

Collateral Warranties – Not To Be Signed At the Beginning

I am assisting a specialist niche area sub-contractor which during the honeymoon period of entering a substantial sub-contract signed every possible warranty for its work including a collateral warranty with the Employer stating that its design and installation work would be perfect.

However, following completion of the sub-contractor's work and prior to the main contract being completed two expensive panels were badly scratched by another sub-contractor whose men were not at all attentive as to where they were and what they were doing.

With all fairness to the main contractor and in a rare moment of honesty, it accepted in writing responsibility for the scratches on the two panels and offered to pay for the repair.

However, notwithstanding the attempts made by the specialist sub-contractor to repair the panels insitu, unfortunately the scratches can still be seen and the specialist sub-contractor has stated that the two panels require replacement and the cost of their replacement will be approximately £50,000.00, partly due to their location and the difficulty in removing them and installing the replacement ones.

The main contractor's contract works insurance covers the event and, therefore, the main contractor is only at risk of having to pay for the insurance claim excess. But because it would mean that the Employer's restaurant in the venue would have to be closed whilst the work is being undertaken, one of the Employer's managers gave a verbal instruction to the main contractor not to replace the panels, but the Employer refuses to issue a letter confirming this.

The main contractor is refusing to release the final moiety of retention, the Performance Bond provided by the sub-contractor's bank (another mistake made during the honeymoon period) and in accordance with the terms of the sub-contract, until the sub-contractor signs a Final Account Statement which states that the sub-contractor has no other claims whatsoever against the main contractor, the main contractor is withholding the retention and Performance Bond and the Performance Bond does not have a back-stop expiry date (a further mistake made during the honeymoon period).

The problem is that the collateral warranty between the Employer and the sub-contractor states that all its design and installation work, including the finished panels are perfect. Therefore, under the collateral warranty the Employer can pursue the sub-contractor directly in seven or ten years' time (the collateral warranty has a limitation period of twelve years) requiring the panels to be replaced and the sub-contractor will then be forced to replace them free of charge, or paying damages if it refuses to do so.

If the sub-contractor had not signed the collateral warranty when entering into the sub-contract, then it could have excluded the two panels from it regarding the completed work, whereas having provided the Employer with the warranty that all its work would be perfect, it is at risk over a twelve year period that the Employer may require the sub-contractor to change the panels free of charge in a number of years' time and the main contractor is refusing to release the final moiety of retention and the Performance Bond unless the sub-contractor signs a Final Account Statement stating that it has no other claims whatsoever against the main contractor, leaving the sub-contractor exposed to this risk.

Collateral Warranties were drafted to be issued on completion of sub-contractors' work, not before they even commenced designing their work and, therefore, if signed at the commencement of a sub-contract they do not take into account any material events that occur during the progress of the main contract. Therefore, a wise sub-contractor should refuse to sign them until its work is completed and paid for.

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