Collateral Warranties, a vote of confidence

***Linklaters Business Services -v- Sir Robert McAlpine Limited And Other* [2010] EWHC2931(TCC)**

In this newsletter, we have previously discussed cases which considered collateral warranties and their enforceability, for example the Scottish Widows Services Limited case which we reviewed in our summer newsletter.

The courts have again dealt with a case where collateral warranties were key and the court and the parties accepted the principle of collateral warranties and that they work as they are intended to. Indeed the judge commented that parties can protect themselves contractually by entering into collateral warranties and can thereby avoid complicated arguments about tortious liability.

The Legal Background

The Linklaters' case, as is usual in construction disputes, involved a complex web of contractual relationships and multiple parties, with added property and maintenance contracts to liven up the mix. The dispute was about the installation of chilled steel water pipes which serve the air conditioning throughout the building occupied by the well-known law firm, Linklaters LLP. The Claimant in the litigation was Linklaters Business Services Ltd, the services arm of Linklaters LLP. I shall refer to the Claimant in this case as Linklaters for simplicity.

Linklaters are tenants of 1 Silk Street, which they have occupied since 1996. The building was redeveloped for them by DS Developments Limited who employed Sir Robert McAlpine Limited (McAlpine) as the main contractor for the works under a JCT Contract. McAlpine employed How Engineering Services Limited (How) as its mechanical and electrical sub-contractor and How then sub-sub-contracted the installation of insulation to the pipe work to Southern Installation (Medway) Limited (Southern). There was no formal written contract such between Southern and How, although there was some paperwork.

As one would expect, Linklaters received a fairly comprehensive package of collateral warranties from McAlpine and How, supported by guarantees from their respective holding companies, but not from Southern. In its sub-contract, How provided a complete indemnity to McAlpine for any breaches of the sub-contract.

Linklaters was responsible under the terms of property management agreements for maintaining the water pipes. Its demise of the premises did not, however, extend to the water pipes.

The Factual Background

Linklaters employed its own fit-out contractors and in September 1996, Linklaters moved into their shiny new building. In June 2006, one of the chilled water riser pipes sprang a leak. The resulting investigations revealed that the pipes were severely corroded throughout the building. Linklaters, with the benefit of advice from an experienced mechanical and electrical engineer, decided to replace the chilled water pipes throughout the building. Linklaters then sued McAlpine and How under the

collateral warranties. How joined Southern to the proceedings in tort, there being no proper contract in place.

The judge decided that the corrosion was caused by water penetration through the insulation, which resulted from poor workmanship in installing the insulation to the pipes and that the corrosion had, in all likelihood, caused the leak.

The Issues

The court dealt with a number of very interesting legal issues in this judgment and in a previous judgment dealing with legal issues arising from Southern's claim against How. While this judgment does not make new law, it is an interesting look at how legal principles are applied to building disputes.

(a) Collateral Warranties

The court proceeded very firmly on the basis that the purpose of collateral warranties is to give parties contractual protection and to avoid the need to bring claims in tort. All the parties involved also proceeded on this basis. Both McAlpine and How accepted that "that if each was materially in breach of the building contract and the sub-contract respectively, each would be to that extent in breach of the relevant collateral warranty".

(b) Liability in Tort

The judge looked at whether Southern, at the bottom of the contractual chain, could be liable to the other parties in tort in the absence of the contractual link provided by collateral warranties or a proper sub-sub-contract being in place.

The judge had decided in a previous hearing that Southern did have a duty to exercise reasonable skill and care. However, in this case he went on to decide that they were not in breach of that duty in how they had installed the insulation. Southern had also argued that even if they might owe a general duty of care to How, a duty of care did not extend to claims for economic loss, in other words for damage to the thing itself. Damage to the thing itself is classified as economic loss and is irrecoverable. In this case, the insulation and the pipe work were effectively inseparable and amounted to one thing. The judge agreed with this argument deciding that the insulation and the pipe work were in effect one installation and that therefore no cause of action could arise.

(c) Repair or Replacement

When the defective pipe work was discovered, Linklaters had two options for dealing with the problem: they could repair the pipes, or replace them. With the benefit of expert advice from a mechanical and electrical engineer, they took the decision to replace the pipe work. There was extensive argument over quantum and whether or not this was a reasonable decision to take and whether other courses of action were open to Linklaters which were reasonable. The judge decided that it was reasonable for Linklaters to take the decision to replace the pipe work, particularly as they were acting with the benefit of professional advice from an experienced mechanical and electrical engineer, and that the cost of the replacement pipe work was therefore recoverable.

Conclusion

This case is interesting for a number of reasons. The judge has looked at the principle of economic loss in the context of modern building practice and considered how it applies to the installation of pipe work insulation. In addition he considered the effectiveness or otherwise of collateral warranties and the reasonableness of the Claimants' decision in pursuing a particular remedial works option. While it may not have created new law, it has certainly clarified how established legal principles apply to construction disputes.

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Let It Snow, Let It Snow, Let It Snow

During the run-up to Christmas, as the snow lay thick on the ground, and the news was full of pictures of stranded travellers at Heathrow, my decision to order the Christmas turkey from a farm in the middle of nowhere began to look increasingly reckless. What would happen if I could not collect the turkey? How could I explain things to my 10 hungry relatives on Christmas Day? Could I blame it on the exceptionally bad weather and give them frozen pizza and cranberry sauce instead? And would they be satisfied?

And so my thoughts turned to the effect the severe weather conditions have had on construction projects in the UK in recent weeks, and how parties will deal with delays and loss and expense caused by the snow and ice.

As ever, the starting point for any sort of analysis is the building contract itself. Different standard contracts deal with weather in different ways.

1. JCT

Under the JCT 2005 contract, "exceptionally adverse weather conditions" is a Relevant Event which entitles the contractor to an extension of time, but not to recover associated loss and expense.

There is no definition of "exceptionally adverse weather conditions" in the contract and the contract administrator must first be satisfied that the weather conditions are exceptionally adverse. The decision is largely up to the contract administrator's discretion.

In making a claim for an extension of time, the contractor must first establish that the weather is sufficiently adverse to be exceptional. Good site records of course will assist, but the most helpful data is likely to be local meteorological reports, going back several years, which will demonstrate that the weather is indeed exceptional for the area.

If some are to be believed and the recent run of wet, mild winters is to be replaced by significantly worse winter weather, establishing exceptionally adverse weather conditions is likely to become more difficult in future years, and contractors should take account of a possible change in prevailing weather conditions in tendering for and planning for jobs.

Once it is established that the weather is a Relevant Event, the contractor then has to demonstrate that the weather has caused the delay, otherwise the entitlement to an extension of time will not arise.

2. NEC

The NEC 3 contract takes a much more detailed approach to bad weather, but does allow the contractor to claim loss and expense as well as delay. Bad weather will constitute a compensation event in certain circumstances.

The contract requires four weather measurements to be taken at a specific weather station on a monthly basis during the project. These are cumulative rainfall, the number of days where the rainfall is more than 5mm, the number of days with a minimum air temperature of less than 0°C and the number of days with snow lying at a specified time. If the recorded weather occurs, on average, less often than once in 10 years, a compensation event will have occurred. So, the weather needs to be sufficiently unusual to occur every 10 years or less.

The contract looks at the weather over the calendar month, so short, sharp spells of bad weather may not amount to a compensation event.

3. ICE

The ICE contract mirrors the JCT contracts and exceptionally adverse weather conditions will entitle the contractor to an extension of time but not to a claim for loss and expense.

Tactical Steps for Contractors and Employers

1. Check the terms of the contract. A standard contract may have been amended to be more or less advantageous to your position.

2. Contractors must notify the employer of any likely delay or of claims for loss and expense in accordance with the terms of the contract. Notice requirements will be strictly interpreted.

3. Remember that there is a two stage process to establishing entitlement to an extension of time or loss and expense. Firstly, it is necessary to establish that the weather is sufficiently bad to found any entitlement and secondly, it is necessary to prove that the bad weather has actually led to delay. Careful records must be kept at every stage.

4. The contractor must remember to mitigate loss wherever possible.

It is unlikely that we have seen the last of the bad weather for this winter and all parties should be prepared for more snow and subsequent disruption.

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Recovering market losses: *Scullion v Bank of Scotland (t/a Colleys)* [2010] EWHC 2253 (Ch)

For many years, the property market seemed indestructible. Yet as markets continue to tumble, developers are finding it difficult to sell property, and investors have seen

their portfolios drop in value and their projected rental income cut. In the event of a dispute, a central question is likely to be: can you recover a loss that is due to the market fall?

Scullion v Bank of Scotland (t/a Colleys) [2010] EWHC 2253 (Ch) was a recent important case brought by a buy-to-let landlord against his bank's surveyors. The surveyors were found to have overestimated Mr Scullion's prospective rental income from his investment, an apartment in Cobham, Surrey. Mr Scullion had to sell four years later, after sustaining significant losses when renting out the apartment, and market movements meant he made a considerable capital loss.

In the aftermath of the buy-to-let bubble, the case is very significant for all the investors who bought when the market was booming. Many amateur buyers relied on the valuation by the lending bank. The judge found that Mr Scullion was entitled to the difference between the price he had paid for the flat and the true value of the property, (which in practice was infact zero) as well as the cost of meeting the normal outgoings of a flat that were not covered by the rental income. However, he was not able to recover compensation for any fall in value due to market movements.

The court followed established precedent on this last point from *South Australia Asset Management Corp v York Montague Ltd* [1996] 3 All ER 365. The judge found that the surveyors were 'plainly not engaged to advise Mr Scullion in general terms whether or not he should go ahead with the purchase'. Mr Scullion was allowed to recover losses attributable to two wrong aspects of the valuation, i.e. overstatement of the market value of the flat and the overstatement of the rental value. However, the surveyor's duties 'did not extend to advising the mortgage lender (still less Mr Scullion) as to the wisdom of entering into the transaction generally or the possibility that the market value of Flat 17 might fall after purchase'. Therefore Mr Scullion could not recover his capital shortfall due to the market tumble.

We shall have to wait for another chance for the courts to investigate the possibility of claiming for market loss in other circumstances. Much of the case law is based on claims in tort, i.e. a wrong done by one party to another which results in loss. In Mr Scullion's case, the tort was the negligent advice. In tort, the role of damages is to put the claimant in the position in which he would have been, had the tort never been committed. That is why Mr Scullion could not recover his anticipated profits from the investment.

However, the role of damages in claims for breach of contract is different. It aims to put the claimant in the position in which he would have been, had there been no breach of contract. The claimant is awarded the profit he would have expected had everything gone according to plan. Imagine a scenario in which a contractor delays completion in breach of contract. This means that the developer cannot sell the property as soon as expected and incurs a loss in a market crash in the meantime. In broad terms, damages may possibly be available for the developer's "loss of chance" with, for example, 70% of the total possible damages being awarded for a claimant who, the court finds, would have had a 70% chance of selling the property. We await the opportunity to test how the courts will respond to such a claim – as, no doubt, does many a developer.

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Never mind the quality … feel the width? Duties of Quantity Surveyors in valuing defective works

If a building project goes wrong, employers are often tempted to sue the entire professional team and the building contractor, so that nobody can escape blame by trying to palm off liability onto anyone who has not been joined to the proceedings: everyone is in it together and will be liable together. However, this approach is not always sensible or cost-effective, and may involve pursuing unattractive arguments against one or more of the defendants, just to keep them in the picture. It will also be subjected to the robust case management attitude of the TCC, not necessarily to the claimant's advantage.

The recent case of *Dhamija and another v Sunningdale Joineries Ltd and others* [2010] EWHC 2396 (TCC) demonstrates some of the pitfalls in pursuing this type of claim.

Mr and Mrs Dhamija had employed an architect, Lewandowski Willcox Ltd, a building contractor, Sunningdale Joineries Ltd, and a Quantity Surveyor, McBains Cooper Consulting Ltd, to build them a new house. The project went wrong and Mr and Mrs Dhamija started legal proceedings in the TCC against the architect, the building contractor and the Quantity Surveyor. The claim appears to have been primarily about alleged defects in the house. There was no recorded written or oral contract between the Dhamijas and McBains Cooper, although a contract undoubtedly existed.

Against McBains Cooper, the Dhamijas made two allegations. Firstly, that they had overvalued the work. Secondly, that they owed the Dhamijas a duty only to value properly executed work and not defective work.

McBains Cooper applied to strike out the second allegation.

The Judge considered the contractual position. He decided that there was a contract between the Dhamijas and McBains Cooper, although that contract was not recorded either orally or in writing and it therefore had to have terms implied into it. He concluded that there was implied into the contract a term that McBains Cooper would exercise the reasonable skill and care of Quantity Surveyors of ordinary competence.

However, he was firmly of the view that there was no implied term only to value properly executed work and not to value defective work. The Quantity Surveyor's duties are confined to valuing works alone. The Quantity Surveyor is not responsible for identifying defects, this is the responsibility of the architect, who is responsible for the quality of the work.

The Judge was also critical of the way in which the Dhamijas had brought their claim, and he recommended in his judgment that they should fundamentally rethink their approach and the basis of the pleaded defects case.

This is not the end of the matter, however. The application to strike out was heard at an early stage, before disclosure. The Judge therefore considered that there was a remote possibility that McBains Cooper might have fallen below the standard of a reasonably competent Quantity Surveyor. He therefore directed the hearing of a preliminary issue, to last a maximum of one day, to deal with this. He commented

that, in his view, it would be an uphill task for the Dhamijas to establish that they had an arguable case against McBains Cooper.

This case demonstrates some of the pitfalls of commencing proceedings in a scattergun fashion without thinking carefully through causes of action and the basis of a claim. The Judge's warnings on costs to the Dhamijas were quite stark. It remains to be seen what will happen next in the litigation.

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Adjudication at any time?

One of the key conclusions of the Latham report was that adjudication 'must become the key to settling disputes in the construction industry' ('Constructing the team', Sir Michael Latham, at paragraph 9.4). However, the question of where adjudication sits on the spectrum of legal and quasi-legal proceedings has led to considerable debate. This article will focus on how the right to refer disputes to adjudication 'at any time' under s. 108 of the Housing Grants, Construction and Regeneration Act 1996 (HGCRA) interacts with other statutes concerning limitation and insolvency.

Limitation

Section 5 of the Limitation Act 1980 sets out the fundamental limitation period for actions founded on simple contract:

'An action founded on simple contract shall not be brought after the expiration of 6 years from the date on which the cause of action accrued.'

The term "action" is defined in s. 38 of the Act: it 'includes any proceeding in a court of law, including an ecclesiastical court'. However, s. 108(2)(a) of the HGCRA allows a party to 'give notice at any time of his intention to refer a dispute to adjudication'. Is there a direct contradiction between these two acts?

This issue arose in the case of *Connect South Eastern Limited v MJ Building Services Group Plc* [2005] EWCA Civ 193. As part of a cross-appeal, counsel for the claimant submitted that it was an abuse of process for the defendant to start adjudication proceedings so long after purportedly accepting a repudiation of the contract. He argued that the phrase 'at any time' in s. 108(2)(a) could not be read literally. This would mean that a party could not refer a dispute to adjudication after the expiry of the relevant limitation period. However, Dyson LJ concluded that the phrase 'at any time' meant exactly what it said. 'There is nothing to prevent a party from referring a dispute to adjudication at any time, even after the expiry of the relevant limitation period' (at 39). The judge therefore concluded that adjudication was not subject to the standard 6-year limitation period.

A similar issue of limitation arose in the case of *Braceforce Warehousing Limited v Mediterranean Shipping Company* [2009] All ER (D) 101. This partly concerned an agreement for a lease which provided for expert determination in the event of a dispute. The claimant contended that the expert had no jurisdiction; indeed, neither party considered the possibility that the Limitation Act may not apply to expert determination. As the judge commented, the express terms of the agreement 'appear[ed] to proceed on the basis that the Limitation Act 1980 applies to experts determination, a premise which, as I raised during argument, does not seem to be

correct'. Again, the judge did not consider that the Limitation Act imposed any time bar on the ability of the defendant to commence an expert determination. This may seem to go against the purpose of the Limitation Act; however, it is a clear reading of the definition of "action" under s. 38 of the Act. Neither adjudication nor expert determination is a "proceeding in a court of law".

Where the interplay of adjudication and the Limitation Act becomes more interesting is the question of whether an adjudication decision gives rise to a new cause of action. There is conflicting authority here but general opinion now indicates that it does. In his *Construction Adjudication*, HHJ Peter Coulson QC approves at 12.20 of the case of *Bovis Lend Lease v Triangle Development* [2002] EWHC 3123 (TCC) in which HHJ Thornton QC held that an adjudicator's decision gives rise to a separate contractual obligation to comply with the decision, therefore giving rise to a new cause of action. Keating on Construction reads at 17-049: 'There is conflicting authority as to whether the decision is a cause of action or whether the cause of action is the original claim. It is submitted that there is an express or implied obligation to comply with the decision and this gives rise to a cause of action.' Furthermore, in *Ringway Infrastructure Services v Vauxhall Motors (No 2*) [2007] EWHC 2507 (TCC), there was a contractual obligation to comply with an adjudicator's decision and the court held that this could rightly be relied upon as a cause of action for an enforcement action.

If adjudication is to be permitted after the expiry of the limitation period, there is little sense in leaving it unenforceable in a court of law due to a limitation issue. It is admitted that there are various situations in which an adjudication is, ultimately, unenforceable (e.g. where the adjudicator was not nominated in accordance with the contract, where the adjudicator made an error, or where there has been a breach of natural justice). However, this reading would effectively impose a limitation period by the back door.

Companies in administration

The plot thickens however, when we consider the interaction of s. 108 HGCRA and s. 11(3)(d) of the Insolvency Act 1986. This sub-section specifies as follows:

'[During the period for which an administration order is in force,] no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as aforesaid.'

The case of *Straume v Bradlor Developments* [2000] BCC 333 was an application to determine whether the court's leave was necessary to commence adjudication under the terms of a building contract between the applicant and a company in administration. The building contract contained a clause which provided for disputes and differences to be referred to adjudication under the statutory scheme introduced by the HGCRA. Before work was completed, administrators were appointed to Bradlor. The judge examined various authorities, starting with the case of *Re Paramount Airways Limited* [1992] 3 All ER 1. Here, Sir Nicolas Browne-Wilkinson VC said that the natural meaning of "other proceedings" in the Insolvency Act was either legal proceedings or quasi-legal proceedings such as arbitration. In *Carr v British International Helicopters Limited* [1994] IRLR 212, the Employment Appeal Tribunal in Scotland held that an application or complaint on application to an Industrial Tribunal was "other proceedings" within the meaning of s. 11(3)(b). In *Straume* therefore, the judge had to decide whether adjudication was qualified as

quasi-legal proceedings. He held that it did, and identified adjudication as a form of arbitration.

This decision has been relied upon in several cases since, such as *Canary Riverside Development v Timtec International* [2000] All ER (D) 1753 and *Joinery Plus Limited v Laing Limited* [2003] EWHC 439 (TCC). Following the commencement of the Enterprise Act 2002, the scope of moratorium provisions during administration has been slightly modified and now reads 'legal process (including legal proceedings, execution, distress and diligence)' in s. 43(6).

So is there a contradiction between how adjudication is viewed in the Limitation Act and in insolvency statute on administration? It is clear that 'other proceedings' in the Insolvency Act could include almost anything. What is the difference, then, between 'proceeding in a court of law' and 'legal process' (Enterprise Act)? A judge arguing the semantics of "legal process" could probably extend it to adjudication as a quasi-legal process under an enactment. But adjudication is unlikely to be proceedings *which take place* in a court of law. If that is the distinction the draftsman wished to draw, this leads us to the conclusion that s. 5 Limitation Act concerns itself solely with litigation conducted in the courts. It will be inconvenient during administration, however, to conduct either litigation or alternative forms of dispute resolution, including adjudication. This will be a matter for the courts to clear up – will the interpretation of "legal proceedings" in *Straume v Bradlor* be applied to the Enterprise Act's "legal process", or will a judge see fit to draw a distinction and align it with the Limitation Act?

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