# Collateral agreements

## A healthy scepticism needed

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In parallel with the increasing complexity of construction procurement, the contractual documentation to govern construction professional appointments has also become more complex. There was a time when your contractual rights and obligations as an architect would have been entirely contained in your appointment; this is no longer the case. Appointments are now commonly accompanied by additional documentation such as collateral agreements, often also referred to as collateral warranties. It has been said that 'It is impossible to un-sign a contract, so do all your thinking before you sign'.[1] This advice is particularly applicable to collateral agreements.

**What is a collateral agreement**

A collateral agreement is an extension of your appointment, where you agree or promise that you will perform the obligations of your appointment for the benefit of a third party, who may be unknown to you at the time you sign the agreement. Or put another way, a collateral agreement confers rights to a third party to enforce your appointment, notwithstanding that they were not a party to the original appointment. A collateral agreement creates a contractual relationship between you and the third party, providing a direct route of recovery from you for any loss they may incur through a breach of contract. This route is more advantageous to the third party in terms of the burden of proof than through taking an action in negligence. The most usual form of collateral agreement is one between you and a third-party beneficiary with an interest in a project, for example a purchaser, a funder, or a tenant. A collateral agreement will usually include a nominal payment, typically €10 being acknowledged as received, as consideration. The nominal payment serves to fulfil the last of the three elements of a contract in law, namely offer, acceptance, and consideration.

**The primary provisions of a collateral agreement**

A collateral agreement will usually have several primary provisions. The first will specify the period for which the agreement will apply, typically this will be six years if signed under hand, or twelve years if signed under seal, from the date of Practical Completion of the project. The duration of the agreement will determine the length of time that you will have to continue to maintain your Professional Indemnity Insurance (PII). There will often be a provision requiring you to present your insurance certification on demand. Most PII policies will cover your liabilities under a collateral agreement, but this will always be subject to conditions. You should be mindful that twelve years is an extended period, during which the PII market may harden. Over time it may become more difficult to secure comparable future premiums that are similar to that at the time of signing the agreement, as is the case in the present market. You may find yourself having to meet significant additional cost to maintain continued cover.

Only the largest of projects will demand a twelve-year liability period, where any agreement should reflect the scale and complexity of the project. For example, a commercial interior fit-out will not be of such scale and complexity to warrant anything other than the six-year liability period, which reflects the liability period under the Statute of Limitations 1957. Always seek to have your appointments made under hand and avoid contracts of appointment made under seal as a practice policy. It follows that you should never enter into a collateral agreement under seal when the originating appointment is under hand. There will be large private sector projects or Public Private Partnership (PPP) projects that will demand a twelve-year liability period within your appointment, which will in turn be reflected in the collateral agreement. These projects usually require a longer design life specification. Both the appointment and any collateral agreement may require project specific arrangements to be considered and put in place as part of your PII.

The agreement will provide for assignability, usually restricted to two times only, being the industry accepted guidance. It is not unknown for unlimited assignment to be sought, which you should robustly resist. You need to be aware that each assignment will further extend the obligations of your original appointment in contract. Finally, the agreement will usually confer step-in rights that permit the third-party beneficiary, usually the funder, to take the place of the client or employer in the event of their insolvency. This means that the third-party beneficiary would become your client, or employer, to enable the project to continue to completion.

**Onerous provisions**

At the beginning of a project, there will usually be no obligation to provide a collateral agreement. If you consider that the possibility exists, it is better to address it up-front, as delay and increasing involvement in the project will dilute your negotiating position. Collateral agreements are most common in the private sector where early enquiry can identify if it will be necessary to enter into an agreement with a third-party funder, a tenant, or purchaser. If an agreement is required, you can take this into account as part of the commercial terms of your appointment.

Your first reaction on being presented with a collateral agreement should be to avoid extending your liability at all. But often commercial pressure – including continued involvement to recoup the cost of past resourcing, the promise of future work, or necessity for project viability, purported or otherwise – may be brought to bear where your negotiating position may be compromised. In the case of a one-off project with a new client, you should strongly resist any onerous provisions. The obligations contained within any collateral agreement should mirror, and be limited, to the obligations within your appointment. There is no reason why a collateral agreement should contain terms that vary from your appointment. If you do consider entering into a collateral agreement, you should confirm that the other consultants involved in the project will also be entering into collateral agreements on the same terms, as you do not want to be the only party providing an agreement.

It is not unusual for a collateral agreement to be drafted in way that is ambiguous, while seeking to impose obligations that are additional to the original appointment. For example, your appointment may provide for you to apply a standard of reasonable care and skill, but the collateral agreement may seek to extend this duty to the more onerous standard of fit for purpose, or to warrant or promise that a building will be fit for use. These more onerous provisions will be almost certainly beyond the cover of your PII, or put more succinctly, if you sign up to these provisions you will probably be uninsured. Similarly, some agreements may seek a guarantee or warranty in relation to your services, or even to impose liquidated damages provisions for non-performance of your services, which will not be covered by your PII. You should always remember that your PII will generally have a contractual liability exclusion. This means that your policy will exclude any liability assumed under contract which would not have attached in the absence of such agreement, in addition to excluding any greater duty of care accepted under contract.

Always beware of provisions that are likely to be uninsurable. An example would be a residential development comprising multiple units where a collateral agreement is sought for the benefit of each future purchaser of a unit. Any collateral agreement of this type will have the effect of extending your obligations in contract, and therefore your liability, far beyond what could be considered reasonable. There may also be a contractual requirement for you to obtain further agreements, which you may not have anticipated or considered. These further agreements will usually arise where you have employed specialist subconsultants, such as acoustic engineers, facade consultants, or landscape architects, as examples. You may find that the subconsultants will be resistant to providing a collateral agreement after the event. In the absence of agreements being provided, you could find your liability further extended.

**Beneficial provisions**

As part of negotiating a collateral agreement, should this be necessary, you should seek to include beneficial provisions to limit, or to set a ceiling for, your liability and that of your insurers. A straightforward limitation is a monetary cap where you accept liability only up to a specified amount. This can be calculated as an agreed multiple of your fee, or more usually, a stated amount such as €1 million, €2 million, or a higher figure depending on the project parameters. Always refer to your PII cover which may be 'in the aggregate' rather than 'each and every', to ensure that your cover will not be exhausted by the collateral agreement in the event of a future claim.

Limitation can also be achieved through the inclusion of a Net Contribution Clause within your appointment and the associated collateral agreement. The clause, which needs to be carefully drafted, seeks to limit your liability to reflect the extent to which a court considers that you are responsible, being within that as set out in your original appointment. In short, you are only responsible for the portion of loss that you have caused and not the loss caused by anyone else. The Net Contribution Clause provision, to protect you from joint and several liability with others, has never been tested in an Irish court. It may be in tested in the future, but the clause has 'saved the day' for consultants in the UK, where it has been tested and upheld by the courts. In the absence of being able to negotiate a Net Contribution Clause in a collateral agreement, you should seek to include an equivalent right of defence clause, to allow you to rely on any limitations that are already in your original appointment, where the above beneficial provisions may have been included.

Finally, negotiate to ensure that there is an adequate dispute mechanism in your appointment, and any collateral agreement, to include conciliation and arbitration, to avoid the considerable time and cost in resolving any dispute through litigation. Also be aware that the Irish court has yet to consider if a collateral agreement falls within the definition of construction contract under the Construction Contracts Act 2013 (CCA 2013), as has been confirmed in the jurisdiction of the UK for the equivalent Act. Should a collateral agreement fall within the remit of the CCA 2013 it is likely to provide a more expedient and cost-effective resolution to any future dispute.

**What to do on receiving a request to provide a collateral agreement**

Regular commentary advises that the standard forms of collateral agreement provided by the construction body institutions favour the consultant to the detriment of the employer. Rightly, or wrongly, this has led to a tendency for more onerous bespoke collateral agreements, prepared by the client legal representatives. There is no legal reason for you to provide a collateral agreement for free, as is often sought, particularly as the third-party beneficiary of the collateral agreement will secure material benefit through a reduction in risk. You may incur substantial future cost from your continued obligation to secure and maintain PII at reasonable terms, apart from the increased exposure to an action in contract from persons unknown. Your first response on receiving a request to consider entering into a collateral agreement should be to secure your costs from your client for a legal and insurance review of the agreement, and then seek advice before proceeding. A reasonable client is unlikely to object to a review as it will be in their interests for any agreement to be acceptable and covered by your PII.

You can also contact the Practice Division at the RIAI, who have experience on the issues relating to collateral agreements, to seek advice. The RIAI publishes a standard form of warranty called the 'Warranty for Professional Services – 1992 Edition' which is usually acceptable to the major PII providers. When a bespoke agreement is proposed, it is preferable to insist on the standard RIAI form as an alternative, which has proved acceptable to many clients. With the benefit of objective advice from the RIAI, that certain provisions are uninsurable, it is not unusual for clients to delete a contentious provision as part of early engagement and negotiation.

**Conclusion**

There will rarely be anything in a collateral agreement that is to your benefit, as its primary purpose is to extend your contractual obligations, and therefore your risk, to persons unknown to the end of a future period. The primary purpose of a contract is to balance risk. In collateral agreements there is rarely an equitable balance of risk, as risk is transferred to you. Any negotiation will be about the nature and extent to which you are willing to accept risk. Be prepared to robustly negotiate to achieve the best terms you can, strictly within the bounds of your PII. Adopt an attitude of representing both you and your insurers, who will respect your efforts. A collateral agreement should always be considered as onerous and treated with a healthy scepticism. You should bear in mind that 'You sign an agreement; you make a contract you live up to it. You never get what you deserve. You get what you negotiate. You got a right to say yay or nay'.[2]

Notes

1 Attributed to Warren Buffett, also known as the 'Oracle of Omaha', US business magnate.
2. Attributed to Don King, the US boxing promoter.