RICS Professional Guidance, England and Wales

Defects and rectifications

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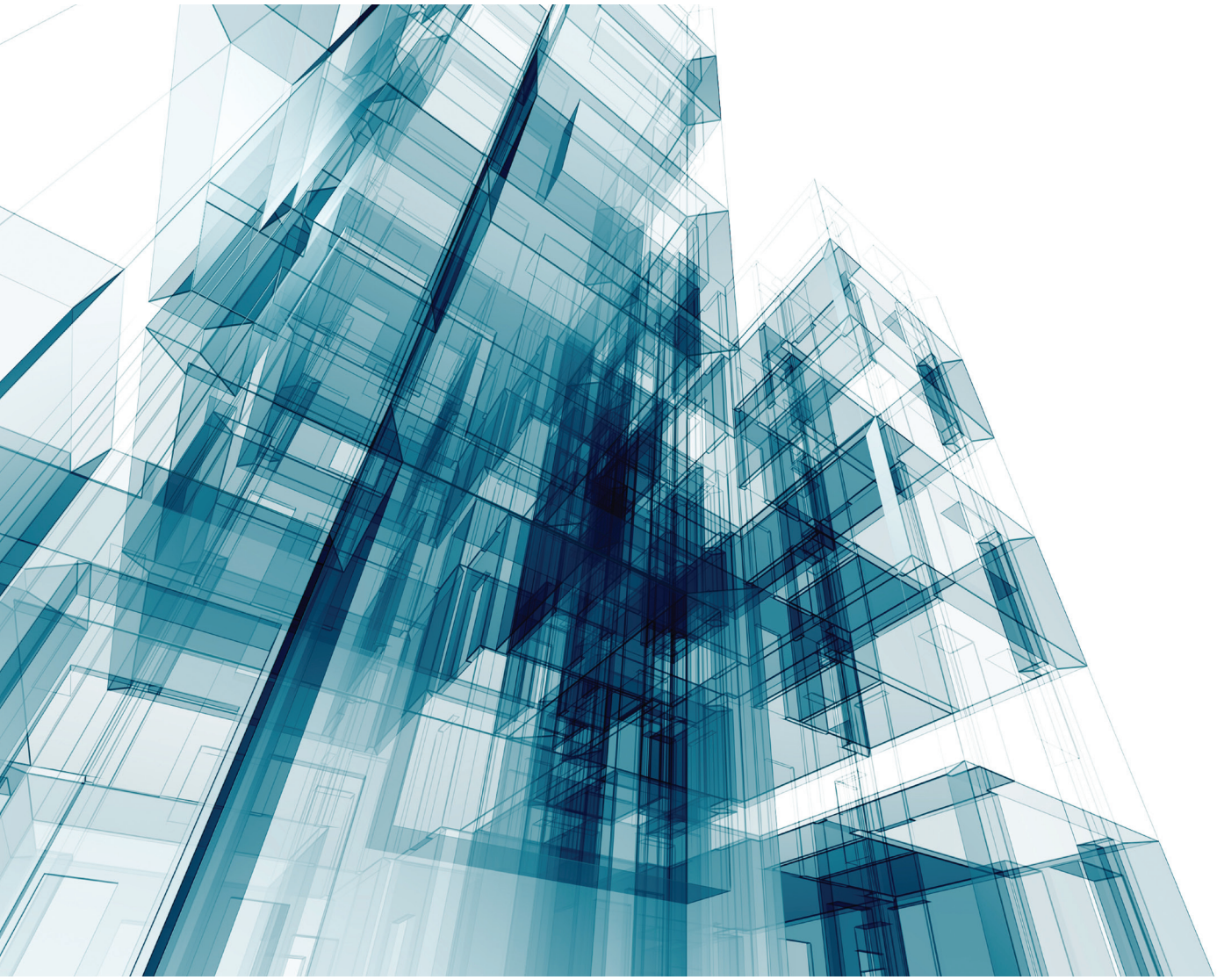

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RICS guidance notes

This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent 'best practice'; that is, recommendations which in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member had acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this note, they should do so only for a good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice. Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the examining Panel.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to reflect case law and legislation applicable at its date of publication. It is the member's responsibility to establish if any changes in case law or legislation after the publication date have an impact on the guidance or information in this document.

Document status defined

RICS produces a range of professional guidance products. These have been defined in the table below. This document is a guidance note.

Type of document	Definition	Status
Standard		
International Standard	An international high level principle based standard developed in collaboration with other relevant bodies	Mandatory
Practice Statement		
RICS practice statement	Document that provides members with mandatory requirements under Rule 4 of the Rules of Conduct for members	Mandatory
Guidance		
RICS Code of Practice	Document approved by RICS, and endorsed by another professional body/ stakeholder that provides users with recommendations for accepted good practice as followed by conscientious practitioners	Mandatory or recommended good practice (will be confirmed in the document itself)
RICS Guidance Note (GN)	Document that provides users with recommendations for accepted good practice as followed by competent and conscientious practitioners	Recommended good practice
RICS Information Paper (IP)	Practice based information that provides users with the latest information and/or research	Information and/or explanatory commentary

1 Introduction

1.1 Purpose of this guidance note

This guidance note is aimed at construction professionals who manage defective construction work when it occurs or those who have to address the consequences of defective work. Such defects may emerge during construction, during a contractual defects rectification period or at some point after all contractual obligations have been completed.

Two key factors determine the approach to be taken towards defects:

- **When they occur** – Contractual mechanisms and the legal approach to defects will differ depending on whether they occur during construction, during the defects rectification period or after the issue of a defects certificate (commonly known as a 'certificate of making good').
- **Whether defects are latent or patent** – By their nature, defects can only be rectified once they become 'patent' or apparent. Defects that have remained latent for some time give rise to a number of often complex legal issues (relating, for example, to evidence of causation, whether the claim is barred for being out of time or whether the claim can even be brought under contract law). Such complexities do not usually affect patent defects.

1.2 What is a defect?

For such a key term, it is surprising how few standard form contracts define a 'defect'. Neither FIDIC nor JCT define the term, although NEC does introduce a standard definition.

A defect could be a reference to faulty workmanship, faulty materials or faulty design. For a defect to be actionable in contract law it must primarily be a breach of contract (in that the work is not in accordance with the specification). If the employer specifically requires the use of broken or sub-standard slates, that might require the use of defective materials, but would not be an actionable defect. If, however, high quality red clay tiles have been used where the employer specified brown tiles, then that in law will be a breach of contract, and the work may be deemed defective.

This concept of a defect as essentially a breach of contract is reflected in the NEC definition of 'Defect' which is 'a part of the works which is not in accordance with the Works Information, or a part of the works designed by the Contractor which is not in accordance with the applicable law or the Contractor's design which the Project Manager has accepted.'

There is no comprehensive definition of what constitutes a 'defect' in English common law. A frequently quoted starting point is the case of *Yarmouth v France* (1887) 19 QBD 647, in which a defect is described as 'anything which renders the plant unfit for the use for which it is intended, when used in a reasonable way and with reasonable care'. The practicalities of construction demonstrate that there are degrees of seriousness in defects, some of which may not be sufficiently serious to impede practical completion and are addressed in snagging lists.

1.3 The distinction between patent and latent defects

In theory, the distinction between patent and latent defects should be easy to identify. Patent defects are 'obvious' defects. Latent defects are hidden and become apparent at a later date. A patent defect could be something that is visually obvious, for example, the omission of mastic seal in the required areas around a shower or bath unit. Such patent defects are often recorded in snagging or defect lists at the time of practical completion. Latent defects may include those defects that, while not obvious at practical completion, become obvious soon after.
If defects become patent during the defects rectification period, most standard form construction contracts contain mechanisms for rectifying them.

A latent defect could be a defective foundation, where there is no visual sign of the defect at completion, or for a significant time thereafter, but which could cause the building to subside in the future. There may, however, be defects that are not discovered simply because the person charged with discovering them failed to carry out their investigations properly.

For this reason, the English courts have defined latent defects as those defects that do not become obvious even though the requisite level of skill and care had been exercised in searching for and identifying them. Or, as a judge put it in one particular case, a latent defect would be a 'defect that would not be discovered following the nature of inspection that the defendant might reasonably anticipate the article would be subjected to': *Baxall Securities Ltd v Sheard Walshaw Partnership* [2002] EWCA Civ 9.

Therefore, the design of a roof drainage system that failed to include sufficient overflow capacity to deal with expected flooding would be a patent defect because the defect would have been obvious to a surveyor if the surveyor had exercised reasonable skill and care at the time of inspection. A patent defect therefore is one that is potentially 'observable' if a proper effort had been made to discover it.

1.4 Differing consequences of patent and latent defects

For patent defects, the key concerns are establishing the employer's right to have the contractor rectify during the appropriate period, whether that is before practical completion, at practical completion or during the defects rectification period. For defects that are discovered some time after practical completion and may be of a more substantial nature, practitioners must consider if there is a contractual right of recourse (e.g. through collateral warranties or third party rights) or whether an action in tort would be more appropriate (in Scottish law tort is referred to as 'delict'). In the case of tort in particular, this gives rise to complex questions on limitation periods. In some circumstances there may also be rights under specific statutes such as the *Defective Premises Act* 1972 (DPA).

1.5 Applicable law

In this guidance note, any references to the position under law are to the position under English law as it applies in England and Wales, unless specifically stated otherwise. Users of this guidance note should not assume that the position under Scots law or the law in Northern Ireland will be identical to the position in England and Wales. Practitioners should always investigate and apply the proper law to the particular circumstances of their project and where necessary take appropriate professional advice.

2 General principles (Level 1 – Knowing)

The extent of the contractor's liability for defects will depend on the nature of risk the contractor has assumed under their contract. A design and build contractor will be responsible for defects in design, materials and workmanship. A construct-only contractor will ordinarily only be responsible for defects in workmanship. Any dispute about defects can lead to complicated issues of causation and the apportionment of responsibility for design related or workmanship related risks. In the case of contracts with a contractor's designed portion (e.g. the JCT Standard Building Contract SBC XQ 2011), the task of identifying responsibility for design and workmanship could be more complicated still, particularly where the actual definition of the contractor's designed portion is unclear or in dispute.

Design professionals, contractors and subcontractors can also be liable for defects in design if their contract contains design responsibilities and obligations. Their role should not be overlooked. Often the root cause of defects lies in the design. Once contractors have demonstrated that they have exercised the appropriate standard of workmanship and diligence in the execution of their works, the spotlight will inevitably fall on the design and designers. There is also an added incentive on claimants to pursue designers since they carry professional indemnity insurance, which is a source of potential financial remedy not dependent on the solvency of the designer, whereas there is often no similar recourse in respect of workmanship only.

2.1 Patent defects

2.1.1 Defects before completion ('temporary disconformity')

There is a debate in English law as to whether defects that occur before practical completion can actually be characterised as defects. The doctrine of 'temporary disconformity' provides that activities undertaken by a contractor prior to practical completion are a work in progress. Any defects during that period are subject to rectification and, provided the works at practical completion are free of defects, the employer ought not to interfere in the earlier works. Proponents of this doctrine argue that the employer's remedy for delays to practical completion that have resulted from badly programmed and executed works is in the right to receive liquidated damages. Such damages are meant to compensate for delays that are caused by the poor management of a project, with the contractor taking the risk of any additional works that have been required in order to achieve practical completion.

This doctrine sits uneasy in the practical reality of construction. The employer might be growing increasingly concerned at the way in which works are being undertaken, and may want to encourage progress to avert a failed project. However, the key risk for an employer is ensuring that any such intervention prior to practical completion is not misconstrued as giving rise to claims of employer prevention. For this reason, contracts should provide specific recourse in the event of defective works prior to practical completion.

2.1.2 Defects under JCT

The JCT standard form (e.g. SBC XQ 2011) contains a number of provisions to address defect issues pre-completion. The architect/contract administrator has a right to open up for inspection any work covered up or to test materials or goods 'whether or not already incorporated in the Works'. The cost of such inspections or tests is at the employer's risk unless the work is found not to be in accordance with the contract (clause 3.17). In addition, the architect/contract administrator has a number of options where work is found to be defective. These include instructing the removal of any defective works, accepting that the defective work can remain, or ordering further opening up for inspections or tests to identify 'to the reasonable satisfaction of the Architect/ Contract Administrator the likelihood or extent... of any further similar non-compliance'.

Any such opening up must be in accordance with the Code of Practice (Schedule 4), which provides a list of criteria that the architect/contract administrator must consider when instructing opening up. The Code of Practice is designed to guide the architect/contract administrator 'in the fair and reasonable operation' of the power to issue instructions under clause 3.18.4. The Code of Practice is a useful way of regulating such investigations, providing a list of issues the architect/ contract administrator should consider and the approach to take; for example the need to act proportionately, or as the Code of Practice puts it, to consider 'the significance of the non-compliance, having regard to the nature of the work in which it has occurred'.

2.1.3 Defects under NEC

The NEC approach to defects during construction (and after completion) is set out in clause 4. The role of 'policing' quality under the NEC is given to the supervisor rather than the project manager. Thus the supervisor notifies defects and issues the defects certificate. However, the project manager has the role of deciding whether or not to accept the defects. The contractor has to correct a defect whether or not it has been notified of it (clause 43.1). The supervisor may also instruct the contractor to search for a defect, but must give reasons for the search in the relevant instruction. Until the 'defects date' (see paragraph 2.1.6), the supervisor can instruct the contractor to search for defects. This can include activities

such as uncovering, dismantling, recovering and re-erecting work as well as carrying out tests and inspections which have not been provided for in the works information (clause 42.1).

Similar to clause 3.18.2 of the JCT standard form, the NEC also contains a provision enabling the acceptance of a defect by way of an amendment to the works information to make the defect compliant with the contract (clause 44.1). Such acceptance requires the contractor to submit a quotation for reduced prices, an earlier completion date or both (although interestingly, does not mention earlier 'key dates'). Where the project manager accepts the quotation, an instruction is given to change the works information, the prices and the completion date. Without that acceptance, the works information is not changed and therefore the defect remains to be rectified.

2.1.4 Defects under FIDIC

Under the FIDIC Red Book (construct-only form) there are extensive provisions enabling the employer to monitor the plant, materials and workmanship being used in the works. There is an obligation on the contractor to submit samples of materials and relevant information, and to allow access to any sites at which natural materials are being prepared so that the employer can inspect or carry out tests. The engineer has specific powers (clause 7.5) to reject 'Plant, Materials or workmanship ... found to be defective or otherwise not in accordance with the Contract'. In addition, costs associated with retesting of plant materials and workmanship as a result of rejection are at the contractor's risk (clause 7.5).

The doctrines of temporary disconformity or employer prevention (see paragraph 2.1.1) may have no influence in legal systems based on civil law (such as France, Germany and some Middle Eastern countries). This is perhaps reflected in the Red Book, which gives the employer or engineer a number of remedies for construction stage defects. Clause 7.6 provides specific powers to the engineer to instruct remedial works that include the power to instruct the removal and re-execution of works that are not in accordance with the contract (clause 7.6 (a) and (b)). In addition, during the carrying out of the works, the employer has the express power to employ third parties where the contractor fails to rectify defects (clause 7.6). The contractor is liable for such costs of rectifying defects, except where they would have been entitled to payment to rectify them.

2.1.5 Post-completion defects – why the contractor should return to rectify defects

If a contract does not contain an express obligation on the contractor to return to rectify defects, there is generally no obligation on the contractor to return and no obligation on the employer to permit the contractor to re-enter and carry out rectification works.

Whatever the precise contractual provisions for defects rectification might be, there are clear incentives for the contractor to rectify defects. The most immediate incentive for the contractor is the retention, the second half of which is returned only once a certificate has been issued certifying that defects have been rectified (certificate of making good issued (clause 4.20.3) under JCT). When certifying practical completion, the architect/contract administrator should satisfy himself that the retention monies that will continue to be held will cover the cost of snagging. Provided that the contract has been properly negotiated and an appropriate level of retention has been agreed, the retention should provide sufficient security for the rectification of defects that emerge during the defects rectification period. The employer should not need to use the valuation process post practical completion as a method of obtaining additional security for the remedying of defects (for example building into the valuation the assumption that rectification will have to be undertaken by third parties). Adopting such an approach to valuation might also be in breach of contract.

Defects are a breach of contract, thereby exposing the contractor to general damages that will primarily be based on the cost of rectifying those defects. The defects rectification period therefore represents for the contractor a way of mitigating exposure by avoiding the risk of the employer employing a third party to rectify and claiming those third party costs (which are likely to be substantial, as a new party will have its own mobilisation costs and will expend time in familiarising itself with the works). The existence of a period for rectifying defects emerging post-completion is therefore in both parties' interests.

2.1.6 Obligations to return to rectify defective works

Many standard forms contain an obligation on the contractor to return to rectify defects identified during a defined period after practical completion (the 'Defects Rectification Period' in the case of JCT).

In JCT, the obligation is on the contractor to make good at no cost to the employer all such 'defects, shrinkages or other faults' (clause 2.38). The defects rectification period begins from the date of practical completion of the works for a period that is specified in the contract particulars, often 12 or 24 months, or more. If no such period is stated, then the period of six months from the date of practical completion of the works (clause 2.38) is the default. In addition, it is usually the practice for the architect/contract administrator to issue a snagging or defects list for de minimis defects at the stage of practical completion. The architect/contract administrator can issue a schedule of defects that occur during the defects rectification period that can be delivered to the contractor as an instruction for a period of 14 days after the expiry of the rectification period (clause 2.38.1).

In addition, the architect/contract administrator can issue instructions for any 'defect, shrinkage or other fault' to be made good until such time as the schedule of defects has been issued, or more than 14 days after the expiry of the defects rectification period (clause 2.38.2). Apart from the retention that the employer will have as security (see paragraph 2.1.5), the contractor remains incentivised to remedy defects under the overarching principle that

defects are a breach of contract entitling the employer to damages.

Under FIDIC, the defects rectification period works in a similar way to the JCT form, in that it is the period in which defects can be notified by the engineer to be corrected by the contractor in a reasonable time period. The procedure relies on the employer or, at the employer's request, the engineer giving notice of defects. The notice can be in the taking over certificate or issued during the defects notification period, as defects become apparent. The onus is thus on the employer to ensure that it complies with the notification procedure to instruct defects rectification. It is also worth noting that the Red Book is a construct-only form, and the costs of rectifying defects are only assumed by the contractor in specific instances where the works have been carried out in breach of contract (clause 11.2(b) and (c)). If the defects in the works are due to design for which the contractor is not responsible (clause 11.2(a)) then any additional work executed will be treated as a variation.

By contrast to the position under FIDIC, the contractor under NEC must correct a defect whether notified or not (clause 43.1). The defects date under NEC is a date set out in the contract data and equates broadly to the end of a period for defects correction found in other standard forms. Until the defects date (that is, before and after completion), there is a mutual obligation on the supervisor and the contractor to notify each other of a defect (clause 42.2).

There is a further concept under NEC relating to defects – the 'defects correction period'. This is not the same concept as the 'Rectification Period' used under JCT or similar concepts under other standard forms. Under NEC, the defects correction period is a specific period (calculated in weeks) within which the contractor must remedy defects after completion (in the case of defects notified before completion) or if a defect is not notified before completion, a period starting from when the defect is notified (clause 43.2). There can be several defect correction periods (indeed the standard form contract data contemplates this). This can be useful on projects where, for example, a defect to critical plant might require a speedier response than defects to other elements of a building. It also enables defects that give rise to health and safety risks to be allocated a specific (shorter) defects correction period. The defects correction period or periods should be set out in the contract data on a project-specific basis.

In the NEC context it is also worth noting the additional obligation under clause 82.1, which obliges the contractor 'Until the Defects Certificate has been issued and unless otherwise instructed by the Project Manager ...[to] replace loss of and [repair] damage to the works, Plant and Materials.' This is in addition to the obligations that exist specifically in respect of defects and the repair obligation appears to apply irrespective of the cause of such loss or repair. Practitioners acting for contractors should analyse the implications of clause 82.1 for their particular project as the onus appears to be on the contractor (if it is to establish an entitlement based on a compensation event) to show that the cause of the damage to the works, plant or materials is due to an employer's risk.

2.2 Latent defects

2.2.1 Claiming for latent defects

Claims for latent defects are likely to arise after all contractual obligations have been completed and often (in the case of defective foundations) a long period after completion. Practitioners may have to look outside the confines of the contract at the overall context of the construction works to ensure that all avenues of recourse can be explored.

In summary, there will generally be three routes open to the party suffering the defective works ('the victim'):

- **A contractual remedy in the law of contract.** This route is the most common route by which a latent defect is raised and dealt with for major building, civil engineering and infrastructure works. While a contract does not have to be a written document (a contract may arise through purely oral agreement – something to be aware of when considering construction works undertaken for homeowners), construction contracts are usually in writing or at least evidenced in writing. In English law, the doctrine of 'privity' means that generally only those with a contractual relationship can sue in the law of contract. If there is no direct contract (e.g. under a professional appointment or a building contract) then a contractual remedy may arise and be exercised through a collateral warranty or in rights granted to a third party beneficiary under the *Contracts (Rights of Third Parties) Act* 1999.
- **In certain instances, a remedy may arise under tort law.** This is a branch of the English common law concerned with compensating victims for wrongs committed by other parties with whom the injured party may have no pre-existing relationship but where the law creates a relationship and imposes a duty of care on one party not to inflict injury on another. An everyday example is the duty on motorists not to injure fellow road users or damage their property. Road traffic accident claims are pursued under the law of tort.

  In a construction context, contractors, subcontractors and design professionals typically carry out work and services which may affect parties with whom they have no contractual relationship. For example, the performance of a subcontractor may impact on the value of the employer's investment. Where there is no direct contractual relationship established, for example through a collateral warranty, the victim of defective design may seek to establish that it has a relationship with the culpable contractor, sub-contractor or design professional and therefore that person owes the victim a duty

of care in tort. Such relationships can be difficult to establish in law, particularly following the landmark decision in *Murphy v Brentwood DC* [1991] 1 AC 398, which has been upheld in decisions of the English courts ever since. This case decided that defective construction work that results in loss to the owner of the building through negligently designed foundations is characterised in law as 'pure economic loss' (the loss that the owner suffers being loss in the value of the building or the cost of putting right the defects). Tort law cannot be used to compensate a loss that manifests itself purely in a reduction in the market value of the victim's property.

There is another branch of tort law under which an action might arise in cases where advice is given for a specific purpose to known recipients. In such cases an adviser (e.g. a certifier, architect or other professional) might be held to have assumed responsibility for negligently certifying that a property is free of defects. This type of claim is known as 'negligent misstatement' and the authority for it stems from the case of *Hedley Byrne and Co Ltd v Heller and Co Ltd* [1964] AC 465. In a recent case, a developer's certifier was held liable to individual leaseholders for negligent misstatement in circumstances where the certifier's relationship was described as 'akin to contract'. The certifier had specifically acknowledged that individual leaseholders would be relying on the certificates and confirmed its own expertise and qualification in issuing such certificates (see the High Court decision in *Hunt and Others v Optima (Cambridge) Limited and Others* [2013] EWHC 681 (TCC)).

- **A claim under the DPA.** In certain circumstances, those with an interest in a 'dwelling' (generally those who occupy a building as their private residence) may have a claim under statute against those involved in the design and construction of the dwelling in the event that it is not fit for habitation when completed.

2.2.2 Introducing limitation periods

The available options when considering actions for latent defects will depend on whether an action can actually be brought in the courts. The law does not allow actions to remain pending indefinitely. The *Limitation Act* 1980 ('the Act') is the main source of law in England and Wales governing the time limits for bringing actions (different legislation applies in Scotland and it should not be assumed that claims in Scotland will be subject to the same limitation position as discussed below, so the position under Scots law should be carefully investigated if relevant). Actions not brought within the relevant time period will be time barred. Therefore, no matter how good a claim may be, the claimant will not be able to proceed further with it once the court has accepted the defendant's case that the claim is brought out of time.

An action is considered 'brought' when the claim is actually filed at court and the court issues the claim form at the request of the claimant. The full text of the Act should be consulted, as different time limits apply depending on the nature of the claim. Claims for personal injury, for example, have shorter limitation periods (and these are not addressed in this guidance note), but the Act should be referred to for these and other limitation periods that might be relevant in a defects context.

The basic position is that a breach of contract claim must be brought within six years from the date of the breach in the case of 'simple' contracts. Simple contracts are those agreed between parties (whether orally, wholly in writing or evidenced in written documents or a combination of oral conduct and written documents) without expressly being executed as deeds. Actions under a deed must be brought within 12 years from the date of practical completion. The limitation period for claims in tort, however, runs for a period of six years from the date harm caused by the tort occurs and not from when the actual tort was committed.

3 Practical application (Level 2 – Doing)

3.1 Patent defects

3.1.1 Practical completion

Practical completion is a key milestone in the construction process. A number of consequences flow from it, and they are discussed in detail in *Defining completion of construction works* (RICS GN 77/2011). From the perspective of defects, the criteria for achieving practical completion are dependent to a large degree on what the contract provides. To varying degrees, standard forms also require the certifier to exercise professional judgment and discretion in deciding when the criteria has been achieved.

Under most JCT standard forms there is no definition of 'practical completion' (the exception is the Major Projects Construction Contract (MP 2011)). Where the works (or, as appropriate, a section) have in the opinion of the architect/contract administrator achieved practical completion, and the contractor has provided to the CDM co-ordinator (or if appropriate to the principal contractor) such information as is 'reasonably required' for the preparation of the health and safety file (under clause 3.23.4) and the 'as built' documents have been provided, then the architect/contract administrator must certify practical completion. Many bespoke amendments, however, insert a definition of practical completion to introduce an element of contractual objectivity.

The implication of the JCT standard form approach therefore is that all defects patent at the point the practical completion certificate is issued will have been rectified or (if an appropriate amendment is made to the standard form) minor items identified on a snagging or defects list for rectification shortly thereafter. The drafting of clause 2.38 assumes that the defects rectification period is a period post-practical completion, specifically to deal with those defects that manifest themselves post-completion. Without a definition of 'practical completion' reference has to be made to how that term is defined in case law. Overall, there are few reported cases on the meaning of practical completion and they do not provide a clear definition of the term. However, parties often try to mirror their understanding of the case law on what constitutes practical completion in the amendments they introduce to JCT to define practical completion. An example of a commonly encountered definition is that the works are in a state:

> *'…which is complete in all respects and free from defects save for any minor items or minor defects the existence, completion, rectification of which in the opinion of the Architect/Contract Administrator would not prevent or interfere with the use and enjoyment of the Works.'*

Where such definitions are used, practical completion is often certified subject to the issue of a snagging list itemising minor items for rectification.

The definition in JCT MP 2011 provides that practical completion takes place where the project is complete 'for all practical purposes' and then lists particular requirements to have been achieved. These include that the relevant statutory requirements have been complied with and that 'neither the existence nor the execution of any minor outstanding works will affect its use'.

Practitioners should understand the precise significance of practical completion under the contract. In general terms, the issue of the practical completion certificate signifies that works have been completed in accordance with the contract and therefore the contractor has discharged its obligations to carry out the works under the contract. The contractor should only be expected to undertake remedial work after completion in accordance with the defects rectification regime in the contract. After practical completion, any additional works that are not related to the remedying of defects should be instructed under a new contract and would therefore be subject to their own terms, including the limitation period that would be applicable to them.

3.1.2 Certifying practical completion: conflicts of interest

Parties to a construction contract should be mindful of the potential for conflicts of interest, particularly in contracts where the design team has been novated from the employer to the design and build contractor. In such circumstances, the employer should ensure that it retains a direct contractual relationship with a representative that is capable of acting on the employer's behalf to undertake the certification of practical completion, agree the snagging list and instruct the rectification of defects that emerge during the defects rectification period. If the whole design team, including the professional with certifying duties, has been novated to the contractor, the employer should not use as a certifier the professional who, following novation, owes duties to the contractor. This can place a strain on the relationship between the employer and the contractor and will prejudice the employer. The employer will have no contractual recourse against the novated consultant and the novated consultant will have no duty to act in the employer's best interests.

3.1.3 Inviting third parties to rectify defects

Some standard forms expressly provide for where the contractor does not rectify defects. For example, NEC provides that if the contractor, having been given access, has not corrected the defect within the defects correction

period the project manager then 'assesses the cost to the *Employer* of having the Defect corrected by other people and the *Contractor* pays this amount' (clause 45.1). In the case where the contractor is not given access to correct a notified defect by the defects date, the project manager assesses the cost to the contractor of correcting that defect and the contractor pays that amount (clause 45.2).

In the FIDIC Red Book, clause 11.4(a) gives employers the option to carry out the work themselves, or have others do so, where the contractor has not rectified the work within a reasonable time, or by a fixed date. This right is one of the three options employers have in such circumstances. The other two being the engineer's ability to determine a 'reasonable' reduction in the contract price for the decrease in value of the works to the employer (a determination that the employer has to carry out in a 'fair manner' under clause 3.4) and the option to terminate 'if the defect or damage deprives the Employer of substantially the whole benefit of the Works or any major part of the Works' (clause 11.4(c)).

Third parties should only be engaged in place of the contractor after a thorough consideration of the consequences, including contractual consequences, of such action. If the employer seeks to claim costs for breach of contract, the contractor might argue that engaging a third party was without valid reason and therefore the employer had not properly mitigated its losses. If there are specific contractual notice requirements to notify defects, these must be specifically adhered to. For example, under FIDIC, where the employer is under an obligation to notify the contractor of defects, they must comply with the notice periods. Not providing the required contractual notice may mean that the employer's right to damages is limited to the cost of the contractor carrying out the defective work rather than the cost incurred in employing third parties: *Pearce & High Ltd v Baxter* [1999] CLC 749.

The decision to engage a third party should only be made where there is good reason to do so. This might be because the employer has lost all confidence in the contractor's ability to remedy the defects due to its previous track record either during construction itself or during the rectification period. Another reason might be that, despite its best efforts, the contractor is simply unable to rectify the defects. Sometimes matters such as contractor insolvency will mean there is no other realistic option. The option to engage third parties should however be considered within the overall context of a specific project.

3.2 Latent defects claims

3.2.1 Understanding the right course of action

For defects that emerge after the defects certificate (or equivalent) has been issued signifying the end of any post-completion defect rectification obligations, and any retention held is paid, some fundamental issues need to be considered before embarking on the appropriate course of action. In particular:

- Is the recourse available under contract law, tort or a statute (e.g. the DPA)?
- What are the time periods following discovery of the defect in which a claim may be brought?

3.2.2 Making claims for defects

When considering making a claim for defective work, a party should first examine the contractual relationship with the person responsible. It may also be necessary to review any available right of recourse through security documents such as parent company guarantees or (less likely post-completion) performance bonds (see *Construction Security and Performance Documents*, RICS GN 101/2013). Alternative options are a claim in tort or under the DPA. Claims in tort or under the DPA are more difficult to establish than claims under contract. Where the person who has suffered the defective work is not the person who originally contracted with the building contractor (or other designer), for example a subsequent purchaser of a defective building, then the subsequent purchaser will have to examine whether it has a contractual relationship (or 'privity' – see paragraph 2.2.1) on which to found a claim. Usually, such a relationship would be founded on one of the following:

- the benefit of the construction contract having been assigned to the purchaser
- the purchaser having the benefit of a collateral warranty, creating a direct contractual relationship; or
- the contractor having granted to the purchaser 'third party rights' under the *Contracts (Rights of Third Parties) Act* 1999.

It is therefore important when structuring a purchase or a procurement of construction works that those with an interest in the completed development have a contractual right of recourse in the event of defects through one of the means identified above. This illustrates the importance of collateral warranties and rights under the *Contracts (Rights of Third Parties) Act* 1999 that afford a contractual right of recourse in the event of latent defects in a building in which that party has an interest. Such rights are usually the only way in which tenants, funders and subsequent purchasers, who would otherwise have no remedy, can establish rights under contract.

Understanding the appropriate right of recourse (in contract, tort or under the DPA) will require practitioners to weigh up a number of considerations. For example, if the party suffering from the defective work does not have a contractual relationship with the party responsible (e.g. a subsequent purchaser who was not given the assignment of the rights in the building contract or was not issued with a collateral warranty), or if the contract under which the works were completed simply cannot be found then alternative remedies in tort may need investigation.

3.2.3 Limitation periods

Another set of considerations in deciding the most appropriate recourse will be limitation periods. If a contract was entered into 'under hand', or as an oral contract, the limitation period begins on the date of breach of contract and not the date on which the breach is discovered. For latent defects this is usually taken to mean the date of practical completion (anything before then, under the doctrine of temporary disconformity, being a work in progress and therefore not a breach of contract). A deed affords the employer a limitation period of 12 years from practical completion in which to bring a claim.

By contrast, in tort, the limitation period is six years from the date on which the harm arising from the breach actually occurs or manifests itself. That date may not be the date on which the tort was actually committed. For example, negligent work may have been carried out by a designer during the construction of the works, but the cracks in the concrete arising from that negligent work may not occur for some years after the works have been completed. The limitation period will run from the point when the first cracks occur. This means that, in certain circumstances, the limitation period under tort could be significantly longer than under contract. Another potential benefit of tort claims is that, in certain limited instances, a person claiming in tort may have an additional three-year period that starts from when they first had knowledge of the damage in which to bring a claim (see paragraph 4.2.3).

4 Practical considerations (Level 3 – Doing/Advising)

4.1 Patent defects

4.1.1 The extent of the duty to investigate defects

Whether or not procedures for managing defects are set out in the contract, the contract administrator should follow accepted good practice in dealing with them. The contract administrator must bring defects to the attention of the contractor at the earliest opportunity so that the contractor has the opportunity to rectify them. This should be done in writing, and the contract administrator may either use a contract administrator's instruction or a specific defect notification form to inform the contractor.

The contract administrator's instruction is likely to be the most useful tool for the contract administrator because it can be used to identify the defect (and therefore leave the appropriate paper trail for later evidential purposes). It can also set out the contract administrator's recommended remedial action for dealing with the defect. By using the contract administrator's instruction, the contract administrator can:

- show that the defect was notified in writing to both the employer and contractor; and
- set out timeframes for the contractor to either comply with or dispute the instruction.

In addition, the practical techniques of good contract administration should be deployed. In the context of defects, these could include:

- keeping logical and detailed contemporaneous records (photographs, sketches, video, test results, meeting minutes, etc.) so that essential details on location and extent or frequency of defective work are available
- taking samples to be laboratory tested where appropriate; and
- operating the contract payment terms to ensure that proper notices are issued and monies are properly withheld (e.g. where the *Housing Grants, Construction and Regeneration Act* 1996 (as amended) applies, the relevant payer notice or the notice of intention to pay less than the notified sum takes into account any amounts relating to defects).

The aim of the types of documents retained should be to arm practitioners with high quality evidence to demonstrate that the works or services as delivered are not consistent with the contracted scope of works. An illustrative list of the types of documents that should be retained is provided in Appendix A.

If the contract does not have procedures to address defects or their consequences, the contract administrator or employer typically has several options, which will generally include:

- requesting that the contractor rectifies the defect at no cost to the employer
- accepting the defect or defective materials and deeming them acceptable (this may be possible where the defect and its consequences are minimal and the employer is under time pressure to get the building finished and in service); or
- (if a defect is not apparent in all areas) prior to requiring remedial action, asking the contractor to carry out a process of opening up works to identify if the defect is present elsewhere.

Contract provisions should be consulted before embarking on any particular route to deal with defects. The contract administrator should check whether there is provision for opening up works in the specification or its preliminary sections.

Investigations to discover whether there are defects can be a costly process. The costs of such investigations may have to be apportioned in any resulting dispute. The apportionment will not only take into account ultimate liability for the defects found but also the reasonableness of approach to the investigation of defects itself. In one case, *McGlinn v Waltham Contractors* [2007] EWHC 149 (TCC), the judge illustrated the principle of reasonableness by stating: 'It is difficult to justify spending £687,000 [on investigations] in order to decide whether or not to spend £870,000 on remedial works'.

The approach to defects should be reasonable in the context of the scale of the alleged defects. For example, a complete stripping of the roof may be unjustified on the basis of the evidence existing at the time of the initial investigation. There ought to be some reasonable grounds for suspecting defective work before opening up is undertaken. Any opening up should be such that reasonable reinstatement/remedial work can be undertaken. Non-intrusive techniques such as infra-red thermography or ground penetrating radar should actively be considered. It is always preferable to avoid future disputes as to the reasonableness of any investigation by reaching agreement (where possible) with other parties before proceeding.

4.1.2 Risk in relation to defects caused by fire and water

Often defects can arise as a result of, or can be caused by, particular risks. Two of the most common are fire and water. Such risks may be intervening events which are not attributable to defective design, workmanship or materials. Practitioners should therefore be alive to such risks and ensure that they are covered off by appropriate insurance. In particular, all parties should be clear about the point at which under a particular contract responsibility for insuring the works passes back to the employer. Under JCT this usually happens at practical completion. On the hand-over of a project, practitioners should ensure that employers are advised to maintain the appropriate coverage for the contents and structures, particularly against the risk of water and fire damage.

4.1.3 The option to terminate and other remedies

Although some forms provide specifically for termination in the event of contractor failure to remedy defects (e.g. FIDIC) and others contain provisions for terminating where the contractor fails to proceed 'regularly and diligently' with the works, termination should be approached with extreme caution and with the appropriate legal advice. If the termination were to be challenged in the courts as not in accordance with the contract or, on the facts, not permitted by one of the termination events, the employer's financial exposure for wrongful termination or repudiatory breach may be significant.

Other options to explore in appropriate circumstances may be calling on a parent company guarantee or (if it is available) the performance bond. These are discussed in more detail in the previously mentioned, *Construction Security and Performance Documents*.

4.2 Latent defects

4.2.1 Contractors' responsibilities

Although the concept of latent defects implies discovery of defects long after the works have been completed, latent defects can of course arise a short period after the defects certificate has been issued. Where contractors have completed all their obligations under the contract, including those during any defects rectification period, they are unlikely to be under any contractual obligation to remedy any latent defects arising. In such circumstances, the practitioner, in investigating the available remedies, should not discount the possibility of inviting the contractor to return to remedy the defects. Provided evidentially it is clear that the latent defect is the responsibility of the contractor, it would be in the contractor's best interests to co-operate, as remedying the defects is likely to be significantly more economical than defending a claim for breach of contract. This also has the added benefit of enabling the employer to effectively mitigate its losses arising from the contractor's breach of contract.

4.2.2 The role of limitation periods

There may be particular circumstances in which more detailed investigation is required into when a cause of action actually arose in order to determine whether there is still time to bring a claim in relation to latent defects that are discovered some time after completion.

4.2.3 Advising on limitation periods under contract

In the case of claims for defects, claims should be brought primarily in breach of contract and (to a more limited extent) in tort or under the DPA. The important starting point therefore is to consider whether the action being contemplated is founded in contract, tort or in statute.

An action for breach of contract must be started within six years from the date on which the cause of action accrues (that being the point from which 'the clock starts to tick'). In contract, the date on which a cause of action accrues is the date of breach. This can raise some difficulties when trying to determine when exactly the breach occurred if considering a claim against a contractor for completion of defective work. The case law suggests that the limitation period for defects in works runs from the date of completion or purported completion and not from the earlier date when the defective work may actually have been carried out.

The actual date on which the cause of action accrues is likely to be fact sensitive, and expert legal advice should be sought to determine such issues (particularly when an action is contemplated close to the end of a limitation period). Where a cause of action arises against a designer, the cause of action may accrue when the design is first prepared or when the production information is first issued, although the actual moment when the cause of action accrues will depend on the facts. A further cause of action could accrue if the designer reviewed the design at a later stage during the works.

When defective work has been carried out by a designer, a cause of action may accrue against the designer at the point in time the designer ought to have but failed to identify the defect in question.

If a claim is brought under a particular type of clause under which one party has agreed to indemnify another against a particular type of loss, the limitation period for a claim under that indemnity could in practice be longer than for breach of contract generally. This is because the general position in relation to claims under indemnities is that the cause of action does not arise until the loss has been *established* or *incurred*. The establishment of a loss could be much later than the actual breach of contract, so the point from which the 'clock starts to tick' in relation to indemnities could well be much later. Claims contemplated under indemnities should be given particular consideration and the potential significance of indemnities should be considered when contracts are being negotiated.

Where a contract is executed as a deed, the time period in which to bring an action is extended to 12 years from when the cause of action accrued, but the rules outlined above on when 'the clock starts to tick' continue to apply. Extending the contractual limitation period is a key reason why many employers insist that contracts are executed as deeds rather than as simple contracts.

In commercial contracting relationships, parties are free to agree shorter or longer limitation periods to those set out in the *Limitation Act* 1980. It is worth noting, however, that where a shorter period is provided for in one party's standard written terms of business for bringing claims in breach of contract, that agreement could be subject to a test of reasonableness under the *Unfair Contract Terms Act* 1977. Generally though, where two commercial parties of equal bargaining strength have agreed to a shorter limitation period, the courts are unlikely to intervene.

Parties are free to vary the statutory limitation periods. Where contracts are entered into as deeds, and particularly given the uncertainty in law as to whether a contractor can be in breach of contract before practical completion (see paragraph 2.1.1), parties often include an express limitation provision in their contracts. These are usually along the lines that 'the liability of the contractor under this contract will expire after 12 years from practical completion of the works'. Using such wording is a sensible way of ensuring certainty in limitation periods that the courts are likely to uphold.

4.2.4 Advising on limitation periods under tort

Early legal advice should be sought where claims in tort are contemplated. Claims in tort will commonly be considered where the 'victim' of defects has no relationship with the contractor, for example a subsequent purchaser or where the limitation period in the contract has expired. Claims for defects under tort can be difficult to establish.

At first sight the tort limitation period looks the same as that for contract: six years from the date on which the cause of action accrues. The similarity is deceptive, as in tort the cause of action accrues when the actionable damage, harm or loss occurs. There could be a significant time-lag between when the tortious act is committed and when the damage occurs. In the case of negligence claims, where damage must be established, the cause of action accrues when the physical damage occurs and not when the negligent act is committed, if the damage does not occur at the same time. This will be the case even if the damage that has been suffered is not actually discovered or reasonably discoverable.

The rule on tort limitation periods gives rise to difficult issues, as the rule is applied to different types of tort that might be relevant to defective construction. One particular kind of tort is that of 'negligent misstatement' (see paragraph 2.2.1), which might in particular apply in the case of defects caused by designers. Any concerns about limitation periods in such cases will be particularly sensitive to the facts and should be explored with the aid of expert legal advice.

It is also worth noting that the *Latent Damage Act* 1986 amends the *Limitation Act* 1980 (by inserting ss. 14A and 14B into the *Limitation Act* 1980). It extends the period in which claims can be brought in tort for negligence (not involving personal injury) by three years, starting from the date when the facts relevant to the cause of action (i.e. the latent defect) became known or could reasonably have been discovered. This is subject to an overriding time limit for actions in negligence of 15 years from when the cause of action to which the damage is alleged to be attributable first accrued.

This means that a claimant who has no knowledge of tortious damage (e.g. suffering a latent defect), who is therefore not able to bring a claim within six years from when damage was actually suffered, has an additional three years in which to bring a claim provided that the claim is made within an overall 15-year period from when the original cause of action accrued.

There is little case law on the application of this extension provision. However to give an example – where a chimney has suffered damage attributable to the specification of inadequate concrete, and that damage (due to the lack of visibility of the damage) was not discovered for the period of six years from when it manifested itself – under the *Latent Damage Act* 1986, the claimant would have a further period of three years from when the claimant knew or ought to have known the material facts about the loss suffered, the identity of the defendant, and its cause of action (that is, knowledge that the loss is attributable to some degree to the act or omission that is alleged to have constituted the negligence). However, that period of three years is subject to a long-stop of 15 years from the date when the original act or omission on which the claim is based first occurred. Therefore, if the claimant gained the requisite knowledge of the damage to the chimney 14 years after the original act or omission on which the claim is based first occurred, the period in which to bring the claim would be one year.

The role of the *Latent Damage Act* 1986 should not be over-emphasised. Commentators suggest it applies primarily to claims in tort arising from negligence. Also, it does not operate to extend limitation periods in contract. As claims in tort for latent defects arising from negligent damage to the 'thing itself' (following *Murphy v Brentwood DC* [1991] 1 AC 398) have been restricted (see paragraph 2.2.1), the ability for claimants to benefit from the additional three years is limited in practice. However, any particular circumstances in which the benefit of the extended limitation period is being sought should be carefully considered against the known facts and expert legal advice should be sought.

4.2.5 Claims under the DPA

A claim under the DPA accrues from the time when the dwelling is completed. The limitation period is six years from that date. If subsequent work is done, then the limitation period for that subsequent work is from the completion of that work. As a claim under the DPA is a claim founded on a statute, the length of the limitation

period should not be affected by whether the contract under which the works were carried out was signed as a deed or executed under hand.

4.2.6 Extending limitation periods in cases of fraud, concealment or mistake

Whatever a limitation period might be, it may be extended in cases where the action is based on the fraud of the defendant, where any fact relevant to the claimant's cause of action has been deliberately concealed by the defendant or where the action is for relief from the consequences of a mistake. The limitation period in such cases begins from when the claimant discovers the fraud, concealment or mistake or could with reasonable diligence have discovered it. It should be noted that this is the basic position under section 32 of the *Limitation Act* 1980 and the application of the law in such cases is complex and fact-sensitive. Appropriate professional advice should be sought where the facts of the case suggest that such issues will be relevant.

4.2.7 Practical considerations

All parties involved in construction should develop systematic methods for storing construction-related documents such as construction contracts, collateral warranties and parent company guarantees. These should be retained for at least the duration of the appropriate limitation period. Professional indemnity insurers will also prescribe particular storage requirements for the duration of the period when the insurer might receive claims. Those requirements should be adhered to. Ready access to original documents will be invaluable in determining the available recourse for parties where latent defects emerge.

4.2.8 Latent defects insurance

Latent defects insurance is increasingly available to cover the cost of rectifying defects that emerge post-completion. Such insurance can cover defects arising from workmanship or design. The principle underlying such policies is that defects must be undiscovered at the time of practical completion. Policies can cover whole buildings or individual elements, such as the roof.

Key advantages of such policies are that they react to material damage and pay-outs are not consequent on proving negligence or breach of contract by the original contractors or designers. They also avoid the complications inherent in considering whether the person who has suffered from a defect has a contractual right of recourse. Therefore they avoid some of the uncertainties in bringing defects claims. A common example in the UK of such policies is the NHBC warranty for new build houses.

Commercially, such policies can be expensive and often have a large excess. They are, of course, also subject to the law around insurance policies relating to 'utmost good faith' (non-disclosure) or misrepresentation. Therefore insurers may not respond to claims where they can establish that material information was not disclosed at the time the insurance was placed. There can be substantial costs associated with setting up such policies, as insurers may wish to manage their risk by actively monitoring the design and construction.

4.2.9 Limiting or excluding liability

Contractors wishing to limit their exposure to liability for defects should consider drafting caps on their overall liability under contract and tort and also seek to specifically exclude certain potential liabilities. This may be of particular concern where some time following completion of the project a latent defect causes further damage to occur. In such cases, the resulting loss might be of a type that could be characterised as 'consequential', indirect loss or loss of revenue. Contractors will usually try to limit or exclude liability for such losses. For example, in the case of a defective office building, the developer loses rental income because the development is not capable of occupation due to latent defects. In addition, the developer may suffer a claim from its tenant for the cost of moving out and paying higher rent for alternative temporary premises. A contractor will be keen to limit its exposure to such losses by ensuring it is only liable for the direct cost of remedying the defects. The developer would have to ensure that it has in place insurance for the loss of such income.

The courts apply particular rules when interpreting such clauses when their meaning is in dispute. Where the wording is ambiguous, such clauses will be interpreted against the party seeking to rely on them. In addition, limitation clauses might be subject to the test of reasonableness under the *Unfair Contract Terms Act* 1977. Such clauses should be drafted with care to ensure that they limit or exclude the sort of liability that the parties intend to limit or exclude.

Summary of limitation periods

Cause of action	Trigger to start limitation period	Length of limitation period	Statutory reference
Simple contract	Date of breach (in construction contract usually on 'practical completion')	Six years	*Limitation Act* 1980 LA, s. 5
Deed	Date of breach (in construction context usually on 'practical completion')	12 years	LA, s. 8
Tort	Date damage is suffered (even if not discovered)	Six years	LA, s. 2
***Defective Premises Act* 1972 (DPA)**	Completion of the building	Six years	DPA, s. 1(5)
Latent damage	Later of: a) date when the damage occurred or b) date on which the claimant first had both the knowledge required for bringing the action and the right to bring such an action	a) Six years b) Three years Overriding time limit: 15 years from the date damage or loss was originally suffered (LA, s. 14B)	LA, s. 14A (as inserted by the *Latent Damage Act* 1986)

Appendix

An illustrative list of the type of records to be kept to evidence defects and investigations carried out:

- contract administrator's instructions (including variation instructions)
- general correspondence relating to defects and defective work (e.g. email exchanges)
- minutes or notes of site meetings, progress meetings
- investigation logs and reports
- drawings and specifications showing or describing the works
- any planning trackers, building regulations trackers or similar working documents
- cash-forecasts and similar cost-related documents
- specialist reports
- test certificates
- visual evidence (photographs and film)
- certificates (e.g. payment certificates, pay less notices)
- health and safety file
- practical completion certificates
- snagging lists
- maintenance records for the property
- certificates of making good defects and final certificates; and
- documentation relating to any insurance claims.

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