Collateral warranties are part and parcel of any large construction project. With onerous and often uninsurable terms increasingly being sought by funders in particular, in this article Cathie Shannon and Mary Smith of Beale & Company consider the provisions to be found in a typical collateral warranty and the steps that might be taken by consultants and contractors to limit their exposure to liability.

Collateral Warranties in focus

For contractors and members of the design team, a Collateral Warranty (CW) is a stand-alone contract, collateral either to the building agreement or to the letter of appointment, with the contractor or design team member being the warrantor.

A CW enables the third party beneficiary of the CW to have the benefit of the building agreement or letter of appointment and to sue the warrantor for breach of contract.

If no CW were to be executed, the third party would have no contractual right to sue the warrantor in the event of there being defects.

UK

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, hence the important of CWs to funders, buyers and tenants.

Building contractors are often required as one of their contractual obligations to obtain CWs from sub-contractors, particularly those taking on design responsibility and regarded by the employer as key.

The same step should be taken by any design team member engaging a sub-consultant providing a CW for an element of the works.

A CW will probably require that a design team member warrant that its services have been performed with reasonable skill and care in accordance with its letter of appointment.

For a building contractor, the CW generally will require that it warrant it has complied and shall continue to comply with its obligations under the Building Contract and these obligations may be listed.

The standard of care provision should be identical to that contained in the contract. For a consultant or contractor with design responsibility, a standard of care greater than ‘reasonable skill and care’, such as a fitness for purpose warranty, should be resisted.

Claims arising from such warranties in general are excluded from cover in professional indemnity insurance policies.

A fitness for purpose obligation does not require that negligence be proved in order for there to be a breach and this could mean that an Insurer could require the policyholder to prove their own negligence.

It is usual to seek to limit liability so that the design team member or contractor is not liable to the beneficiary of the CW for any act or omission which is not a breach of the letter of appointment or building agreement.

All construction professionals should seek to ensure that a ‘no greater liability’ clause is included in their CWs, to ensure...
that they can have no greater liability to the beneficiary of the CW than they do to their client, as well as a clause confirming that they may rely on any defences and limitations available to them under their letter of appointment or building agreement.

**Importance**

It is of primary importance for contractors and design team members that a financial cap on liability be included in CW.

If there is no financial cap on liability, then the warrantor’s liability to the beneficiary will be unlimited.

Seek to include a clause limiting liability to the cost of making good physical defects in the works and excluding indirect or consequential loss in its entirety.

It is generally preferable to be specific as to what types of indirect or consequential loss are being excluded, for the avoidance of doubt.

Whilst these are often resisted by funders in particular, always seek to include a net contribution clause, providing that the construction professional is only liable to the extent that it is responsible for any defects in the work.

Net contribution clauses are contractual provisions which attempt to avoid the iniquities of the Civil Liability Act 1961 providing for joint and several liability of concurrent wrongdoers.

In the period following the economic downturn, this legislation often operated to ensure that consultants holding professional indemnity insurance bore the brunt of claims in respect of defective buildings, where the contractors either had no assets or were insolvent.

Net contribution clauses have not been tested in the Irish Courts, but have been upheld in a number of UK decisions, which an Irish Court might have regard to should it have to rule upon whether to uphold such a clause.

**Typically**

A CW typically will provide that professional indemnity insurance has to be in place and maintained for 6 or 12 years, that a particular level of cover will be provided and that ‘reasonable endeavours’ will be made to put in place and maintain PI insurance from date of PC, provided PI is available at commercially reasonable rates.

Seek to ensure that the ‘endeavours’ to be made to obtain PI cover are no more than reasonable.

Case law in the UK, which may be of persuasive effect in Ireland, has held that a party contractually bound to make ‘best endeavours’ to achieve a particular end, may be obliged to take steps that do not necessarily align with its own interests, in order to comply with its contractual obligations.

Note too that the fact that a particular level of PI cover is expressed in the CW does not mean that any claim for damages made by the beneficiary of the CW will be limited to that sum.

Only a limitation of liability provision in the CW will operate to ensure that the quantum of any claim is limited to a particular sum.

The period of the CW 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 CWs may arise some time after a project has completed.

Seek to ensure that in case of step-in, any outstanding fees will be paid by the funder.

CWs generally include provision allowing for the assignment of the benefit of the CW to another party, as this makes the property more marketable.

Seek to limit the number of permitted assignments and if possible ensure that consent, not to be unreasonably withheld, is to be obtained before the CW is assigned.

There may be a provision in the CW that the CW may be assigned once without the prior written consent of the warrantor, but that thereafter consent must be obtained, such consent not to be unreasonably withheld or delayed.

The terms on which the CW may be assigned, if at all, merit careful consideration.

Some professional indemnity insurance policies on the market exclude from cover claims arising out of the assumption of obligations to more than two subsequent owners or occupiers of works in relation to which the policy holder has been performing the services.

**Stand alone**

Construction professionals have to keep in mind that a CW is a stand-alone contract and that in entering into it, they take on contractual obligations to the beneficiary.

For a construction professional, ideally the period would be stated to be 6 or 12 years from completion of project or cessation of services, whichever is the earlier.

Step-in rights generally are provided for in CWs entered into with funders and the purpose of this is to enable the funder to ‘step in’ to the employer’s shoes in the event of the employer’s liquidation or bankruptcy.

**Right**

Typically, a step-in clause provides that the construction professional has a right to determine its employment pursuant to the letter of appointment or building agreement, 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 CW usually provides that the funder will take on the obligations of the employer and that the letter of appointment or building agreement will continue to have full force and effect.

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