



Collateral Warranties & Third Party Rights

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COLLATERAL WARRANTIES & THIRD PARTY RIGHTS



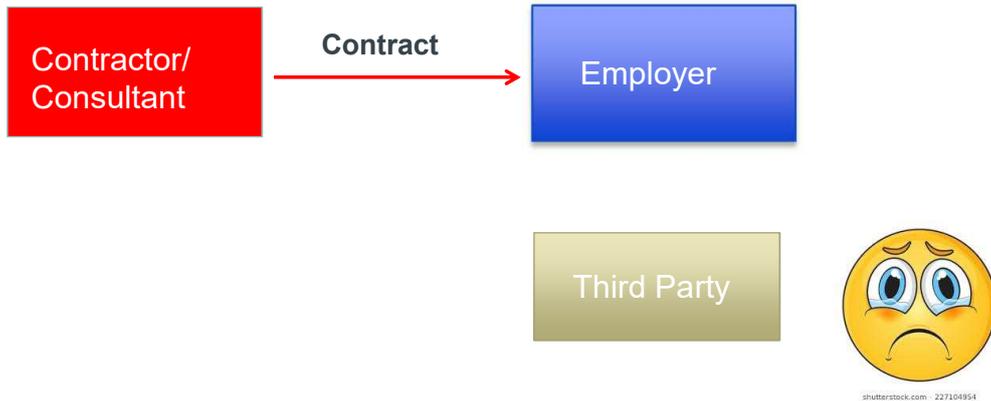
- ▶ Why are Collateral Warranties and Third Party Rights needed?
- ▶ Types of Performance Security granted to third parties
- ▶ Collateral Warranties as a “construction contract”?
- ▶ When should Collateral Warranties/TPRs be given?
- ▶ Common terms in CWs/TPRs
- ▶ Other points & Further reading



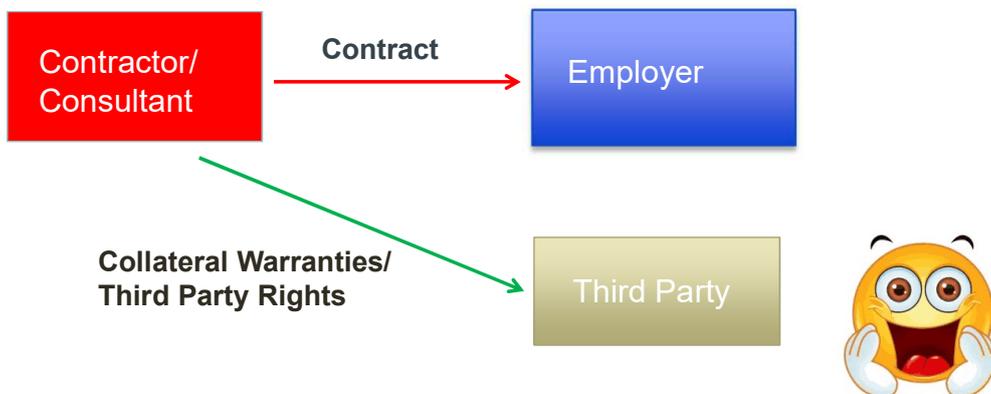
COLLATERAL WARRANTIES & THIRD PARTY RIGHTS - WHY ARE THEY NEEDED?



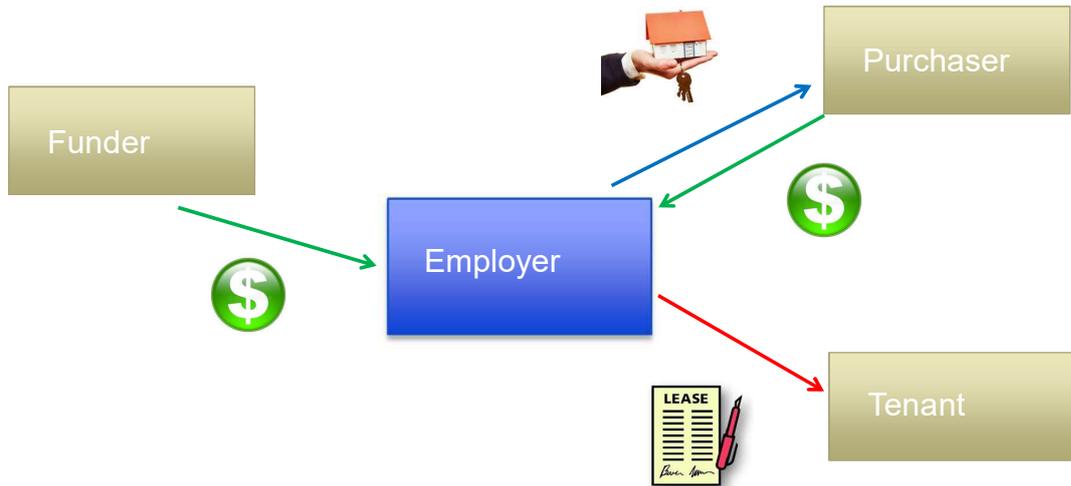
► Doctrine of Privity of Contract



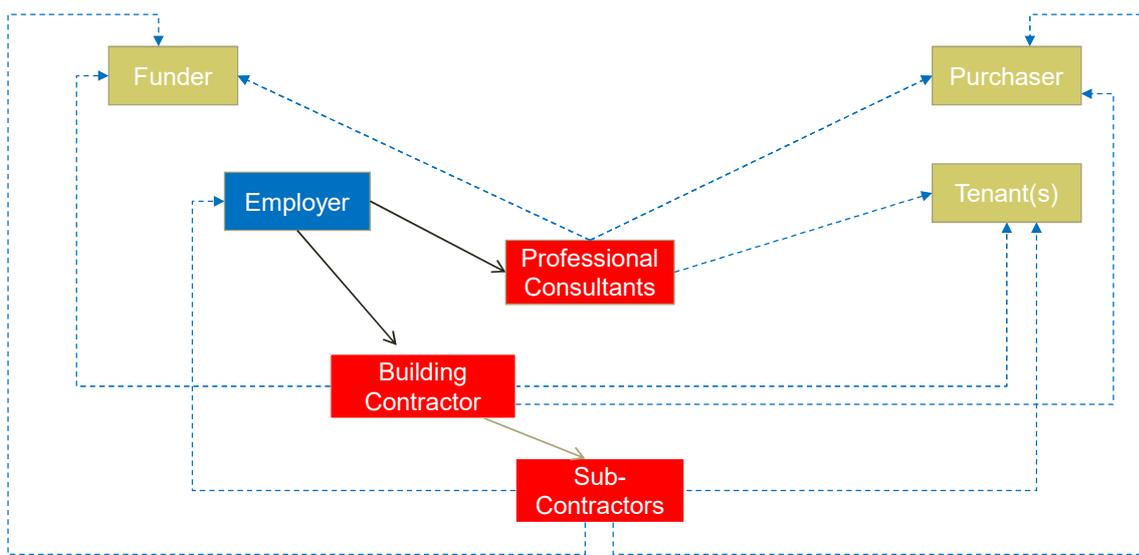
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CAN YOU GET AWAY WITH NOT GIVING A WARRANTY?



▶ *Kier Construction Limited v E M Saunders Partnership LLP* [2018]



- ▶ Consultant required to provide a collateral warranty when requested to do so in a form attached to their appointment
- ▶ Form contained many gaps, e.g. level of professional indemnity cover to be provided, list of parties to whom liability will be apportioned under net contribution clause.
- ▶ Defects discovered in the works several years after the services had been completed.



- ▶ Third party then requested a collateral warranty; consultant refused to grant one as they knew it will saddle it with liability to the third party for the defects.
- ▶ Court ordered Consultant to provide collateral warranty on the basis that they had originally undertaken to provide one.

CAN YOU GET AWAY WITH NOT GIVING A WARRANTY?



▶ *Liberty Mercian Ltd v Cuddy Civil Engineering Ltd and Others* [2014]

- ▶ Contract required contractor to procure warranties from a sub-contractor (Quantum (GB) Limited) in favour of the Employer & an environmental consultant
- ▶ Contract between Contractor and Employer terminated & Quantum (GB) Limited also went into insolvency and had been dissolved – both prior to the Collateral Warranties being provided.
- ▶ Court considered it was appropriate to order specific performance to require the warranty to be provided.
- ▶ Re insolvency of Quantum, warranty was required to be provided notwithstanding that Quantum had no assets because the warranty was insurance backed





TYPES OF PERFORMANCE SECURITY GRANTED TO THIRD PARTIES



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS



- ▶ **Collateral Warranties** (“CWs”)
 - ▶ Contract between Consultant/Contractor and Third Party
- ▶ **Third Party Rights** (“TPRs”)
 - ▶ Right given to third party to enforce the Appointment/Building Contract
 - ▶ Contract (Rights of Third Parties) Act 1999 applies
- ▶ **Both** CWs and TPRs contain a warranty from the Consultant/Contractor that it has complied with the Contract/Appointment
- ▶ **Both** also mirror the terms of the Appointment in some respects

DIRECT AGREEMENTS



- ▶ Used on more complex projects, e.g. PFI/PPP projects
- ▶ Generally required by Funders:
 - ▶ Grants a right of step-in, to remedy the termination event or to substitute a new project company or contractor
 - ▶ Allows the Funder to complete the construction works and to minimise disruption to the income stream.
- ▶ Many similarities with Collateral Warranties granted in favour of Funders



RELIANCE LETTERS



- ▶ Similar to collateral warranties/TPRs, but
 - ▶ Provided by consultants who have **written reports** for use on the project (not carried out design/works)
 - ▶ Grants funder the right to rely on the contents of the report as if they had commissioned it
 - ▶ Often contains the same terms as collateral warranties relating to
 - ▶ maintenance of insurance
 - ▶ copyright
 - ▶ assignment





IS A COLLATERAL WARRANTY A CONSTRUCTION CONTRACT?



PARKWOOD LEISURE v LAING O'ROURKE [2013]



PARKWOOD LEISURE v LAING O'ROURKE [2013]**The facts:**

- ▶ Parkwood was the tenant of a new swimming pool;
- ▶ Collateral Warranty provided by Laing O'Rourke
- ▶ Parkwood alleged that the warranty's wording made it a construction contract under the Act
- ▶ Parkwood issued proceedings - issue was whether the collateral warranty was a construction contract for the purposes of the Construction Act 1996

PARKWOOD LEISURE v LAING O'ROURKE [2013]**The decision:**

- ▶ “...**warrants, acknowledges and undertakes that...it has carried out and shall carry out and complete the Works in accordance with the Contract**” [Clause 1 of the Collateral Warranty]
- ▶ The TCC decided that the warranty's wording gave rise to a contract for construction operations (s. 104 Construction Act 1996)
- ▶ Needs to be determined in light of the wording and factual background
- ▶ Is the contractor undertaking to carry out construction operations or simply warranting a past state of affairs?

PARKWOOD LEISURE v LAING O'ROURKE [2013]**Lessons learnt:**

- ▶ Contractors and sub-contractors will have to review the terms on which they are prepared to give warranties
- ▶ Think about standard forms eg JCT Purchaser/Tenant Warranty
- ▶ A collateral warranty which undertakes to carry out or complete works will almost inevitably be caught by the legislation.
- ▶ To try to avoid this:
 - ▶ Don't repeat obligations from the main construction contract
 - ▶ Refer to 'warranties' rather than 'undertakings'
 - ▶ What about detailed adjudication provisions in the warranty?

**WHEN SHOULD COLLATERAL
WARRANTIES/THIRD PARTY RIGHTS BE GIVEN?**

WHEN SHOULD COLLATERAL WARRANTIES BE GIVEN?



- ▶ Common requirement is to provide CWs/TPRs etc. to funders as a condition precedent to receiving funding;
- ▶ If Appointments are being novated, security should be provided to Employer at the same time as the Novation Agreement is entered into.
- ▶ Could be provided at the same time as the Appointment/Building Contract is entered into;
- ▶ General requirement for all collateral warranties, including those provided by sub-contractors, to be provided prior to practical completion



HOW LONG DOES A COLLATERAL WARRANTY LAST?



- ▶ ***Swansea Stadium v City and Council of Swansea [2018]***
- ▶ Collateral Warranty provided after Practical Completion
- ▶ Limitation period to bring a claim under the Collateral Warranty may have commenced at Practical Completion, i.e. prior to the date the Collateral Warranty was provided
- ▶ Beneficiary tried to bring a claim more than 12 years after practical completion, but within 12 years of entering into the Collateral Warranty
- ▶ **Claim was time-barred**
- ▶ **Court felt that the intention of the parties was to mirror the Building Contract**



HOW LONG DOES A COLLATERAL WARRANTY LAST?



▶ *Bloomberg LP v Sandberg and Another [2015]*

- ▶ Cladding contractor (Malling) provided a collateral warranty in favour of a tenant (Bloomberg), containing a 12 year limitation clause
- ▶ Two years following this collateral warranty, a separate CW was provided by a façade consultant (Sandberg)
- ▶ 13 years after the Malling warranty was entered into, a cladding tile fell from the building; claim against Malling was time-barred
- ▶ Bloomberg brought a claim against Sandberg under their warranty, and Sandberg sought a contribution from Malling
- ▶ **Court held that even if Malling's liability under their warranty was time-barred, this didn't mean that they may still not be required to provide a contribution to damage/defects due to this claim.**



COMMON TERMS IN COLLATERAL WARRANTY & THIRD PARTY RIGHTS



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS – NO GREATER LIABILITY



- ▶ *Consultant shall be under no greater liability under the terms of the Warranty than they would be under the terms of the Appointment*
- ▶ Not always included in all warranties/third party rights, but is quite standard.
- ▶ What would be the effect if this clause was not included?



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS - EQ. RIGHTS OF DEFENCE



- ▶ **Example clause from consultant CW/TPR:**
 - ▶ The Consultant shall be entitled in any action or proceedings by the Beneficiary to rely on any limitation against the Beneficiary and to raise the equivalent rights in defence of liability as it would have had against the [Employer]/[Contractor] as if the Beneficiary had been named as **joint employer** under the [Appointment] [Building Contract].
- ▶ **JCT P/T Warranty clause 3.4:**
 - ▶ The Contractor shall be entitled in any action or proceedings by the Purchaser or Tenant to rely on any term in the Building Contract and to raise equivalent rights of defence of liability as he would have against **the Employer** under the Building Contract
 - ▶ If “joint”, beneficiary can bring claim regardless of whether the Employer itself has a claim.

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — CONSISTENCY WITH UNDERLYING DOCS

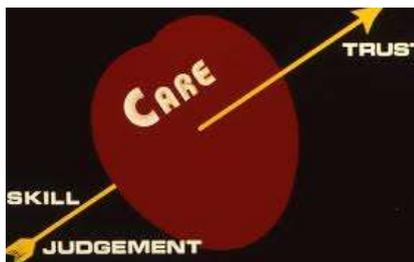


- ▶ Important to ensure that the terms of the CWs/TPRs are consistent with the following clauses in the Appointment/Building Contract:
 - ▶ Skill and care (“Reasonable”? “All reasonable”? “Standard to be expected of...”?)
 - ▶ Prohibited Materials (standard of care, standards being used)
 - ▶ Insurance (amount, basis of insurance, period for maintaining cover, “rates and terms”)
 - ▶ Copyright (irrevocable, list of uses, right to grant sub-licences/be transferable)

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — SKILL & CARE



- ▶ The Consultant warrants to the Beneficiary that he has exercised and that he will continue to exercise in the performance of the Services **[all the] [the reasonable]** skill, care and diligence **to be expected of a property qualified and competent consultant** in the disciplines to which the Services relate experienced in carrying out work of a **similar size, scope and complexity** to the Development



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — SKILL & CARE



▶ All the skill and care/Best endeavours

- ▶ the obligation is clearly the most onerous level of the three but by no means an absolute obligation and the concept of reasonableness still applies
- ▶ the warrantor is required to take steps a prudent, determined and reasonable employer, acting in his own interests and desiring to achieve that result, would take
- ▶ the warrantor must **exhaust all options available to it and to incur costs doing so**
- ▶ the warrantor may consider its own interests and is not required to take any actions to ruin itself financially

▶ Reasonable skill and care

- ▶ a notably lesser obligation than “all the skill and care/best endeavours”
- ▶ the warrantor can choose one of a number of reasonable courses of action (not every course available) to achieve the desired result
- ▶ the warrantor is not required to sacrifice its own interests and can strike a reasonable balance between the obligation and all relevant commercial considerations
- ▶ the warrantor may be required to incur limited costs

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — SKILL & CARE



▶ **Compromise position:** All reasonable skill and care

- ▶ the least developed one under English law
- ▶ traditional orthodoxy is that it sits halfway between “best endeavours” and “reasonable endeavour” but there are arguments that it equates to “best endeavours” in all aspects
- ▶ the consultant is likely required to pursue a number of reasonable options and explore them to the extent reasonable
- ▶ the consultant may be required to incur cost but not significant sums
- ▶ it may or may not require the obligor to sacrifice its own commercial interest



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — PROHIBITED MATERIALS



- ▶ “does not specify to use or (as appropriate) authorise or approve the specification or use by others of...”
- ▶ “Not in conformity with relevant British or European Union Standards or Codes of Practice”
- ▶ Can make reference to “Good Practice in the Selection of Construction Materials” (British Council of Offices, 2011)
- ▶ Could also list materials which are prohibited
- ▶ Particularly important for consultants with design responsibility (i.e. Arch, Structural Eng, M&E) & D&B Contractors



Biohazard



Chemical Hazard



Poison

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — INSURANCE



- ▶ “The Consultant will maintain professional indemnity insurance...from the date of this Deed until 12 years after Practical Completion of the Development”
 - ▶ of not less than £[]([] million pounds)
 - ▶ for any one occurrence or series of occurrences arising out of any one event/for each and every claim or series of claims arising out of any one event/for any one claim/in the aggregate/subject to [one][two][unlimited] reinstatements
 - ▶ (but subject to a separate limit in relation to claims relating to asbestos, pollution and/or contamination of £[] in the aggregate)
 - ▶ “provided such insurance is generally available in the market to members of your profession at commercially reasonable rates and terms”
- ▶ Carve out for actions which invalidate insurance claims

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — COPYRIGHT



- ▶ The copyright in the Material shall remain vested in the Consultant, but the Consultant hereby grants to the Beneficiary an **irrevocable, royalty free and non-exclusive licence** to copy and use the Material and to reproduce the designs contained in it for any purpose whatsoever ... *Such licence shall be capable of sub-licence and shall be transferable by the Beneficiary*
- ▶ Consultants may want licence to be subject to all fees due being paid
 - ▶ Royal Institute of British Architects (RIBA) Consultant's Appointment contains provision requiring the Employer to **pay** for any sub-licences which it wants to grant to tenants

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — STEP-IN CLAUSE



- ▶ Allows the Third Party to “step in to the shoes of the Employer/Contractor”
- ▶ Period of notice that has to be given: normally 21 or 28 days
- ▶ Third Party can serve a notice within this time, and then becomes liable to pay the Consultant/Contractor
- ▶ **Step-In Priority:** If more than one Beneficiary receives a warranty and tries to step-in at the same time, who does the Contractor/Consultant have to listen to?
- ▶ Not normally given to Purchasers and Tenants



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — ASSIGNMENT



- ▶ **Does not have to be consistent with the same term in the Appointment**
- ▶ Normally limited to two or three times
- ▶ Assignments by way of security and to affiliates normally excluded from this limit



- ▶ **No Loss:**
 - ▶ The Consultant hereby undertakes not to contend, whether in proceedings or otherwise that his liability to the Beneficiary should be reduced or extinguished by reason of the Employer having suffered no loss or loss different from the Beneficiary.

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — LIMITATIONS ON LIABILITY



- ▶ JCT CWa/P&T clause 1.1.1:
 - ▶ The Contractor shall be liable for the **reasonable costs of repair, renewal and/or reinstatement** to the extent that the Purchaser or Tenant incurs such costs.
- ▶ JCT clause 1.3 (**Net Contribution Clause**)
- ▶ JCT clause 3:
 - ▶ The Purchaser or Tenant has **no authority to issue any direction or instruction** to the Contractor in relation to the Building Contract.
- ▶ JCT clause 9:
 - ▶ For the avoidance of doubt, the Contractor shall have **no liability** to the Purchaser or Tenant under this Agreement **for delay** in completion of the Works.



EXAMPLE PROVISIONS – FINANCIAL CAPS ON LIABILITY



- ▶ Cap on liability:
 - ▶ Except for liability for death and/or personal injury, the Consultant's maximum liability to the Client under or in connection with this Agreement and all other documents relating to the Services (whether in contract, tort (including negligence), for breach of statutory duty or otherwise) is limited to ● million pounds (£ ●,000,000) *[for any one occurrence or series of occurrences arising out of any one event][in the aggregate]*

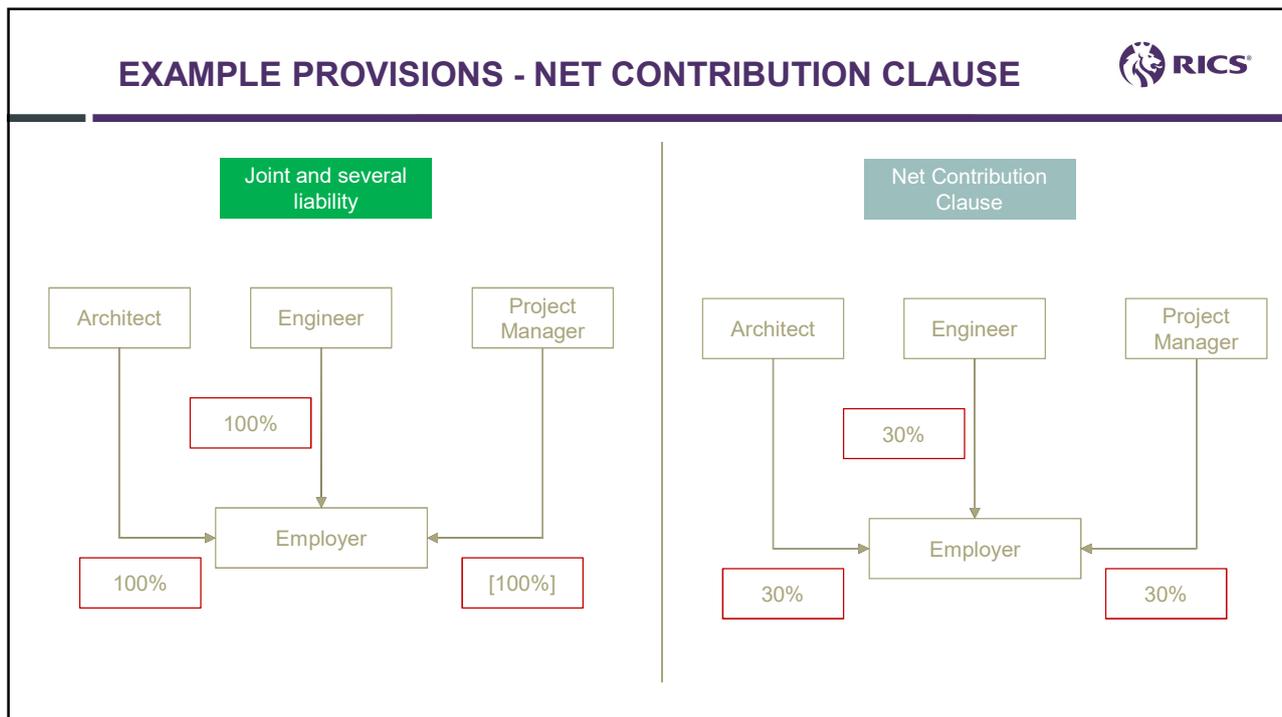


EXAMPLE PROVISIONS - NET CONTRIBUTION CLAUSES



- ▶ **Net Contribution Clause:**
 - ▶ The Consultant's liability to the Employer is limited to that proportion of the Employer's losses for which the Consultant is responsible under this contract
 - ▶ Some net contribution clauses refer to "losses which are just and equitable having regard to the extent of the Consultant's responsibility" and refer to other consultants such as the design consultants and the contractor
 - ▶ When acting for the Employer, insertion of such a clause in the Appointment should be fiercely resisted!

EXAMPLE PROVISIONS - NET CONTRIBUTION CLAUSE



West v Ian Finlay Associates [2014]



- ▶ Ian Finlay & Associates engaged as an architect in relation to a refurbishment of Mr and Mrs West's home
- ▶ Engaged under RIBA standard Architect's appointment, which contained the following net contribution clause:
- ▶ *Our liability for loss and damage will be limited to the amount that it is reasonable for us to pay in relation to the contractual responsibilities of other consultants, contractors and specialists appointed by you*
- ▶ Building contractor also appointed who also engaged several specialist contractors
- ▶ Significant defects discovered following practical completion, by which time Contractor was insolvent



West v Ian Finlay Associates [2014]



- ▶ Parties were in an equal bargaining position
- ▶ Net contribution clause not contrary to the requirement of good faith



- ▶ While net contribution clause caused an imbalance between the parties, this was not significant because
 - ▶ the use was prevalent in **RIBA's form of appt**
 - ▶ clause would not be regarded as **unusual** in a commercial contract
 - ▶ Mr & Mrs West took the final decision to engage the building contractor and were **intelligent** enough that they would have appreciated its financial stability was important (Mr West had a background in banking!)

COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — FURTHER WARRANTIES



- ▶ Clause granting the right to the Beneficiary to require the Contractor/Consultant to enter into further warranties in favour of other third parties (e.g. another funder, a further purchaser, successor tenant)
- ▶ This right is usually subject to the terms of the Appointment:
 - ▶ Cap on number of warranties to be provided?
 - ▶ “any” F/P/T or “first” F/P/T?
 - ▶ May need to look closely at the definitions of Funder, Purchaser or Tenant in the Appointment



COLLATERAL WARRANTIES & THIRD PARTY RIGHTS — OTHER POINTS TO CONSIDER



- ▶ Contractor Warranties/TPRs:
 - ▶ Has a **Parent Company Guarantee** been provided under the Building Contract? If so, what effect does this have on the Warranty/TPR provided by the Contractor?

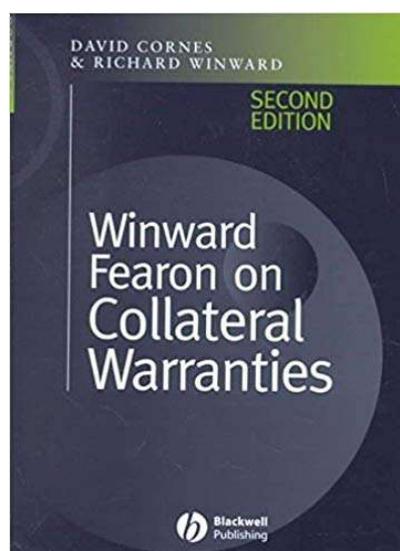
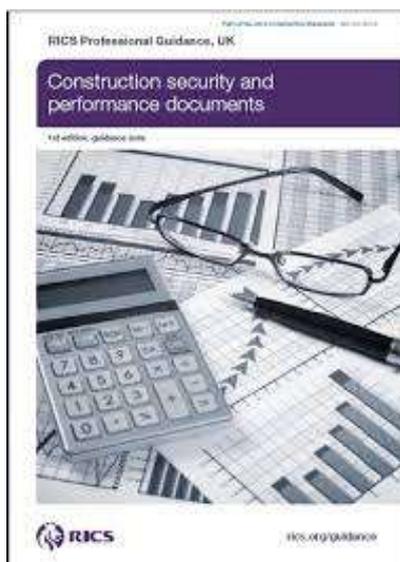


Consultant Warranties/TPRs:

Which types of Consultants would be the **most important** to provide warranties, from the perspective of a Funder, Purchaser or Tenant?

MUST be consistent with Funding Agreement/Agreement for Lease

Further reading



QUESTIONS



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