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COMMERCIAL COMMON SENSE IN THE TIME-BARRING OF CLAIMS UNDER COLLATERAL WARRANTIES IN SCOTLAND

- Recent Scottish Appeal Court case favours commonly understood interpretation of prescription of claims in respect of latent defects.
- Scots Law of prescription clarified, bringing more similarity with English law position.
- Key principle of "equivalence" between obligations under building contracts and collateral warranties.

WHAT HAPPENED BEFORE?

Earlier in 2019, we reported on the Scottish Outer House (first instance) decision in the case of *British Overseas Bank Nominees & Henderson v Stewart Milne Group Limited*, which considered whether – under Scots law – a collateral warranty granted by a contractor in favour of a beneficiary created a fresh prescriptive period for claims under that warranty in relation to known defects. The case dealt with defects apparent at the point of purchase of the asset, and known about at the date of grant of a fresh collateral warranty by the contractor in favour of the purchaser (the Pursuer in the case). A claim in relation to the same defects under the building contract would have prescribed as being more than five years following the date on which the defects became apparent, but the court held that the warranty started a new prescriptive clock ticking in respect of claims brought under it, and therefore accepted the Pursuer's argument that its claim could proceed.

The Defender in the case - Stewart Milne Group Limited - had designed and constructed a car-park in Inverurie under an SBCC Design & Build (2007 revision) contract. Practical Completion was achieved in 2009. Henderson purchased the car-park in June 2013, and Stewart Milne granted Henderson a fresh collateral warranty during the August of that year. In June 2018 – less than five years following the grant of the warranty, Henderson raised proceedings against Stewart Milne in respect of defects in the car-park – the key point in Henderson's claim being that the warranty created a fresh five-year period in which it was entitled to bring its claim.

The decision in the case caused some discussion amongst practitioners and in the industry. For the granters of collateral warranties, the Outer House decision clearly would make granting fresh collateral warranties after the date of practical completion a riskier enterprise, given a fresh prescriptive period would commence in relation to claims under them. For owners of commercial property – for whom the delivery of a construction package is a key element of the marketability of the asset – obtaining fresh collateral warranties suddenly became a much more difficult exercise, if it wasn't difficult enough already.

SO WHAT'S HAPPENED NOW?

Perhaps unsurprisingly, the contractor appealed. The decision of the Scottish Inner House has been to reverse the original decision. In a clear statement, the Court held that the Pursuer's claim had prescribed given the passage of time since the relevant defect became apparent. There are several strands to the Court's decision, but the impact for practitioners, industry professionals, and granters of warranties is relatively clear:

- the Court placed emphasis on the "equivalence" of obligations under a building contract (or consultancy appointment) and under a collateral warranty granted by the same party. The granting of a warranty did not start a fresh "five-year clock" running;
- the commercial purpose of a collateral warranty was to extend the rights available under a building contract or consultancy appointment to particular parties, but not to extend the quality of the rights themselves. The commercial purpose of the warranty was not to put the Beneficiary in a "better" position than the original Employer;
- "no greater liability" and "equivalent defence" clauses affected the duration and quality of the rights on offer. In the context of prescription (the time available to bring a claim), these clauses meant that the same prescriptive period applicable under a building contract or appointment applied under a collateral warranty granted pursuant to it.

SO WHAT?

This case is important both from a legal and a commercial perspective.

Legally, the impact of the 1973 Prescription and Limitation (Scotland) Act has been clarified – while section 13 of this Act expressly prohibits parties contracting out of the Act's provisions on the prescriptive periods relating to claims, the Stewart Milne appeal decision confirms that the common limitation clauses in building contracts and collateral warranties do have the effect of capping the 20-year period of long negative prescription – usually to the shorter period of 10 or 12 years from the date of practical completion.

Commercially, the possible loophole which had been created by the Outer House decision has now been firmly pulled shut – the position is now relatively clear that the granting of a fresh collateral warranty does not create a fresh five-year period for a claim relating to a known defect. Where the building contract or consultancy appointment contains a contractual limitation period on raising claims, that limitation period will carry through and constrain the ability of a Beneficiary to bring its own claim under the warranty.

SO DOES THIS CHANGE ANYTHING?

The period between the Outer House and Inner House decisions in this case has seen many industry professionals, consultants, and contractors take fresh legal advice on this subject. Regardless of the outcome of the appeal, many will now be more reluctant to grant fresh warranties following the achievement of practical completion (even although the Inner House decision arguably re-establishes the law as many understood it before the case was brought).

In Kier Construction v WM Saunders (2016), the Scottish Courts established that the obligation to grant a collateral warranty could be enforced through the courts years after completion of the Works, provided the underlying obligation was still valid. Owners of commercial property assets should now not assume that contractors or consultants will voluntarily grant such warranties at the first time of asking where the request comes after practical completion - at which point the Employer has far less leverage to seek the granting of fresh warranties. Raising court proceedings to enforce the obligation to grant the warranty may be required.

In terms of commercial property purchase transactions, more reliance may be placed on pre-purchase surveys and the warranties given by sellers to their purchasers. Where assets are sold subject to known defects, we may see purchasers becoming more protective of their position and demanding more in the way of contractual protection from sellers, given that five-year prescriptive "clocks" may already be running in respect of those defects.

SO IS EVERYTHING SETTLED?

While the *Stewart Milne* Appeal decision should allow the waters to calm on this subject, there is further change coming, in the form of the Prescription (Scotland) Act 2018. The Act is not yet in force, but it will bring about further tweaks to the law in this area.

We will cover the new Act, and its impact on construction contracts, in further editions of Constructive Comments.

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