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Defects & Defect Liability Period

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1 INTRODUCTION

1.1 What is a construction defect?

1.1.1 Differing viewpoints and interests.

1.1.2 Builder, developer, contractor, subcontractor, supplier, manufacturer, leaseholder, homeowner.

1.1.3 Substantial defect or a nuisance claim (e.g. a squeaking floor).

1.1.4 Lack of maintenance or normal wear and tear.

1.2 Four main categories:

1.2.1 Design deficiencies

1.2.2 Material deficiencies

1.2.3 Specification issues

1.2.4 Workmanship deficiencies.

1.3 Structure of this paper:

1.3.1 English law, with reference to some standard forms of contracts in respect of defects;

1.3.2 Limitation issues; and

1.3.3 The assessment of damages (cost of reinstatement vs. diminution in value).

2 AN ENGLISH CONSTRUCTION CONTRACT

2.1 An entire contract. See *Modern Engineering v Gilbert Ash* [1974] AC 689, in particular Lord Diplock:

> *"A building Contract is an entire contract for the sale of goods and work and labour for a lump sum price payable by instalments as the goods are delivered and the work done."*

2.2 Compare with the concept of substantial performance.

2.3 An interesting criticism was described in *Bickerton v North West Metropolitan Regional Hospital Board* [1969] 1 All ER 977 in respect of the drafting of the RIBA 1963 Standard Form of Contract:

> *"Unnecessary, amorphous and tortuous … it seems lamentable that such a form … should be so deviously crafted with what in parts can only be as calculated lack of forthright clarity."*

2.4 The JCT Suite of Contracts has been revised several times since then, and the current 2005 suite of JCT contracts has also been updated from time to time. The current situation in the Standard Form of Building Contract (SBC) 2011 comprises:

2.4.1 Section 2.1 – Contractor's obligations to carry out and complete the works;

2.4.2 Condition 2.30 – Architect or contract administrator to certify when the works are practically complete;

2.4.3 Condition 2.38 – Rectification period (previously defects liability period);

2.4.4 Conditions 2.32 & 2.37 – Liquidated (or delay) damages. The employer's sole remedy for late completion;

2.4.5 Condition 3.18 – Defects for the works to be made good at the contractor's cost;

2.4.6 Condition 4.18 – Retention: 5% until practical completion, then 2.5% during the defects rectification period;

2.4.7 Condition 4.15 – The final certificate.

2.5 Section 2.1 appears in the following terms:

> *"The Contractor shall carry out and complete the Works in a proper and workmanlike manner and in compliance with the Contract Documents, the Construction Phase Plan and other Statutory Requirements, and shall give all notices required by the Statutory Requirements."*

2.6 Condition 2.30:

> *"When in the Architect/Contract Administrator's opinion practical completion of the Works or a Section is achieved and the Contractor has complied sufficiently with clauses 2.40 and 3.23.4, then:*
>
> *.1 In the case of the Works, the Architect/Contract Administrator shall forthwith issue a certificate to that effect ('the Practical Completion Certificate');*
>
> *.2 In the case of a Section, he shall forthwith issue a certificate of practical completion of that Section (a 'Section Completion Certificate').*
>
> *And practical completion of the Works or the Section shall be deemed for all the purposes of this Contract to have taken place on the date stated in that certificate."*

2.7 The word "practically" is not defined in the contract, but has been the subject of some judicial considerations, particularly the meaning of "practical completion".

2.8 In *HW Neville (Sunblest) Limited v William Press & Son Limited* HHJ Newey QC said:

> *"I think that the word 'practically' in Clause 15(1) gave the Architect a discretion to certify that William Press had fulfilled its obligation under Clause 21(1) where very minor de minimis works had not been carried out, but if there were any patent defects in what William Press had done the Architect could not have given a certificate of practical completion."*

2.9 In an earlier House of Lords decision of *City of Westminster v Jarvis*, Viscount of Dilhorne said:

> *"The Contract does not define what is meant by 'practically completed'. One would normally say that a task was practically completed when it was almost but not entirely finished; but 'Practical Completion' suggests that that is not the intended meaning and that what is meant is the completion of all the Construction work that had to be done."*

2.10 FIDIC adopts a different approach in Clause 10.1(a). The engineer is to:

> *"issue the Taking-Over Certificate to the Contractor, stating the date on which the Works or Section were completed in accordance with the Contract, except for any minor outstanding work and defects which will not substantially affect the use of the Works or Section for their intended purpose (either until or whilst this work is completed and these defects are remedied)."*

2.11 The Society of Construction Law's Delay and Disruption Protocol (October 2002) suggests that substantial completion and practical completion should be defined as the completion of all of the construction work that has to be done, subject only to very minor items that are incomplete. This approach adopts the minority opinion of Salmon LJ in *Jarvis v Westminster*, who said in relation to practical completion that it was:

> *"For all practical purposes, that is to say for purposes of allowing the employer to take possession of the works and use them as intended, but not 'complete' down to the last detail, however trivial and unimportant."*

2.12 One view therefore is that completion under a building contract is (subject to any clear definition in the contract) completion of all of the contract works, subject to any minor items and subject to any known defects that would prevent the employer from taking over and making use of the project.

2.13 Condition 2.38 relates to the rectification period, and states:

> *"If any defects, shrinkages or other faults in the Works or a Section appear within the relevant Rectification Period due to materials, goods, or workmanship not in accordance with this Contract or any failure of the Contractor to comply with his obligations in respect of the Contractor's Design Portion:*
>
> *.1 such defects, shrinkages and other faults shall be specified by the Architect/Contract Administrator in a schedule of defects which he shall deliver to the Contractor as an instruction not later than 14 days after the expiry of that Rectification Period; and*
>
> *.2 notwithstanding clause 2.38.1, the Architect/Contract Administrator may whenever he considers it necessary issue instructions requiring any such defect, shrinkage or other fault to be made good, provided no instructions under this clause 2.38.2 shall be issued after delivery of a schedule of defects or more than 14 days after the expiry of the relevant Rectification Period.*
>
> *Within a reasonable time after receipt of such schedule or instructions, the defects, shrinkages and other faults shall at no cost to the Employer be made good by the Contractor unless the Architect/Contract Administrator with the Employer's consent shall otherwise instruct. If he does so otherwise instruct an appropriate deduction shall be made from the Contract Sum in respect of the defects, shrinkages or other faults not made good."*

2.14 During the rectification period the contractor has not just an obligation to return, but also the right to return and remedy defects.

2.15 The default position under English law would be that the employer would have the right to correct any defects and then claim damages from the contractor. The purpose therefore of the defects rectification or defects liability period is one of mitigation. It is

surely more economic and more sensible for the contractor to return and correct any defects.

2.16 In practice, this often includes the completion of any snagging items or punch list items. In reality, it is used as the period during which the works are in reality finally and absolutely completed, and during which any patent defects are resolved.

3 PATENT AND LATENT DEFECTS

3.1 There is an important distinction between patent and latent defects.

3.2 A patent defect is one that is visible or detectable at practical completion or during the defects liability period. The test is an objective one, according to *Sandserson v National Coal Board* [1961] 2QB 244:

> *"A patent defect is not latent when there is none to observe it. The natural meaning of the word 'patent' is objective, not subjective. It means 'observable, not observed'. A patent defect must be apparent on inspection, but it is not dependent on the eye of the observer; it can blush unseen. In this case, although the defect was in darkness, it was patent. Had the plaintiff or his mate shone their lamps on it at the relevant moment, they would have seen it."*

3.3 A latent defect is by its own nature concealed. It may not manifest itself for many years. A typical example might be defective foundations that do not become apparent until cracks appear in the building many years later. See, for example, *Baxall Securities Ltd v Sheard Walshaw Partnership* [2002] EWCA Civ 09, para 46:

> *"The concept of a latent defect is not a difficult one. It means a concealed flaw. What is a flaw? It is the actual defect in the workmanship or design, not the danger presented by the defect … To what extent must it be hidden? In my judgment, it must be a defect that would not be discovered following the nature of inspection that the defendant might reasonably anticipate the article would be subject to."*

3.4 As the test is an objective one, it is likely that in the commercial context a defect is patent if it can be discovered with the benefit of skilled third-party advice. This can have an impact on the commencement of the limitation period.

4 THE CONTRACTOR DOES NOT HAVE AN AUTOMATIC RIGHT TO REMEDY DEFECTS

4.1 There is no common law right for a contractor to return and remedy a defect. A contractor only has a right if the contract expressly provides for the contractor to return and remedy a defect.

4.2 If the contract contains a defects liability, rectification or maintenance period, then the contractor has a right (and an obligation) to return to site and remedy any defects. The contractor is obliged to return within a reasonable period and remedy those defects.

4.3 The default position is that the employer may engage others to remedy the defect and claim damages.

4.4 There is some tension between the requirement for an employer to mitigate its loss, and at the same time request a contractor to return to site in circumstances where the employer may have lost confidence in the contractor's ability to properly and adequately remedy defects.

4.5 A complete refusal to allow a contractor to return to site might mean that an employer cannot claim more than it would have cost the original contractor to remedy a defect. See *Pearce & High v Baxter & Baxter* [1999] BLR 101 CA.

5 PRACTICAL OR SUBSTANTIAL COMPLETION

5.1 Most contracts do not define completion, practical completion, substantial completion or any other such terms that might be adopted. Under English law the following principles may apply:

5.1.1 At the date of practical completion the works should be free from patent defects (*Westminster Corporation v Jarvis* [1970] 1 WLR 637).

5.1.2 Practical completion can be achieved regardless of the presence of a latent (unseen or undiscovered) defect.

5.1.3 The defect or rectification liability period is to allow the contractor to remedy any latent defects that are not apparent at practical completion (not patent ones).

5.1.4 The third party certifying practical completion has a discretion to certify practical completion even where there are minor or *"de minimus"* works still to be carried out (*H W Neville (Son) Ltd v William & Son Ltd* (1981) 20 BLR 78). However, this does not allow for practical completion to be certified where the works are more substantial than simply minor or *de minimus*.

5.1.5 An architect or contract administrator can insist on completion of all snagging items before certifying practical completion.

5.1.6 An employer or owner can properly insist on completion of all snagging items before practical completion is certified.

5.1.7 A certifying third party might therefore be liable to an employer or owner if they ignore an employer's proper representations, but nevertheless certify practical completion in the event.

6 DEFECTS AND BREACHES

6.1 A defect is a breach of contract.

6.2 The inclusion of a defects or rectification period does not reduce the employer's right nor reduce the contractual impact of a defect; it remains a breach unless the contract provides otherwise.

6.3 Must the employer notify the contractor of a defect?

6.3.1 The express terms of the contract must always be considered.

6.3.2 Failure by the employer to notify the contractor does not relieve the contractor. The contractor is still liable for the defect as a breach of contract. There might be an impact upon the assessment of damages, see *Pearce & High v Baxter & Baxter* and also *Persimmon Homes (South Coast) Ltd v (1) All Aggregates (South Coast) Ltd (2) Cemex UK Properties Ltd* [2008] EWHC 2379 (TCC).

6.3.3 Take care, as an employer's notice to a contractor can in certain circumstances be considered a condition precedent to the making of a claim. This will, however, be dependent upon the wording of the contract (see *London and South West Railway (The Flower)* (1875) 1 CPD 77.

7 MAINTENANCE OBLIGATIONS AND DEFECT OR RECTIFICATION OBLIGATIONS COMPARED

7.1 The distinction can be made between defect rectification obligations and maintenance obligations.

7.2 An obligation to remedy defects is quite simply that: the rectification of defects during the defects liability period.

7.3 However, if the contractor agrees to maintain the works then there is usually a wider obligation. Much will depend upon the precise wording set out in the contract.

7.4 Maintenance obligations can include any reasonable improvements during the maintenance period, and so great care is needed in considering the wording of any maintenance obligation.

7.5 In *Sevenoaks Railway v London, Chatham and Dover Railway Co* (1879) 11 ChD 625, the contractor was required to carry out reasonable improvements as the maintenance provisions were to keep the works in the "same state".

8 FINAL CERTIFICATE

8.1 The Joint Contracts Tribunal Standard Building Contract (SBC) provides for the issuing of a final certificate about one year after practical completion. It determines the final payment in respect of the final account. In that respect it is conclusive.

8.2 Under English law it has been taken to be conclusive as to matters of quality (see the Court of Appeal decision in *Crown Estates Commissioners v John Mowlem & Co Ltd* [1994] 70 BLR 1.

8.3 An architect or certifier cannot know whether there are any latent hidden defects. JCT introduced a caveat at clause 1.1 to deal with this issue:

> *"no Certificate … shall of itself be conclusive evidence that any works, any materials or goods or any design completed by the Contractor … are in accordance with this Contract."*

9 LIMITATION

9.1 Under English law claims become statute barred either:

9.1.1 After 6 years for a "simple" contract; or

9.1.2 After 12 years for a contract under seal.

9.2 Under a warranty or a guarantee time might start to run from the date on the document.

9.3 Under the Limitation Act 1980, section 32, a limitation period under a contract can be extended if the contractor has deliberately concealed the defect. This, however, requires deliberate concealment and is difficult to prove.

9.4 A claim in tort adopts a different approach. Under section 2 of the Limitation Act, the cause of action becomes statute barred 6 years from "*the date upon which the cause of action accrued*".

9.5 In *Perelli General Paperworks v Oscar Faber & Partners* [1982] 21 BLR 99, Lord Fraser said:

> "*It seems to me that, except perhaps where the advice of an architect or consulting engineer leads to the erection of a building which is so defective as to be doomed from the start, the cause of action accrues only when physical damage occurs to the building.*"

9.6 Importantly, the commencement date for the limitation period is therefore postponed until the defect appears or can be discovered with reasonable diligence.

9.7 The Latent Damage Act 1986 extends the limitation period for negligence in certain circumstances:

> "*Six years from the date on which the cause of action accrued (the date is established in accordance with Perelli); or*
>
> *Three years from the date on which the plaintiff knew he had an action, whichever is the later, but subject always to a 15 year long stop from the date of the negligence complained of.*"

10 DAMAGES

10.1 Under English law, damages in contract are based upon the claimant's "*expectation loss*". The claimant is to be put, so far as it is possible by the payment of money, in the position he would have been in had the contract been properly carried out.

10.2 In a claim for negligence, the claimant is to be put in the position he would have been in had the tort not occurred.

10.3 There are three (perhaps competing) ways to assess the loss caused by defective work:

10.3.1 Cost of reinstatement (or cost of cure);

10.3.2 Diminution in value; or

10.3.3 Loss of amenity.

11 THE GENERAL RULE – COST OF REINSTATEMENT

11.1 Losses caused by defective work are most frequently assessed by reference to the cost of putting right that work. This is known as the cost of reinstatement or sometimes the cost of the cure.

11.2 The alternative approach – diminution in value. The courts occasionally decide that the correct measure of damages is based upon a diminution in the value of the property. See *Ruxley Electronics & Construction Ltd v Forsyth* [1995] UKH 8.

11.3 If the defect is irreparable or the cost of reinstatement is out of all proportion to the benefit to be gained, then the cost of reinstatement might not be applicable (*Applegate v Moss* [1971] 1 QB 406; *Darlington Borough Council v Wiltshire Northern Ltd* [1994] EWCA Civ 6).

11.4 The question as to whether a party really intends to effect the repairs is also relevant (*Ruxley Electronics & Construction Ltd v Forsyth*). If the repairs have already been paid for by someone else other than the claimant, then this is probably irrelevant (see *R Taylor v Hepworth* [1977] 1 WLR 659). Third parties could include an insurer or a landlord.

11.5 A claimant's right to recover a diminution in value might be limited to the maximum cost of the repair (*Murphy v Brentwood* [1990] 2 WLR 944 (CA)).

11.6 The principles in *Ruxley* appear in summary to be:

11.6.1 The cost of remedial works may be allowed unless it is wholly disproportionate for the benefit gain as to make it unreasonable;

11.6.2 If it is disproportionate, then the claimant might recover on the basis of a diminution in value, if there has been any; and

11.6.3 Damages might not be limited to diminution in value or reinstatement. A further figure might be allowed to reflect the loss of amenity or inconvenience to the claimant for not having received what he had wanted and what he had bargained for.

12 LOSS OF AMENITY

12.1 A claim could be brought for distress, anxiety, discomfort, inconvenience and loss of amenity. This would be in addition to reinstatement or diminution in value.

12.2 A claim for loss of amenity is possible in a consumer contract, but highly unlikely (to be suffered or recoverable) in a commercial contract. In *Johnson v Gore Wood & Co* [2002] 2 AC 1, contract breaking was considered to be an instant of commercial life, and commercial parties were expected to meet it with mental fortitude.

12.3 A building owner might be able to recover general damages for loss of amenity (*Farley v Skinner 1980* [2002] 2 AC 732 HL).

13 REINSTATEMENT AND DIMINUTION

13.1 In limited circumstances it might be possible to recover the cost of reinstatement and the diminution in value.

13.2 In *William Cory & Son v Wingate Investments* (1980) 17 BLR 109, the claimants owned a warehouse and the defendant was to install hard standings in concrete. The defendant constructed the hard standings of tarmacadam. The concrete would have lasted 40 or 50 years, but tarmacadam required resurfacing every 5 years. Tarmac resurfacing was going to cost £63,000, but resurfacing in concrete was going to cost £117,000. At first instance the judge stated:

> *"In my judgement, the prima facie rule is that the Plaintiff is entitled to such damages as will put him in a position to have the building to which he contracted unless the cost of reinstatement is wholly disproportionate to the advantages of re-instatement. There can be little doubt that had a concrete surface been laid initially, it would not have had to be re-laid during the currency of the leases. On the other hand, it would have been necessary to relay an asphalt surface at least once and possibly twice. The position today is unchanged. On that ground alone the cost of re-instatement cannot be said to be wholly disproportionate to the advantages of re-instatement. The advantages are the relief of the necessity to re-lay the surface in 20 years or so, with the cost and disruption which that would involve. The Defendants contend that the Plaintiffs can be compensated for the cost of re-laying asphalt by the payment of compensation and that, in any event, that contingency will be taken into account in part in the rent reviews. I consider these possibilities to be fraught with uncertainty. It would be difficult, if not impossible, to determine a basis of compensation and the extent that an inferior surface could be taken into account in a rent review is uncertain. On*

the other hand, as Mr Wood said, providing concrete would fulfil the conditions specified by the Plaintiffs. They would not have to do maintenance or replacement work other than what they would have done if the contract had not been breached. No speculation for assessing compensation would be necessary, and it would save possible injustice under the rent review clause."

13.3 In the Court of Appeal, Walton J said:

"There may be many cases where the carrying out of remedial work to bring the building into line with the specification may be so entirely out of line with what the cost of those works would be and the nature of those works having regard to the nature of the building as a whole that the court would gladly accept some other basis for the assessment of damages. But from first to last in this case nobody has ever suggested that a concrete hard standing is either extravagant or something so utterly outside what would be found in a normal contract to provide a depot of this kind as to cause the courts to say that something cheaper but equally as good ought to be substituted … If (tarmacadam) is a substitute for concrete, which itself is estimated to outlast the length of the two leases without renewal or repair, it is a poor substitute. Can it really be that the court can substitute margarine for butter in this manner, even though many people cannot tell the difference? For myself I entirely refute such suggestions; once it has to be admitted, admitted it has been, that the tarmacadam will need replacement by something else in the very near future, speaking for myself I think that that is an end of this part of the case. But even if it is not, then at the very least it must be shown, and shown conclusively, that the plaintiffs are acting unreasonably in asking for concrete instead of asphalt. Here the only consideration advanced is the matter of cost. Taking 1977 prices, the concrete solution costs about £117,000 and the acceptable asphalt solution about £63,700. But that latter is not a comparable figure: the asphalt itself would not last for the remainder of the 42 years and would have itself to be renewed again at some stage, and in renewing it, the plaintiff's business would thus be disrupted not once but twice."

14 DATE OF ASSESSMENT

14.1 The general principle is that assessments of damages are made on the date upon which the damage is accrued (*Milingos v George Frank (Textiles) Ltd* [1976] AC 443). There are, however, many exceptions.

15 **WHEN COULD THE REPAIRS FIRST HAVE BEEN CARRIED OUT?**

15.1 The court might determine that the appropriate value is at the date upon which the repairs could reasonably have been carried out (*Dodd Properties v Canterbury CC* [1980] 1 WLR 433).

16 **OTHER FACTORS**

16.1 Other factors might also be taken into account, such as:

16.1.1 The financial ability of the claimant to pay for the repairs. The claimant might first need to sue for recovery;

16.1.2 The defendant's conduct such as its refusal to participate in the discussions and actions relating to the defect or its refusal to admit liability;

16.1.3 The financial burden of carrying out the repairs might outweigh the gain and the ability to complete (defects free) the building and/or realise the value of the property.

16.2 In a commercial context, the expectation is that money will be borrowed in order to rectify the works, liquidate the loss and then seek recovery of the losses.

16.3 There are particular difficulties where the loss has not been fully liquidated; these are considered below.

17 **ASSESSING THE LOSS**

17.1 The cost of rectification is more likely to be recovered if the remedial works have been carried out in accordance with an expert's advice (*The Board of Governors of the Hospitals for Sick Children and Another v McLaughlin & Harvey Plc and Others (Great Ormond Street)* [1987] 19 Con LR 25).

17.2 The court will still, however, examine the remedial works to see that they were really necessary (*Birse Construction Ltd v Eastern Telegraph Co Ltd* [2004] EWCH 2512).

18 **DAMAGES: OTHER CONSIDERATIONS**

18.1 There are some further considerations in relation to damages for rectification:

18.1.1 ***New for old*** – there is no discount for replacing an old item with a new one. The defendant will have to bare that entire cost, because absent of the defendant's breach there would not have been a replacement (*Hollebone v Midhurst & Thurnhurst Builders Ltd* [1968] 1 Lloyds Rep 38).

18.1.2 ***Betterment*** – a claimant cannot, however, pass on the cost of repairing to a higher standard (*Richard Robertson v Douglas Smith Stimson* (1988) 46 BLR 50).

18.1.3 ***Mitigation*** – a claimant should mitigate its loss. These standards are, however, relatively low, and it is for the defendant to show that the claimant acted unreasonably. The House of Lords in *Lodge Holes Colliery Co Ltd v The Borough of Wednesbury* [1908] AC 323 said that a court should be "*very indulgent and always bear in mind who is to blame*".

18.1.4 ***Alternative estimates*** – a number of estimates should be obtained for the work in order to select the most appropriate.

18.1.5 ***Cheap option*** - the cheapest option is usually the most appropriate (*Riverside Property Investment Ltd v Black Hawk Automotive* [2004] EWHC 3052 (TCC)).

18.1.6 ***Rental cost*** – if there is a considerable delay in rectifying the works then the lost cost of renting the space might not be recoverable.

18.1.7 ***Consequential losses*** – care is needed here as many costs are considered to be direct and recoverable.

18.1.8 ***Loss of profit*** – can be a direct recoverable loss.

18.1.9 ***Management expenses*** – a claimant might be able to recover them, subject to proper records (*Tate & Lyle Distribution v GLC* [1982] 1 WLR 149).

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