

What happens to collateral warranties if the client goes into liquidation?

Rachel Barnes, September 2009

Griffiths & Armour have recently received queries concerning the position of consultants in respect of collateral warranties when their clients go into liquidation. We set out below some general guidance about this.

Where the collateral warranties have already been entered into by the consultant

The consultant would still be liable under the collateral warranty. His liability to the holder of the collateral warranty does not end simply because his client has gone into liquidation. The rights under the collateral warranty are separate stand-alone rights from those under the appointment.

Whether or not the consultant has been paid by the client would make no difference to his liability under the collateral warranty unless that was a precondition to the consultant becoming liable under the collateral warranty, which is extremely unlikely.

Griffiths & Armour were asked whether the collateral warranty would be void in this situation because of the wording frequently found in collateral warranties - that the consultant shall have no greater liability to the collateral warranty-holder than he would have had to his original client. The argument was that this would mean the consultant's liability under the collateral warranty was now nil because the consultant would no longer have any liability under the appointment.

That would not in fact be the case.

The "*no greater liability*" wording is directed at the position where the losses of the collateral warranty-holder may be different from and greater than those of the client because the consultant's liability to the client was restricted in some way or ways. In that case the holder of the warranty can collect no more than the client could.

The consultant's liability to his client under the appointment does not end simply because the client has gone into liquidation. A claim could still be brought through the liquidator, receiver or administrator (or trustee in bankruptcy if he is an individual) of that client until the time for bringing that claim is barred. If the claim was brought and the consultant were liable he would have to pay whatever was due as a result. Even if the client is a company which is struck from the register, there are ways of getting them restored to the register (though a registration application is itself subject to a limitation

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period). Liquidation etc may mean that a claim is slightly less likely to be brought as the liquidator etc may find it difficult to fund such a claim.

It is also possible, as we are currently finding, that the receiver or liquidator may assign the rights under the original appointment to a purchaser or tenant or other person interested in the development. Most appointments allow for assignment of rights without consent or are silent on the subject which would mean that such assignment is permissible. The assignee is then entitled to bring any claim under the appointment that the original client was entitled to bring.

This is a reason why consultants should consider carefully whether they should restrict the right to assign. Although any claim for outstanding fees would be available as a set-off against a claim by an assignee, the consultant will not be able to sue the assignee for any outstanding fees, unless the appointment provides otherwise, because no "*obligation*" of the original client will pass under such an assignment.

Remember too that where a consultant is exercising his rights to suspend (whether under the Construction Act or under the appointment) or his right to terminate because of non-payment, it is usual for collateral warranties to provide that the funder and possibly also the purchasers and tenants have to be given certain notices before those rights can be exercised. These will have to be complied with in addition to any requirements for notices in the appointment.

Where the collateral warranties have not yet been entered into when the client goes into liquidation

The question is whether the consultant still has to enter into a collateral warranty in such circumstances, in particular where the client has failed to pay monies due to the consultant.

The first thing to do is check the terms of the appointment. Some make it clear that the collateral warranties have to be given whether or not the consultant is owed any money, in which case the consultant would have to give them except possibly where there has been a repudiatory breach – see below. Some make it clear that collateral warranties are only to be given if the consultant has been paid up to date, but this is rare.

If the consultant exercises a right he has been given by his appointment to terminate that appointment because the client has not paid, or because of the client's insolvency, this will not bring to an end the consultant's obligation to give collateral warranties in the future unless the appointment so provides, which again is very unlikely.

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If there are substantial outstanding fees at the point where the consultant is being asked for the collateral warranty, the consultant may be able to make use of a usual provision in the collateral warranty under which the consultant has to acknowledge that all fees due to date have been paid (as in the CIC standard form). He can legitimately refuse to sign the collateral warranty until he is paid because he cannot make such an acknowledgement if it is untrue and funders may be sufficiently alarmed by this to intervene to ensure payment is made as they may well have to pay the outstanding fees in the event that they decide to step into the appointment if the client subsequently goes into liquidation.

If the failure to pay by the client is very serious this could amount to a repudiatory breach by the client. This will depend on the particular facts of the case. If the breach is repudiatory, it has to be "*accepted*" by the consultant within a reasonable time and then the consultant is relieved from the performance of any further obligations under the appointment which would include the giving of collateral warranties.

Legal advice should always be taken before the consultant exercises this right because the financial consequences for a consultant if the breach is not repudiatory can be very serious.

There is often a right to the consultant to terminate for "*material breach*" under the appointment. However, "*material breach*" is not necessarily sufficient to constitute repudiatory breach and so advice should also be taken before a consultant uses this as an argument for not entering into collateral warranties.

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