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BRITISH OVERSEAS BANK V STEWART MILNE – SPOTLIGHT ON COLLATERAL WARRANTIES

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SUMMARY

For contracts that typically amount to a few pages, *collateral warranties* undoubtedly generate more than their fair share of case law. Normally, those cases are run of the mill but every now and then one comes along that gives pause for thought.

Such was the case for me with the judgment of the Outer House of the Scottish Court of Session in *British Overseas Bank Nominees Ltd v Stewart Milne Group Ltd*. This case concerned whether a purchaser was out of time to bring a claim against the contractor under a collateral warranty.

What happened?

In August 2008, the developer appointed the design and build contractor, Stewart Milne, to build among other things, some retail units and a car park. The contract was an amended SBCC Design and Build Contract 2005, incorporating Amendment 1 (issued April 2007) and October 2007 Revision. It placed an obligation on the contractor to grant collateral warranties in favour of any subsequent purchasers and tenants.

The development was completed in or around 2009 and sold in June 2013 to the purchaser, which was provided with a contractor collateral warranty. The car park, which had been designed and constructed by the contractor, suffered from flooding at its northern border. Following an investigative report by Colliers International in May 2013, all parties were aware of this issue and further, that the contractor was at fault. The purchaser issued proceedings for the cost of remedying the defects in the car park on 21 June 2018. It claimed that the contractor was in breach of its obligations under the warranty because the flooding resulted from its defective design and construction.

The contractor argued that the purchaser was out of time, on the basis that because the warranty included *no greater liability and equivalent rights of defence* (ERD) provisions, the "prescriptive period" (the Scottish equivalent of the *English law of limitation*) under the building contract, which

ended in June 2014 (five years after *practical completion*) or at the latest May 2018 (five years after the date of the Colliers report), applied to the collateral warranty. The prescriptive period imposed by statute was irrelevant.

The key clauses, which will be familiar to many, were:

> "2.3 The Contractor shall have **no greater duty** to the Beneficiary under this Agreement than it would have had if the Beneficiary had been named as the employer under the Building Contract…
>
> 3.1 The Contractor shall be entitled in any action or proceedings by the Beneficiary to rely on any limitation in the Building Contract and to raise the **equivalent rights in defence of liability** as it would have against the Employer under the Building Contract (other than counterclaim, set-off or to state a defence of no loss or a different loss has been suffered by the Employer than the Beneficiary).
>
> 3.2 No action or proceedings for any breach of this Agreement shall be commenced against the Contractor after the expiry of 12 years from the date of issue of the final statement of practical completion or the equivalent under the Building Contract…"

However, the purchaser responded that its rights under the warranty were not affected by the prescriptive period under the building contract, but were subject to a fresh five year prescriptive period beginning with the grant of the collateral warranty.

The issue boiled down to whether clause 3 of the warranty incorporated a prescriptive period corresponding to that applying to the contractor's liabilities to the employer, or whether the general law of prescription operated in such a way that a new prescriptive period ran from the date of the collateral warranty, on the basis that that was a new and distinct contract.

Outer House decision

At first instance, the Outer House held in favour of the purchaser, ruling that the statutory prescriptive period prevailed. It said that the wording of the collateral warranty did not mean that the purchaser should be treated as "standing in the shoes" of the employer under the building contract. It meant "no more than the content and scope of [the contractor's] duties were equivalent to those it owed to [the employer]."

As regards the ERD clause, the court accepted that prescription would amount to a "defence of liability" but held that this would not be a defence arising under the building contract within the meaning of the clause. Neither of these clauses therefore had the effect of binding the purchaser to the prescriptive period under the building contract.

In short, despite the inclusion of no greater liability and ERD provisions the court ruled that the law of prescription prevailed and so the purchaser could bring its claim.

My reaction

Although the court was careful to say that the judgment was only relevant to collateral warranties governed by Scots law (because the law of prescription differs from the English law of limitation), the result felt odd to me.

First, because it was at odds with what the parties had expressly agreed in their collateral warranty. How could the court's interpretation of the collateral warranty (importing the law of prescription to derail express contractual wording) be reconciled with the *established principles of contractual interpretation* applied in both English and Scottish cases?

Also, logically, absent express contractual agreement to the contrary, why would the warranty, an agreement which was simply "collateral" to the main contract, have a different limitation period to that under the main contract? How would this work commercially? Why would the contractor sign up to that?

What made it more surprising was that the decision came shortly after the (English) case of *Swansea Stadium Management Company Ltd v City & County of Swansea and another*. This considered the same issue but here the court held that the limitation period under the collateral warranty ran from the date of practical completion under the building contract.

You may ask why I was so perplexed by a Scottish case that made clear it would have little application to English law collateral warranties. Well, regardless of the weight that the case may be accorded in subsequent judicial reasoning, it nonetheless opened the door for potential challenges to the *Swansea* view of how greater liability and ERD clauses work (*Blyth & Blyth* anyone?) and this would have implications for all collateral warranties regardless of the governing law.

For all these reasons I was interested to see what the Inner House had to say when the case was heard on appeal.

Inner House decision

On appeal, the *Inner House overturned the first instance ruling* and held in favour of the contractor.

In a clear and well-reasoned judgment, the court made clear that its decision was based on the principle of "equivalence". This is the idea that the fundamental purpose of a collateral warranty is to place the beneficiary and the contractor in an equivalent position to the original employer and contractor. This means that the contractor's obligations to the beneficiary should not be extended beyond those undertaken in the original contract. Therefore, the beneficiary should have the same affirmative rights of action as the original employer with those rights of action subject to the same qualifications, limitations and defences as available to the contractor under the original building contract.

The court noted the importance of time-bar provisions to a contractor and said that the collateral warranty should normally be subject to the same time bar as applied to the original building contract. However, it was open to the parties to agree a different time bar (which could be shorter than the statutory period), subject to the mandatory nature of the statutory law of prescription. It said:

> "…the policy reasons for doing so are obvious: it provides the parties with closure, and avoids any risk arising from the loss of evidence as a result of the passage of time…"

Final thoughts

It is pleasing to see that this judgment aligns with the *Swansea* interpretation of how time bars should operate under collateral warranties. Given that the parties expressly agreed the contractual provisions that created the prescriptive period, it seemed very odd that the operation of the "default" statutory prescription could then disapply it. The message that practitioners continually give to their clients about saying exactly what they mean in their contract would not have held true if the first instance judgment had been upheld. So it's good to see that order has been restored. Until of course the next time…

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