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SOLICITORS



COLLATERAL
WARRANTY
ADVICE
SCHEME

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What is a collateral warranty?

A warranty is essentially a warranty or promise made by one party (the warrantor) to another (the beneficiary). A collateral warranty is a warranty which exists "collateral" to or next to, an underlying agreement.

The most common example is a collateral warranty that sits alongside the building contract. The building contract will be between a contractor and the employer (the person or organisation that commissions the work). The collateral warranty is a promise by the contractor to someone else, say a prospective tenant, that they have performed and will perform their obligations under the building contract.

Collateral warranties are also often given by sub-contractors and sub-consultants on a project – usually a building project. It will be the contractor who appoints the subbies and enters into contracts, or appointments, with them. The subbies will then give collateral warranties to the employer.

Common warrantors can include:

- Contractors
- Architects
- Subcontractors
- Sub-consultants

Effectively, people or organisations whose work is important to more than just the person who appoints them.

Common beneficiaries include:

- Employers
- Purchasers
- Tenants
- Funders

Effectively, people who care that the development, project, or building is built properly but who won't themselves be appointing the people building and designing it.

We didn't have a contract though....

We now know what collateral warranties are and who gives them. The next question is, "why have them at all"? Well, in this regard, it's important to be clear about who you do and do not have contractual relations with.

In the case of a building or development contract, the contractual relationship exists between the building contractor and the employer – the person or organisation who commissions the work - they are the ones that actually enter into the contract.

If we take the relationship between the building contractor and an eventual purchaser of the development, or a future tenant, no contract exists between them. As a result, if the building was inherently defective, a purchaser will not necessarily have a claim against the building contractor for breach of contract. The contract wasn't made with them - so they can't sue for breach of contract - even if a breach has taken place. The age-old privity of contract defence.

Sometimes the purchaser or tenant might have a claim against the builder for negligence. But the Courts have tended to take a very restricted approach as to which losses are recoverable in those circumstances. The case law for these types of disputes, in negligence, and the damages that can flow, are lengthy and fun....but only for the lawyers arguing over them.

The solution for a purchaser or funder of a development is to receive collateral warranties from parties with whom they would otherwise not have a contract with. This enables them to pursue the warrantor directly for breach of contract.

Key things that a collateral warranty should cover:

Collateral warranties must attach to the main contract or agreement that they are “collateral” to. Provision should be made for some or all of the following:

- Who is the beneficiary of the collateral warranty, who they could be assigned to and for how long (or how many times)?
- Whether the standard of work is the same as or more onerous than that which is provided for in the underlying contract;
- Is there any chance the original contract provides for less onerous obligations than the collateral warranties?
- Any net-contribution element – the extent to which the provider of the collateral warranty could be liable for the fault of some other parties
- Step-in rights such as an insolvency situation
- Any applicable limitation periods
- Any insurance limits which must be maintained and for how long;

Our advice to you

Our role is to ensure that you receive good advice on the following:

- The strengths and weaknesses of the collateral warranty you are being asked to provide;
- Areas where the collateral warranty presents a risk to you when compared with the terms of your insurance policy

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