The University of Salford

School of Science, Engineering and Environment

LLM Construction Law & Practice

Third-Party Rights in Construction Contracts: Developments since Murphy v Brentwood

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Abstract

Construction is a complex, multi-party industry and the doctrine of privity of contract has created problems for third parties involved in the construction process since its inception. Several mechanisms have developed to evade the doctrine, but the tort of negligence was the primary method until the decision in *Murphy v Brentwood DC* removed the possibility of the recovery of pure economic loss for defects under tort. The focus of this research is the development of the law of third-party rights since that judgment, concentrating specifically on collateral warranties and the Contracts (Rights of Third Parties) Act 1999. The research follows a primarily doctrinal approach but also considers the implications of the developments in the context of construction. The extensive usage of collateral warranties in the industry has led to several cases coming before the courts enabling the law to develop. The most significant development is the possibility of collateral warranties being construction contracts. However, the Act has not received as much judicial consideration, particularly in construction, so it has not developed as quickly. The research has shown that the two mechanisms, developed to provide third parties with a remedy for losses arising out of a contract made for their benefit, can provide equivalent rights, the only real difference is the availability of statutory adjudication.

Declaration

I declare that this work is my own. Where the work of others is used, or drawn upon, it is attributed to the relevant source. I have read and understood the University Academic Misconduct Procedure.

Signature 

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ID Number 00651197 Date 1st September 2023

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1 Introduction

1.1 Background

Construction is a complex, multi-party industry. In almost all construction projects many different parties beyond the employer and the contractor, are brought together to complete the project.[1] There can be design consultants, cost consultants, sub-contractors, suppliers, funding organisations, purchasers, and tenants. Without a direct contractual link, third parties can struggle to claim for losses caused by defects in the design or workmanship. This is due to the common law doctrine of privity of contract, a rule that means only parties to a contract can enforce rights and obligations under it.[2] Over the years, the doctrine has come under significant criticism,[3] and several mechanisms have developed to evade it.[4]

Without a contractual remedy many third parties looked to the law of tort to recover their losses. The law of tort deals with breaches of a duty defined in law, rather than a duty voluntarily assumed under contract.[5] The tort of negligence, which provides a remedy for the breach of a duty of care, was first defined as a separate tort in the case of *Donoghue v Stevenson*.[6] The "Neighbour Principle" defined the parameters for determining when a duty of care exists, consequently creating a route to bypass the doctrine of privity of contract.[7]

In the 1960s and 70s, this law saw significant development[8] with the courts becoming more willing to award damages to third parties for defects caused by the negligence of contractors and consultants.[9] The House of Lords judgment in *Anns v Merton LBC*[10] greatly expanded the situations where a duty of care may exist. Many saw this as opening the floodgates to claims against contractors and design teams. It quickly attracted criticism from the courts[11] who started moving away from the decision. It wasn't until a decade later that it was actively challenged.

Lord Bridge and Lord Oliver expressed doubts about the *Anns* decision,[12] then, two years later, it was overruled, as were the decisions that relied on it.[13] This confirmed that liability in tort should be limited to defects that cause injury to persons or damage to property other than the property itself,

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[1] Jim Mason, *Construction Law: From Beginner to Practitioner* (Routledge 2016) 213.

[2] Will Hughes, Ronan Champion and John Murdoch, *Construction Contracts: Law and Management* (5th edn, Routledge 2015) 142; Julian Bailey, *Construction Law*, vol 1 (3rd edn, London Publishing Partnership 2020) para 2.06; Hugh Beale (ed), *Chitty on Contracts* (34th edn, Sweet & Maxwell 2022) para 20-001.

[3] Hughes, Champion and Murdoch (n 2) 142.

[4] John Adriaanse, *Construction Contract Law: The Essentials* (4th edn, Palgrave 2016) 82.

[5] Catherine Elliott and Frances Quinn, *Tort Law* (11 edition, Pearson Education Limited 2017) 2.

[6] [1932] UKHL 100, [1932] AC 562, 580 (Lord Atkin).

[7] RFV Heuston, 'Donoghue v Stevenson in Retrospect' (1957) 20 Modern Law Review 1, 10–11.

[8] David L Cornes and Richard Winward, *Winward Fearon on Collateral Warranties* (2nd edn, Blackwell Science 2002) para 2.7.

[9] Cyril Chern, *The Law of Construction Disputes* (Taylor and Francis 2019) 283.

[10] [1977] UKHL 4, [1978] AC 728.

[11] Hughes, Champion and Murdoch (n 2) 348.

[12] *D&F Estates Ltd v Church Commissioners for England* [1988] UKHL 4, [1989] AC 177, 210 (Lord Bridge), 213-14 (Lord Oliver).

[13] *Murphy v Brentwood DC* [1990] UKHL 2, [1991] 1 AC 398, 457 (Lord Mackay).

removing the possibility of third parties claiming for the pure economic loss of defects under the tort of negligence.

1.2 Research Focus

The decision in *Murphy v Brentwood* significantly increased the difficulty in third parties recovering losses caused by defects in the design or construction of buildings. At this point the construction industry saw an enormous growth in the use of collateral warranties.[14] They are used to bypass the doctrine of privity of contract, creating direct contractual links between various parties linked to a construction project, including tenants, owners or funders and the consultants, contractors and sub-contractors carrying out the works.[15] Unfortunately, due to the number of parties involved, contractual links often end up forming complicated webs, involving the negotiation of many separate contracts.[16]

Around the same time, the Law Commission began a consultation on reforming the law of privity of contract. The consultation looked at the potential of giving certain rights to third parties under contracts made for their benefit.[17] The commission issued its final report in 1996 suggesting that the law of privity of contract should be reformed, with one of the proposed benefits being that legislation could enable contracting parties to avoid the need for collateral warranties.[18] The result was the Contracts (Rights of Third Parties) Act 1999 which gained royal assent on 11 November 1999 and came into effect for contracts entered into on or after 11 May 2000.[19]

Despite the introduction of the Act 23 years ago, collateral warranties are still widely used throughout the industry and still induce nightmares in construction professionals. The amount of time and money expended negotiating terms and chasing missing or incomplete warranties, sometimes years later,[20] could be an unnecessary waste. A study carried out in 2015 points to a widespread lack of understanding of the Act,[21] coupled with the fact collateral warranties had been in extensive use across the industry for a decade by the time the Act came into effect, as reasons for the continued use of collateral warranties.

Unfortunately, collateral warranties are not clear-cut either. In 2013, the courts[22] introduced the idea that they could be considered contracts for construction operations under the Housing Grants, Construction and Regeneration Act 1996 (HGCRA).[23] This decision was not appealed, so the industry accepted this position until 2021 when the date of execution of the collateral warranty was used to

[14] Adriaanse (n 4) 329.

[15] Julian Bailey, *Construction Law*, vol 2 (3rd edn, London Publishing Partnership 2020) para 12.151.

[16] Law Commission, 'Privity of Contract: Contracts for the Benefit of Third Parties' (Law Com No 242, 1996) para 3.12.

[17] Law Commission, 'Privity of Contract: Contracts for the Benefit of Third Parties' (Law Com CP No 121, 1991) 3–4.

[18] Law Commission (n 16) para 3.17; Vijay Bange, 'Third Party Adjudication Rights' (2015) 26 Construction Law 20, 22; Hughes, Champion and Murdoch (n 2) 358; Liam McKenna and Jennifer Charlson, 'The Contract (Rights of Third Parties) Act 1999 versus Collateral Warranties in the UK Construction Industry' (2015) 31 Construction Law Journal 320, 320.

[19] Contracts (Rights of Third Parties) Act 1999 s 10(2).

[20] Mason (n 1) 214–215.

[21] McKenna and Charlson (n 18) 328–29.

[22] *Parkwood Leisure Ltd v Laing O'Rourke Wales and West Ltd* [2013] EWHC 2665 (TCC), [2013] BLR 589 [22]-[23], [27] (Akenhead J).

[23] Housing Grants, Construction and Regeneration Act 1996 s 104.

challenge the idea.[24] At appeal, the decision was overturned.[25] Coulson LJ decided that a collateral warranty could have retrospective effect so the date of execution was not relevant. This position is not yet finalised though as the case has been granted permission to appeal to the Supreme Court.[26]

Meanwhile, the Act has also continued to develop. In 2014, a case came before the Technology and Construction Court (TCC) where the Act had been used to allow affiliated companies with a direct interest in the project to enforce terms of the appointment.[27] Ramsey J found that the rights granted under the Act did not include the right to adjudicate and there was no freestanding right under the HGCRA 1996[28] because the Respondent was not a party to the construction contract even by virtue of the rights granted under the Act.[29]

The law of third-party rights in construction has developed along two separate lines since the judgment in *Murphy v Brentwood*. Each method appears to provide third parties with a remedy for losses arising out of a contract made for their benefit, but to which they are not a party. In construction, collateral warranties are still the primary method chosen, but they present a significant time and cost impact on many major projects. If the Act can be used to reduce the amount of separate collateral warranties that have to be drawn up and negotiated, there would be a huge benefit to the industry. The two methods are still being developed so it would be beneficial to understand how each has developed and whether they really do serve the same purpose. If the two options provide the same legal rights and remedies, then maybe it is simply education that is needed to reduce the wasted time that collateral warranties currently present.

1.3 Overall Aim and Individual Objectives

This research aims to demonstrate how the law of third-party rights has developed, along two separate lines, since the judgment in *Murphy v Brentwood DC*[30] overturned the decision of the Lords in *Anns v Merton LBC*.[31]

1. Identify the reasons for the growth in the use of collateral warranties in the construction industry and the introduction of the Contracts (Rights of Third Parties) Act 1999 following the judgment in *Murphy v Brentwood DC*.
2. Explore the development of the law relating to the use of collateral warranties in the construction industry.
3. Explore the introduction and development of the law relating to third-party rights granted under the Contracts (Rights of Third Parties) Act 1999.

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[24] *Toppan Holdings Ltd v Simply Construct (UK) LLP* [2021] EWHC 2110 (TCC), [2021] Bus LR 1357 [22]-[24], [26]-[31] (Bowdery J).

[25] *Abbey Healthcare (Mill Hill) Ltd v Simply Construct (UK) LLP* [2022] EWCA Civ 823, [2022] Bus LR 1079 [72]-[73] (Coulson LJ).

[26] The Supreme Court, 'Permission to Appeal - December 2022 and Early January 2023' (*The Supreme Court*, 2022) <https://www.supremecourt.uk/news/permission-to-appeal-december-to-january-2022-2023.html> accessed 11 March 2023.

[27] *Hurley Palmer Flatt Ltd v Barclays Bank Plc* [2014] EWHC 3042 (TCC), [2014] BLR 713.

[28] Housing Grants, Construction and Regeneration Act s 108.

[29] *Hurley Palmer Flatt* (n 27) [43]-[44] (Ramsey J).

[30] *Murphy* (n 13).

[31] *Anns* (n 10).

4. Evaluate the current state of the Law in England and Wales relating to collateral warranties and rights granted under the Contracts (Rights of Third Parties) Act 1999.
5. Determine if collateral warranties and rights granted under the Contracts (Rights of Third Parties) Act 1999 are equivalent.

2 Literature Review

2.1 Background of Third-Party Rights in Construction Contracts

There are many third-party relationships in the construction industry. For example, a sub-contractor will carry out work for the main contractor, but the ultimate beneficiary is the owner.[32] There is no direct contractual link between the sub-contractor and the owner, therefore the owner is a third-party beneficiary to the contract between the sub-contractor and the main contractor. If there are defects in the work, the owner would claim against the main contractor, who could in turn claim against the sub-contractor. However, if the main contractor became insolvent, the owner would have no route to recover their losses due to the doctrine of privity of contract.

The doctrine developed through the courts during the 19th Century before becoming settled in 1861.[33] The principle set out that no stranger could take advantage of a contract even when made for their benefit.[34] Crompton J suggested it would be a 'monstrous proposition' to say that a person could sue upon a contract made for their benefit but could not be sued upon the same contract.[35] The judgment was confirmed and defined as the 'true common law doctrine' in the Court of Appeal,[36] but it wasn't until 1915 that the House of Lords affirmed the principle 'that only a person who is a party to a contract can sue on it' as fundamental.[37]

There has been significant criticism of the doctrine.[38] Several mechanisms have developed to try to evade its restrictions.[39] Initially, solutions were sought using the law of tort, which concerns a breach of duty rather than a breach of contract. The tort of negligence, first defined in *Donoghue v Stevenson*,[40] was the original method used by third parties to claim damages for defective works. Lord Atkin's 'neighbour principle' provided a cause of action for people who have suffered harm due to the carelessness of others. Some restrictions were included so as not to open the floodgates for anyone to raise a claim.[41] The dissenting view was that if a duty of care was owed in that case, then one could be owed in almost any situation, including the construction of a house.[42] Lord Buckmaster felt taking that step had the potential to open the floodgates to many more claims where previously there was no cause of action.

The law of negligence was confined to imposing a duty of care not to cause injury to persons or damage to property other than the thing itself. Any defect in the item itself was deemed to be pure

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[32] Julian Bailey, *Construction Law*, vol 3 (3rd edn, London Publishing Partnership 2020) para 20.05.

[33] *Tweddle v Atkinson* [1861] EWHC QB J57, 121 ER 762; Beale (n 2) para 20-004.

[34] *Tweddle* (n 33) 763–64 (Wightman J).

[35] ibid 764 (Crompton J).

[36] *Gandy v Gandy* (1885) 30 Ch D 57 (CA) 63 (Cotton LJ), 69 (Bowen LJ).

[37] *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] UKHL 1, [1915] AC 847, 853 (Viscount Haldance LC).

[38] ibid 855 (Lord Dunedin); *Drive Yourself Hire Co (London) Ltd v Strutt* [1954] 1 QB 250 (CA) 273–74 (Denning LJ); *Beswick v Beswick* [1966] Ch 538 (CA) 563 (Danckwerts LJ); *Woodar Investment Development Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277 (HL) 300–301 (Lord Scarman); *Darlington BC v Wiltshier Northern Ltd* [1995] 1 WLR 68 (CA) 76–77 (Steyn LJ); Hughes, Champion and Murdoch (n 2) 142; Beale (n 2) para 39-233.

[39] Adriaanse (n 4) 82.

[40] *Donoghue* (n 6) 580.

[41] ibid 583–84 (Lord Atkin), 618-19 (Lord Macmillan); Elliott and Quinn (n 5) 16.

[42] *Donoghue* (n 6) 577–78 (Lord Buckmaster), 599-601 (Lord Tomlin).

economic loss and therefore not recoverable in tort.[43] This prevented third parties from recovering damages for defective design or workmanship, but it wasn't long before the law of tort saw a period of rapid expansion as predicted by Lord Buckmaster.

The first step was an extension to allow for the recovery of pure economic loss caused by negligent advice or information. The concept was introduced by Denning LJ.[44] Although his opinion was not accepted, it paved the way for the Lords in *Hedley Byrne & Co Ltd v Heller & Partners Ltd.*[45] They reviewed previous cases and concluded that there was no reason in law that the principles set out in *Donoghue v Stevenson* should only be applicable to deeds and not words. This could have been a catalyst to huge amounts of litigation with third parties seeking claims for pure economic loss where they had no other route to claim. However, the Lords were cautious when defining the parameters so this did not happen.

Although not construction-related, the case of *Home Office v Dorset Yacht Co. Ltd*[46] brought about a different way of thinking about the tort of negligence that was used in later construction cases to further expand its reach. Lord Reid felt that instead of asking if recognised principles apply to a new point of the law of negligence, the time had come to apply the new point unless there is valid justification for its exclusion. Lord Denning MR used this idea in the case of *Dutton v Bognor Regis UDC*[47] where he also stated that the distinction between a defect that causes injury, and a defect that could cause injury, but is rectified before, is an impossible one believing the responsible party should be liable either way.[48] This appears to be a reasonable step until considered against the huge increase in liability for contractors and construction professionals. The dissenting opinion of Stamp LJ highlighted the possibility this move could 'open up a new field of liability' that could not be controlled.[49]

The possibility of third parties claiming the cost of repairing dangerous defects in a building they had purchased was introduced. Several cases followed on these lines.[50] The point was examined in more detail in *Anns*,[51] where a two-stage test was described to establish when a duty of care arises. Lord Wilberforce stated that where the neighbour principle applies between two parties and the carelessness of one party could give rise to damage to the latter, then a duty of care arises. It is then necessary to establish if there are any considerations that would limit or reduce the scope of that duty in the situation.[52] He also stated that the nature of the damage was 'material, physical damage'.[53]

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[43] Issaka Ndekugri, 'Tortious Negligence in Construction: Past, Present and Future' (1993) 9 Construction Law Journal 175, 176.

[44] *Candler v Crane, Christmas & Co* [1951] 2 KB 164 (CA) 178–79 (Denning LJ).

[45] [1963] UKHL 4, [1964] AC 465, 488–89 (Lord Reid), 502-03 (Lord Morris), 506-08, 514 (Lord Hodson), 528-30 (Lord Devlin), 538-39 (Lord Pearce).

[46] [1970] AC 1004 (HL) 1027 (Lord Reid).

[47] [1972] 1 QB 373 (CA) 397 (Lord Denning MR).

[48] ibid 396 (Lord Denning MR).

[49] ibid 414–15 (Stamp LJ).

[50] Cornes and Winward (n 8) paras 2.10-2.11.

[51] *Anns* (n 10).

[52] ibid 751–52 (Lord Wilberforce).

[53] ibid 759–60 (Lord Wilberforce).

This appears to have been an attempt to bypass the common law restriction on the recovery of pure economic loss.[54]

A broad expansion of the law of negligence was created putting construction professionals, contractors and sub-contractors at risk of 'claims in negligence from a fairly wide range of potential plaintiffs'.[55] Some commentators felt this decision extended the duty of care from taking care not to cause harm with one's actions to taking positive action to remove the risk of causing harm,[56] potentially changing the landscape of the law of negligence by moving from a passive duty of care to an active one.

The final expansion came in 1982 when a nominated sub-contractor was found to owe a duty of care to the employer for defective workmanship.[57] In this case, it was decided there was a close commercial relationship between the employer and the sub-contractor that justified this position. However, many felt this was an artificial justification as there is nothing unusual about an employer employing a contractor, who then employs a sub-contractor to carry out work on their behalf.[58]

This was the end of the expansion of the law of tort. In 1985, Lord Keith stepped away from these developments stating that the passages in *Home Office v Dorset Yacht* and the two-stage test in *Anns* should not be treated as definitive.[59] Instead, he felt each case should be decided on its merits considering the particular parties, circumstances and whether the breach resulted in loss.[60] This was closely followed by Lord Brandon who felt that Lord Wilberforce could not have intended to provide 'a universally applicable test of the existence and scope of a duty of care in the law of negligence'.[61] He suggested that the two-stage test was not supposed to be adopted in situations where a duty had been held not to exist.

By the mid-1980s, the state of the law was in disarray, with the decision in *Anns* receiving widespread criticism, it seemed inevitable that a challenge would come before the House of Lords at some point.[62] This did not happen until 1988.[63] Following a full analysis of the historical developments, Lord Bridge set out the principle that a claim can be made for injury or damage caused by a hidden defect, but if the defect is discovered before any damage is caused, then *Donoghue v Stevenson* cannot be applied. Although he does not go so far as to overrule the decision in *Anns*, he does suggest the decision 'involves a departure from this principle'.[64]

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[54] BS Maresinis and Simon Deakin, 'The Random Element of Their Lordships' Infallible Judgment: An Economic and Comparative Analysis of the Tort of Negligence from Anns to Murphy' (1992) 55 Modern Law Review 619, 621.

[55] Cornes and Winward (n 8) para 2.13.

[56] JC Smith and Peter Burns, 'Donoghue v. Stevenson - The Not so Golden Anniversary' (1983) 46 Modern Law Review 147, 158–159.

[57] *Junior Books Ltd v Veitchi Co Ltd* [1982] UKHL 4, [1983] 1 AC 520, 546 (Lord Roskill).

[58] Cornes and Winward (n 8) para 2.12; Hughes, Champion and Murdoch (n 2) 328; Adriaanse (n 4) 317; Bailey, *Construction Law* (n 15) para 10.110.

[59] *Governors of the Peabody Donation Fund v Sir Lindsay Parkinson & Co Ltd* [1985] AC 210 (HL) 239–41 (Lord Keith).

[60] ibid 240.

[61] *Leigh & Sillivan Ltd v Aliakmon Shipping Co Ltd (The Aliakmon)* [1986] AC 785 (HL) 815 (Lord Brandon).

[62] Maresinis and Deakin (n 54) 620; Cornes and Winward (n 8) para 2.19.

[63] *D&F Estates* (n 12).

[64] ibid 206 (Lord Bridge).

Lord Oliver also considered the decision in *Anns*, finding it 'difficult to reconcile' with the conventional basis of tortious liability for negligence.[65] He set out the position that a builder is only liable at common law for negligence where their carelessness in carrying out the work leads to actual damage to either person or property.[66] This decision resulted in the 'immediate and urgent boost in the use of collateral warranties' which created a contractual relationship on which to base claims.[67]

The defining case on the court's position regarding liability for economic loss under the tort of negligence came in 1990.[68] Looking back over recent cases, including Privy Council decisions, Lord Keith and Lord Bridge agreed with the general principles that:

- The two-stage test is not universally applicable.[69]
- Novel categories of negligence should be developed incrementally.[70]
- The decision in *Anns* could be regarded as 'judicial legislation'.[71]

They then decided to apply the 1966 *Practice Statement (Judicial Precedent)*[72] to overrule the decisions in *Anns* and *Dutton* and 're-establish a degree of certainty' regarding liability for pure economic loss in the tort of negligence.[73] Lord Bridge confirmed the legal position in this regard. The recovery of pure economic loss for repairing a defect in quality, or the loss of a building that has become valueless, can only be made where they result from the breach of a contractual duty. There can only be recovery in tort where there is 'a special relationship of proximity'.[74]

There have been several notable exceptions added since, including a case where a prohibition on assignment without consent allowed the employer to claim damages on behalf of a third-party purchaser.[75] This was later confirmed,[76] but only where there was not already a direct legal remedy available, like a collateral warranty or rights granted under the Act.[77] The scope and extent of exceptions to tortious claims for pure economic loss are outside the scope of this research. However, the uncertainty presented by the ruling in *Murphy* and the various available exceptions makes it an unwise proposition to rely on the law of tort.

The available exceptions to the doctrine of privity of contract are very narrowly defined which has led the construction industry to find new ways to grant rights to third parties involved in the

[65] ibid 213 (Lord Oliver).

[66] ibid 214 (Lord Oliver).

[67] Cornes and Winward (n 8) para 2.22.

[68] *Murphy* (n 13).

[69] ibid 461 (Lord Keith) citing *Yuen Kun Yeu v Attorney-General of Hong Kong* [1988] AC 175.

[70] ibid (Lord Keith) citing *Council of the Shire of Sutherland v Heyman* (1985) 157 CLR 424.

[71] ibid 471 (Lord Keith), 473 (Lord Bridge).

[72] [1966] 1 WLR 1234 (HL).

[73] *Murphy* (n 13) 471–72 (Lord Keith).

[74] ibid 475 (Lord Bridge).

[75] *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd, and St Martins Property Corporation Ltd v Sir Robert McAlpine Ltd* [1994] 1 AC 85 (HL).

[76] *Alfred McAlpine Construction Ltd v Panatown Ltd* [2000] UKHL 43, [2001] AC 518, 529–32, 536 (Lord Clyde), 570, 574 (Lord Jauncey), 576–77 (Lord Browne-Wilkinson).

[77] ibid 544 (Lord Goff), 575 (Lord Browne-Wilkinson).

construction process. The first of which is the use of collateral warranties to create contractual relationships where ordinarily there would be none.

2.2 Development of the Law Relating to Collateral Warranties

The decisions in *D&F Estates* and *Murphy* had a significant impact on the landscape of third-party rights in construction. There was enormous growth in the use of collateral warranties in the industry to provide contractual remedies to third parties to whom contracts are purported to benefit.[78] They are used to bypass the doctrine of privity of contract by creating direct contractual links between various parties linked to construction projects, including tenants, owners or funders and the consultants, contractors and sub-contractors carrying out the works.[79] Unfortunately, due to the number of parties involved, contractual links often end up forming complicated webs and involve the negotiation of many separate contracts.[80]

A collateral warranty is usually a tripartite agreement, involving two parties to a separate contract and a third party receiving a benefit under that contract.[81] The purpose is to promise to the third party that the party providing the service, or completing the work will perform all their obligations under the separate contract with reasonable skill and care.[82] If the party is in breach of its obligations, the third party will have a right of action against them.[83] Main contractors are often required to enter into collateral warranties with a funder, owner, future tenant(s) or proposed purchaser confirming that the works will be carried out in full accordance with their contract with their client.

The process of drafting, negotiating, and re-drafting innumerable collateral warranties on construction projects is lengthy and involves huge amounts of legal costs. Even on smaller projects, there can be many separate warranties required making the legal costs out of proportion to the profit of the project.[84] In the early days, there were no standard forms of collateral warranty available, making the negotiation process that much longer,[85] however, the introduction of several standard forms of collateral warranty has not stopped the use of bespoke terms being used.

Collateral warranties usually include various provisions on top of the obligation to carry out their services or work with reasonable skill and care. These include a requirement to take out and maintain professional indemnity insurance for a specified duration, although the JCT standard forms only call for it if required by the building contract. There is often a requirement for a royalty-free licence to copy and use design documents for specific purposes, usually relating to the project.

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[78] John Cartwright, 'The Assignment of Collateral Warranties' (1990) 6 Construction Law Journal 14, 14; Cornes and Winward (n 8) viii–ix; Hughes, Champion and Murdoch (n 2) 353–54; Adriaanse (n 4) 329; Cyril Chern (n 9) 283; AC Walton, 'Collateral Warranties and Construction Contracts: A Victory of Substance over Form' (2022) 38 Construction Law Journal 487, 487.

[79] Cornes and Winward (n 8) para 3.3; Bailey, *Construction Law* (n 15) para 12.151.

[80] Law Commission (n 16) para 3.12.

[81] Anthony Speaight QC and Matthew Thorne, *Architect's Legal Handbook: The Law for Architects* (Taylor & Francis Group 2021) 233.

[82] Hughes, Champion and Murdoch (n 2) 353–54.

[83] Cornes and Winward (n 8) para 1.5.

[84] ibid para 10.7.

[85] Hughes, Champion and Murdoch (n 2) 354.

Another important clause found in collateral warranties is a limitation of liability clause. These sometimes require that the warrantor has no greater liability to the beneficiary than to their primary client. The courts found that outstanding payments under a building contract could be used as equitable set-off against a warranty claim from a third party due to the wording of such a clause.[86]

Limitation clauses are often accompanied by a net contribution clause which aims to limit the warrantor's liability to their share of the responsibility for the losses, although beneficiaries will often try to get indemnity against all losses.[87] The enforceability of net contribution clauses was tested in the courts, and the judge found that although the clause in question created an imbalance, it was not in breach of the Unfair Contract Terms Act 1977 (UCTA) or The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).[88]

When the beneficiary is the funder, or the employer in the case of sub-contractor collateral warranties, a clause can be included to allow step-in rights should the employer, or contractor, become insolvent during the works.[89] These are often supported by a clause preventing the contractor, or sub-contractor, from terminating the contract due to insolvency. The purpose of this is clear, allowing the beneficiary to step into the position of the insolvent party to complete the project.[90] This is a form of novation, so the three parties involved would need to sign the collateral warranty to confirm their agreement, if the relevant circumstances occur.[91]

Collateral warranties sometimes include restrictions on assignment. They are usually requested by warrantors to limit the number of unknown third parties to whom they could be liable.[92] The assignment of contractual rights can be either legal or equitable and legal assignment is governed by section 136 of the Law of Property Act 1925.[93] Assignment itself is a complicated topic that is beyond the scope of this research. However, it is foreseeable that a building could be sold, or a tenant changed, within the period of limitation and a latent defect may be revealed at this stage. If the rights of the collateral warranty have been assigned, within any restrictions detailed in the warranty, then the new purchaser or tenant would have a right to recover damages.

The law relating to collateral warranties has continued to develop. Following the introduction of the HGCRA 1996, commentators felt that it was clear a collateral warranty could not be a construction contract under section 104.[94] However, all that changed when the question was raised on whether the beneficiary of a collateral warranty could refer a dispute with the warrantor to adjudication.[95] As statutory adjudication is available to the parties to a construction contract, the question became

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[86] *Safeway Stores Ltd v Interserve Project Services Ltd* [2005] EWHC 3085 (TCC), 105 Con LR 60 [51]-[55] (Ramsey J); McKenna and Charlson (n 18) 322.

[87] Hughes, Champion and Murdoch (n 2) 354; McKenna and Charlson (n 18) 323; Adriaanse (n 4) 331.

[88] *West v Ian Finlay and Associates* [2014] EWCA Civ 316, [2014] BLR 324 [58], [60]-[61], [68]-[69] (Vos LJ).

[89] Pippa Beesley, 'Protecting Funders' (2015) 26 Construction Law 29, 30.

[90] Lindy Patterson, 'Funders and Distressed Projects' (2009) 20 Construction Law 14, 15.

[91] Cornes and Winward (n 8) para 7.47.

[92] McKenna and Charlson (n 18) 323.

[93] Adriaanse (n 4) 331–32.

[94] Cornes and Winward (n 8) para 9.26.

[95] *Parkwood Leisure* (n 22) [22]-[23], [27] (Akenhead J).

whether the warranty could be considered a construction contract.[96] It was found that a collateral warranty could be a construction contract under section 104 of the HGCRA 1996 if warranting to carry out and complete the works. Although the decision received criticism, it was generally accepted throughout the industry.[97]

The principle established was that if a collateral warranty was for works that had already been completed, it would not be a construction contract.[98] Bowdery J confirmed this in 2021 when considering a warranty executed more than four years after completion of the works.[99] However, the Court of Appeal took a different view. The judges agreed that a collateral warranty could be a construction contract, but that it was dependent on the wording. The majority then considered that a contract could be both a collateral warranty and a construction contract and the focus should be on the promise made within the contract rather than how the promise was formed.[100] They felt the wording of section 104 of the HGCRA 1996 was broad and should not be read narrowly, so if a collateral warranty promised to carry out construction operations, then it would be a construction contract. Stuart-Smith LJ considered this interpretation of section 104 to be strained arguing that the warrantor would need to be performing construction operations directly for the warrantee.[101] The dissenting position seems to go against the generally held interpretation of the wording of the HGCRA 1996, but the Supreme Court has since granted the parties a right to appeal,[102] so this could soon be resolved.

For now, a collateral warranty can be a construction contract if it relates to ongoing construction operations, regardless of the date of execution. The date on which the warranty is intended to take effect, even if it is retrospective, establishes whether it will qualify.

2.3 The Introduction of the Contracts (Rights of Third Parties) Act 1999

The doctrine of privity of contract has received much criticism since it was first set out. In 1937, the Law Revision Committee attempted to reform the law allowing third parties to enforce a contract in their own name if the contract purports to confer a benefit on them.[103] Then, Lord Denning argued that *Tweddle v Atkinson* was an unfortunate case that departed from a 200-year-old rule.[104] He also felt it was modified by section 56 of the Law of Property Act 1925, although his views were not generally accepted.[105] Lord Reid accepted this view arguing that if Parliament were to procrastinate over legislative reform much longer, maybe the House of Lords could deal with it.[106] Several more

[96] Peter Sheridan, 'Back to the Future: Construction Operations and Collateral Warranties Update' (2022) 38 Construction Law Journal 238, 238.

[97] Walton (n 78) 487.

[98] Peter Sheridan, 'Construction Act Review: Construction Operations Update' (2015) 31 Construction Law Journal 406, 408–09.

[99] *Toppan Holdings* (n 24) [22]-[24], [26] (Bowdery J).

[100] Walton (n 78) 489.

[101] ibid 490.

[102] The Supreme Court (n 26).

[103] RST Chorley and others, 'The Law Revision Committee's Sixth Interim Report Note' (1937) 1 Modern Law Review 97, 106–07.

[104] *Drive Yourself Hire* (n 38) 273–74 (Denning LJ).

[105] Robert Flannigan, 'Privity - the End of an Era (Error)' (1987) 103 Law Quarterly Review 564, 573.

[106] *Beswick v Beswick* [1967] UKHL 2, [1968] AC 58, 72 (Lord Reid).

judges added their support, including Lord Scarman[107] and Lord Diplock who described the rule as 'an anachronistic shortcoming' that was a reproach to English law.[108]

After its creation in 1965, the Law Commission looked at the topic of third-party rights but felt that it would require reform of the doctrine of consideration as well, so did nothing at that time.[109] Finally, in 1991, they started a consultation with a view to giving certain third parties rights under contracts made for their benefit.[110] In their initial paper, they set out a number of reasons that cast doubt on the doctrine of privity of contract, including some discussed earlier. The paper also considered the potential impact on some key sectors including construction and insurance. Collateral warranty usage was considered with the potential effect of reform being the removal of the need for them.[111] The paper then set out some initial recommendations for consultation.

The doctrine of privity continued to receive judicial criticism during and after the consultation with judges finding alternative ways to ensure a party in breach of contract was not free from liability.[112] The Commission's final report, issued in 1996, set out their arguments for reform along with a draft bill. This was presented to, and amended by, the Houses of Parliament during the first half of 1999 and resulted in the Contracts (Rights of Third Parties) Act 1999. One of the proposed benefits of the Act was that it could enable contracting parties to avoid the need for collateral warranties, however, Cornes and Winward argue it has not fulfilled this hope, possibly due to the lack of judicial consideration.[113] This has also been raised more recently in the 2015 report by McKenna and Charlson where one of the main reasons for using collateral warranties instead of the Act was that they were tried and tested.[114]

When first introduced, some commentators praised the Act for reversing troublesome aspects of the common law,[115] although the general opinion appears to have been one of caution.[116] Dolan argues that although the Act has the potential to dispense with the need for collateral warranties, the construction industry is not brilliant at getting contracts executed prior to works commencing. Furthermore, parties receiving benefits under the Act may wish to have a greater involvement in the negotiation of the terms of the main construction contract. This would extend the time and cost of the negotiations. Dolan also argues that should the terms of the main construction contract be

[107] *Woodar Investment* (n 38) 300 (Lord Scarman).

[108] *Swain v Law Society* [1983] 1 AC 598 (HL) 611 (Lord Diplock).

[109] Law Commission (n 17) para 1.3.

[110] ibid 3–4.

[111] ibid para 4.14.

[112] Jeremy Winter, 'Contracts (Rights of Third Parties) Bill' (1999) 10 Construction Law 23, 23–24.

[113] Cornes and Winward (n 8) para 3.60.

[114] McKenna and Charlson (n 18) 330–31.

[115] Neil Andrews, 'Strangers to Justice No Longer: The Reversal of the Privity Rule Under the Contracts (Rights of Third Parties) Act 1999' (2001) 60 Cambridge Law Journal 353, 354; Cornes and Winward (n 8) para 3.46.

[116] Elizabeth Dolan, 'Collateral Warranties – the Attraction Lingers' (2000) 11 Construction Law 19, 21; Catharine MacMillan, 'A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999' (2000) 63 Modern Law Review 721, 738.

unclear, it could lead to significantly greater liability to third parties. They do, however, note that the Act does present an attractive option for simplifying the process and reducing costs.[117]

MacMillan accepted that the Act is a 'sound piece of legislation', but there are many implications brought about that must be considered. These include the possibility of excluding provisions of the Act, the benefits bestowed upon third parties, whether a burden can be imposed and more, but ultimately, they run through the positives and negatives written into the Act itself. What seems clear from the analysis is that MacMillan believes the Act allows the law to give effect to the intentions of the contracting parties, which was another aim of the Law Commission.[118]

It has been suggested that the Act abolishes the doctrine of privity of contract,[119] although this is not a universal opinion. The intention of the Law Commission was that reform would introduce a mechanism allowing third parties to enforce a contract made for their benefit.[120] Beale tends to agree this has been achieved and the Act has introduced a wide-ranging exception to the doctrine.[121] Privity of contract still applies whenever the Act does not, in accordance with section 1.[122]

In their 2015 research paper, McKenna and Charlson looked at the uptake of the Act and the perceived barriers to use. The results showed that although usage is increasing, collateral warranties were still preferred in the industry, citing step-in rights and assignment as key items that are easy with collateral warranties, but not so much with the Act.[123] This is supported by Cornes and Winward who state that 'the Act cannot be used to create step-in rights' for a funder,[124] whereas Macaulay felt this was not only possible but a good reason for the industry to adopt the provisions of the Act.[125]

The courts considered the right to refer a dispute to adjudication under the Act in 2014, finding that a third party is not a party to the contract, so has no right to statutory adjudication.[126] In a review of the case, Bange suggested that although the wording of that particular contract failed to confer a right to adjudicate, specific wording within a schedule of third-party rights could overcome this issue.[127]

The construction industry is traditionally slow to adapt to change, so it was no surprise that the Joint Contracts Tribunal (JCT) ignored the Act when it introduced its own suite of collateral warranty documents in 2001 to support its 1998 suite of contracts. This position did not change when the 2005 suite was released, nor when the 2007 and 2009 amendments were issued. With the release of the 2011 suite of contracts though, the JCT embraced the Act including a schedule of third-party rights

[117] Dolan (n 116) 20–21.

[118] MacMillan (n 116) 733–38.

[119] *Johnson v Gore Wood & Co* [2002] 2 AC 1 (HL) 40 (Lord Goff); Richard Cockram, 'Collateral Warranties: Time to Break the Habit' (2005) 5 Briefings in Real Estate Finance 1, 4–5; Cyril Chern (n 9) 285.

[120] Law Commission (n 16) paras 7.2-7.5.

[121] Beale (n 2) para 20-091.

[122] Contracts (Rights of Third Parties) Act 1999.

[123] McKenna and Charlson (n 18).

[124] Cornes and Winward (n 8) para 3.59.

[125] Mark Macaulay, 'Warranting Third Party Rights' (2000) 16 Construction Law Journal 265, 271.

[126] *Hurley Palmer Flatt* (n 27) [20], [22]-[23].

[127] Bange (n 18) 22.

in all their main contract forms. It is particularly interesting that the JCT has incorporated step-in rights into their schedule. The NEC4 suite of contracts provides for collateral warranties under Option clause X8 and the Act under clause Y(UK)3, but there is no detail as can be found in the JCT suite.

2.4 Summary

The rule of privity of contract has caused significant difficulties for the construction industry since its inception in the late 19th century. Various mechanisms have developed to evade it, but the law of tort was the primary method used in construction. This led to a significant expansion in the law that was eventually put back on track through the decisions in *D&F Estates* and *Murphy*. This was where the use of collateral warranties in the industry took off. Collateral warranties provide third parties with a contractual right to recover losses for defects.

In the meantime, the Law Commission was in the process of reviewing and consulting on reform of the doctrine of privity of contract leading to the introduction of the Contracts (Rights of Third Parties) Act 1999. The construction industry was specifically cited as a target beneficiary of the new legislation. However, the use of collateral warranties was already second nature to the industry, so adoption of the Act has been very slow.

Since the early 1990s, the law relating to both collateral warranties and the Act has developed through the judiciary providing that one can be considered a construction contract under the HGCRA 1996, and the other cannot. This research will endeavour to establish what other developments have impacted on these methods of granting rights to third parties, and how that could affect the use of them by the industry.

3 Research Methodology

This research aims to fully explore the development of two mechanisms for granting contractual rights to third parties and how they can be utilised in construction. This will require a detailed examination of the law as it is written.

Adopting the right research strategy is important when trying to achieve the objectives and satisfy the aim of the research, requiring an understanding of the options available. Research strategies can broadly be described as either quantitative or qualitative,[128] but there are a wide variety of methods within each category. Quantitative research deals with numerical and statistical data, and qualitative research provides interpretations of subjective data, including existing or new data.[129] This study will not be considering any numerical data, instead focussing on interpreting the law so a qualitative strategy will be required.

Qualitative research comes from an 'interpretivist' philosophical position considering the context in which the data are sought, but that does not preclude the use of 'positivist' or 'realist' perspectives.[130] This research is concerned with the interpretation of the law, so this approach fits with its requirements, however, it is important to note that there are negatives to all approaches.

Legal research has traditionally focused on a doctrinal, or black-letter, approach dealing with the law's meaning, or doctrine, through the analysis of case law, statutes and rules. It has been said that doctrinal research could be categorised as quantitative if the result of the research was the same whoever carried it out, however, case law does not lend itself to this because it requires interpretation. Analysing legislation and relevant case law will not provide an objectively verifiable statement of the law but instead a carefully weighted analysis of the relevant information providing an interpretation.[131] Initially, this methodology appears to be the most appropriate method given the topic, however, it is important to consider the other options available.[132]

Since the late 1960s, a second method has developed, sometimes referred to as 'law in context', or socio-legal studies.[133] Moving away from the rigid, inflexible approach of traditional doctrinal research, considering how legal doctrines interact with sociological, historical and other contexts.[134]

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[128] Jonathan Grix, *The Foundations of Research* (2nd edn, Palgrave Macmillan 2010) 117; Colin Robson and Kieran McCartan, *Real World Research* (4th edn, John Wiley & Sons Ltd 2015) 18.

[129] Grix (n 128) 32.

[130] ibid 120–21.

[131] Ian Dobinson and Francis Johns, 'Legal Research as Qualitative Research' in Wing Hong Chui and Michael McConville (eds), *Research Methods for Law* (2nd edn, Edinburgh University Press 2017) 23–25.

[132] Michael Salter and Julie Mason, *Writing Law Dissertations: An Introduction and Guide to the Conduct of Legal Research* (Pearson Education 2007) 49.

[133] Wing Hong Chui and Michael McConville (eds), *Research Methods for Law* (2nd edn, Edinburgh University Press 2017) 1,5.

[134] Anthony Bradney and Fiona Cownie, 'Socio-Legal Studies: A Challenge to the Doctrinal Approach' in Mandy Burton and Dawn Watkins (eds), *Research Methods in Law* (2nd edn, Routledge 2018) 42–43.

This method developed from the belief that law cannot be properly understood without understanding its impact on society.[135]

There are other legal research methods available that will not be used for this research. Comparative legal research looks overseas at other legal systems, possibly considering options for reform, or possibly just understanding a different way of dealing with common problems.[136] This method has been rejected on the basis that although the Contracts (Rights of Third Parties) Act 1999 has improved the law of third-party rights, it has not really simplified it,[137] so adding the law from another jurisdiction would stretch the scope of this research beyond what is possible within the time constraints.

The final method described by Lammasniemi is theoretical analysis or critical legal theory.[138] This method takes a theoretical perspective on an aspect of the law, such as a feminist perspective, and then critically analyses it from that perspective.[139] This method has also been rejected as this research is concerned with understanding the development of the law and its application to the construction industry without any additional perspective.

The doctrinal approach can be quite restrictive in its perspective, discarding material that is deemed irrelevant to a strictly legal analysis.[140] Sometimes it is easier to interpret the law in context, taking a more interdisciplinary approach.[141] Case law can be affected by the social context in which it is made, requiring interpretation from the perspective of that context. Chynoweth also describes a distinction between pure and applied legal research. This distinction highlights the difference between research for pure academic knowledge and understanding (legal theory) and research with a specific purpose (expository).[142] Some form of doctrinal research is required for almost all forms of legal research as it is always necessary to understand the legal aspects of the research.[143]

This research considers third-party rights law in the construction context. A primarily doctrinal approach will be used to demonstrate the development of the two legal mechanisms available. A socio-legal approach will then be required to understand the use of collateral warranties and the Contracts (Rights of Third Parties) Act 1999 in context.

The literature identified in the previous chapter includes references to several relevant cases so will form the basis for the initial case law search using Westlaw, i-law.com and LexisNexis. The case law

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[135] Paul Chynoweth, 'Legal Research' in Andrew Knight and Leslie Ruddock (eds), *Advanced Research Methods in the Built Environment* (Wiley 2008) 29; Laura Lammasniemi, *Law Dissertations: A Step-by-Step Guide* (2nd edn, Routledge 2022) 67–68.

[136] Geoffrey Wilson, 'Comparative Legal Scholarship' in Wing Hong Chui and Michael McConville (eds), *Research Methods for Law* (2nd edn, Edinburgh University Press 2017) 163–64.

[137] Beale (n 2) para 20-003.

[138] Lammasniemi (n 135) 68–70.

[139] Panu Minkkinen, 'Critical Legal "method" as Attitude' in Mandy Burton and Dawn Watkins (eds), *Research Methods in Law* (2nd edn, Routledge 2018) 146–50.

[140] Salter and Mason (n 132) 62.

[141] Chynoweth (n 135) 30; Lammasniemi (n 135) 65.

[142] Chynoweth (n 135) 30–31.

[143] ibid 31, 37; Terry Hutchinson, 'Doctrinal Research: Researching the Jury' in Mandy Burton and Dawn Watkins (eds), *Research Methods in Law* (2nd edn, Routledge 2018) 14–15.

will be the primary source of information for understanding the law of collateral warranties and how that has developed since the case of *Murphy v Brentwood*[144] overruled the decision in *Anns v Merton*.[145] Within the case law, judges and counsel refer to further cases that also need to be reviewed to assess their relevance in satisfying the objectives and aim of the research. Some of the key cases will have been subject to review and discussion in both professional and academic journals, so the next step will be to find relevant academic literature to support the interpretation of the case law.

The same approach will be taken when reviewing the development of the Contracts (Rights of Third Parties) Act 1999. However, as new legislation, it is important to review the wording, but also the Law Commission reports and Hansard for the discussions surrounding its introduction. There were several articles identified in the literature review that looked at this prior to the Act coming into force, and several that followed. Reviewing the thoughts and opinions of academics before and after the introduction of the Act will give some insight into how the Act changed during its transition through Parliament. Comparing this to the discussions in Hansard should help to provide an understanding of whether the initial legislation wording matched the proposals of the Law Commission.

The data collected from case law and academic literature will be analysed and interpreted using a detailed literature review. When analysing the data collected, simply making a statement of the law based on the legislation and case law is not feasible. It involves analysing and weighing up the different judicial, as well as academic, opinions to try to find a sensible interpretation that can be applied to the construction industry.[146] Decisions from a superior court will carry more weight than those of the lower courts,[147] and both will be preferable to academic opinion, but the academic opinion can be used to support the interpretation of the judgments.

When analysing case law, it is essential cases are not analysed in isolation. This approach could lead to rationalising contradictions or ambiguities.[148] Looking at cases together will help to identify and interpret the underlying rules that have been set out, and hopefully reduce the likelihood of identifying rules that are not there. A further problem when analysing case law is the potential for bias to affect the interpretation.

There is a tendency for individuals to view new information from their own viewpoint, judging it by their own pre-conceived ideas. This is known as confirmation bias and has the tendency to skew the results of the research to confirm an existing opinion.[149] In order to try to avoid this, all data including case law and academic literature will be reviewed on the facts presented. The opinions espoused will be included and compared with similar as well as opposing viewpoints to get a rounded view of the position. That could include dissenting opinions in judgments and differing perspectives on the

[144] *Murphy* (n 13).

[145] *Anns* (n 10).

[146] Dobinson and Johns (n 131) 24–25.

[147] ibid 34.

[148] Salter and Mason (n 132) 72–73.

[149] Jaap Bos, *Research Ethics for Students in the Social Sciences* (1st edn, Springer Nature 2020) 120–21.

outcome of a judicial decision. It is only by analysing both sides of the argument that the true position can be found.

Once both methods have been researched, they will be compared to understand where the legal rights granted differ, if at all. This comparison will draw on the judicial as well as academic opinion, with the aim to provide an objective comparison, free from bias.

4 Research

4.1 Collateral Warranties

Collateral warranties are not a new mechanism created out of necessity. There is evidence of their use as far back as 1899,[150] although not in the same format as now. One of the earliest construction cases to come before the courts regarding collateral warranties concerned the construction of a hospital.[151] Although this case was not part of the explosion in use, it includes some important points.

4.1.1 Performance Obligations

A nominated sub-contractor of the plaintiff provided a collateral warranty to the defendants prior to entering into a contract with the plaintiff providing that they would 'exercise all proper care and skill in the design of the sub-contract works'. The commentary provided in the Building Law Report described the use of a collateral warranty as a necessity due to the 'perceived deficiency in the standard form of building contract'.[152] The belief was that an appropriate chain of contractual responsibility could not commercially be maintained, following issues encountered in *Independent Broadcasting Authority v EMI Electronics Ltd.*[153] The chain of contractual responsibility can easily be lost when one of the parties in the chain becomes insolvent. This is another driver for the need for third-party rights in construction contracts.

Lawton LJ confirmed the warranty given was not a warranty that the design would be fit for purpose or any such greater obligation, but the fact the floors 'visually looked wrong' was sufficient to conclude the sub-contractor did not use the proper care and skill required.[154] Goff LJ stated that 'in certain circumstances, a breach of the duty of care can come close to a breach of warranty' referring to the suggestion that there is a danger that the duty to exercise due care and skill may be treated as a breach of an absolute warranty relating to the work of professional people.[155] He then set out that a professional person, using reasonable skill and care, should be able to form a correct judgment as to whether their design falls within the acceptable standard. This is the warranty being provided and it is this standard to which a professional person should be judged when assessing negligence.

4.1.2 The Legal 'Black Hole'

Construction projects should be built to last, creating a 'class of future owners' who sit outside the contractual relationships of the project. This provides a potential separation between losses incurred and the legal right to recover.[156] Various cases have considered this issue which has been described

[150] *De Lassalle v Guildford* [1901] 2 KB 215 (CA), [1901] 3 WLUK 120.

[151] *Holland Hannen & Cubitts (Northern) Ltd v Welsh Health Technical Services Organisation* (1985) 35 BLR 1 (CA).

[152] ibid 4.

[153] [1980] 14 BLR 1 (HL).

[154] *Holland Hannen* (n 151) 16–17 (Lawton LJ).

[155] ibid 21–22 (Goff LJ).

[156] Cornes and Winward (n 8) para 6.21.

as a 'legal black hole'.[157] The principle is that a party cannot claim damages where they have suffered no loss, but the party who has suffered the loss has no rights either.

The courts considered two cases simultaneously, one where an assignee claimed damages, the other where the original contracting party sought damages following assignment.[158] The assignments in both cases were found to be invalid so the assignee could not recover damages. The Lords found that the original party could recover the losses of the third party as they were not able to recover them directly, but they were split on the reasoning. Lord Browne-Wilkinson felt an exception previously associated with contracts for carriage by sea[159] could apply to construction cases,[160] but Lord Griffiths adopted a new principle. He felt a party to a contract should be entitled to recover damages for loss of performance providing the required 'repairs have been or are likely to be carried out'.[161] This principle became known as the broader ground,[162] and was later supported by the Steyn LJ.[163]

The discussion on recovery of third-party losses continued in the case of *Alfred McAlpine Construction Ltd v Panatown Ltd*[164] where the contractor provided a duty of care deed, or collateral warranty, to the owner of the site, but it was the employer who brought the case to trial. The judges considered the history and development of the law, agreeing broadly with the principles set out in *Linden*. The majority preferred the narrower ground principle but felt the existence of a direct contractual link with the owner meant the employer could not recover the losses on behalf of the owner.[165] However, the dissenting judges preferred the broader ground, arguing that the employer should not lose their right to recover losses under the contract.[166]

On initial review, this seems to create another 'black hole' in which claims can be lost but, as pointed out by Lord Browne-Wilkinson, had the claim been brought by the owner under the duty of care deed, the claim could have succeeded.[167] Another interesting point is that the judges were assuming the employer was claiming to recover the loss suffered by the owner.[168] The result may have been different had the employer been clear the claim was for loss of performance with the intention of completing the remedial works itself. This fits with Lord Griffiths' broader ground. A method found in some standard forms of collateral warranty available today is that the warranty does not become effective until practical completion.[169]

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[157] *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd* [1982] SLT 50 (OH) 54 (Lord Stewart); *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd* [1982] SC (HL) 157 177 (Lord Keith).

[158] *Linden Gardens Trust* (n 75).

[159] *Dunlop v Lambert* (1839) 6 CL & F 600; *Owners of Cargo Laden on Board the Albacruz v Owners of the Albazero (The Albazero)* [1977] AC 744 (HL).

[160] *Linden Gardens Trust* (n 75) 114–15 (Lord Browne-Wilkinson).

[161] ibid 96–97 (Lord Griffiths).

[162] David Friedman, 'Black Hole Cases' (2008) 24 Construction Law Journal 10, 16.

[163] *Darlington BC* (n 38) 80 (Steyn LJ).

[164] *Alfred McAlpine* (n 76).

[165] ibid 530–32 (Lord Clyde), 566-68, 574 (Lord Jauncey), 575-77 (Lord Browne-Wilkinson).

[166] ibid 545–47, 552–53, 557–58, 560–61 (Lord Goff), 584-85, 587, 593-96 (Lord Millett).

[167] ibid 577–78 (Lord Browne-Wilkinson).

[168] Brian Coote, 'The Performance Interest, Panatown, and the Problem of Loss' (2001) 117 Law Quarterly Review 81, 84.

[169] The Joint Contracts Tribunal Ltd, *JCT Contractor Collateral Warranty for a Purchaser or Tenant 2016* (Sweet & Maxwell 2016) cl 1.1.

4.1.3 Assignment

Assignment is the transfer of rights or interests from one party to another.[170] Collateral warranties are generally capable of being assigned, but often have limitations attached. Although beneficiaries may prefer unlimited assignments, the industry standard is to set a limit at two assignments, sometimes with consent not to be unreasonably withheld, in order to limit the warrantor's exposure to unknown third-party claims.[171] The courts have confirmed that an express provision that consent is required for assignment should be enforceable, and is not against public policy.[172] So restrictions on assignment are enforceable, but should a restriction prove to be an unfair term under either the UCTA 1977 or UTCCR 1999, it will most likely become unenforceable.

More recently, the courts considered a case where a collateral warranty allowed for two assignments, but consent, not to be unreasonably withheld or delayed, was required for further assignments. The benefits were validly assigned twice, but then the assignee went into administration and the administrator assigned the benefits back to the previous assignee without seeking the required consent.[173] The final assignment was confirmed to be invalid, but Stuart-Smith J considered the possibility that the failed assignment could have effect as a declaration of trust by the assignor in favour of the assignee. He found that the existence of a trust depends on the intentions of the parties which can be derived from the collateral warranty wording and relevant factual matrix.[174] In this case, he found there to be 'no justification for interpreting the deed as a declaration of trust', further reinforcing the position that restrictions on assignment cannot be evaded.[175]

Bowsher J considered a claim under a collateral warranty assigned by liquidators dealing with the original beneficiaries.[176] The claimant argued that the inclusion of the warranty documents in the schedules of the conveyancing documents showed an intent to assign and acted as an equitable assignment. The judge did not agree stating that 'it does not take many words to assign the benefit of a warranty'.[177] The conveyancing documents were lengthy, and Bowsher J felt the solicitors who drew up the documents would not have left an assignment up to an implication. There was no expression of intent to assign or any express wording that the warranties were being assigned, therefore, there was no assignment.

The remoteness of damages claimed under assignment has also been considered.[178] The assertion was that the damages were too remote to be recoverable. A collateral warranty provided to a funder was assigned to the management company of the property. Morris J agreed that an assignee cannot recover losses that were beyond the reasonable contemplation of the parties at the time of entering

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[170] Mason (n 1) 216; Bailey, *Construction Law* (n 32) para 20.57.

[171] McKenna and Charlson (n 18) 323.

[172] *Linden Gardens Trust* (n 75) 103, 106–08 (Lord Browne-Wilkinson).

[173] *Co-operative Group Ltd v Birse Developments Ltd* [2014] EWHC 530 (TCC), [2014] BLR 359 [61]-[64].

[174] ibid [88] (Stuart-Smith J).

[175] ibid [89]-[92] (Stuart-Smith J).

[176] *Allied Carpets Group Plc v Whicheloe Macfarlane Partnership* [2002] EWHC 1155 (TCC), [2002] BLR 433.

[177] ibid [35] (Bowsher J).

[178] *Orchard Plaza Management Co Ltd v Balfour Beatty Regional Construction Ltd* [2022] EWHC 1490 (TCC), [2022] 6 WLUK 138.

into the warranty,[179] and no more can be recovered than the assignor could recover should the assignment not have happened.[180] However, he found that loss in the form of the cost of repairs should have been reasonably foreseeable by both parties, as should the possibility of the warranty being assigned to someone not providing funding.[181]

It is clear the courts will carefully consider the wording of a collateral warranty before allowing parties to evade liability with a 'no loss' or 'loss too remote' argument. The cost of repairing defective works is unlikely to be categorised as too remote, even when claimed by an assignee, unless there is a clear intention in the wording of the warranty that it should not be recoverable.

4.1.4 Limitation Act 1980

Subsequent purchasers or tenants may become aware of defects much later in the life of a project, so it is vital to know the date on which any collateral warranty comes into effect. The date of effect can have a significant impact on the availability of a legal remedy for defects if the claim is being raised near the end of the limitation period.[182]

The courts have considered this issue several times, alongside the possibility that a collateral warranty could have retrospective effect. The specific wording will be the first consideration, and if a defined date on which it should have effect is included, then that should be determinative of the cause of action date. Nelson J confirmed execution after that date will not affect this as the intention of the parties is clear. The warranty will have retrospective effect.[183] However, where no date is defined, the 'factual matrix of the contract' will be considered to decide whether a collateral warranty has retrospective effect. In reviewing this point, O'Farrell J concluded that the parties intended the collateral warranty to have effect from practical completion.[184]

Warrantors are unlikely to want their liability under a collateral warranty to extend beyond that under their main contract, so the position of the courts is a positive one suggesting they will assume the cause of action dates will match unless otherwise stated, expressly or by clear implication. However, contribution claims under the Civil Liability (Contribution) Act 1978 may be allowed after a direct claim has expired.[185] Although the detail was 'sparse', Fraser J confirmed that a procedural bar to direct claims issued after a cut-off date does not extinguish a right for a contribution claim.

This brings further confusion to the status of the Limitation Act 1980 in relation to collateral warranties. On the one hand, the cause of action date should generally be linked to the date of practical completion of the works. On the other hand, if a claim is raised in contribution rather than directly against the warranty, there is a possibility that the limitation period will have a different

[179] ibid [72] (Morris J).

[180] ibid [73] (Morris J).

[181] ibid [74]-[77] (Morris J).

[182] Limitation Act 1980 ss 5, 8.

[183] *Northern & Shell Plc v John Laing Construction Ltd* [2003] EWCA Civ 1035, 90 Con LR 26 [46]-[47], [50] (Nelson J).

[184] *Swansea Stadium Management Co Ltd v Swansea City and County Council* [2018] EWHC 2192 (TCC), [2018] BLR 652 [44], [47]-[48], [56] (O'Farrell J).

[185] *Bloomberg LP v Sandberg* [2015] EWHC 2858 (TCC), [2016] BLR 72 [31], [37] (Fraser J).

commencement date. This will obviously depend on the specific facts of the case in question, but it should be borne in mind when considering the limitation period for claims.

4.1.5 Limitation of Liability

As discussed during the literature review, limitation of liability clauses are a common element of collateral warranties. Building contracts often limit liability by specifying that any required warranties will not impose a greater liability than that contained in the contract.[186] Such a clause could be used to apply rights of set-off against an amount claimed under a collateral warranty. Ramsey J considered this point when a third-party tried to claim damages for defects to a car park. The employer had become insolvent but owed the contractor a significant sum. Ramsey J confirmed that the 'no greater liability' clause meant the outstanding sum could be used as a set-off against the claim reducing it to zero.[187] This has resulted in more careful drafting of limitation of liability clauses to exclude set-off or any counterclaims under the main contract.[188]

In *Oakapple Homes (Glossop) Ltd v DTR (2009) Ltd*, Ramsey J was again asked to consider the application of a 'no greater liability' clause. This time a defence of contributory negligence was raised arguing that the employer was both the 'beneficiary' and 'joint employer' because the architect's appointment had been novated to the contractor, and both companies were part of the same group. Ramsey J plainly rejected this argument stating that an employer under a construction contract could never be liable, vicariously or otherwise, for the negligence of the contractor so a contributory negligence defence cannot be successful.[189]

The Scottish courts considered the argument that the phrase 'liability for costs' referred specifically to the reinstatement costs and consequential losses were damages that were specifically excluded.[190] The judge did not agree finding that the warranty was 'granted in general and unqualified terms' so without any clear limitations on this, the claimant would be entitled to recover all losses subject to the 'common law rules of remoteness of damage, as set out in *Hadley v Baxendale* and other cases'.[191] This case also considers the use of a net contribution clause to limit liability. On the specific wording included in the collateral warranty, the judge found that the liability was subject to apportionment appropriate to the responsibility of other parties.

4.1.6 Net Contribution

Net contribution clauses are commonly used to reduce the likelihood that parties will become liable for the full amount of the loss without the possibility of claiming contributions from other liable parties. The general principle is to define contract terms that provide the same provisions as the Civil Liability (Contribution) Act 1978 so parties can limit their liability.[192] Without it, the parties responsible

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[186] Paul Newman, 'Further Guidance on Collateral Warranties' (2007) 2007 Construction Newsletter 52, 52.

[187] *Safeway Stores* (n 86) [54] (Ramsey J).

[188] Suriya Edwards and Julie Teal, 'Set-off to Apply to Third Parties' (2016) 27 Construction Law 26, 26; [2013] EWHC 2394 (TCC), 150 Con LR 110 [27].

[189] *Oakapple Homes* (n 188) [37], [44]-[45] (Ramsey J); Stuart Pemble, 'Battle of the Insurers' (2013) 2013 The Estates Gazette 109, 109; Michael Wooley, 'Warranties Need to Reflect the Facts' (2013) 24 Construction Law 20, 21.

[190] *Glasgow Airport Ltd v Kirkman & Bradford* [2007] CSIH 47, 2007 SC 742 [5].

[191] ibid [11] (Lord Kingarth).

[192] Cornes and Winward (n 8) paras 9.88-9.91.

for the same damage would be jointly and severally liable for the whole of the loss.[193] One of the first cases to consider the effectiveness of these provisions, was a decision of the Scottish courts which cannot bind the courts of England and Wales.

The TCC considered a net contribution clause in an architect's appointment finding that the wording was unclear so did not limit the architect's liability against the contribution of the main contractor.[194] Edwards-Stuart J concluded that under the UTCCR 1999[195] the clause should be interpreted in favour of the client.[196] This interpretation was not accepted by the Court of Appeal who felt the 'normal meaning of the words is crystal clear'.[197] Vos LJ did not find the factual matrix to suggest any other interpretation. He also confirmed it did not fall foul of regulation 5(1) of the UTCCR 1999. When considering the test of reasonableness under the UCTA 1977, he found the clause as written was reasonable and therefore provided an effective limitation on the architect's liability.[198]

Warrantors looking to limit their liability using a net contribution clause are likely to find support from the courts, but it would be wise to draw the warrantee's attention to the clause and ensure the wording is not ambiguous.[199]

4.1.7 Right to Adjudicate

Collateral warranties were once silent on dispute resolution procedures, but the contract to which they were collateral usually contained arbitration agreements or defined the courts as having jurisdiction.[200] In 1998, the HGCRA 1996 introduced statutory adjudication to the construction industry. This became the default method for resolving disputes but was not considered to be relevant to collateral warranties as they could not be contracts for construction operations under the Act.[201] Or could they?

The TCC first considered this point when a beneficiary sought a declaration that the collateral warranty was a construction contract for the purposes of Part II of the HGCRA 1996 and therefore a dispute could be referred to adjudication.[202] Various issues were considered including the wording of section 104 of the HGCRA 1996, the wording of the warranty and The Construction Contracts (England and Wales) Exclusion Order 1998.[203] Akenhead J disregarded the exclusion order as it related to contracts of insurance and bonds but carefully considered the wording of the warranty. It was not simply warranting a 'past state of affairs' but instead provided an undertaking to 'carry out and

[193] Will Buckby and Andrew Croft, 'Appeal Court Backs Net Contribution Clauses' (2014) 25 Construction Law 17, 17.

[194] *West v Ian Finlay and Associates* [2013] EWHC 868 (TCC), [2013] 4 WLUK 293 [203] (Edwards-Stuart J).

[195] Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083) reg 7(2) since revoked by the Consumer Rights Act 2015 sch 4 para 34.

[196] *West v Ian Finlay* (HC) (n 194) [198], [202]-[203] (Edwards-Stuart J).

[197] *West v Ian Finlay* (CA) (n 88) [29]-[31] (Vos LJ).

[198] ibid [62]-[68] (Vos LJ).

[199] Buckby and Croft (n 193) 19; Dileep Pisharody, 'What a Difference a Year Makes' (2014) 25 Construction Law 29, 31.

[200] Cornes and Winward (n 8) para 9.107.

[201] ibid 9.26; Walton (n 78) 487.

[202] *Parkwood Leisure* (n 22) [1], [13]; Sheridan (n 98) 407.

[203] *Parkwood Leisure* (n 22) [17]-[27] (Akenhead J).

complete the Works'. This ultimately convinced Akenhead J that a collateral warranty could be a construction contract.[204]

The implication was that if a collateral warranty included an undertaking to the beneficiary to carry out and complete the works, then it would most likely be considered a contract for construction operations under the HGCRA 1996. However, if it was simply warranting that the works had been completed in accordance with the contract, it would likely fall outside that definition.[205] Although the decision received some criticism,[206] it was generally accepted by the industry.[207] Coulson suggested that it would make commercial common sense if any 'parasitic warranties' to a construction contract were also treated in the same way.[208]

Walker and Lixenberg considered how the position would be different under the JCT 2011 standard forms of collateral warranty. They suggested the wording of the JCT Contractor Collateral Warranty for a Purchaser or Tenant would fall outside of the HGCRA 1996, but the JCT Contractor Collateral Warranty for a Funder was likely to be considered a construction contract.[209] The 2016 edition of the JCT standard forms of collateral warranty appear to follow the same wording as the 2011 suite suggesting this judgment has not been interpreted negatively by the industry.[210] The JCT produces several different variants of these collateral warranties and the sub-contractor versions match the wording of the contractor versions with the addition of a Sub-Contractor Collateral Warranty for an Employer that is also likely to be considered a construction contract.[211]

Some commentators proposed that the outcome of this case would have been different had the works already been completed when the collateral warranty was executed.[212] Bowdery J considered this with a collateral warranty that was signed four years after practical completion and eight months after remedial works had been completed by another contractor.[213] Although the wording of the warranty covered both past and future performance of obligations under the contract, Bowdery J felt that the timing of execution showed that it could be nothing more than a warranty of a past state of affairs.

The decision was appealed seeking confirmation of whether collateral warranties could ever be construction contracts under section 104 of the HGCRA 1996 and whether the date of execution of a

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[204] ibid [27] (Akenhead J).

[205] McKenna and Charlson (n 18) 322; Sheridan (n 98) 408–09.

[206] Stuart Pemble, 'An Error of Judgment' (2013) 2013 The Estates Gazette 123, 123.

[207] Walton (n 78) 487.

[208] Peter Coulson, *Coulson on Construction Adjudication* (4th edn, Oxford University Press 2019) para 2.21.

[209] Steven Walker QC and Marc Lixenberg, 'Collateral Warranties: UK Case Law' (Society of Construction Law 2014) 14–15 <https://www.scl.org.uk/papers/collateral-warranties-uk-case-law> accessed 17 March 2023.

[210] The Joint Contracts Tribunal Ltd, *JCT CWa/P&T 2016* (n 169) cl 1.1; The Joint Contracts Tribunal Ltd, *JCT Contractor Collateral Warranty for a Funder 2016* (Sweet & Maxwell 2016) cl 1.

[211] The Joint Contracts Tribunal Ltd, *JCT Sub-Contractor Collateral Warranty for the Employer 2016* (Sweet & Maxwell 2016) cl 1.1; The Joint Contracts Tribunal Ltd, *JCT Sub-Contractor Collateral Warranty for a Funder 2016* (Sweet & Maxwell 2016) cl 1; The Joint Contracts Tribunal Ltd, *JCT Sub-Contractor Collateral Warranty for a Purchaser or Tenant 2016* (Sweet & Maxwell 2016) cl 1.1.

[212] Pemble (n 206) 123.

[213] *Toppan Holdings* (n 24).

warranty makes any difference.[214] The judges agreed on the first point, confirming the decision of Akenhead J to be good law,[215] but opinions were divided on the specific application to the warranty in question. Stuart-Smith LJ considered the omission of the word 'undertakes' as central to the idea that there was no direct obligation to the warrantee,[216] but the difference in meaning between 'to warrant' and 'to undertake' in this context is negligible.[217] Coulson LJ described it as semantic 'hair-splitting'[218] and Jackson LJ considered the distinction to be 'too fine to lead to a different outcome'.[219] The majority held that the wording of the warranty, read in the context of the situation, provided sufficient recognition of primary obligations to the warrantee.

On the final issue, the judges were agreed that the timing of execution of the warranty was not as important as the wording. As with other construction contracts, there is nothing to stop a warranty from having retrospective effect,[220] and the fact the works were complete should not be determinative of whether it can be construed as a construction contract.[221]

The law on this point is clear, a collateral warranty can be a construction contract provided there are clear obligations on the warrantor to the warrantee for construction operations. The warranty must not be for a past situation but can have retrospective effect. However, permission to appeal has been granted so there is still a possibility that the Supreme Court could reverse the decision.[222]

4.1.8 Summary

Collateral warranties have been in use since at least the end of the 19th century in various guises, but the case law did not properly start to develop until the cases of *D&F Estates* and *Murphy* brought about an explosion in their usage.[223] Since then, the courts have ruled on:

- The interpretation of performance obligations.[224]
- The provision of rights to remove a legal 'black hole' where losses cannot be recovered.[225]
- The effectiveness of assignments and clauses restricting assignment.[226]
- The effective date of a collateral warranty and how that relates to the Limitation Act 1980.[227]

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[214] *Abbey Healthcare* (n 25).

[215] ibid [28]-[31] (Coulson LJ), [82]-[83], [141] (Stuart-Smith LJ), [162]-[163] (Jackson LJ).

[216] ibid [37]-[39] (Stuart-Smith LJ).

[217] Walton (n 78) 491.

[218] *Abbey Healthcare* (n 25) [67] (Coulson LJ).

[219] ibid [160] (Jackson LJ).

[220] ibid [71]-[73] (Coulson LJ), [164]-[165] (Jackson LJ).

[221] ibid (Coulson LJ), [88] (Stuart-Smith LJ), [164] (Jackson LJ).

[222] The Supreme Court (n 26).

[223] Cornes and Winward (n 8) viii–ix; Hughes, Champion and Murdoch (n 2) 353–54.

[224] *Holland Hannen* (n 151) 16–17 (Lawton LJ), 21-22 (Goff LJ).

[225] *Linden Gardens Trust* (n 75) 96–97 (Lord Griffiths), 114-15 (Lord Browne-Wilkinson); *Alfred McAlpine* (n 76) 530–32 (Lord Clyde), 566-68, 574 (Lord Jauncey), 575-77 (Lord Browne-Wilkinson).

[226] *Linden Gardens Trust* (n 75) 107–08 (Lord Browne-Wilkinson); *Co-operative Group* (n 173) [89]-[92] (Stuart-Smith J); *Allied Carpets* (n 176) [35] (Bowsher J).

[227] *Northern & Shell* (n 183) [46]-[47] (Nelson J); *Swansea Stadium* (n 184) [44], [47]-[48], [56] (O'Farrell J).

- The possibility of a contribution claim outside the limitation period under the Limitation Act 1980.[228]
- The effectiveness of limitation of liability and net contribution clauses.[229]
- Whether collateral warranties can be considered construction contracts under the HGCRA 1996 for the purposes of instigating adjudication proceedings, although this one may yet change when the case comes before the Supreme Court.[230]

The steady development of the law of collateral warranties has helped to bolster their position as the primary method of granting rights to third parties, despite the costs involved in negotiating and chasing them.[231] The Contracts (Rights of Third Parties) Act 1999 was introduced after collateral warranty usage had permeated the industry, but its original aim was to provide a statutory route to achieve the same thing.

4.2 Contracts (Rights of Third Parties) Act 1999

Although the law of privity of contract was only formalised in 1861, calls for its reform were made early in the 20th century with the Law Revision Committee attempting to reform the law in 1937. Following much judicial and academic discussion on the matter, the Law Commission finally started the process in 1991 with its consultation paper 'Privity of Contract: Contracts for the Benefit of Third Parties'.[232] The Law Commission's draft bill, included with their 1996 final report, was put before the House of Lords on 3 December 1998. Following some debate and minor amendments, the bill received royal assent on 11 November 1999 and applies to contracts entered into on or after 11 May 2000. The Act does not apply in Scotland where the doctrine of '*jus quaesitum tertio*' (rights on account of third parties) can be used to confer a benefit on a third party, although collateral warranties are still used to provide a direct contractual link.[233]

The fact collateral warranties were already in heavy use when the Act came into effect means adoption has been slow. Although usage is increasing, collateral warranties are still the preferred method of granting third-party rights in the construction industry.[234] In fact, the construction industry represented the main opposition to reform of the law of privity given the devices that have been developed over the years to get around the rule worked reasonably well.[235] The industry specifically referred to the complexity of construction projects and the contractual arrangements used to argue that the bill did not adequately deal with this.[236] Without usage, the development of the

[228] *Bloomberg* (n 185) [31], [37] (Fraser J).

[229] *Safeway Stores* (n 86) [54] (Ramsey J); *Oakapple Homes* (n 188) [37], [44]-[45] (Ramsey J); *Glasgow Airport* (n 190) [11] (Lord Kingarth); *West v Ian Finlay (CA)* (n 88) [29]-[31], [62]-[68] (Vos LJ).

[230] *Parkwood Leisure* (n 22) [23], [27]-[28] (Akenhead J); *Toppan Holdings* (n 24) [21]-[24], [26] (Bowdery J); *Abbey Healthcare* (n 25) [62], [71]-[73] (Coulson LJ), [88], [111] (Stuart-Smith LJ), [158], [164] (Jackson LJ).

[231] McKenna and Charlson (n 18) 329–30.

[232] Law Commission (n 17).

[233] Cornes and Winward (n 8) para 3.8.

[234] McKenna and Charlson (n 18) 320.

[235] Law Commission (n 16) para 1.7.

[236] HL Deb 2 February 1999, vol 596, cols 1423–24 (Lord Howie).

law has been slow. There are relatively few cases concerning construction, but there are cases dealing with the interpretation of the Act.

4.2.1 Granting Rights

Section 1 of the Act provides the right for a third party to enforce a term in a contract to which they are not a party. It sets out a two-limb test of enforceability under section 1(1). The first limb is unambiguous stating that if a contract expressly provides that a third party may enforce a term of the contract, then that right has been granted. Cornes notes that uncertainty arises in the wording of section 1(1)(b) where it provides for a right to enforce a term if it 'purports to confer a benefit' on that third party.[237] The Law Commission proposed that a third party should be able to enforce a contract made for their benefit where it meets with the intention of the parties.[238] The particular wording set out in the draft bill was discussed during the House of Lords debates with a possible amendment being to omit section 1(1)(b).[239] However, it was agreed this could create an injustice and go against the principles of the bill so it remained. As did section 1(2) which provides that section 1(1)(b) will not apply if it appears the parties 'did not intend the term to be enforceable by the third party'. The Law Commission intended section 1(2) to act as a rebuttable presumption on section 1(1)(b) to reduce the degree of uncertainty that could be introduced without it.[240]

The first case to come before the courts looked specifically at the meaning of section 1. In *Nisshin Shipping Co Ltd v Cleaves & Co Ltd*, it was accepted that there were no express clauses providing a benefit so they could not rely on section 1(1)(a).[241] The issue was whether any clauses 'purported to confer a benefit' on the claimant and whether the parties intended the term to be enforceable by them. Colman J held that it was clear that a benefit was conferred on the claimant.[242] He then interpreted section 1(2) clarifying that enforceability is not disapplied because there is no clear intention that the term should be enforceable by the third party, but instead when it is clear the parties did not intend the term to be enforceable.[243] He held that the parties were neutral on the matter and as such section 1(1)(b) would not be rebutted.

This may seem like a very fine distinction, but supports the position set out by the Law Commission providing guidance as to how to approach contract drafting to ensure rights are not conferred by mistake. The point was further supported when Clarke LJ concluded, in support of the first instance judgment, that the terms clearly conferred a benefit on the owners and the existence of a chain of contracts was not a good reason to rebut this presumption.[244] This is somewhat against the recommendations of the Law Commission who proposed that the reform should not cut across a 'deliberately created chain of liability'.[245] However, it suggests the courts will favour an interpretation

[237] Cornes and Winward (n 8) paras 3.25-3.26.

[238] Law Commission (n 17) paras 5.10-5.15.

[239] HL Deb 2 February 1999, vol 596, col 1425.

[240] Law Commission (n 16) para 7.17.

[241] [2003] EWHC 2602 (Comm), [2004] All ER (Comm) 481 [10].

[242] ibid [13]-[14] (Colman J).

[243] ibid [23] (Colman J).

[244] *Laemthong International Lines Co Ltd v Artis (The Laemthong Glory) (No2)* [2005] EWCA Civ 519, [2005] 2 All ER (Comm) 167 [30] (Clarke LJ).

[245] Law Commission (n 16) para 7.18(iii).

that a contract confers a benefit and the opposing party must prove they did not intend for the term to be enforceable. Therefore, if the intention is that a term should not be enforceable by a third party, it should be clearly stated. Some commentators even advocate excluding the Act altogether.[246]

The initial step of defining when a term purports to confer a benefit received further clarification from Clarke J. He confirmed that a benefit is not purported to be conferred on a third party simply because the position of the third party is improved by the contract.[247] One of the primary purposes of the contract must be to benefit the third party, rather than an incidental effect of it. This decision appears to set a clearer boundary between a contract that purports to confer a benefit on a third party and one that doesn't. If the third party is benefitting indirectly because of the contract, then they are unlikely to have enforceable rights under that contract.

A series of cases involving clauses in contracts of employment to make deductions for trade union subscriptions have considered the position of the trade union as a third party. Laing J felt that a contractual term may have more than one purpose finding that the benefit to the trade union was not incidental, but a direct purpose of the clause.[248] However, the Court of Appeal more recently found that although a benefit was clearly conferred on the trade union, and there was no wording to suggest the term was not intended to be enforceable, the parties clearly did not intend the trade union to be able to enforce the term of the employment contract.[249] Underhill LJ clarified that the 'intention in question must be the common intention of both parties'.[250]

This decision appears to bring the position on purporting to confer a benefit in line with the intentions of the Law Commission. The employment contract in question does benefit the trade union, but that is not the purpose of the contract. It is an incidental benefit with the primary purpose being to provide a benefit to the employee to enable them to keep up with their trade union subscriptions directly through their wages.

4.2.2 Express Identification of Third Party

The Act then sets out who the relevant third parties could be under section 1(3). They must be expressly identified in the contract by name, as a member of a class or answering a particular description, but they do not need to exist at the point of execution. This then allows for future purchasers or tenants to be identified despite the specific person or company not being known. Cornes suggested that the inclusion of members of a class, or answering to a particular description, could open parties up to a very wide range of third-party beneficiaries,[251] but it was not too long before the courts reviewed it.

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[246] MacMillan (n 116) 725; Paul S Davies, 'Excluding the "Contracts (Rights of Third Parties) Act 1999"' (2021) 137 Law Quarterly Review 101, 101.

[247] *Dolphin Maritime & Aviation Services Ltd v Sveriges Angfartygs Assurans Forening* [2009] EWHC 716 (Comm), [2010] 1 All ER (Comm) 473 [74] (Clarke J).

[248] *Cavanagh v Secretary of State for Work and Pensions* [2016] EWHC 1136 (QB), [2016] 5 WLUK 302 [73] (Laing J).

[249] *Secretary of State for the Home Department v Cox* [2023] EWCA Civ 551, [2023] 5 WLUK 259 [102]-[106] (Stuart-Smith LJ), [81]-[88] (Lewis LJ), [118]-[119] (Underhill LJ).

[250] ibid [118] (Underhill LJ).

[251] Cornes and Winward (n 8) para 3.33.

Clarke LJ considered the wording of a letter of indemnity concluding that the identification of a third-party as a member of a particular class or answering a particular description should be 'viewed against its surrounding circumstances or factual matrix'.[252] He found that the wording was sufficient to suggest the third-party was expressly identified in the letter of indemnity.

In *Avraamides v Colwill*,[253] Waller LJ considered a very similar situation. The first instance judge considered that the reference to 'customers' in a transfer agreement between a company that refurbished the Avraamides' bathroom and the respondent was an express identification of the claimant as a third party with whom a benefit was conferred. However, Waller LJ took a step back and considered the identification against the rest of the wording of the relevant term, and the factual matrix of the case. It was his opinion that the word 'express' in section 1(3) does not allow a process of construction or implication and although 'customers' was an identified class of parties, the obligation under the term was to pay liabilities properly incurred, not just to customers. If this were to provide a benefit to the customers, then it could also provide a benefit to many unidentified classes.[254]

The wording in Waller LJ's decision provides a narrower interpretation of the Act, but Flaux LJ considered this to be an error.[255] He suggested the wording should have been 'process of construction by implication' following the decision in *The Laemthong Glory* and confirming the express identification should be a process of construction of the whole contract. This possibly moves away from the original intentions of the Law Commission who were clear that 'third party rights cannot be conferred on someone who is impliedly in mind'.[256] Although, considering the construction of the whole contract is more likely to assist with establishing the class or description of third parties with whom benefits are to be conferred. This series of judgments simply clarifies the intention that third parties do not have to be expressly identified by name if they can be identified as a member of a particular class or matching a particular description.

4.2.3 Varying or Rescinding the Contract

In section 2, the Act provides a mechanism to prevent parties to a contract varying or rescinding the contract where a third party has a right to enforce a term of the contract. This mechanism only works should the third party have communicated their assent to the promisor, relied on the term with the awareness of the promisor, or if the promisor could have reasonably foreseen that the third party would rely on the term, and they did. This is designed to protect third parties but also provides for the parties to the contract to include an express term that negates it. The Law Commission originally set out that the parties could not vary or 'cancel' the contract, but Lord Hacking proposed that 'cancel' should be changed to 'rescind', and the Lord Chancellor, Lord Irvine, agreed to avoid the removal of one party's right to accept the repudiation of the other party.[257]

[252] *The Laemthong Glory* (No.2) (n 244) [38], [41]-[44], [46]-[48] (Clarke LJ).

[253] [2006] EWCA Civ 1533, [2007] BLR 76.

[254] ibid [18]-[20] (Waller LJ).

[255] *Chudley v Clydesdale Bank Plc (t/a Yorkshire Bank)* [2019] EWCA Civ 344, [2020] QB 284 [77] (Flaux LJ).

[256] Law Commission (n 16) para 8.1.

[257] HL Deb 27 May 1999, vol 601, col 1055 (Lord Irvine).

The timing of the communication of assent provided some difficulty in the case of *Precis (521) Plc v William M Mercer Ltd*, where the claimant argued that the assent to the term should have been made prior to the performance of the act to which the third party is entitled to receive a benefit.[258] Behrens J was not convinced by this argument, confirming that the Act should be given the natural meaning of the words used. Once assent is communicated, the parties cannot then rescind or vary the contract without their consent regardless of when that assent is received. He could find no words in the Act or the Law Commission's reports to suggest that assent had, or should have, a time limit.[259] This was affirmed by Arden LJ in her decision at appeal where she confirmed that reading such words of restriction into section 2(1)(a) could not be done.[260]

There was some discussion during the consultation period that this provision would cause significant problems with variations under construction contracts. However, the Law Commission made it clear that variations as described by construction contracts are variations to the works, not variations to the contract. As the right to vary the works is a contractual one, and third-party rights are conferred by the contract, they would also be subject to such variations.[261] An option has been included in section 2(3) for the parties to include an express provision to allow variation or rescission of the contract without the consent of the third party or to require consent under different terms, thus relieving any concerns regarding the parties' freedom of contract.

4.2.4 Other Provisions

In their final report, the Law Commission postulated three options for providing rights of defence against third-party claims. The first option was that only defences affecting the existence or validity of the contract or term would be available to the promisor. The second option was all defences, set-offs or counterclaims arising out of, or in connection with, the contract that would have been available had the claim been brought by the promisee would be available to the promisor. Finally, all defences, set-offs or counterclaims available had the claim been brought by the promisee would be available.[262] The Law Commission believed the first option was too restrictive, and the third option too broad and therefore settled on option two allowing promisors to rely on all defences and set-offs that would have been available had the claim been brought by the promisee and which arose out of, or in connection with, the contract. They added a further caveat that it should be a relevant defence to the contractual provision on which the third party is claiming to ensure the third-party's right is not being defeated by a defence not relevant to the claim.[263]

The possibility was raised that this rule could have serious implications for a third party who may have their rights diminished by a defence for which they were unaware. The Commission recommended the ability of the parties to the contract to include an express provision removing this right or extending the defences to all available against the promisee. There has been no judicial

[258] [2004] EWHC 838 (Ch), [2004] 4 WLUK 142 [313].

[259] ibid [315]-[318] (Behrens J).

[260] *Precis (521) Plc v William M Mercer Ltd* [2005] EWCA Civ 114, [2005] 2 WLUK 372 [39] (Arden LJ).

[261] Law Commission (n 16) para 9.37; HL Deb 27 May 1999, vol 601, cols 1056–57 (Lord Hacking, Lord Irvine).

[262] Law Commission (n 16) para 10.8.

[263] ibid paras 10.11-10.12; Contracts (Rights of Third Parties) Act 1999 s 3(3).

consideration of section 3 of the Act yet, but commentators do expect claims to be raised against this in the future.[264]

Section 4 confirms that section 1 does not affect the rights of the promisee to enforce any term of the contract. The general principle is to ensure the promisee does not lose their right to sue on recognition of a third party's rights.[265] This could have been useful in the case of *Alfred McAlpine v Panatown*[266] had the Act applied to their contract. The difficulty in that case was that the duty of care deed with the owner of the land meant the employer under the building contract was unable to claim for the losses incurred by the failure of the builder. Although there has been some criticism of the decision,[267] had the rights been granted under the Act, it is possible that the employer could have relied on section 4 to claim damages. In particular, the argument that the duty of care deed was not intended for the building owner, but rather for subsequent owners could easily have been described in the contract using the Act. Again, this would depend on clear contract drafting. The possibility of double liability for the promisor, a cause for concern noted by Macaulay,[268] should be alleviated by section 5 which provides for the reduction of an award to a third party to the extent that it is appropriate to sums already recovered.

There are several exceptions noted in section 6 to ensure that no rights are conferred on third parties for various types of contracts, like bills of exchange, incorporation documents for partnerships, contracts of employment, contracts for carriage of goods by sea and several others. Section 7 then adds some interesting provisions that ensure some of the existing exceptions to the law of privity are not superseded. This means that if there is already a right or remedy available to a third party through other means, then the Act will not affect those rights. It also provides clarification on the application of the UCTA 1977 and the Limitation Act 1980, before confirming that a third-party should not be treated as a party to a contract for the purposes of any other Act, or statutory instrument made under any other Act.

4.2.5 Usage in Construction

The introduction of the Act provides an opportunity for a reduction in the use of collateral warranties in the construction industry. Unfortunately, the industry criticised the Act when it was introduced, and the main drafting bodies for standard form contracts chose to exclude the operation of the Act by default.[269] This led to the limited uptake of the Act. Another potential problem found in the construction industry is that frequently, construction projects commence without a contract in place.[270] The possibility also exists for a project to be completed without a formal contract ever being executed. This would leave third parties without any remedy as there is no way to satisfy the conditions of the Act without a formal contract in place. On the other hand, if the main contract has

[264] Cornes and Winward (n 8) para 3.37.

[265] Law Commission (n 16) paras 11.1-11.2.

[266] *Alfred McAlpine* (n 76).

[267] Coote (n 168) 94.

[268] Macaulay (n 125) 267.

[269] ibid 271; Cornes and Winward (n 8) paras 3.49-3.50; Robert Stevens, 'The Contracts (Rights of Third Parties) Act 1999' (2004) 120 Law Quarterly Review 292, 317.

[270] Dolan (n 116) 21.

not been executed, then it is likely any associated collateral warranties would be in the same position, so third parties would still be without a remedy.

The protracted negotiation of collateral warranties and the associated costs have been cited as reasons for the adoption of the Act, but wouldn't the same issue arise with the use of rights under the Act? Individual sub-contractors, consultants, and other parties involved in construction often require amendments to collateral warranties to suit their requirements, so it is likely they would want a say in the granting of third-party rights under the Act.[271] This possibility could have a significant impact on the negotiation of the main contract which could then delay project start, and potentially increase project costs. Alternatively, the contracting parties could ignore the Act entirely meaning that it would apply, but the interpretation and uncertainty brought about by this would be detrimental to all parties.

Collateral warranties have presented a particular problem regarding the use of statutory adjudication as a method of dispute resolution under section 108 of the HGCRA 1996. Unfortunately, it seems that rights granted under the Act have not made this any simpler. In *Hurley Palmer Flatt Ltd v Barclays Bank Plc*,[272] a dispute arose regarding design defects in a chilled water system. The defendant, as a recognised third party, referred the dispute to adjudication but the claimant sought a declaration that they were not entitled to do so. The defendant argued that section 1(4) meant that the dispute was subject to the adjudication clause within the appointment referring to the conditional benefit idea discussed by Colman J in *Nisshin Shipping*,[273] and proposed by the Law Commission in their report.[274] Ramsey J did not accept this argument, first confirming that the appointment wording did not suggest that the adjudication clause applied,[275] then carrying out a detailed analysis of the Act to provide further reasons why it did not apply.

Section 1(4) was always intended to provide a conditional benefit where the right to enforce a term of the contract could be conditional on something else, for example an arbitration clause. This was part of the argument, if it could apply to arbitration, then why not adjudication? However, arbitration is a mandatory alternative dispute resolution procedure that replaces the parties right to litigate, whereas adjudication is a voluntary alternative method that is still subject to final determination either through arbitration or the courts.[276] This specific point was raised during the Parliamentary debates. Lord Hacking proposed an amendment to section 1(4) to ensure that if the parties were bound to an arbitration clause, the third party was not able to override that and take their dispute to court.[277] However, the Lord Chancellor noted that the proposed amendment would mean that a third party's right to enforce would be subject to any dispute resolution of the contract. He agreed that arbitration needed to be considered, but the proposed amendment went too far.[278] The final position on the matter was that the application of the Arbitration Act 1996 should be included, but other

[271] ibid.

[272] *Hurley Palmer Flatt* (n 27).

[273] *Nisshin Shipping* (n 241) [36] (Colman J).

[274] Law Commission (n 16) paras 10.24-10.32.

[275] *Hurley Palmer Flatt* (n 27) [20]-[23] (Ramsey J).

[276] ibid [28] (Ramsey J).

[277] HL Deb 27 May 1999, vol 601, col 1054 (Lord Hacking).

[278] ibid (Lord Chancellor).

dispute resolution methods should be rejected.[279] Section 8 provides the necessary mechanism to do this.

Further support for the position of Ramsey J can be found in the HGCRA 1996 itself. Section 108(1) provides that a 'party to a construction contract has the right to refer a dispute arising under the contract for adjudication'[280] and section 7(4) of the 1999 Act clearly states that a 'third party shall not … be treated as a party to the contract for the purposes of any other Act'.[281] This clearly shows that statutory adjudication cannot apply to rights granted under the Act, but should the parties wish to provide the option for adjudication, they could confer such a benefit expressly in the terms. This could be a useful addition to construction contracts given how adjudication has become the leading method of alternative dispute resolution in the industry since its introduction.

Adoption of the Act in the industry has been slow. Charlson and McKenna noted in their 2015 study that one of the primary reasons for this was seen as being a lack of understanding of the Act.[282] The lack of inclusion in the main standard form contracts was probably a contributing factor. However, in recent years the main contract drafting bodies have changed their position regarding the Act with the latest version of the JCT Design and Building Contract 2016 (also the 2011 edition) including an option for granting third-party rights under clause 7.4, with supporting clauses 7A and 7B defining specific classes of parties. Clause 7E then refers to the way in which rights will be granted from sub-contractors and Schedule 5 provides the specific rights relevant to purchasers and tenants. The latest NEC4 Engineering and Construction Contract also provides for the application of the Act under Secondary Option Clause Y(UK)3 although it is far more open to the parties to provide the detail than the JCT contracts.

4.2.6 Summary

The Contracts (Rights of Third Parties) Act 1999 provides a method for granting rights to third parties under a contract as an exception to the law of privity of contract. It applies to all contracts, save for the exceptions defined in section 6, where it has not been excluded. The contract should either expressly provide, or purport to confer, a benefit on a third party who is expressly identified by name, as a member of a class or answering a particular description. The courts have shown they will interpret section 1(1)(b) broadly, and that it is up to the parties to the contract to rebut the presumption under section 1(2).[283]

The parties to a contract that provides a benefit to one or more third parties cannot vary or rescind the contract once the third party has confirmed their assent, the promisor is aware they have relied on the term or should reasonably have foreseen that they would rely on it.[284] The assent does not have to be received before the action under the contract has commenced, but once assent or reliance is confirmed, then no variation to, or rescission of, the contract can happen without the consent of

[279] ibid 1058 (Lord Hacking), cols 1058-1060 (Lord Chancellor).

[280] Housing Grants, Construction and Regeneration Act 1996 s 108(1).

[281] Contracts (Rights of Third Parties) Act 1999 s 7(4).

[282] McKenna and Charlson (n 18) 329.

[283] *Nisshin Shipping* (n 241) [23] (Colman J); *The Laemthong Glory* (No.2) (n 244) [30] (Clarke LJ).

[284] Contracts (Rights of Third Parties) Act 1999 s 2.

the third party unless an express provision has been included to allow this.[285] This does not affect variations to the works, as commonly seen in construction contracts, as these are not variations to the contract.[286]

The Act provides the promisor with access to all the relevant defences against a third party as would have been available had the claim been brought by the promisee, but it also allows the parties to vary this through express provisions in their contract. Section 4 ensures that the rights of the promisee are not removed through the application of the Act, and section 5 aims to protect the promisor from double liability.

Usage in construction is limited, but the publishers of the standard forms of contract predominantly in use in the UK have now included provisions for the application of the Act, with particularly detailed schedules of rights included in the last two editions of the JCT standard forms. Adoption within the industry has been slow, but it is increasing, so in the next few years there may be more cases going to court to test the provisions of the Act and provide further clarification.

[285] *Precis (HC)* (n 258) [315]-[318] (Behrens J); *Precis (CA)* (n 260) [39] (Arden LJ).

[286] Law Commission (n 16) para 9.37.

5 Findings

The research has confirmed that the primary intention behind both collateral warranties and the Contracts (Rights of Third Parties) Act 1999 is to provide a mechanism to work around the law of privity of contract. Both mechanisms achieve this in different ways, but do they provide the same benefits?

5.1 Standard Provisions of Collateral Warranties

Collateral warranties are still the dominant method of granting rights to third parties in the construction industry.[287] They typically include clauses to:

- Define the performance obligations owed to the third party.
- Grant licenses to copy and use design documents for any purpose relating to the works.
- Define required levels and durations of professional indemnity insurance.

These clauses often duplicate existing provisions within the main contract. For example, the copyright licenses provided to third parties under clause 4 of the JCT Contractor Collateral Warranty for a Purchaser or Tenant 2016 can also be found in clause 2.38 of the JCT Design and Build Contract 2016.[288] However, if these clauses are not drafted using the exact same wording, or included by reference, it can create a disparity, as seen in the case of *Alfred McAlpine v Panatown*.[289]

The rights granted under these typical clauses can just as easily be granted using the Contracts (Rights of Third Parties) Act 1999. Section 1 of the Act allows the parties to confer the benefit of any term to a third party providing they are expressly identified by name, as a member of a class or matching a particular description. This has the benefit of ensuring there is no ambiguity between the rights granted to third parties and the rights available to the parties under the contract. It also presents a possible negative if the terms of the contract are not clear as to whom the benefit is to be conferred. The courts have shown they will adopt a broad interpretation of when a benefit is to be conferred and will expect a clear indication that the benefit was not intended to be enforceable to rebut the presumption.[290]

5.2 Assignment

Assignment allows rights and causes of action to be assigned, or transferred, from one party to another.[291] This can include rights granted under the Act, either as an equitable assignment or a legal assignment.[292] The Law Commission recommended that a third party should be able to assign its rights under the Act, but there is no discussion about any limits on assignment.[293] Parties who are required to provide collateral warranties, and their insurance companies, often require a limit to the

[287] McKenna and Charlson (n 18) 330–31.

[288] Cockram (n 119) 6.

[289] *Alfred McAlpine* (n 76) 532 (Lord Clyde).

[290] *Nisshin Shipping* (n 241) [23] (Colman J).

[291] Mason (n 1) 216; Bailey, *Construction Law* (n 32) para 20.57.

[292] Cockram (n 119) 8–9.

[293] Law Commission (n 16) paras 14.6-14.7.

number of assignments and the courts have found clauses that require consent, or limit the number of assignments to be enforceable.[294] The JCT Design and Build Contract 2016 requires consent prior to assignment,[295] so this could also apply to any third-party rights granted under the Act. There is also a clause included in the third-party rights schedule[296] that allows for two assignments of any third-party rights without consent with no further assignments allowed. This shows that there is congruency between the Act and collateral warranties as far as assignment is concerned.

It has been suggested that granting rights to third parties under the Act may be more secure than assigning rights as some rights are not assignable but, theoretically at least, provided the parties agree, any right may be granted under the Act.[297] It is even conceivable that assignment could be avoided entirely if the class of third parties was, for example, 'all future purchasers and/or tenants'. Although, it is unlikely that a contractor or consultant would be willing to accept this given the potential for unknown third-party claims in the future.

5.3 Limitations

There have been some difficulties defining the cause of action date in relation to collateral warranties over the years, with the courts generally finding it to match the date of practical completion, or the date defined in the warranty regardless of when it was executed.[298] In theory, this should not be an issue with the Act as any rights granted under the building contract would have the same limitation period as the contract itself, and the cause of action would also be linked. This has not been tested in the courts yet, so there is still uncertainty on this point.

Limitations of liability and net contribution clauses are common requirements of warrantors to ensure they are only liable for the proportion of the loss for which they are responsible. Under the Act, a third party is only granted the right to enforce specific terms so cannot bring claims that have a greater liability, or longer duration than detailed within the contract itself.[299] Standard form contracts do not traditionally include 'net contribution clauses', so does this mean that using the Act would require contractors to rely on the Civil Liability (Contribution) Act 1978? The JCT Design and Build Contract 2016 includes a net contribution clause within the third-party rights schedules,[300] so it seems unlikely that parties would be required to rely on a contribution claim under the 1978 Act. However, again there has yet to be any judicial consideration of this point at the time of writing.

5.4 Step-in Rights

Step-in clauses provide a funder with the ability to 'step into' the employer's position should they become insolvent or breach their agreement with the contractor.[301] The funder then takes on all the

[294] *Linden Gardens Trust* (n 75) 103–09 (Lord Browne-Wilkinson); *Co-operative Group* (n 173) [80], [89]-[92] (Stuart-Smith J).

[295] The Joint Contracts Tribunal Ltd, *JCT Design and Build Contract 2016* (Sweet & Maxwell 2016) cl 7.1.

[296] ibid sch 5, pts 1, para 6 and 2, para 10.

[297] Stevens (n 269) 319–20.

[298] *Northern & Shell* (n 183) [46]-[47] (Nelson J); *Swansea Stadium* (n 184) [44], [47]-[48], [56] (O'Farrell J).

[299] Cockram (n 119) 8.

[300] The Joint Contracts Tribunal Ltd, *JCT DB 2016* (n 295) sch 5, pts 1, para 1.3 and 2, para 1.1.

[301] Lindy Patterson (n 90) 15–16; Beesley (n 89) 30.

benefits and obligations under the contract. Step-in clauses are commonly cited as a reason for using collateral warranties over the Act.[302] It is easy to see why given the primary purpose of the Act is to confer benefits under a contract on a third party, not to impose burdens.[303] However, there is very little case law regarding step-in clauses suggesting that either they work very well, or they are rarely exercised.[304]

Cornes suggested that step-in rights cannot be created using the Act,[305] but other commentators have taken a different view.[306] Cockram argues that the difficulty with step-in clauses has been resolved with section 1(4),[307] and Beesley states that it simply requires additional care.[308] The exercise of step-in rights requires a novation agreement between all three parties because both benefits and burdens are being transferred. This means that granting step-in rights under a collateral warranty requires either the warranty to be executed by all three parties, ideally as a deed so consideration is not an issue, or a separate deed of novation must be executed by all three parties. If a separate deed of novation is used, then it does not matter whether a clause is included in the main contract or a collateral warranty, providing that the circumstances under which the deed of novation will be executed are clearly defined.

The schedule of third-party parties included in the JCT Design and Build Contract 2016[309] includes a step-in clause that broadly matches the one included in the JCT Contractor Collateral Warranty for a Funder 2016.[310] The funder is a party to the collateral warranty but not to the contract, however, clause 7.4 of the contract refers to a 'rights particulars' document that is to accompany the contract should any third-party rights be granted either via the Act or using collateral warranties. There is a model form included in the JCT Design and Build Contract Guide 2016,[311] but there is nothing stopping a similar document from being used that requires all three relevant parties to execute it to satisfy the novation requirements.

5.5 Dispute Resolution Provisions

Traditionally, collateral warranties have been silent on dispute resolution procedures,[312] but the latest edition of the JCT forms include a clause that the English courts shall have jurisdiction removing any ambiguity should the main contract have an arbitration agreement.[313] Adjudication has become the default first step in resolving disputes in the construction industry with the introduction of the HGCRA 1996. However, statutory adjudication is for the parties to a contract for construction

[302] McKenna and Charlson (n 18) 332–33.

[303] Law Commission (n 16) paras 10.24-10.32.

[304] Lindy Patterson (n 90) 16.

[305] Cornes and Winward (n 8) para 3.59.

[306] Macaulay (n 125) 271; Maria Harris, 'Third Party Rights Revisited' (2002) 13 Construction Law 20, 21; Beesley (n 89) 31.

[307] Cockram (n 119) 11.

[308] Beesley (n 89) 31.

[309] The Joint Contracts Tribunal Ltd, *JCT DB 2016* (n 295) sch 5, pts 1, para 1.3 and 2, para 1.1.

[310] The Joint Contracts Tribunal Ltd, *JCT CWa/F 2016* (n 210) cl 1.1.

[311] The Joint Contracts Tribunal Ltd, *JCT Design and Build Contract Guide 2016* (Sweet & Maxwell 2016) 21–23.

[312] Cornes and Winward (n 8) para 9.107.

[313] The Joint Contracts Tribunal Ltd, *JCT CWa/F 2016* (n 210) cl 15; The Joint Contracts Tribunal Ltd, *JCT CWa/P&T 2016* (n 169) cl 11.

operations. It was originally believed that collateral warranties could not be contracts for construction operations.[314] The courts have found that they can be,[315] although a final ruling from the Supreme Court may yet change that.[316]

The position regarding the Act seems much clearer. In *Hurley Palmer Flatt v Barclays Bank*, the courts set out their position.[317] The decision hinged on three factors:

- Adjudication is a voluntary mechanism.
- Section 108(1) of the HGCRA 1996 provides a right to adjudication to parties to a contract.
- Section 7(4) of the Act states that a third party cannot be treated as a party to the contract for the purposes of any other Act.

For these reasons, the courts found that the principle of section 8 that applies to arbitration agreements could not be extended to adjudication. If the parties wished adjudication to be an option to third parties, that could be achieved by specifically conferring a right to adjudicate, but as it currently stands, it is already an available option with collateral warranties so this may be a better choice.[318] It is also worth noting that the schedule of third-party rights provided by the JCT forms of contract does not provide any provision for adjudication.

5.6 Summary

The decisions in *D&F Estate* and *Murphy* brought about a necessity for providing a contractual route for purchasers and tenants to recover losses for defective design or construction work. Collateral warranties were quickly adopted by the industry and the necessary clauses have developed over time. The Contracts (Rights of Third Parties) Act 1999 was introduced with the primary purpose of providing an exception to the doctrine of privity of contract. One of the purported benefits of the Act was that it could effectively eliminate the need for collateral warranties.

In principle, it appears that the Act can be used to provide the same rights to third parties as collateral warranties. Limitation clauses, net contribution clauses, insurance requirements and copyright licenses can all easily be provided through either option. In fact, the wording within the third-party rights schedule in the JCT forms of contract largely matches the respective JCT forms of collateral warranty, further supporting the position that the two mechanisms available provide the same capabilities.

[314] Cornes and Winward (n 8) para 9.26.

[315] *Parkwood Leisure* (n 22) [23], [27]-[28] (Akenhead J); *Abbey Healthcare* (n 25) [62] (Coulson LJ), [158] (Jackson LJ).

[316] The Supreme Court (n 26).

[317] *Hurley Palmer Flatt* (n 27) [20]-[23], [28] (Ramsey J).

[318] Bange (n 18) 22.

6 Conclusions

The overall aim of this research was to demonstrate how the law of third-party rights has developed, along two separate lines, since the judgment in *Murphy v Brentwood DC* overturned the decision of the House of Lords in *Anns v Merton LBC*. The research focus was on the use of collateral warranties and the introduction of the Contracts (Rights of Third Parties) Act 1999, both of which were intended to provide a contractual method of granting rights to third parties. The specific research objectives were to:

1. Identify the reasons for the growth in the use of collateral warranties in the construction industry and the introduction of the Contracts (Rights of Third Parties) Act 1999 following the judgment in *Murphy v Brentwood DC*.
2. Explore the development of the law relating to the use of collateral warranties in the construction industry.
3. Explore the introduction and development of the law relating to third-party rights granted under the Contracts (Rights of Third Parties) Act 1999.
4. Evaluate the current state of the Law in England and Wales relating to collateral warranties and rights granted under the Contracts (Rights of Third Parties) Act 1999.
5. Determine if collateral warranties and rights granted under the Contracts (Rights of Third Parties) Act 1999 are equivalent.

6.1 Research Objectives

6.1.1 Objective 1 – Reasons for the use of collateral warranties and the Act

The doctrine of privity of contract, first set out in 1861, prevents a third party from enforcing the terms of a contract even if made for their benefit. Since its inception, the courts have tried to find ways to evade it, creating various exceptions to try to prevent parties from escaping liability for problems they have caused. The tort of negligence was an early route to bypass privity of contract in the construction industry. The law was expanded considerably during the 1960s, 70s and 80s culminating in the decision in *Anns v Merton* which is seen as the beginning of the end of the expansion. Several decisions made gradual steps backwards during the 1980s, with the decision in *Murphy v Brentwood* finally overruling *Anns* and removing that route to claim for pure economic loss.

The multi-party nature of the construction industry means there are usually several third parties involved in most construction projects who derive a benefit from them. Those third parties need an adequate mechanism for recovering losses caused by contractors, consultants, or sub-contractors long after the building contracts have been completed. The tort of negligence could still be used for cases of injury or damage to other property but was no longer an adequate route for recovery of pure economic loss. Collateral warranties had already been used in the industry, but not extensively. It was the shift in the law brought about by the decision in *Murphy* that led to the explosion in the use of collateral warranties but also led to renewed calls for reform of the law of privity. Whilst the Law Commission drafted and carried out their consultation on reform, the construction industry adopted collateral warranties for all situations that required a third party to be granted rights under a construction contract.

6.1.2 Objective 2 – Development of collateral warranty law

When collateral warranties were first used in the industry there were no standard forms. Everything had to be drafted on a per-project basis. The status of the clauses found in all current collateral warranties was unclear, with little judicial consideration to provide clarity. As their usage has grown, disputes have arisen, and the courts have considered the interpretation and validity of various clauses. Assignment and its application to collateral warranties has been considered, resulting in changes to the way collateral warranties are worded to avoid losses disappearing down a legal black hole between an employer and owner. Depending on the wording of the collateral warranty it is possible to set off outstanding payments under the building contract against a claim under a warranty.

It was once thought that a collateral warranty could not be a contract for construction operations under the HGCRA 1996, but the courts have since considered this issue and agreed, up to the Court of Appeal, that it is possible they can be construction contracts. It has also been agreed that they can have retrospective effect without changing that position.

The extensive use of collateral warranties across the industry has helped to bring about the development of the law. Disputes in the interpretation of clauses, or rules relating to the usage and assignment of rights have provided much for the courts to consider, leading to clarity on many standard provisions. It is only through judicial consideration that the law develops.

6.1.3 Objective 3 – Development of third-party rights legislation

The introduction of the Contracts (Rights of Third Parties) Act 1999 followed a long process of consultation beginning in 1991. The Law Commission issued its final report in 1996, but the Bill was not read in Parliament until December 1998 when it was considered in detail before gaining royal assent on 11 November 1999. One of the proposed benefits of the Act was that it could eliminate the need for collateral warranties. Unfortunately, adoption in the construction industry has been slow, partly because collateral warranties were already in heavy usage across the industry, but also partly due to the lack of judicial consideration.

Clarification of the law has predominantly come from outside the industry. An incidental benefit to a third party does not satisfy section 1 so they cannot enforce any terms of the contract. The rebuttable presumption on the intent of enforceability has been interpreted in the third party's favour where the parties to the contract have not provided sufficient evidence that they did not intend the term to be enforceable. The courts have considered the implication of section 1(3) requiring third parties to be expressly identified by name, as a member of a class, or matching a particular description. There has been a bit of fluctuation on this point, but the current position is that the identification of a third party should be viewed against the surrounding circumstances and factual matrix of the particular contract.

The fact that adoption has been slow in the industry has stunted the development of the law of third-party rights. Several difficult elements have been resolved in other industries, but there are still sections within the Act that could use judicial clarification on interpretation and usage in

practice. Unfortunately, this cannot happen if the industry continues to exclude the provisions of the Act from their contracts.

6.1.4 Objective 4 – Current state of the law of third-party rights

The law of third-party rights is still developing. Later this year, or possibly early next year, the Supreme Court will consider the position of collateral warranties as construction contracts, hopefully setting the final word on the subject. The position of the Contracts (Rights of Third Parties) Act 1999 still has a way to go before it will be settled with several provisions and use cases yet to be considered by the courts. The fact that usage of the Act is starting to grow shows that funders and developers are starting to see a benefit in using the Act rather than collateral warranties. It is this increase in usage that will lead to development when disputes arise and end up in front of the TCC.

6.1.5 Objective 5 – Comparison of collateral warranties and the Act

The research has shown that most provisions commonly found in collateral warranties can be included in a schedule of third-party rights using the Act. Some limitations on liability will already be included in the contract, but others can be added. Assignment of contractual rights is possible using either collateral warranties or the Act, but if a limitation is required, then a clause needs to be inserted. This can be done within the collateral warranty or schedule of rights so is easily achieved with either method.

Step-in clauses are commonly required by funders and the general feeling is that although the process is well-known and understood for collateral warranties, it can just as easily be accomplished using the Act. The current edition of the JCT Design and Build Contract already has a provision for granting step-in rights to a funder either through a collateral warranty or through the provisions of the Act. A separate deed of novation would be required to exercise the right of step-in under the Act, where the collateral warranty would be executed by all three parties with specific conditions on when step-in can be exercised.

The primary difference between the rights granted using the two methods is that collateral warranties can, currently, be considered construction contracts for the purposes of referring a dispute to adjudication, whereas rights granted under the Act cannot. This does not mean that a right to adjudicate cannot be conferred on a third party, but it would require careful drafting.

In conclusion, the Contracts (Rights of Third Parties) Act 1999 provides equivalent provisions to collateral warranties in their current form. The only difference is the statutory right to adjudication. Collateral warranties are negotiated with each party required to provide them. That can happen once the main contract has been executed. Rights granted under the Act may require additional negotiation to finalise the main contract, but once agreed, all parties will be providing equivalent rights and there will be no need to chase numerous companies for agreement and execution of individual warranties. There is likely to be a longer lead-in period to the main contract execution, but then there is no further need to negotiate many separate warranties as each new consultant or specialist sub-contractor is appointed. The Act has the potential to significantly reduce the legal fees for major construction projects.

6.2 Recommendations

The Act provides a workable alternative to collateral warranties, but its untested position provokes hesitancy in its use. The advantages available are overshadowed by this but with careful drafting, it is possible to grant third parties the same rights as with collateral warranties. Moving away from the currently untested position would require funders and developers to adopt the Act for their future projects. It is recommended that parties to construction contracts familiarise themselves with the Act to understand the implications and possibilities. Once understood, the parties would then be in a better position to suggest that the Act be used instead of the usual collateral warranties.

A good way to support this would be for large professional bodies, like the RICS, RIBA and CIOB, to provide continuous professional development (CPD) events to their members to increase awareness and understanding across the industry. This would help to promote the Act and increase its usage which is the only way the law will develop and clarity on certain provisions can be provided.

6.3 Limitations and Further Study

This research has been limited to third-party rights granted using collateral warranties and the Contracts (Rights of Third Parties) Act 1999. However, the exceptions developed under the law of tort have continued to develop so there are still avenues to recover using tort rather than contract. There are also several statutes that provide rights. The Defective Premises Act 1972 provides a duty to owners and subsequent purchasers of dwellings that the work is carried out in a workmanlike, or professional manner, with proper materials and such that the dwelling will be fit for habitation when completed.[319] The Latent Damage Act 1986 extends the limitation of a cause of action in negligence for a subsequent owner should a property be transferred before the material facts about the damage become known to the previous owner.[320] Both could have an impact on the mechanisms explored and would add to the depth of the research, but a larger research study would be required to fully explore these.

Finally, the Building Safety Act 2022 brought in wide-ranging changes across the industry including changes to limitation periods in certain circumstances, granted additional rights to specific third parties and defined additional duties in relation to building safety. It is likely that there will be an impact on third parties due to the introduction of this Act. Further research into this would help parties to construction contracts understand their potential liabilities to named and unnamed third parties in the future.

6.4 Self-Reflection

The research process did not follow the plan set out in the research proposal. When starting the research into the first objective, it became apparent that there was significant overlap within the literature. The original plan was quickly abandoned, and the research progressed using a more holistic approach. Quotations and references were added to the relevant section with initial draft notes added to frame the overall dissertation.

[319] Defective Premises Act 1972 s 1(1).

[320] Latent Damage Act 1986 s 3; Bailey, *Construction Law* (n 15) para 10.94.

The chosen methodology, although appropriate, presented difficulties separating the literature review and the main body of the research. This study is essentially an extended literature review focussing on the case law and legislation so there were several occasions where too much detail was included in the literature review, and it had to be reconsidered.

Concluding the findings was also problematic as the aim was to demonstrate how the law has developed along two separate lines. Both the mechanisms discussed are still developing so providing a conclusion to the research almost seemed counter-intuitive. What is clear is that further research needs to be done once the law has matured to see if the conclusions will be any different.

Appendix A – Research Ethics Statement

LLM Dissertation (Construction Law and Practice)

I confirm that I have submitted an application for ethical approval. No further ethical issues were raised.

I also confirm that I carried out my research in accordance with the ethical approval application for which approval was duly granted.

Name: Richard Perry

Signature: 

Student ID: 00651197

Date: 1st September 2023

Appendix B – Word Count Details

The word count of this dissertation consists of all text within chapters 1 to 6 except for the footnote references. No other text prior to chapter 1 and after chapter 6 are applicable.

Applicable Word Count Total: **17,986** words

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