Letters of Appointment and Collateral Warranties

Letters of Appointment

Letter/Deed of Appointments reflect the scope of the project and the nature of the Insured's own involvement.

Collateral Warranties

The purpose of collateral warranties is to create legal relationships, particularly duties, which would not otherwise exist. Collateral warranties are necessary because English Law does not generally permit a third party to enforce rights arising out of a contract to which it is not a party. However, an employer can now, with the agreement of the Insured, use the Contracts (Rights of Third Parties) Act 1999 to give third parties directly enforceable rights without the need for a warranty. The contract can explicitly define those terms that are intended to be enforceable by third parties. In time, this legislation may replace collateral warranties, but will not do so until parties to construction contracts have the confidence that it meets all the needs currently fulfilled by the warranty.

Typical examples of collateral warranties are:

- A consulting engineer, in addition to signing a contract with an Employer for the design and supervision of a project (the Appointment), might be asked to provide a warranty to third parties such as a funding agency (known) or the future tenants or purchasers (probably known) of the Employer's new asset when completed under the project.

- A consulting engineer, in addition to signing a contract (the Appointment) with a Contractor for design work under the Contractor's design and construct contract with an Employer, might be required to provide a warranty to the Employer or other third parties buying the completed project.

- A consulting engineer, originally engaged by the Employer, then has its terms of engagement novated to the Contractor, to create a design and construct relationship between the Employer and the Contractor. The Employer will probably still want a collateral warranty from the consultant.

- A nominated sub contractor, in addition to signing a contract with a Main Contractor for the design, supply and installation of specialist work (the Appointment) is often required to provide a warranty for the design element of its contract to the Employer who is in contract with the Contractor.

Typical Clauses –
Generally Applicable to Collateral Warranties and Letters of Appointments

Standard of Care – What is expected?

Avoid going beyond "*reasonable*, skill and care". The Insured should not be required to exercise a standard of care higher than this, although clients will occasionally attempt a draft clause which provides that the Insured should use "proper" or "professional" skill and care (these should be deleted and changed to "reasonable") Don't worry if the word "diligence" is also used.

Deleterious Materials – Does the Agreement contain an inappropriate list?

The Insured's duty should be limited to exercising "reasonable skill and care" to see that *he* does not *specify* any of these materials. If the Insured is required to use reasonable skill and care to ensure that no other parties specify/use such materials, then a proviso to the clause should be added to ensure that it does not impose an additional duty on the Insured to supervise Works:-

"Provided always that nothing in this clause extends the Consultant's duties to supervise the Works"

Some clauses contain a "catch all" proviso at the end of the clause i.e. "The Consultant warrants that he will not specify any other substance that is not in accordance with the British/European Standards and Codes of Practice *at the date of the use of the said substances*". This is too onerous. A reasonable compromise is to limit it to the Standards in force at the date of the specification.

Professional Indemnity Cover

Check it is at the correct level. The Insured will usually be asked to maintain the insurance for 12 years – make sure this is only required where the insurance is available in the market at commercially reasonable rates – i.e. by adding to the end of the clause *"Provided always that such insurance is available in the market at commercially reasonable rates"*.

It is also usual for clients to try and include a clause that enables them to organise PI cover on behalf of the Insured where the Insured is unable to maintain the requisite level, to be later reimbursed by the Insured. Whilst this is not a policy point, it is in the Insured's interest to delete this clause.
If the client is able to effect insurance on the Insured's behalf, it is unlikely to be at commercially reasonable rates, which will be borne by the Insured.

It should be noted that many PI policies do not provide cover for environmental impairment.

Collateral Warranties – Does the Appointment require the Insured to enter into collateral warranties or allow them to be assigned?

Some Appointments include an obligation on the Insured to provide collateral warranties in a form annexed to the Appointment. Sometimes, it is usual for the Appointment to include a clause that obliges the Insured to enter into a warranty in a 'form to be agreed'.

As regards to how many collateral warranties the Insured can enter into, this may not be specified in the policy, but in any event it is in the Insured's (and underwriters') interest to set a limit, if they can. Whilst the Insured should have no objection to collateral warranties being given to a financier or purchaser of the whole of the completed building or a single tenant of the whole/substantial part of it, it may be a problem in respect of tenants in a multi-tenanted building. Clearly the more tenants, the more potential claims there will be in the event of any defective design or incorrect advice.

Many policies do however provide that a collateral warranty may only be assigned twice where the Beneficiary is a Funder, Financier and/or Bank, and assigned once where the Beneficiary is any other party (i.e. tenant, purchaser). One should therefore look to limit the number of assignments accordingly.

Copyright – Is the Client granted a licence to use the Insured's drawings?

Not a policy condition, but it is always advisable that the Insured retains the copyright in his drawings, documents etc and grants a licence to the client to use them. Also consider including the following words:

"*The Consultant shall not be liable for any use of the [Drawings] for any purpose by the Client or its assignee other than that for which the same were prepared by the Consultant or on its behalf".*

Adjudication and Arbitration – How will disputes be resolved?

This may be referred to in the policy so have a look at this, but primarily you should ensure that the Adjudicator is independent – i.e. the Adjudicator should not be named in the Appointment. Further you should ensure that their decision is not binding and may be referred to a court of law.

Fitness for Purpose/Guarantees – Is the duty increased by the warranty?

Fitness for purpose obligations imposes a greater standard of care than "reasonable skill and care" because they impose a duty to achieve a result. Claims that arise out of such clauses are often excluded under the policies and accordingly should be deleted.

The words "fitness for purpose" are not always used. Other words which have the same effect are: *"The Consultant warrants and undertakes that the Works will be*

properly designed or meet the requirements of the Employer in all respects or will comply with all relevant statutes".

You should also look to avoid guaranteeing the designs performance or a fixed delivery time.

Blanket Indemnities

Most policies look to indemnify the Insured against negligence i.e. failure to use reasonable skill and care. The policy will provide an indemnity to the Insured in accordance with the Courts of Law i.e. those losses that are reasonably foreseeable.

You will sometimes find that the client attempting to claim more than what is reasonably foreseeable. Such a clause is often worded along the lines of "The consultant shall indemnify and hold harmless the tenant/Beneficiary from and against all claims actions costs losses and expenses made or suffered by a tenant as a result of any breach by the consultant of its warranties and undertakings under this Deed". The key word being "all".

This should not be accepted. The best position would be to delete the clause in its entirety to put the client in the same position of relying on the usual rules for recovery of his losses.

Unfortunately, this is often not accepted so you may wish to consider the following clause as an alternative:

The [Consultant] will indemnify the [Client] against all loss, damage, costs and expenses caused as a direct result of the [Consultant's] negligence or negligent breach of contract provided such losses were reasonably foreseeable as likely to be incurred by the Client and provided always that liability for personal injury or death shall not be excluded or limited in any way"

If the Client refuses to amend the agreement as above, as a last resort you could suggest that the words *"Provided such losses do not exceed those losses that would be awarded by a Court of Law in the absence of this clause"* are added to the end of the blanket indemnity.

Also be aware that blanket indemnities often occur for **Intellectual Property Rights Clauses**. In such cases, you should look for the clause to be deleted and replaced with:

"The Consultant is to be responsible to the Client for all losses which are reasonably foreseeable as likely to be incurred by the [Client] by reason of the Consultant infringing or being held to infringe any intellectual property rights in the performance of the Services".

Services

Generally, the Insured should check these carefully to ensure they accurately reflect the Services they intend to provide. In particular are your really intending to "monitor or supervise the works". This obligation should normally be limited to inspecting the works on a periodic basis to check they are proceeding generally in accordance with their specification.

Third Party Rights

The following clause should be added to Letters of Appointment and Collateral Warranties:

"It is agreed that nothing in this agreement shall confer or is intended to confer on any person any right to enforce any term of this agreement which that person would not have had but for the Contracts (Rights of Third Parties) Act 1999".

Net Contribution Clause – Could the Insured's liability be disproportionate?

This generally only applies to collateral warranty agreements, however, it can be used in Letters of Appointments. Many policies specify that the Insured must not sign any agreement that would increase his potential liability in the absence of the agreement. This could happen if he signs a collateral warranty agreement where none of the other design team sign the same and the rest of the members of the design team have become insolvent. Under the terms of the Civil Liability Act 1961, a plaintiff can enforce a Judgement against each concurrent wrongdoer even though a particular concurrent wrongdoer might only (according to the Court or Arbitrator) have contributed in a small way to the problem. Accordingly, the Insured could pick up the entire tab even if the Contractor (and indeed the whole design team) has some responsibility.

To avoid this situation the Insured should try and negotiate the inclusion of a net contribution clause. This will limit the Insured's liability to the extent of the Insured's default as follows:

The [Consultant's] liability for loss under this Agreement shall be limited to that proportion of such loss which it would be just and equitable to require the [Consultant] to pay having regard to the [Consultant's] responsibility for the same on the basis that [insert names of all the members of the design team] shall be deemed to have provided contractual undertakings on terms no less onerous than this Agreement to the [Beneficiary] in respect of the performance of their services in connection with the [Development] and shall be deemd to have paid the [Beneficiary] such proportion which it would be just and equitable for them to pay having regard to the extent of their responsibility".

If its inclusion is not accepted by the client, then the Insured should ensure that he obtains evidence from the client that all other members of the design team have signed equally onerous agreements, as follows:

"It is a requirement of this Agreement that all other members of the professional team including sub-consultants having design input shall enter into similar warranties".

Deeds of Novation

These should be simple documents that transfer the obligations and liabilities of the Insured from the Client to the Contractor or Funder. It gives the Contractor or Funder the duties and liabilities of the Client under the Appointment. The Novation should not increase the Insured's obligations in any way and should not add any additional warranties. Be sensible, if there are warranties, just check they match the Deed of Appointments. For the avoidance of doubt, you might want to negotiate adding the following clause to the Novation:-

"It is acknowledged by all parties that nothing in this Deed of Novation shall increase in any way the responsibilities of the Insued, in scope or liability, to the [Contractor] had the [Contractor] been named as joint client with the [Client] under the Appointment".

General

You should try and include the following wording in the Collateral Warranty Agreement:

"The Consultant shall have no greater responsibility in scope or liability to the [Beneficiary] by virtue of the Deed than it would have had if the Beneficiary had been named as joint client under the Appointment"

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