



Construction law in Ireland: collateral warranties

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In a new series, Ogier's experts on construction law in Ireland discuss and explain key foundational elements of construction law frequently queried by clients, including variations, liquidated damages, extensions of time under construction contracts and arbitration / conciliation.

Collateral warranties play a crucial role in the construction sector. They are ancillary / supplementary to the main construction contract and can be legally complex, regularly prompting queries from clients. We summarise the purpose of collateral warranties and key points to be aware of when entering into them, to avoid disputes and unnecessary risk exposure.

What is a collateral warranty?

The main construction contract typically creates a direct contractual chain between the employer, the contractor, the consultant and the sub-contractors. This contract legally binds the parties to the agreement under contract law. In Ireland, the doctrine of privity of contract still applies, meaning that only the people or companies who are part of the contract may be bound by it.

However, there are other third parties with an interest in the construction project who often fall outside the main contract, such as the funders and beneficiaries (for example, a purchaser or tenant) of the project. The purpose of a collateral warranty is most typically to create a direct contract between a funder / beneficiary and the contractor / consultant / sub-contractor working on the project (the warrantor). The collateral warranty allows the beneficiary to have a contract to rely upon, in the form of a warranty, in the event that it needs to enforce rights and take action should issues arise, for example, with workmanship.

Collateral warranties provide security to parties who have an interest in the construction project / development or have acquired an interest in the project / development either at a particular construction phase or post-completion. They can cover latent defects, sub-standard products, workmanship, or defective designs.

| The purpose of collateral warranties

Risk management and protection

Allows third parties to claim damages directly from contractors, consultants, or sub-contractors in the event of a breach of their obligations as outlined in the warranties.

Ensuring standards

They ensure that the work carried out meets the agreed standards and quality, as the contractor or consultant warrants to the beneficiary that they have complied with the terms of the main contract or provided their services with reasonable skill and care.

Funding requirements

In many cases, lenders require collateral warranties as a condition for funding construction projects. These warranties are also referred to as "funder collateral warranties", and provide lenders with a direct right of recourse against contractors and consultants in the event of defects or non-performance.

Sale and leaseback transactions

Collateral warranties are often crucial in sale and leaseback transactions. They give both the buyer and the tenant rights against the parties responsible for the construction of the building.

| Key considerations

Parties entering construction contracts may feel pressured into entering collateral warranties to secure the contract and often do so without fully considering the legal implications and risks. The following are some aspects that parties should consider before agreeing to execute collateral warranties.

Is it an obligation?

First, consider whether you are obliged to provide the requested collateral warranty. In some instances, the request to enter the collateral is a request and not an obligation in order to work / continue work on a project.

Liability scope

Ensure that the warranty does not make place responsibility on you for items outside the actual scope of work that you carried out. For example, a mechanical and electrical engineer should not execute a collateral warranty which imposes responsibility on them for elements designed by the

architect You do not want to be in a position where you are assuming liability for another party's work.

Insurance

Parties should always ensure that their insurers are comfortable with the exposure being signed up to and should consult with their brokers to ensure that the collateral warranty is validly covered by their insurance policy.

Supplemental protective clauses

Do not assume that the wording of the collateral warranty is not subject to further negotiation. You should consider seeking further protective clauses to be inserted into the collateral warranty, including:

- **No greater liability clause:** such clause seeks to ensure that you do not face exposure to the beneficiary more than was agreed with the employer
- **Net contribution clause:** such a clause would seek to limit your liability to only that element of a loss which you contributed to
- **Liability cap:** seeks to set a limit on the time and money you can be held liable for, i.e., the amount proposed by you usually matches the limit of indemnity contained in your professional indemnity policy

Critical aspects

Beneficiaries will often seek to include clauses in collateral warranties which can be problematic, including:

- **Step-in rights:** provide a right for the beneficiary to step into the place of the warrantor in a project
- **Precondition to payment:** some collateral warranties can be drafted in a manner such that their execution can be made a precondition to payment
- **Enduring power of attorney:** in some instances, the main contract gives the employer the right to execute collateral warranties on behalf of subcontractors

Notable recent developments

A recent landmark decision was made in the UK Supreme Court ruling in *Abbey Healthcare (Mill Hill) Ltd (Respondent) v Augusta 2008 LLP (formerly Simply Construct (UK) LLP)* [2024] UKSC 23 on whether collateral warranties constitute "construction contracts" under the Housing Grants

(Construction & Regeneration) Act 1996 (the UK Act). The decision was significant as it confirms that collateral warranties typically will not be considered construction contracts for adjudication purposes. This means that parties cannot refer disputes regarding collateral warranties to construction adjudication. The UK Supreme Court made the decision on the basis that collateral warranties do not involve a separate obligation to carry out construction operations but merely promise to perform existing obligations under the building contract.

While the decision will only be of persuasive authority in Ireland, the definition of “construction contract” in the Construction Contracts Act 2013 is nonetheless substantially the same as the definition in the UK Act, meaning it is likely the Irish Courts and adjudicators will apply the same interpretation. However, this does not prevent parties from including contractual dispute resolution mechanisms in warranties if deemed appropriate. This development helps clarify the Courts' position regarding the avenues for resolving disputes regarding collateral warranties and delineating the boundaries of statutory adjudication.

Conclusion

It is essential that all parties engaging in construction contracts are aware of the purpose and common issues arising under collateral warranties, as they are an important and unavoidable part of the contractual process. This article touches on only some of the key considerations on a complex area of law. Specialist advice should be taken prior to parties agreeing to execute collateral warranties due to the wide-ranging and sometimes onerous obligations collateral warranties can expose parties to.

How Ogier can help

Ogier's construction law experts in Ireland are available to provide expert advice and assistance on construction and building matters in Ireland. Please contact a member of our team via their contact details below.

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