 4HN
www.fenwickelliott.com