

Number 22

## Collateral Duties to Third Parties

Let's start with the most obvious question: what is a collateral warranty? The problem is that historically, English law would not permit a claimant to recover "financial" losses unless there is a direct contract between the parties. This is a severe drawback where, for example, a bank lends to a developer but there is no direct contract between the bank and, say, the architect who designed the building. A purchaser or tenant has the same potential problem. The collateral warranty has been devised to provide a "contractual bridge" to overcome this difficulty. Banks will invariably insist on warranties being provided by all consultants, contractors and others with a responsibility for design or construction. Prospective purchasers or tenants will similarly wish to have warranties entitling them to proceed directly against the design or construction team if defects are discovered.

The collateral warranty is the instrument through which the consultant or contractor warrants that it will carry out and complete its obligations under its consultancy agreement or building contract – and in so doing it grants to the third party a right to claim for breach of contract against it if it fails to perform.

### The Basic Contents of a Collateral Warranty

These are briefly as follows:

#### (a) Duty of Care

The consultant warrants to the beneficiary of the warranty that it has exercised the degree of reasonable skill and care in the performance of its duties that it originally owed to the employer. Always remember, however, that the warranty relates to the consultant's duties under the appointment and therefore the standard of duty and care demanded in the collateral warranty will not generally exceed that standard. It is important therefore always to ask to see the actual contract to which the warranty refers before agreeing any warranty.

#### (b) Deleterious materials

Developers will invariably have their own list of "banned" materials which they do not want used in a development. The prohibited materials will normally be those regarded by current "Codes of Practice" as being detrimental to the environment or health and safety – asbestos being a prime example – or those regarded in the industry as not conforming to good building practice. In the collateral warranty the consultant will warrant that the banned materials will not be, or have not been, used.

#### (c) Copyright

Within the warranty, the consultant will usually grant a licence to use and copy all those documents which it has prepared for any purpose relating to the premises. It is important to try to secure in the collateral warranty the right for the beneficiary to use the drawings and other copyright material in future projects.

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## (d) Professional Indemnity Insurance

A developer or other beneficiary of the collateral warranty should always insist that the consultant maintains adequate professional indemnity insurance to cover any future claims made against the consultant. Obviously a warranty which is not covered by appropriate insurance would be potentially worthless in the event of a claim if the consultant does not have the resources to meet the claim itself.

## (e) Assignment

The developer or other beneficiary of the warranty should seek the right to assign the benefit of the collateral warranty on any number of occasions in the future.

## (f) Limitation

The limitation period or “lifespan” within which any actions or proceedings for any warranty breach may be taken will vary from 6 years (if the warranty is signed as a simple agreement) or 12 years (if it is executed as a deed). It is obviously in the interests of the beneficiary of the warranty to have the greater protection period of 12 years.

## The Contracts (Rights of Third Parties) Act 1999

An attempt has been made by Parliament to replace the need to give a collateral warranty through passing the Contracts (Rights of Third Parties) Act 1999. Under this Act, Parliament has tried to give a third party the right to proceed against a consultant or contractor directly, but the drawbacks of the legislation are two-fold.

Firstly, to succeed to these rights, the third party must demonstrate that the contract purports to confer a benefit upon the third party or expressly says that the third party can enforce it. This may be a difficult onus to fulfil unless the third party is specifically referred to in the agreement either by name or by a particular class.

Secondly, Parliament permitted the parties to expressly exclude the operation of this 1999 Act if the parties agreed.

In our experience, despite the 1999 Act, banks and other lending institutions which finance large developments will require collateral warranties as a condition of lending. This is compounded by insurers of consultants and contractors being hostile to the 1999 Act and insisting upon the 1999 Act being excluded from all agreements. It is unsurprising, therefore, that the 1999 Act is widely regarded as failing to eliminate the need for collateral warranties and for the foreseeable future at least, the collateral warranty is “here to stay”.

The drafting of collateral warranties requires great care and the points highlighted above are in no way a conclusive list of all the points to be taken into account. For further advice on collateral warranties please contact, at first instance, Gordon Hall on 020 7227 7345 ([gordon.hall@rlb-law.com](mailto:gordon.hall@rlb-law.com)) or Paula Abrahamian on 020 7227 6759 ([paula.abrahamian@rlb-law.com](mailto:paula.abrahamian@rlb-law.com)).

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Readers are advised to take specific advice before acting in reliance on the matters set out in this briefing.

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