Collateral Agreements – some pointers for Irish consultants

Consultants are often called upon to execute Collateral Agreements and some may take this step without knowing the additional risks they take on as a result.

A Collateral Agreement or Collateral Warranty ("CA") is an agreement that is collateral to another agreement. For a member of a construction design team, any CAs they enter into will be collateral to their letter of appointment. A CA entered into between a Consultant and a third party generally provides the third party with the benefit of the letter of appointment, enabling them to seek damages for breach of contract in the event of problems with the building. Typically, common law rights are preserved for the parties to the CA and in the event of legal action, the Consultant would face a claim in tort as well as a claim for breach of contract.

A Consultant who is to provide a CA should seek to ensure that its liability is limited to physical damage to the building and exclude consequential loss of any sort.

In the UK, the Contracts (Rights of Third Parties) Act 1999 allows a third party to enforce a contract, either where the contract expressly provides that he may, or where it may be inferred that the third party should be entitled to enforce a term. There is no equivalent legislation in Ireland.

A CA will probably require that a Consultant warrant that its services have been performed with reasonable skill and care in accordance with its letter of appointment. The standard of care provision in the CA should be identical to that contained in the Consultant’s letter of appointment. A standard of care greater than “reasonable skill and care” (such as a fitness for purpose warranty) should be resisted, as claims arising from such warranties in
general are excluded from cover in professional indemnity ("PI") insurance policies. It is usual to limit liability so that the consultant is not liable to the beneficiary of the CA for any act or omission that is not a breach of the letter of appointment. Consultants should seek to ensure that such a "no greater liability" clause is included in their CAs, as well as a clause confirming that they may rely on any defences and limitations available to them under their letter of appointment.

A financial cap on liability should be included in the CA, with due regard being had to the limit of indemnity in the PI cover held by the Consultant. A Consultant should seek to include a clause limiting its liability to the cost of making good physical defects in the works and excluding indirect or consequential loss in its entirety. It is best to be specific as to what types of indirect or consequential loss are being excluded. The Consultant should seek to ensure that a "net contribution clause" is included, providing that the Consultant is only liable to the extent that it is responsible for any defects in the work. CAs may be required from other parties and the Consultant should seek to limit its liability to that sum for which they would have been liable had all those who were required to provide CAs actually provided them. Net contribution clauses are an attempt to get around the iniquities of the Civil Liability Act 1961 providing for joint and several liability of concurrent wrongdoers, which so often ensures that Consultants with PI cover end up bearing the brunt of claims in respect of defective buildings where the contractors have no assets or are insolvent. Some care should be given to which parties to the project are to be included within the scope of the net contribution clause.

A CA typically will provide that PI insurance has to be in place and maintained for 6 or 12 years, that a particular level of cover will be provided and that the Consultant must use "reasonable endeavours" to put in place and maintain PI insurance from date of PC, provided PI cover is available to the Consultant at commercially reasonable rates. The Consultant should seek to ensure that the endeavours to be made are no more than reasonable (e.g. not best endeavours) and that a definition of what constitutes a commercially reasonable rate is included in the CA. This may assist in the event the Consultant is having difficulties obtaining insurance. The period of the CA typically will be either 6 or 12 years from PC, depending on whether executed under seal. Care should be taken with this provision, as claims on foot of CAs may arise years after a project has completed.

A Collateral Agreement should not be considered in isolation from the consultant’s letter of appointment and policy of insurance.
The Consultant should seek to ensure that provision is made in the CA for fees to be paid in the event their drawings are to be re-used by the beneficiary of the CA for extension or reconstruction purposes.

Step-in rights typically are provided for in CAs entered into with funders and these are intended to enable the funder to step into the employer's / developer's shoes in the event of liquidation or bankruptcy of that party. Typically, a step-in clause provides that the Consultant has a right to determine its employment pursuant to the letter of appointment, but will have to give notice to the funder of intention to do so, providing the funder with an opportunity to “step-in” to the contract. The CA usually provides that the funder will take on the obligations of the employer and that the letter of appointment will continue to have full force and effect. A Consultant should seek to ensure that in case of step-in, any outstanding fees will be paid by the funder.

Bespoke CAs generally include provisions allowing for the assignment of the benefit of the CA to another party, as this makes a property more marketable. Consultants should seek to limit the number of assignments that are permitted and if possible ensure that the consent of the Consultant, not to be unreasonably withheld, is to be obtained before the CA is assigned. There may be a provision in the CA that the CA may be assigned once without the prior written consent of the Consultant, but that thereafter consent must be obtained, such consent not to be unreasonably withheld or delayed. The terms on which the CA may be assigned, if at all, merit careful consideration. Some PI policies on the market exclude from cover claims arising out of CAs that require the Consultant to assume duties to more than two subsequent owners or occupiers of works in relation to which the policy holder has been performing the services.

Consultants should be aware that a CA is a stand alone contract and that in entering into it, they take on contractual obligations to the beneficiary. Legal and insurance advice may need to be taken before the CA is executed and the CA cannot properly be considered in isolation from the letter of appointment and the Consultant’s PI policy.

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