

Collateral Warranties & Construction Contracts

Collateral warranties essentially bridge the contractual gap between parties upstream and downstream of a middle party, such as employers and sub-contractors separated by the contractor, or funders and contractors separated by the employer.

This article considers when a collateral warranty might be considered a construction contract for the purposes of the HGCRA and thus gives parties to that contract the right to adjudicate. This article will also consider what options are available if no right to adjudication exists.

What is a collateral warranty?

The rule of privity of contract applies in English jurisdiction, meaning that a third party cannot enforce the terms of a contract. As such, an Employer cannot enforce the terms of a sub-contract between a contractor and sub-contractor. This was recently confirmed in *Multiplex Construction Europe Limited* where the Court restated its reluctance to impose a duty of care in respect of pure economic loss where parties do not have a contractual relationship. Hence, collateral warranties are a useful contracting tool.

A collateral warranty is a kind of side agreement between parties without a direct contractual link, for a warrantor to perform the work required of its direct contractual agreement. In this side agreement the beneficiary (the party receiving the warranty) is afforded the ability to claim against the warrantor (the party giving the warranty) should it not perform its obligations.

When it comes to construction contracts, a construction professional, such as a consultant, contractor or subcontractor will usually provide such a warranty to a main contractor, employer or funder. In doing so, it establishes a direct contractual relationship between it and the beneficiary which is an extension of its obligations to its immediate contract party.

Construction contracts & the right to adjudicate

Section 104(1) of the HGCRA provides that a “*construction contract*” is:

“An agreement for carrying out construction operations, arranging the carrying out of construction operations by others or providing labour or the labour of others for carrying out of construction operations, amounts to a construction contract.”

Where a construction contract fits the definition of a “*construction contract*” under the HGCRA it will afford the parties the statutory right to refer disputes arising from this contract to adjudication. Under section 108, parties to a construction contract have a statutory right to adjudicate any dispute in connection with the construction contract. The right to adjudicate is often desirable for parties as it is a commercially pragmatic and relatively quick 28-day process. Adjudication helps to maintain cashflow as it aims to remove the need to undertake lengthy and extensive court proceedings to recover damages.

When is a collateral warranty a construction contract?

The decision in *Parkwood Leisure Ltd* (2013) demonstrated how the wording and relevant contractual background are fundamental factors when deciding if a collateral warranty amounts to a “*construction contract*”:

“One needs primarily to determine in the light of the wording and of the relevant factual background each such warranty to see whether, properly construed, it is such a construction contract for the carrying out of construction operations”.

The Court found the collateral warranty in *Parkwood* to be a “*construction contract*” for the following reasons:

- a. The underlying contract was a construction contract;
- b. The language in the warranty mirrored that of the underlying construction contract. It was “*for the design, carrying out and completion of the construction of a pool development*”;
- c. The words “*warrants*”, “*acknowledges*” and “*undertakes*” were included in the contract. The warranty included an undertaking to carry out and complete works under the construction contract; and
- d. The fact that the contract was retrospective was no bar to it being a construction contract.

This meant that the protections of the HGCRA applied, including the statutory right to adjudicate and thus the adjudicator’s award was enforced.

When is a collateral warranty not a construction contract?

The Court in *Parkwood* made it clear that not all collateral warranties will fit the definition of a “*construction contract*”. The decision in *Toppan Holdings Ltd* (2021) provided an application of the *Parkwood* principles to a collateral warranty to conclude that the collateral warranty in question was not a construction contract.

A dispute arose from a collateral warranty between the parties which was referred to adjudication. Toppan and the second claimant were both awarded damages in excess of £850,000 each and interest in respect of remedial works, professional fees and loss of trading profit. Simply refused to comply with the decision and Toppan began enforcement proceedings. Simply contended that the adjudicator lacked jurisdiction as the collateral warranty was not a construction contract for the purposes of the HGCRA.

The TCC agreed with Simply’s position for the following reasons:

- a. The language of “*acknowledges*”, “*warrants*” or “*undertakes*” found in the *Parkwood* contract was omitted from the *Toppan* contract. This language is key to finding that a construction contract exists as the contractor undertakes to carry out and complete the works; and
- b. The warranty was executed four years after practical completion of the works and months after defects were rectified - “... *by the time the [collateral warranty] was executed, it was a warranty of a state of affairs past or future akin to a manufacturer’s product warranty.*”

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Parkwood would indicate that most collateral warranties which relate to construction contracts would meet the criteria established to also be “*construction contracts*”. As such, parties should be aware that disputes arising under these agreements can be referred to adjudication and may also be afforded other protections / obligations of the HGCRA.

Toppan made it clear that an agreement to stand over previous works is not a construction contract, even if those previous works were construction operations. This is a developing area of law, and more situations may arise where a collateral warranty is not a construction contract.

Where a collateral warranty does not meet the *Parkwood* criteria, a statutory right to refer the dispute to adjudication will not exist. As such, it would be necessary to pursue claims in accordance with pre-action protocols. In such instances, it may be appropriate for the parties to consider including their own Alternative Dispute Resolution (“*ADR*”) provisions in the agreement which may include adjudication to potentially avoid the expense of litigation.

Contracting parties in Ireland should note that this issue has not yet come before the Irish Courts. The Construction Contracts Act 2013, which is the Irish equivalent of the HGCRA, defines “*construction contract*” similarly to the HGCRA. As such, the UK body of case law may prove persuasive in the Republic of Ireland on this issue.

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