

Collateral warranties

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The English law of tort has developed significantly over recent years and it has become increasingly difficult to claim in negligence for "pure economic loss". As a result, it has become necessary for funders, purchasers and lessees of developments to protect themselves in case of defective buildings or workmanship by creating a direct contractual relationship between themselves and the contractors, sub-contractors and professional and design team responsible for the construction of the development. Whilst it is still possible that a claim in tort for personal injury or damage to neighbouring property will succeed, it is now clear that this is not the case in respect of claims for financial loss.

Previously the only party to enjoy the benefit of a direct contractual relationship with all parties, through the building contract and/or the deeds of appointment, was the developer, but it is now become standard practice in Jersey as well as in the UK for collateral warranties to be given by those parties undertaking the work, in favour of those parties ultimately occupying, owning or funding the development. The English Third Party Rights Act 1999 does not apply in Jersey and therefore the only alternative to collateral warranties would be an assignment of the building contracts, which would clearly not be feasible in a multi-let or ongoing development. It is worth noting that under the 1999 Act it is not possible to transfer the burden of a contract to a third party, only the benefit. Therefore because of this and the fact that the construction industry is so familiar with standard form collateral warranties, these are still very much the norm in the UK too.

Any prudent owner, and in particular any developer seeking to sell the development in due course, will seek to have in place an agreement or various agreements for lease with tenants, binding them in to fully repairing

and insuring leases upon practical completion of the development, or the relevant parts thereof.

In such circumstances a lessee should request, as a minimum, collateral warranties from the contractor and professional team involved in the construction of the building. Depending on the nature of the Joint Contracts Tribunal (JCT) building contract being entered into, the owner would also be advised to require collateral warranties from the professional team.

There are two main types of building agreement, the JCT Building Contract (Private with Quantities) and the JCT Building Contract (with Contractor's Design).

In the former, the contractor covenants to follow the plans prepared by the owner's architects, mechanical and electrical engineers etc. The contractor enters into the JCT directly with the owner. The owner will also appoint the architect, mechanical and electrical engineers etc and will, therefore, be able to action any or all of these parties for breach of contract on the basis of this a direct contract with them.

The lessee however, has no form of contract with any of these parties and therefore (in the absence of collateral warranties) would have no right of recourse against any of the parties involved in its construction.

In the latter form of contract (Contractor's Design), the contractor is effectively given a brief and organises a design to the owner's requirements using his own professional team.

The only direct contract is the JCT building contract between the owner and the contractor. Neither the owner, the lessee, nor the funder has any form of contract with any member of the professional team and the lessee and the funder have no contract with the contractor.

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Collateral warranties, therefore, provide for the these parties to be able to claim against either the contractor and/or any of the professional team or (in the case of the JCT with Contractor's Design) against the professional team used by the contractor.

It should be a requirement at the time of the execution of the JCT (no matter which type) that the professional team involved agree to enter into collateral warranties with the owner (if need be) and any funder or lessee of the new building. This then allows these parties to bring an action against the contractor and any member of the professional team for any defects that may occur in the premises caused through the fault or negligence of that particular person. Collateral warranties are sometimes known as duty of care deeds.

Members of the professional team will generally seek to restrict their liability under a collateral warranty agreement, although an "industry standard" has developed over the years. Standard limitations include a "no greater duty" clause and/or an "equivalent rights of defence" clause. A "no greater duty clause" provides that the party granting the warranties (the contractor, sub-contractor or consultant) cannot owe the beneficiary (the lessee, funder or owner as the case may be) any greater duty than it owes under the building contract or deed of appointment. An "equivalent rights of defence" clause provides that the warrantor may use any defence they may have under the provisions of the building contract or deed of appointment to defend a claim under the collateral warranty. It is of course essential that any collateral warranty agreement is consistent with and reviewed in conjunction with the building contract or deed of appointment to which it inter-relates.

Depending on the relative negotiating positions of the parties and the nature of the project, further limitations that may be agreed (though not usually by funders) include a "net contribution clause", limiting liability to a "fair and reasonable" amount or a clause limiting consequential economic loss. The professional team may seek to limit or even exclude their liability for any economic loss beyond the reasonable costs of repair, renewal and/or reinstatement of the building in the event of defects appearing, thus excluding

for example any loss of rent or profits that may be incurred as a result. A lessee should of course resist such a limitation or exclusion as there is a real risk that the premises could be rendered unfit for use in the event of defective design or construction and in such circumstances collateral warranties will provide little comfort if loss of income is carved out of the agreement.

Collateral warranties in favour of funders generally contain fewer limitations than those in favour of an owner or a lessee and are usually trilateral; between the warrantor, the developer and the funder. The funder should generally be advised to seek to include step-in rights, which provide greater protection by allowing the funder to take over the role of the developer (or "step into its shoes") in completing the development in the event of the developer's breach of the loan agreement or facility documentation, the building contract or any deed of appointment, or upon the developer's insolvency. Step-in rights are not exclusive to funders though and can sometimes be achieved in favour of other parties, for example a purchaser of the whole of a new building under construction.

There will be a requirement in the collateral warranty that the professional maintain indemnity insurance. It is important that confirmation of the insurance cover is obtained at the time of the professional entering into the warranty and also that the professional provides confirmation from the insurer that he may enter into the collateral warranty and that the terms of such a warranty are agreed. The beneficiary of the collateral warranties should check that the level of the insurance cover is adequate and, on an ongoing basis, that the relevant indemnity insurance is still in place.

Collateral warranties usually limit the liability period to ten years in Jersey, although sometimes this liability period is limited to twelve years if the format used in Jersey follows the collateral warranties issued under English Law. Under English law a collateral warranty is given by way of a deed and therefore has a term of twelve years.

The collateral warranty agreement will usually specify that there can only be a specified number of assignments of the warranty

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to another party. It is important that the beneficiary is able to assign the benefit of the warranty to any purchaser of the property or assignee of a lease within ten years of completion. Any purchaser of the property or assignee of the lease in that period should be advised to require an assignment of the benefit of the warranty in order to have recourse against the original contractor or professional team, should the need arise.

From the lessee's point of view it would be preferable to require the lease to be drafted in such a way as to ensure that the lessee would not be responsible for any defects arising through negligence or breach of contract of the contractor and/or the professional team. A prudent owner may not allow this. The lessee would therefore need to be able to have recourse against both the contractor and the professional team and obtaining the benefit of collateral warranties would be of fundamental importance.

In the absence of collateral warranties it is probable that any claim against the contractor and/or the professional team would result if not in a court action, then at the very least in lengthy negotiations. All of which could result in extra costs to the lessee. Moreover, if the terms of the lease require the lessee to make good any defects, then the lessee would have to pay to remedy these prior to being able to recoup any losses from the contractor and/or the professional team. It is therefore crucial that these issues are dealt with upon the negotiation of the lease.

Collateral warranties are in addition to the defects period set out in the JCT. The majority of contractors in the Island will now agree to a twelve-month defects liability period from the issue of the certificate of practical completion. Regardless of whether or not collateral warranties are in place, it is important from both the owner's, the funder's and/or the lessee's stance that any known defects are fully noted and dealt with in accordance with the terms of the relevant JCT contract within this defects liability period.

Points to remember:

- Depending on the nature of the Joint Contracts Tribunal (JCT) building contract being entered into, site owners should require collateral warranties from the

professional team.

- Lessees should request, as a minimum, collateral warranties from the contractor and professional team involved in the construction of the building.
- There will be a requirement in the collateral warranty that the professional maintain indemnity insurance. The owner/lessee/funder should check that the level of the cover is adequate and, on an ongoing basis, that the relevant indemnity insurance is still in place.
- It is important that the owner/lessee/funder be able to assign the benefit of the warranty to any purchaser of the property, assignee of the lease or any new funder.

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