

Collateral Warranties

A collateral warranty is a contract which gives a third party rights collateral to rights in an existing contract entered into by two separate parties.

1. An example

For example, a contractor is appointed to construct an office development for a developer. That developer intends to lease the office development under a pre-let agreement to a corporate tenant on the basis of a fully repairing and insuring lease. Due to privity of contract the contractor would normally only be contractually liable to the developer if defects arise. However, the collateral warranty establishes a contractual relationship between the corporate tenant and the contractor against defect which the tenant can then rely on for a period of 10 years from practical completion. This is important to the tenant who is obliged under the lease to maintain and repair the building.

2. Who needs Collateral Warranties?

A party taking an interest in a property needs collateral warranties (i.e. a purchaser, tenant or fund).

3. Why are Collateral Warranties needed?

It is not possible for a party with an interest in a building to sue a construction team for defects in that building (caused by the construction team's negligence) unless there is a direct contractual agreement between the parties. The only party who can sue the construction team for breach of contract is the original employer (i.e. the developer). By having the construction team grant collateral warranties in favour of a third party the third party is also able to sue the construction team.

4. Who provides Collateral Warranties?

This depends on the method of construction procurement. As a general rule, warranties are required from the contractor, sub-contractors who have design input, and the professional team comprising the architect, structural engineer, mechanical and electrical engineer and any other design consultant. This may also include anyone carrying out surveys at an early stage of the project (i.e. geotechnical or environmental consultants).

Building contracts and deeds of appointment may provide for warranties to be given but may limit the number available and will generally annex a draft of the warranty which will be provided. Ideally these will have been approved (in general or specifically) by the contractor's or professional's insurers. If not, the value may be limited to the assets of the contractor or professional concerned.

The information and expressions of opinion contained in this guide are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.

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