OUTER HOUSE, COURT OF SESSION

[2018] CSOH 125

CA64/18

OPINION OF LADY WOLFFE

In the cause

(FIRST) BRITISH OVERSEAS BANK NOMINEES LIMITED; (SECOND) WGTC NOMINEES LIMITED, together as nominees and trustees for the Janus Henderson UK PROPERTY PAIF

Pursuers

against

STEWART MILNE GROUP LIMITED

Defender

Pursuer: Thomson QC; Brodies LLP
Defender: McKenzie; Anderson Strathern LLP

21 December 2018

Introduction and background

Précis of circumstances giving rise to debate

[1] The car park at a retail park developed in 2009, designed and constructed by the defender, is averred to be subject to ponding and flooding at its northern boundary. The pursuers acquired the site on 27 June 2013. In reliance on a collateral warranty in their favour dated 24 June and 28 August 2013 ("the Collateral Warranty"), the pursuers sue the defender for breach of various obligations defined by reference to a building contract entered into between the defender and the pursuers' predecessors as owners of the site.

[2] The defender argues that, at the time these proceedings were raised, any claim Northburn would have had against the defender would have been extinguished by prescription and, it has a defence in the form of a contractual bar against a like claim by the pursuers. The defender also argues that, properly construed, the pursuers, as beneficiaries under the collateral warranty, can have no higher right than the original counterparty.

[3] The pursuers' reply is to argue that, on delivery of the Collateral Warranty to the pursuers, after its execution, the defender came under the obligations to the pursuers including those obligations which arose under clauses 2.1 and 2.2. Prior to the delivery of the Collateral Warranty to the pursuers, the defender owed no contractual obligations to the pursuers.

[4] These issues were argued at debate.

Background

The Building Contract between the defenders and a third party (Northburn)

[5] The defender entered into a building contract (the "Building Contract") with Northburn Developments Limited ("Northburn") dated 20 and 21 August 2008 for the design and construction of eight new retail units to developer's shell standard, together with garden centre slab, sundry tenant fit-out works and associated car parking, service yards and related external works (the "Works") at Souterford Road, Uryside South, Inverurie (the "Site").

[6] The Building Contract was in the form of the SBCC Design and Build Contract for use in Scotland (DB/Scot) 2005 Edition October 2007 Revision, as amended by the document entitled "Amendments to the SBCC Design and Build Contact for use in

Scotland 2005 incorporating Amendment 1 (Issued April 2007) and October 2007 Revision". In the Building Contract, Northburn was referred to as the Employer and the defender as the Contractor.

Allegedly defective works

[7] The defender carried out the Works in terms of the Building Contract. As part of the Works, the defender designed and constructed the car parking area at the Site. The Works were completed in or around 2009. The pursuers' case is that, in carrying out the Works, the defender had breached various obligations which it owed in terms of the Building Contract. The pursuers aver that the "[d]efender's design and construction of the Works did not comply with the terms of clauses 2.1, 2.2, 2.11 and 2.17 of the Building Contract. The car park at the Site, as designed and constructed by the [d]efender, suffers from flooding at its northern boundary. A properly designed and installed car park would not suffer from flooding in ordinary course." The alleged failures of design and construction are further particularised. The detail of these alleged breaches do not matter for present purposes. It suffices to note that the pursuers' claim is based on the Collateral Warranty granted in their favour in the following circumstances.

The pursuers' acquisition of the Site and the Collateral Warranty in their favour

[8] The pursuers became the owner of the Site (and the buildings/development which had been constructed thereon by the defender in terms of the Works carried out under the Building Contract) pursuant to missives entered into between them and Northburn dated 27 June 2013 (comprising two letters) (the "Missives"). In terms of the Missives, the date of entry was 27 June 2013. Further, again in terms of the Missives, Northburn was obliged

to deliver to the pursuers various collateral warranties, including a Collateral Warranty in the pursuers' favour executed by the defender.

The Collateral Warranty

[9] The collateral warranty by the defender in favour of the pursuers provided *inter alia* as follows:

> "2.1 The Contractor [ie the defender] warrants and undertakes to the Beneficiary [ie the pursuers] that it has carried out and completed and will carry out and complete the Works in accordance with and subject to the terms of the Building Contract, and that it has observed and performed and will observe and perform all of its duties and obligations expressed in or arising out of the Building Contract.
>
> 2.2 The [defender] further warrants and undertakes to the [pursuers] that the design of the Works and the selection of goods, materials, plant and equipment for incorporation in the Works have been or will be designed or selected with all the reasonable skill, care and attention to be expected of a prudent and experienced, properly qualified and competent designer of the relevant discipline with experience of developments of a similar size, scope, complexity and value to the Development all to the same effect as if the [defender] had been appointed by the [pursuers]."

[10] For its part, the defender relies on clauses 2.3 and 3.1 of the Collateral Warranty, as follows:

> "2.3 The [defender] shall have no greater duty to the [pursuers] under this Agreement than it would have had if the [pursuers] had been named as the employer under the Building Contract.
>
> ...
>
> 3.1 The [defender] shall be entitled in any action or proceedings by the [pursuers] 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 [ie Northburn] under the Building Contract ..."

[11] Counsel referred to clause 1 of the Collateral Warranty, which provided *inter alia*:

> "[T]he provisions of Clause 1 of the Building Contract Conditions regarding interpretation and construction shall be repeated herein."

[12] For present purposes, the only provision of Clause 1 of the Building Contract regarding interpretation and construction which the defender drew to the attention of the Court is the following in clause 1.4:

> "1.4 In the Agreement and these Conditions and the Schedule, unless the context otherwise requires:
>
> .1 the headings are included for convenience only and shall not affect the interpretation of this Contract;
>
> …"

[13] The defender's counsel submitted that, pursuant to this clause, the headings in the Collateral Warranty should be regarded as being included for convenience only, and not as affecting the interpretation of the Collateral Warranty.

Submissions on behalf of the defender

Motions

[14] Mr McKenzie, who appeared on behalf of the defender, moved the following motions:

1) The defender's primary motion was for the court to sustain the defender's first and third pleas-in-law and to dismiss the action. The defender's first plea was to the relevancy and its third plea was in the following terms:

> "The defender, pursuant to clauses 2.3 and 3.1 of the Collateral Warranty having no liability to the Pursuers in consequence of having no liability to the Employer under the Building Contract in respect of the alleged breaches of the Building Contract presently founded upon by the Pursuers, any such liability having been extinguished by operation of prescription by the time the present action was raised, decree of absolvitor should be pronounced."

2) In the alternative, the defender invited the Court to sustain the defender's first plea-in-law to the extent of excluding from probation the averments (namely, in Article 6 of Condescendence, from "With reference to the Defender's averments in answer" to the end of the article), and thereafter to put the case out By Order for a discussion on further procedure.

3) In addition to either 1 or 2 above, the pursuers' first plea-in-law should be repelled (at least so far as the issues to be debated are concerned), and the pursuers' second plea-in-law should also be repelled.

Outline of defender's argument

[15] The pursuers aver that the defender breached the obligations set forth in clauses 2.1 and 2.2 of the Collateral Warranty, in respect that the defender's design and construction of the Works did not comply with various clauses of the Building Contract. Breach of the Building Contract is an essential component of the pursuers' claim. The defender denies having failed to comply with the Building Contract. However, on the denied hypothesis that the defender did fail to comply with the Building Contract as averred by the pursuers, the defender also avers that any obligation which the defender may have owed to the Employer (ie Northburn) under the Building Contract to make reparation therefor was extinguished by the operation of prescription by 19 June 2014 or, at the latest, by the time the Summons was served in the present action on 21 June 2018.

[16] The defender submitted that, as any obligation which it may have owed to Northburn in respect of breach of the Building Contract had been extinguished by operation of prescription then, on the proper construction of the Collateral Warranty, the pursuers are contractually barred from succeeding against the defender in the present

action. Further, contractual bar is an equivalent defence of liability in the present action to the defence of prescription which the defender would have had against Northburn under the Building Contract. That is the result of textual analysis of the Collateral Warranty set in its factual and legal context, and is consistent with commercial or business common sense.

[17] Furthermore, the defender submitted that the onus was on the pursuers to prove that their claim is not contractually barred. If the defender's submission as to the proper construction of the Collateral Warranty is well founded, then it is for the pursuers to prove that any obligation which the defender owed to Northburn to make reparation for breach of the Building Contract in respect of the matters condescended upon remained extant at the time the Summons in the present action was served. The pursuer does not make any averments which would allow it to lead the evidence necessary to prove that matter.

Relevant principles of contractual construction

[18] The defender noted that the legal principles to be applied in relation to the construction of a commercial contract in Scots law are well established. They are summarised by the First Division in *Midlothian Council* v *Bracewell Stirling Architects* [2018] PNLR 25; [2018] CSIH 21 at [19], as follows:

> "The court must ascertain the intention of the parties by determining what a reasonable person, having the background knowledge of the parties, would have understood from the language selected by them (*Arnold* v *Britton [2015] A.C. 1619*, Lord Neuberger at [15], applied in *@SIPP Pension Trustees* v *Insight Travel Services 2016 S.C. 243*, Lady Smith, delivering the Opinion of the Court, at [17] and *HOE International* v *Andersen 2017 S.C. 313*, Lord Drummond Young, delivering the Opinion of the Court, at [19]). The meaning of the words used must be assessed having regard to other relevant parts of the Agreement. In the event that there are two possible constructions, the court is entitled to prefer one

which is consistent with business common sense ..."

[19] From the cases referred to in that summary, the defender emphasised the following as particularly relevant observations from Lord Neuberger in *Arnold* v *Britton*, where he emphasises four matters at [17]-[22]:

(1) commercial common sense should not be invoked to undervalue the importance of the language used by the parties in the contractual provision being construed;

(2) that whilst poor drafting makes it easier to depart from the natural meaning and clear drafting makes it more difficult to do so, the court is not thereby justified in embarking on an exercise of searching for or constructing drafting infelicities so as to facilitate such departure;

(3) that commercial common sense is only relevant to how matters would have been perceived at the time of contracting and is not to be invoked retrospectively; and

(4) although commercial common sense is very important the court should be slow to reject the natural meaning of a provision as correct simply because it seems a very imprudent term for one of the parties to have agreed, the purpose of interpretation being not to identify what the court thinks the parties ought to have agreed but what they have in fact agreed. (See *@SIPP Pension Trustees*).

[20] Mr McKenzie also referred to two further observations in relation to the construction of contracts. The first was by Lord Hodge in *Wood* v *Capita Insurance Services Ltd* [2017] AC 1173 at paragraphs [12] and [13]:

"This unitary exercise involves an iterative process by which each suggested

> interpretation is checked against the provisions of the contract and its commercial consequences are investigated: the Arnold case, para 77 citing *In re Sigma Finance Corpn [2010] 1 All ER 571*, para 12, per Lord Mance JSC. To my mind once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.
>
> Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements. Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But negotiators of complex formal contracts may often not achieve a logical and coherent text because of, for example, the conflicting aims of the parties, failures of communication, differing drafting practices, or deadlines which require the parties to compromise in order to reach agreement. There may often therefore be provisions in a detailed professionally drawn contract which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process, of which Lord Mance JSC spoke in *Sigma Finance Corpn [2010] 1 All ER 571*, para 12, assists the lawyer or judge to ascertain the objective meaning of disputed provisions."

He also referred to Lord Drummond Young's observation that "In giving a contract a contextual interpretation it is clear that the legal context must be considered as well as the factual context.": *Grove Investments Ltd* v *Cape Building Products* 2014 Hous LR 35, [2014] CSIH 43, at [12]. The defender submitted that the subsequent explanation of *Grove Investments* which was given by the Court in *@SIPP Pension Trustees* at [43]-[44] does not qualify or affect this particular statement.

[21] Counsel then turned to identify the context relevant to the interpretation of the Collateral Warranty.

The factual and legal context relevant to construction of the Collateral Warranty

[22] Under the Building Contract the defender was obliged to provide to Northburn, within 21 days of written notice to do so, duly executed Collateral Warranty agreements from the defender in favour of *inter alia* the "Purchaser" in the form set out in Schedule Part 11 to the Building Contract. Schedule Part 11 to the Building Contract contained a form of Collateral Warranty Agreement, which provided the following at clause 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."

The same long-stop clause was found in the Collateral Warranty which is the subject of the present proceedings.

[23] For present purposes, what Mr McKenzie took from this was the following:

(1) The defender was under an obligation in the Building Contract to grant Collateral Warranties, in the form set out therein, to *inter alia* the Purchaser upon written notice to do so;

(2) Northburn could give the requisite 21 days written notice to the defender to provide such a Collateral Warranty, eg in favour of a Purchaser, at any time after execution of the Building Contract;

(3) But, as no action or proceedings for any breach of the Collateral Warranty could be commenced by the beneficiary thereof after the expiry of 12 years from the date of issue of the final statement of practical completion or its equivalent under the Building Contract, it follows that in order for any warranty to be of practical value to a Purchaser, Northburn would have to give the requisite written notice to the defender

more than 21 days before the expiry of the 12 year period; and

(4) The defender might not be required to grant a Collateral Warranty to a Purchaser such as the pursuers until some very considerable time after practical completion under the Building Contract – the time could be 10 or 11 years after practical completion, for example.

[24] The purpose of a collateral warranty is to provide a right of action between parties who, under the standard legal structures used in construction contracts, would not otherwise be in any contractual relationship. It thus confers title to sue on the grantee of the warranty. There is no reason that any person who becomes liable for the cost of repairing a defect in a building should not sue for the cost, provided that he is the beneficiary of a collateral warranty provided by the person responsible for the defect, and provided that the collateral warranty is in terms that are habile to recover that cost: *Scottish Widows Services Ltd* v *Harmon/CRM Facades Ltd (In Liquidation)* 2010 SLT 1102 at [17] and [18]. A collateral warranty creates a right of action where one would otherwise ordinarily not exist. In essence, it fills a gap in order that the party who might eventually suffer loss but who has no contractual nexus with the wrongdoer can sue. It would not ordinarily be used to create additional rights which the original creditor under the building contract would not have (or has lost or given up).

Clause 3.1

[25] In relation to clause 3.1, Mr McKenzie submitted that:

(1) prescription is a "*defence of liability*";

(2) prescription is a defence of liability "*under the Building Contract*";

(3) in any event, the phrase "*under the Building Contract*" is a descriptive phrase

which relates to claims which might be brought by Northburn, not to defences which might be advanced by the defender; and

(3) the equivalent to the defence of prescription, which the defender would have against Northburn, is that of contractual bar based upon liability for breach of the equivalent obligation owed to Northburn having been extinguished by operation of prescription.

He developed those submissions as follows.

Prescription is a "defence of liability"

[26] Prescription is a "*defence of liability*" because, when it operates in the context of breach of contract, it extinguishes the obligation to make reparation: (sections 6(1) and (2) of the Prescription and Limitation (Scotland) Act 1973 ("the 1973 Act"), and Schedule 1, paragraph 1(d). In this regard it sits in contrast to limitation, where the underlying obligation is not extinguished: *Dunlop* v *McGowans* 1979 SC 22 per the Lord Justice Clerk at p34, as mentioned in *Pelagic Freezing Ltd* v *Lovie Construction Ltd* [2010] CSOH 145 at [92]. If a plea of prescription is upheld, the appropriate decree is one of *absolvitor* rather than dismissal, reflecting the fact that no liability can be established. Prescription was, it was submitted, the paradigm example of a "*defence of liability*". There was no reasonable construction of the phrase "*defence of liability*" which would not include a plea of prescription.

Prescription is a defence of liability 'under the Building Contract'

[27] Furthermore prescription was a defence of liability that the defender would have against Northburn "*under the Building Contract*". The phrase "*under the Building Contract*"

does not mean the same thing as "*pursuant to the terms of the Building Contract*". The phrase "*under the Building Contract*" is wide enough to include defences to contractual claims which arise by operation of law. This was reinforced when regard was had to the words used by the parties themselves as comprising examples of those defences of liability "under the Building Contract" which are *not* to be available to the defender, namely "counterclaim", "set-off" or "to state a defence of no loss or a different loss has been suffered by the Employer than the Beneficiary". A counterclaim is, obviously, not what one would ordinarily describe as a defence of liability: if established, a counterclaim may provide a basis for "set-off" or compensation, which in turn may extinguish liability: *Inveresk plc* v *Tullis Russell Papermakers Ltd* 2010 SC (UKSC) 106 *per* Lord Hope at [30] and Lord Rodger at [71]. The mere fact that a counterclaim exists did not of itself affect the question of a defender's liability to the pursuer under the principal claim. Nevertheless, parties here have agreed, by their express use of language, that "counterclaim" is to be regarded as a defence of liability under the Building Contract for the purposes of clause 3.1 of the Collateral Warranty. Similarly, while set-off *may* be a defence of liability, it arises by operation of law, not pursuant to any particular contractual provisions, and yet parties have agreed, by their express use of language, that it is to be regarded as a defence of liability "under the Building Contract". Again similarly, a defence of "no loss" or "different loss" is not a defence which would depend upon any particular provisions being contained in the Building Contract, but is one which would arise from the normal legal rules on title and interest to sue and on the recoverability of damages: and yet parties have agreed, by their express use of language, that such defences are to be regarded as defences of liability under the Building Contract.

[28] The defence of prescription arises no less "under the Building Contract" than

does "counterclaim", "set off" or to state a defence of "no loss or a different loss has been suffered by the Employer than the Beneficiary". Yet it was submitted, that what was striking was that the parties had chosen *not* to exclude, from the "equivalent rights in defence of liability … under the Building Contract" which the defender is entitled to rely on, the defence of prescription.

[29] The effect, it was submitted, was that an equivalent to the defence of prescription *is* available to the defender in any action or proceedings by the pursuers, if the defence of prescription would have been available to it in a question with Northburn. The phrase "under the Building Contract" was a descriptive phrase which related to claims which might be brought by Northburn, not to defences which might be advanced by the defender.

[30] It was submitted further, that, standing the difficulties of describing "counterclaim", "set-off" and to state a defence of "no loss or a different loss has been suffered by the Employer than the Beneficiary" as defences "under the Building Contract", the better reading of clause 3.1 was as follows (words added in bold):

> "… and to raise the equivalent rights in defence of liability as it would have against the Employer [**in respect of claims arising**] 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)."

[31] On this alternative approach the defences of "counterclaim", "set off" and stating a defence of "no loss or a different loss has been suffered by the Employer than the Beneficiary" would not need to be considered as a list of what the parties consider to be defences "under the Building Contract". The phrase "defence of liability" would not be qualified by "under the Building Contract", and on that footing the defence of prescription would, it is submitted, plainly be a "defence of liability".

[32] On either approach, however, it was submitted the result is the same. For these reasons, prescription was either a "defence of liability … under the Building Contract", or it is a "defence of liability in respect of claims arising under the Building Contract". The equivalent defence to prescription, which the defender would have against Northburn, is that of contractual bar, based upon the equivalent obligation owed to Northburn having been extinguished by operation of prescription.

[33] Counsel for the defender argued that clause 3.1 spoke of the equivalent rights in defence of liability. Perhaps obviously, the clause does not require the same rights in defence of liability. Where the defence of liability which the defender would have against Northburn does not also exist against the pursuer, the question was: what was the equivalent right in defence of liability?

[34] In the case of prescription, the defender submitted that if the defence of prescription would have been available to it as against Northburn, the equivalent right in defence of liability in a question with the pursuers was contractual bar. If prescription has operated as against Northburn in respect of any particular matter, the pursuers are not entitled to succeed against the defender in respect of the same underlying matter, by virtue of the terms of the Collateral Warranty. Counsel then turned to the terms of clause 2.3.

Clause 2.3

[35] With reference to clause 2.3, the defender submitted simply that the word "duty" is synonymous with "obligation". On that footing, clause 2.3 may be read as (word substituted in bold):

> "The Contractor shall have no greater **obligation** to the Beneficiary under this

> Agreement than it would have had if the Beneficiary had been named as the employer under the Building Contract."

[36] The obligation with which the present action was concerned was the obligation to make reparation. If any obligation to make reparation to the Employer (ie Northburn) under the Building Contract would have prescribed before the present action was raised, the defender's obligation to the pursuers under the Collateral Warranty would be greater in duration than that owed to the employer, unless the court were to hold that the passage of time as against the Employer also counted against the pursuers. The court was invited to so hold, thereby giving effect to clause 2.3.

[37] The pursuers argue that the effect of clauses 2.3 and 3.1 of the Collateral Warranty was to ensure that, at the date of delivery of the Collateral Warranty, the pursuers acquired under the Collateral Warranty rights against the defender which were commensurate with the rights which were then possessed by Northburn against the defender under and in terms of the Building Contract. The critical point was that in order for the rights acquired by the pursuers under the Collateral Warranty to be "commensurate" with the rights which were then possessed by Northburn against the defender under and in terms of the Building Contract, it was necessary to take account of the passage of time in relation to Northburn's rights. In other words, if the right possessed by Northburn (ie the right to reparation in respect of loss suffered as a result of the breaches of contract now founded upon by the pursuers) was one which had been in existence for four years, it followed that the right may only have one year left before it would be extinguished by operation of prescription. In order for the pursuers to acquire a "commensurate" right under the Collateral Warranty, it is necessary that the pursuers acquire the right subject to the temporal restriction, imposed by the 1973 Act, which

exists as against Northburn. Otherwise the pursuers would obtain a greater, more extensive, right than Northburn (ie one which will not be extinguished for 5 years rather than one which may be extinguished after 1 year).

[38] The question of equivalence had been considered by O'Farrell J in the Technology and Construction Court ("the TCC") in *Swansea Stadium Management Company Limited* v *City and County of Swansea and Interserve Construction Limited* [2018] EWHC 2192 (TCC) at [49] and [53]. The clause before the TCC had slightly different wording to clause 2.3. In that case the clause was:

> "Provided that the Contractor shall have no greater liability under this Agreement than it would have had if the Beneficiary had been named as joint employer with the Employer under the Contract".

The TCC stated:

> "[49] Firstly, the purpose of the Collateral Warranty was to provide a direct right of action by the Claimant against the Second Defendant in respect of its obligations under the Building Contract to which the Claimant was not a party. Such purpose was served by a warranty that gave the Claimant the same rights against the Second Defendant that it would have had if there had been privity of contract but did not require any extension of those rights …
>
> [53] Mr Mort submits that the proviso to clause 1 is concerned with the nature and scope of the obligations giving rise to any liability but does not extend to cover the duration of any duty or the timing of any claim. He submits that the plain purpose of the proviso is to ensure that by providing the undertakings in the Collateral Warranty, which may or may not correspond precisely with the terms of the Building Contract, the Second Defendant is not agreeing to some more onerous obligation than it had under the Building Contract, or that it would have owed to the Claimant had the Claimant been an employer under the Building Contract. In my judgment, that interpretation would not be an accurate reflection of the words used. The reference in the proviso to the Claimant's position being as if it 'had been named as joint employer' is a clear indication that the parties intended the Claimant to stand in the shoes of the employer. The Second Defendant's liability to the Claimant was intended to be coterminous with its liability to the employer under the Building Contract. One must look to the Second Defendant's liability under the Building Contract to determine the limits of its liability under the Collateral Warranty."

[39] In a similar vein, in *Friends Provident Life Assurance Ltd* v *Sir Robert McAlpine Limited* [2014] CSOH 74 at [25] Lord Woolman was concerned with a collateral warranty which "envisages equivalence between the claims of WDL [the employer under the building contract] and the person who has the benefit of the warranty." The wording in question was that the defender: "shall owe the same but no greater duty and shall be under no greater liability in scope or quantum to the Purchaser hereunder in respect of the performance of the Building Contract than the duty it owes and the liability it has to the Client pursuant to the Building Contract."

[40] The court was invited to hold that when clause 2.3 of the Collateral Warranty spoke of the Beneficiary having been named as the employer under the Building Contract, and when clause 3.1 spoke of the defender being entitled 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, these were clear indications that the parties intended the pursuers to "stand in the shoes" of Northburn and that they expected "equivalence" between the claims of Northburn and the claims of the pursuers.

Commercial common sense

[41] Mr McKenzie submitted that the defender's proposed construction of the Collateral Warranty was the more commercially sensible construction, for a number of reasons. First, on the pursuers' construction, a breach of the Building Contract by the defender could have occurred at the date of practical completion (in 2009 according to the pursuer's averments). Material physical damage resulting therefrom could have occurred in, say, early 2010. Northburn could have raised proceedings in, say, late 2016. The defender could have raised a prescription defence and the court could have

sustained that defence by, say, late 2018.

[42] And yet, according to the pursuers' construction, the pursuers would be entitled to succeed in proceedings raised under the Collateral Warranty in, say, late 2019 (suppose that they purchased and became the beneficiary of the Collateral Warranty in early 2019), in respect of the same breach of the Building Contract as had been unsuccessfully relied upon by Northburn. It was submitted that such a result was very unlikely to have been the intention of the parties. There was no obvious reason why the defender would, objectively, intend to bring about such a result at the time of contracting. Nor was there any obvious reason why the pursuers, reasonably, would insist on such a result at the time of contracting.

[43] In this regard it should be noted that a purchaser, such as the pursuers, at the time of contracting, was in a position to carry out due diligence in relation to its proposed purchase (for example by having surveys done). Indeed, it appeared that the pursuers did so in the instant case. Purchasers such as the pursuers were therefore in a position to protect themselves in relation to any defects, for which the contractor was responsible, and which had already manifested themselves in the subjects of purchase, through their contract with the sellers of the building and in their contracts with professionals such as surveyors who act for them. A contractor, in contrast, was not likely to be in a position to protect itself in any question with the proposed purchaser in relation to any such defects, because it would be under an existing obligation, under the building contract, to enter into a collateral warranty on terms which there may be little if any scope to alter at the time the warranty comes to be entered into.

[44] The purpose of prescription was to cut off stale claims, not least because of the risk of loss of evidence: see *Johnston, Prescription and Limitation* (2nd ed) at

paragraphs 1.58 to 1.62. It did not make commercial sense to impute to parties an intention to create a fresh prescriptive period in respect of existing, manifest, defects when a collateral warranty was granted (at least absent very clear wording to bring about such a result).

The onus of proof

[45] In *Pelagic*, Lord Menzies had to deal with the question of onus in the context of prescription. At paragraphs [93] to [95] he said:

> "93 … However, I find it difficult to understand why there should be a burden on a defender of proving that a pursuer has no legal right of action. As Mr Johnstone observes in his discussion on this subject, the difficulty of the general rule that the burden of proof falls on the party who asserts the affirmative lies in deciding what is the affirmative. The proposition that the pursuer has an existing legal right of action is no less an affirmative proposition than the proposition that a right of action has prescribed.
>
> 94 In the present case, the pursuers come to court asserting that they have an existing legal right against the defenders. The defenders deny the existence of that legal right by raising the issue of its extinction by prescription. Viewed in this light, I consider that the burden of satisfying the court that they have a legal right of action against the defenders rests with the pursuers.
>
> 95 It does not seem to me that there is anything innately unfair or contrary to principle in requiring the pursuers to satisfy the court that they have a legal right of action. There is no greater difficulty for the pursuers in discharging the burden of proof than there would be for the defenders …"

[46] That approach was followed by Temporary Judge Wise QC (as she then was) in *Santander UK plc* v *Allied Surveyors Scotland plc* 2011 SCLR 249 (at [34]). It was submitted that Lord Menzies' reasoning was apt in the present context as well as in the context of prescription.

[47] In the present case the pursuers asserted the continuing existence of their cause

of action. The defender disputed this, on the basis of (i) its construction of the parties' contract, and (ii) the factual position as regards prescription of any obligation owed by it to Northburn. By parity of reasoning, it was submitted that if the defender's construction of the parties' contract was accepted and the pursuers were to continue to assert the existence of their cause of action, the onus was on the pursuers to prove that any obligation owed by the defender to Northburn had *not* been extinguished by the operation of prescription prior to commencement of the present proceedings.

[48] However, the pursuers' pleadings contain no averments of facts which would enable them to satisfy that onus at proof. That is the basis upon which the defender seeks, in its primary motion, dismissal of the action.

Conclusion

[49] For the foregoing reasons, it was submitted that the defender's construction of the Collateral Warranty should be preferred, and the case disposed of as indicated in its motion.

Submissions on behalf of the pursuers

Motions

[50] Mr Thomson QC, who appeared on behalf of the pursuers, made the following motions:

1) For the court to sustain their second plea-in-law, and to exclude from probation certain averments. On that basis, the defender's third plea-in-law should be repelled.

2) The pursuers further submitted that their own averments anent the

proper construction of the Collateral Warranty were relevant and that, accordingly, the defender's first plea-in-law should be repelled (at least so far as the issues to be debated are concerned).

The pursuers' principal argument

Précis of defender's position

[51] The pursuers sue as the beneficiaries of the Collateral Warranty granted in their favour by the defender. The dispute between the parties concerned the proper construction of the Collateral Warranty, particularly clauses 2.3 and 3.1.

[52] The defender's pleaded position, in respect of these provisions in the Collateral Warranty was (in short) that in a question between it and Northburn (the original employer) prescription started to run on 18th June 2009 and that, because no relevant claim was made by Northburn (or indeed the Pursuers) by 18th June 2014, any obligation which would have been owed to Northburn (but for the sale of the Site and so on) would have been extinguished by the operation of prescription such that, so the argument runs, the defender is entitled to assert an equivalent defence against the pursuers (albeit not actually one of prescription) in terms of clauses 2.3 and 3.1 of the Collateral Warranty. That argument was unsound. It proceeded upon a misconstruction of the relevant provisions within the Collateral Warranty.

The case-law on interpretation

[53] The principles applicable to the construction of commercial contracts such as the Collateral Warranty are now clear: see *Rainy Sky SA* v *Kookmin Bank* [2011] 1 WLR 2900, [14]; [20]-[27] and *Arnold* v *Britton*, [14]-[22]; *Wood* v *Capita Insurance Services Ltd*; *HOE*

International v *Andersen* [18]-[26]; *Midlothian Council* v *Bracewell Stirling Architects*, [19].

[54] As is usually the case, the difference between the parties in this case is as to the proper application of these principles to the terms of the Collateral Warranty.

The pursuers' interpretation of the Collateral Warranty

[55] The starting point, in the pursuers' submission, was that the defender did not come under any obligations to the pursuers until the Collateral Warranty was delivered to the pursuers. Nor were the terms of the Collateral Warranty retrospective: cf *Swansea Stadium Management*; and *Northern & Shell plc* v *John Laing Construction Ltd* [2003] EWCA Civ 1035. Even if one assumed, therefore, that the obligations now founded upon were immediately enforceable, it followed that, as between the pursuers and the defender, those obligations were enforceable until extinguished by operation of the short negative prescription, five years after delivery of the Collateral Warranty, unless a relevant claim or relevant acknowledgement were made to interrupt that prescriptive period, and otherwise subject to the express contractual limitation provided for by clause 3.2.

[56] On the defender's construction of the Collateral Warranty, however, the period during which the defender's obligation to make reparation to the pursuers was enforceable was subject to some latent limitation, based upon the period during which any obligation to make reparation could have been enforced by Northburn, under the Building Contract, and that in circumstances where the parties had in fact expressly addressed themselves to the creation of a contractual limitation in clause 3.2. It made no sense to say that the Collateral Warranty was subject to some further (unexpressed) contractual limitation.

[57] Mr Thomson QC submitted that the language of clauses 2.3 and 3.1 of the

Collateral Warranty simply did not support such a conclusion.

[58] Rather, the plain import of both clauses 2.3 and 3.1 was to provide, first, that the substantive scope of the duties owed by the defender to the pursuers under the Collateral Warranty were to be "no greater" than under the Building Contract (clause 2.3) and, secondly, that, so far as liability for any breach of duty was concerned, the defender would be able to rely upon any limitations in the Building Contract and to raise any defences available "under the Building Contract (clause 3.1). Neither clause 2.3 nor clause 3.1 of the Collateral Warranty said anything about the effects of prescription: indeed, nor could the parties exclude or "contract out" of the law in relation to prescription, including in particular the short negative prescription of five years (see the 1973 Act, section 13).

[59] Nor did either clause say anything about the "duration" of the obligations, one way or the other. That was to say, neither clause positively identified the period of time during which the obligations would be enforceable, nor did either clause state that the obligations arising under the Collateral Warranty would not be enforceable after a particular period of time or subject to any temporal limitation. In that state of affairs, Mr Thomson QC submitted, one was necessarily left with the default position provided for by the law, namely, that the obligations will cease to exist (and thus, necessarily, to be enforceable) upon the expiry of the applicable prescriptive period of five years or, if earlier, by the contractual limitation provided for by clause 3.2. In this respect, it was worth contrasting the language of clauses 2.3 and 3.1 with the clause which was before the Court (the TCC) in *Oakapple Homes (Glossop) Limited* v *DTR (2009) Limited (in liquidation) and others* [2013] EWHC 2394 (TCC). In that case, the relevant clause in the warranty provided:

> "The Consultant has no liability hereunder which is greater or of longer duration than it would have had if the Beneficiary had been a party to the Appointment as joint employer PROVIDED THAT the Consultant shall not be entitled to raise under this Deed any set-off or counterclaim in respect of sums due under the Appointment." (Emphasis added)

[60] Ramsey J said this about this clause :

> "55 … The benefit of the warranty which has to be 'no greater or longer lasting' than that in the Appointment refers to the scope, extent and duration of the liability …"

[61] It is the absence of language of that sort ("or of longer duration") which, in the pursuers' submissions, quite clearly established that the intention of the parties was to address the substantive scope of the duties which were to be assumed under the Collateral Warranty, rather than the period of time during which those duties would exist *et separatim* be capable of enforcement.

[62] The soundness of this conclusion was, it was submitted, reinforced by the following additional points.

1) First, the supposed ground on which (contractually) the pursuers' claim was barred was that there would be a statutory defence of prescription had an action been brought now by Northburn. Such a defence, however, was not a "limitation in the Building Contract" and nor was it "an equivalent right in defence of liability as [the defender] would have against the Employer under the Building Contract".

2) Secondly and in any event, the relevant *tempus inspiciendum*, so far as clauses 2.3 and 3.1 of the Collateral Warranty were concerned was the date of delivery of the Collateral Warranty. Both clauses were plainly directed towards the position as it stood at the date of the delivery of the Collateral Warranty, with a view to providing that, as at that date, the

pursuers did not acquire greater rights (as a matter of substantive content) than were then held by Northburn, as Employer. The clauses were not intended to limit the rights of the pursuers (in the future) by undertaking some comparison (at the time of a claim made by the pursuers) between the claim actually made by the pursuer with a claim hypothetically made (at that future date) by Northburn under the Building Contract, at least insofar as the question of the enforceability of the substantive obligations is concerned – the Collateral Warranty, in short, provides no basis for importing a defence based on prescription in respect of Northburn's hypothetical claim under the Building Contract into the actual claim made by the pursuers under the Collateral Warranty.

3) Thirdly, although in *Swansea Stadium Management*, O'Farrell J considered that a clause in equivalent terms to clause 3.2 of the Collateral Warranty (rather than, it should be noted, clause 3.1) was to be regarded as having "retrospective" effect (based upon the construction which was placed upon a clause in the contract which was before the Court of Appeal in *Northern & Shell*, which stated that the warranty was to "come into effect on the day following the date of issue of the Certificate of Practical Completion under the Building Contract"), it is submitted that the correct view is simply that clause 3.2 identifies when (prospectively) claims under the Collateral Warranty will be contractually barred rather than, retrospectively, making the Collateral Warranty enforceable from the date of practical completion under the Building Contract. The alternative conclusion, in *Northern & Shell*, was unsurprising having regard to the

particular terms of clause 5 in the contract in that case, which finds no equivalent in the Collateral Warranty.

[63] It was submitted that the language of the Collateral Warranty was clear and unambiguous, and that that language supported only the construction contended for by the pursuers, essentially for the reasons advanced by the pursuers.

[64] If, however, the view was taken that other constructions were at least available, then the construction contended for by the pursuers was, at the very least, an available construction. On that basis, the court should prefer the construction which best accords with commercial common sense. On that basis, it was the pursuers' submission that, essentially for the reasons set forth in Article 6 of Condescendence, their construction best accords with commercial common sense (and thus should be preferred and given effect to) whereas the defender's construction makes no commercial sense.

[65] For all of these reasons, it was submitted that the defender's averments regarding the meaning and effect of clauses 2.3 and 3.1 of the Collateral Warranty, as set out in Answers 6 and 7, were irrelevant and should be excluded from probation, and the defender's third plea-in-law should be repelled.

Discussion

Preliminary observations

Principles of interpretation

[66] The principles of interpretation are well understood, were not disputed and they may be summarised as follows:

1) The court must ascertain the intention of the parties by determining what a reasonable person, having the background

knowledge of the parties, would have understood from the language selected by them. The meaning of the words used must be assessed having regard to other relevant parts of the contract. In the event that there are two possible constructions, the court is entitled to prefer one which is consistent with business common sense (see *Midlothian Council* v *Bracewell Stirling Architects*).

2) Once one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each (*Wood* v *Capita Insurance Services Ltd*, per Lord Hodge, giving the Opinion of the Court, at [12]).

3) In giving a contract a contextual interpretation, the legal context must be considered as well as the factual context (*Grove Investments Ltd* v *Cape Building Products* at [12]).

Parties lodged a joint bundle of authorities and they made reference to the wording of some of the contractual provisions or collateral warranties in those cases. However, in none of those cases was the wording on all fours with that in the Collateral Warranty under consideration in this case. Further, there can be a danger in focusing on the meaning of a particular phrase in one case from a sister jurisdiction, especially if considered in isolation from its relevant factual and legal matrix, and trying to import that context-sensitive meaning into a different case, at least where aspects of the underlying

substantive law may differ. The English law of limitation is different, and operates differently, than the Scots law of prescription. For example, in some of the English cases one of the issues that arose for interpretation was the "retrospectivity" of the collateral warranty, in the sense that the collateral warranty under consideration had attributed to it a commencement date prior to its grant. Such a question could not arise in Scots law. (It was common ground between the parties that, on its grant, the Collateral Warranty created new rights, in favour of the pursuers, in respect of which a new prescriptive period began to run.) Given these differences between the two separate legal systems, drafters of the collateral warranties may approach the question of accommodating the interaction between rights under a collateral warranty and the operation of the relevant rules on prescription (in Scotland) or limitation (in England) in different ways. What might require to be provided for in one jurisdiction may not arise in the other. Even if a phrase or clause in one of the English cases is similar to one in the Collateral Warranty in this case, it is necessary to bear in mind that the two similar clauses or phrases may nonetheless operate differently in the two jurisdictions on precisely the question at issue in this case and, equally importantly, for the same reasons, what may be inferred from the omission to include a particular form of words may be very different. For these reasons, and having regard to the very particular issue in this case (involving a question of the Scots Law of Prescription), I found reference to other cases to be less helpful than might normally be the case.

Prescription

[67] The debate touched on the operation of prescription. On that topic, it

suffices to observe that an obligation to make reparation for loss, injury or damage caused by an act, neglect or default is a single, indivisible obligation. The right to raise an action to enforce such an obligation accrues when *injuria* concurs with *damnum (Dunlop* v *McGowans* 1980 SC (HL) 73 at p81). As noted above, parties proceeded on the footing that any like claim by Northburn against the defender under the Building Contract had been extinguished by prescription.

Effect of the grant of the Collateral warranty

[68] Parties are agreed that the Collateral Warranty created new rights in favour of the pursuers and, as a correlative, the defender owed certain obligations to the pursuers as specified in the Collateral Warranty. The debate also proceeded on the assumption that, as the Collateral Warranty created new rights in favour of the pursuers, a new quinquennial prescriptive period ran from the date of its grant in respect of the obligations thereby created. On that approach, an issue which featured in some of the English cases, such as *Northern & Shell*, as to whether a collateral warranty is "retrospective" (with the consequence that the relevant English limitation ran from an earlier point in time than the grant of the collateral warranty in question), does not arise.

Presumed prescription of any like claim habile to Northburn and contractual bar

[69] Parties proceeded on the basis that, if Northburn had a claim founding on like breaches by the defenders of the obligations under the Building Contract, it would have been extinguished by operation of negative prescription. In their defence to the pursuers' claim, the defender does not invoke a plea of prescription directly. It relies on

prescription indirectly, as available by virtue of a contractual bar, on its interpretation of clause 3.1.

The issue debated between the parties

[70] The issue debated concerned the scope of the "equivalent rights in defence of liability" available to the defender by virtue of clause 3.1 of the Collateral Warranty to resist the pursuers' claim. In particular, the question is whether, on the proper construction of the Collateral Warranty, the defender is entitled to raise, in defence of the present action, a defence of contractual bar on the footing that a defence of contractual bar is the "equivalent right" in defence of liability as the defence of prescription which the defender avers it would have against the Employer (Northburn) under the Building Contract.

Purpose of a collateral warranty

[71] The purpose of a collateral warranty is to provide directly enforceable rights between parties who, under the standard legal structures used in construction contracts, would not otherwise be in a direct contractual relationship. Upon grant, a collateral warranty creates free-standing obligations owed by the granter (in this case, the defender) in favour of the beneficiary (in this case, the pursuers). Putting it another way, the Collateral Warranty conferred title to sue on the pursuers (as grantees of the Collateral Warranty) in respect of specified obligations which, but for the Collateral Warranty, the defender owed to third parties (ie Northburn). The grant of a collateral warranty was necessary to overcome the difficulties in what would otherwise be third party claims and which can involve problematic issues of privity of contract, arguments about no losses

having been incurred by the cedent of an assigned interest of an employer or the irrecoverability of third party losses and so on as illustrated by cases such as *Alfred McAlpine Construction Ltd* v *Panatown Ltd (No 1)* [2001] 1 AC 518 and *GUS Property Management Ltd* v *Littlewoods Mail Order Stores Ltd* 1982 SC (HL) 157. It suffices to note Lord Drummond Young's discussion of the purpose and effect of collateral warranties in *Scottish Widows Services Ltd* v *Harmon/CRM Facades Ltd (In Liquidation)* at [17] and [18], which I am grateful to adopt.

The factual and legal context

[72] In ascertaining the intention of the parties, it is necessary to apprehend the background knowledge of the parties, including the legal context. In truth, the factual and legal context was relatively limited. The parties did not feel it necessary to agree any specific facts by joint minute for the purposes of the debate. The defender relied on the fact that the Building Contract was amended to insert a new clause 7.4, obliging Northburn to provide collateral warranty agreements in a specified form in favour of a funder, tenant or purchaser (all as defined) and that the Collateral Warranty granted was in the form agreed (see Part 11 of the Schedule to the Building Contract). The defender drew out certain features, the principal one being that the defender might require to give a Collateral Warranty many years after practical completion.

[73] The debate proceeded principally on a consideration of the Contractual Warranty itself. Before turning to the Contractual Warranty, it is helpful first to note that the legal obligations created under the Building Contract are the essential legal context in which the Collateral Warranty was granted. I note, too, that subcontractors were also obliged to grant collateral warranties in terms very similar to the Collateral Warranty.

The Building Contract was framed on the basis that a third party, such as the pursuers, might acquire an interest in the site. A third party acquiring such an interest could seek to acquire the employer's rights under the Building Contract (eg by assignation) or to acquire equivalent rights (eg by a free-standing contract with the defender). While the pursuers might have acquired the Employer's rights under the Building Contract by assignation, ie legally "stepping into the shoes" of Northburn, that technique was not adopted. (In that event, the principle *assignatus utitor jure auctoris* would apply, which may place the pursuers *qua* assignee in a less favourable position than obtaining rights under a free-standing collateral warranty.)

[74] In my view, it is part of the relevant context that the Collateral Warranty brought into existence new obligations (albeit equivalent to those enjoyed by Northburn under the Building Contract) and the commencement of a fresh prescriptive period in respect of those obligations. It was common ground between the parties that one consequence of the grant of the Collateral Warranty was the commencement (by operation of law) of a new quinquennial prescriptive period upon its grant. It may reasonably be inferred that this formed part of the background knowledge of the parties. For this reason, I do not accept the defender's submission (at para [37], above) that in order for the rights created by the Collateral Warranty in favour of the pursuers to be "commensurate" with or equivalent to the rights conferred on Northburn under the Building Contract, that the pursuers' rights under the Collateral Warranty required to be treated (via a contractual bar) as subject to the prescriptive period relating to Northburn's rights. The effect would be to displace the prescriptive period which parties agree commenced upon the grant of the Collateral Warranty. Such an approach does not accord with the legal context, known to all parties (i.e. that the Collateral Warranty would create new rights). It would also

involve a somewhat unusual restriction or (if the quinquennium has passed) the abrogation of those rights.

[75] In relation to parties' arguments about the commerciality of their respective interpretations, I did not find these persuasive. What was said to be "commercial" to one party (the pursuer would expect to have a full 5-year period to enforce obligations under the Contractual Warranty), was met with a countervailing "commercial" proposition (the defender's approach secured a high degree of certainty), or it could be asserted to be disadvantageous to the other (ie the defender being subjected to claims under the Collateral Warranty years after any like obligation under the Building Contract would have prescribed (which the pursuers countered with the observation that the obligation to grant was limited to the first two purchasers). Each party's commerciality arguments were no more or less consistent with the purpose of a collateral warranty described above. The pursuers' approach does have the benefit of better according with the legal matrix, including the creation of new rights in its favour upon the grant of the Collateral Warranty. Accordingly, the answer to the issue debated falls to be determined principally by the words used. I therefore turn to consider the terms of the Collateral Warranty.

The Collateral Warranty

[76] The pursuers stressed that the Collateral Warranty was not an assignation but that it created new obligations owed by the defender to them. The scope of these is set out in clauses 2.1 to 2.3. By clause 2.1, read short, the defender warranted that it had duly completed the Works in accordance with the Building Contract and had (or would) perform "all of its duties and obligations" in or arising from the Building Contract. In

clause 2.2 the defender warranted that the defender had completed the Works to a specified standard, "all to the same effect as if [the defender] had been appointed by the [pursuers]". By clause 2.3 it is stipulated that the defender "shall have no greater duty" to the pursuers under "this Agreement" (ie the Collateral Warranty) "than it would have had if [the pursuer] had been named as the employer under the Building Contract".

[77] By virtue of these clauses, in combination, the duties the defender assumed to the pursuers by virtue of the Collateral Warranty mirrored those owed by the defender under the Building Contract to the original counterparty, the employer (Northburn): clause 2.1 ensured that the new duties have the same *content* of the duties the defender owed to Northburn under the Building Contract and clause 2.2 provided that these are to be performed to the same *standard* of performance as those under the Building Contract. (The defender's submission that the Collateral Warranty did not impose additional duties is correct, if that is understood as not creating duties different in content, scope or standard than those owed by the defender to Northburn under the Building Contract. However, that is uninformative, or at least not determinative, of their duration.) The same effect might have been achieved by an assignation but, in that circumstance, the pursuer would have been the successor to Northburn to the original obligations created in the Building Contract. In that circumstance, of course, it would undoubtedly be the case that it acquired those rights subject to the running of the prescriptive period. (There might also be disadvantages to the cedent in such an arrangement, not least the prospect of the defender seeking to set off any claims it might have against Northburn.)

[78] Clauses 3.1 to 3.3 of the Collateral Warranty sets out limits to the duties and obligations created by the preceding clauses. Clause 3.3 precludes double recovery by the pursuers for any loss or damage arising from delay for which another party (either

the Employer or any beneficiary under another collateral warranty) has made recovery for the same loss or damage. Clause 3.2 precludes the commencement of an action or proceedings more than 12 years after the final statement of practical completion. It is a long-stop, creating a contractual bar to any claim. Counsel suggested that 12 years reflected the period that would arise under English limitation law. Mr Thomson QC submitted that this is a limitation clause, and the only limitation clause concerning the temporal scope of the obligations created by the Collateral Warranty. For his part, Mr McKenzie invoked clause 3.1, which was the principal focus of the debate, as affording a contractual bar to the pursuers' claim and, by implication, also having effect as a temporal restriction or limitation on the pursuers' rights. He argued that this was achieved because prescription was a defence of liability under the Building Contract, construing that phrase "under the Building Contract" broadly. Further, the words in parentheses supported a broad construction of the phrase "under the Building Contract", because (it was argued) set off was also a remedy that arose *ipso jure*. The defender broke this down into a series of questions, to which I now turn.

Is prescription a defence of liability?

[79] The defender argued prescription was the paradigm example of a "defence of liability". If upheld, the appropriate decree was one of absolvitor. I did not understand the pursuers particularly to resist this. In my view, a plea of prescription is clearly a "defence": if upheld, it affords a complete defence to a claim, even if the merits of the claim are unresolved. A "liability" includes a responsibility in law to make good the consequences of breach of the obligation, breach of which is the basis of a claim. If the requisite period of negative prescription has run (without a relevant claim or relevant

acknowledgement to interrupt that period, and which is not otherwise postponed), then the obligation in question is extinguished. In this sense, speaking generally, prescription affords a substantive defence. Another substantive defence might simply be that the defender did not breach the obligation in question. That is, classically, a defence on the merits. I accept the defender's submission that the phrase "defence of liability" is sufficiently broad to include a defence (such as prescription) which relieves the defender of liability for breach of an obligation (ie because prescription has extinguished the obligation to make reparation). However, as noted above, prescription is invoked only indirectly, in the form of a contractual bar.

Is prescription a defence of liability "under the Building Contract"?

[80] The defender argued that prescription is a defence of liability "under the Building Contract" and that the preposition "under" is broader than, say, "pursuant to". In the alternative, he argued that "under the Building Contract" is descriptive and, further, it is descriptive of the *Employer's claims* under the Building Contract. This is made clearer, it was said, by inclusion of the words it suggested. I do not accept this submission.

[81] As noted above, essential to the factual matrix was the existence of the Building Contract and the interlocking contractual relationships it brought into existence. In agreeing to grant collateral warranties to third parties, the defender was potentially subject to new obligations to those third parties and which were created on the grant of the Collateral Warranty. The first part of clause 3.1 ("…to rely on any limitation **in** the Building Contract…"(emphasis added)) ensured it could rely on any limitation provision contained in the Building Contract, such as one imposing an overall cap on a recoverable

amount or on a liquidated damages clause. The particular part of clause 3.1 relied upon is introduced by a different preposition ("under", not "in"). The phrase "equivalent rights of defence of liability…", are those available "**under**" the Building Contract. The fact that the same preposition is not used is suggestive of a defence not contained as an express term in the Building Contract. To that extent, the use of the preposition "under" invites a slightly broader approach. However, in my view, that formulation still requires that the defence be intrinsic to the Building Contract. After all, the Building Contract is the touchstone of the rights and obligations known to the parties and in knowledge of which they sought to define new rights and obligations brought into existence by virtue of it (ie such as the Collateral Warranty). The defences that are contained in the parentheses, of set off or no loss or a different loss, are consistent with this analysis. Each of these is a defence that is undoubtedly based on rights derived from the Building Contract. A counterparty's claim of set off would necessarily require to be based on its own substantive rights under the Building Contract and by which, in reliance on the principle of mutuality, it asserts that enforcement of the first party's claim be suspended (or, if liquid, extinguished *pro tanto*) by reason of breach of the obligations owed by the first party to it. Similarly, the party asserting no loss or a different loss, would only be doing so by reference to losses incurred (or claims made) by other parties to the Building Contract consequent on a breach of its terms.

[82] Does the phrase "under the Building Contract" nonetheless fall to be more broadly construed? The defender argued that the phrase "defence of liability under the Building Contract" was sufficiently broad to encompass defences arising by operation of law. The defender sought to bolster this argument by looking at the excluded defences. He argued that a defence of set off arose by operation of law and hence, by implication,

other defences arising by operation of law (such as prescription) are also included within the governing phrase.

[83] While set off is not a term of art in Scots law, it is generally understood (in a non-insolvency context) to refer to a substantive right in terms of which obligations owed to a counterparty may be extinguished or performance suspended. The cognate right, in Scots law, is that of compensation. While those two terms are often used interchangeably, the requirements of compensation (in terms of the Compensation Act 1592) in a non-insolvency context are stricter (eg the debts set off against each other must be liquid and there must have been *concursus debiti et crediti* in respect of the parties). In the case of either set off or prescription, however, the right invoked (of set off or compensation) must be asserted and sustained. If it is not invoked, it does not have effect. It does not operate *ipso jure*. Even the remedy of retention, some features of which overlap with "set off", must also be pled. Accordingly, I do not accept that the set off arises by operation of law, as the defender contended. The remedies or defences included within the parentheses, therefore, do not afford any support for the defender's contention for a broad reading of "under the Building Contract".

[84] What of the fact that prescription is not mentioned at any point in the Building Contract? Several observations may be made. First, arguments from silence are, perhaps, a little problematic, as it is not always clear if an omission is intentional or due to oversight. There is, in my view, force in the pursuers' submission that clause 3.2 is the only one to address itself to any temporal defence or restriction of rights. (I accept his submissions, recorded in paragraph [58] above, that clause 3.1 was silent on the duration of any obligation.) If it is correct that the figure of 12 years in clause 3.2 reflects the equivalent doctrine of prescription or limitation in English law, this is suggestive (but no

more) that parties had, at least, expressly addressed the issue of claims being precluded (it matters not whether these are barred or extinguished) by the effluxion of time. Secondly, for the reasons provided above, parties may also be presumed to know that the grant of a Collateral Warranty created independent rights in favour of the pursuers (mirroring those in favour of Northburn under the Building Contract) but which set running their own, new quinquennial prescriptive period (and which is not as a matter of law synchronised with the prescriptive period running in respect of any rights created under the Building Contract). Thirdly, an express clause purporting to impose a contractual bar on the pursuers' claim by reference to period of time, which is bound to be shorter than the quinquennium (unless the Collateral Warranty was granted contemporaneously with the Building Contract), might arguable fall foul of the prohibition in section 13 of the 1973 Act against contracting out of *inter alia* section 6 of the 1973 Act. (Not having had the benefit of further submissions, I express no view on this issue.) I note that had the parties intended to confine *any* claim for breach of the Building Contract to five years (apart from continuing defaults or latent defects etc it was made regardless of by whom), whether made by the original employers (Northburn) or their successors (the pursuers), this could readily have been achieved by the mechanism of assignation of Northburn's rights under the Building Contract. However, that mechanism was not used. I accept the pursuers' submission that clause 3.1 of the Contractual Warranty, properly construed, does not import the kind of temporal restriction on the enforcement of the pursuers' rights that the defender contended for. Its language, construed in the relevant context, simply does not say that.

[85] Finally, in relation to the phrase "as if the [defender] had been appointed by the [pursuers]" at the end of clause 2.3, I should address this. I do not regard this phrase as

meaning that the pursuers or their claims should be treated in all respects as "standing in the shoes" of Northburn. It is in my view significant that the pursuers did not replace Northburn in the contractual nexus of the Building Contract. In my view, having regard to the terms and context of this phrase (in that part of the Collateral Warranty defining the Contractor's obligations), this phrase was intended to mean no more than the content and scope of the defender's duties were equivalent to those it owed to Northburn. Properly construed in its relevant factual and legal matrix, it did not stipulate that the enforcement of the pursuers' rights under the Collateral Warranty were subject to the effect of prescription operating on Northburn's rights under the Building Contract. For this reason, too, I am not persuaded that the case of *Swansea Stadium Management Company Ltd* v *City and County of Swansea and Interserve Construction Ltd* (from which the phrase "in the shoes of" is taken: see paragraph [53]) is of any assistance. The contractual wording in that case was different. That case was also concerned with the equivalent of clause 3.2 in this case, operating as a contractual limitation and in circumstances where 12 years had also elapsed since practical completion. It was not addressing the circumstances in this case, and whether a statutory defence (available to the contractor against the employer) can be invoked indirectly by way of a contractual bar.

[86] In the present case, the parties to the Building Contract did not provide for a third party wishing to exercise the employer's rights under the Building Contract to do so by substitution (of the pursuers for Northburn). Rather, the third party acquired equivalent rights (to those of Northburn) but the creation of which necessarily brought in train a new prescriptive period, as parties would be presumed to know. Notwithstanding that, they made no express provision governing that circumstance. Given that the logic of the defender's position is that the pursuers were to be denied the benefit of the running of

the full quinquennial period in respect of the rights they acquired against the defender under the Collateral Warranty, even assuming that this could be achieved consistently with section 13 of the 1973 Act, this would be contrary to the normal legal rules and, hence, the expectations and shared understanding of the application of those legal rules. In those circumstances, one would expect this to have been expressly provided for in the Collateral Warranty, not least because this might constitute a significant restriction on or abrogation of the rights thereby created. However, there is no express provision in the Collateral Warranty to preclude the pursuers having the benefit of the full quinquennial period in respect of the rights it acquired under the Collateral Warranty. Finally, I should record that I was not persuaded by the pursuers' submission, based on the case of *Oakapple Homes (Glossop) Limited* v *DTR (2009) Limited (in liquidation) and others*, that the omission to use words such as "no liability….which is a duration…" was fatal to the defender's argument. This is for the reasons already explained above. I accept as a generality the defender's submission that the same result (as that in *Oakapple*) might be achieved by different wording or a different combination of classes. However, in my view, that result has not been achieved on the basis of the clauses I have considered in the Collateral Warranty.

Onus of proof and pleading incumbent upon the pursuers

[87] In light of the decision I have reached, this issue does not arise. In any event, I accept the pursuers' submission on this matter, to the effect that this was not a case about prescription but about the proper interpretation of a contractual limitation (albeit based on prescription). In those circumstances, *Pelagic* has no application.

Final Observations

[88] I did not understand parties to argue that there was any significance arising from differences in phraseology between clause 2.1, by which the defender warranted that it had performed all of its "duties **and obligations**" arising from the Building Contract, and the stipulation in clause 2.3 that it shall have "no greater **duty**" to the pursuers under the Collateral Warranty. While the pursuers did not demur from the defender's suggestion that "duty" in clause 2.3 should be read as "obligation", I am disinclined to accept this submission. If anything is to be made of the omission of "obligation" from clause 2.3, it is the perhaps over subtle point that prescription extinguishes the obligation to make reparation for breach of a contractual right (not the contractual right itself). On this precise reading of clause 2.3, the Contractor was accepting no higher contractual duty, but it did not secure a like restriction of any *obligation* to make reparation for breach of duty. In other words, while the content of the duties assumed under the Collateral Warranty was equivalent to those owed to Northburn under the Building Contract, the enforcement of the obligation (eg to make reparation for breach of duty) was not tied to its enforceability by Northburn under the Building Contract. On the other hand, the inclusion of the word "obligations" in clause 2.1 does not particularly add to the warranty given in that clause. It is not necessary to grant a warranty for an obligation that the law itself would impose; in this context, the obligation to make reparation. If that is correct, the phrase "duties and obligations" may be no more than the kind of linguistic redundancy beloved of drafters of legal deeds (of which "last will and testament" and "cease and desist" are well-known examples).

Decision

[89] For these reasons, it follows that the defender's plea of prescription falls to be repelled. I shall reserve all question of expenses meantime. I shall put the matter out By Order for submissions on the terms of the interlocutor.