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Latent defect angles

How do you control - and overcome - legal difficulties with latent defects, such as establishing contractual liability and recovering from your own or third party insurers?

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What is a defect?

Defect: non-compliance of the Works or a Works Item with the Contract [including a failed test and, after Substantial Completion, work that has not been completed]. **PW-CF1 to 5**

A Defect is

- a part of the *works* which is not in accordance with the Scope 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.

NEC4 ECC

'anything which renders the plant etc. unfit for the use for which it is intended, when used in a reasonable way and with reasonable care.'

Yarmouth v France [1887]
19 QBD 647

design, construction, maintenance defects

fitness for purpose

The Contractor shall ensure...that the completed Works are fit for their intended purpose as stated in or to be inferred from the Works Requirements. PW-CF2&4 clause 8.1(4)

damage

patent or latent

before or after completion

'temporary disconformity' *Argo Invest Overseas Ltd v Stewart Milne Group Ltd* [2018] CSOH 120

Contractual remedy

8.5 Defects

- 8.5.1 The Employer's Representative may direct the Contractor to search for a Defect or suspected Defect or its cause. This may include uncovering, dismantling, re-covering and re-erecting work, providing facilities for tests, testing and inspecting. If, through searching or otherwise, the Contractor discovers a Defect, the Contractor shall notify the Employer's Representative as soon as practicable.
- 8.5.2 If, through notification or otherwise, the Employer's Representative becomes aware of a Defect, the Employer's Representative may direct the Contractor to do any of the following [or any combination of them]:
- (1) to remove the Works Item with the Defect from the Site
 - (2) to demolish the Works Item with the Defect, if incorporated in the Works
 - (3) to reconstruct, replace or correct the Works Item with the Defect
 - (4) not to deliver the Works Item with the Defect to the Site.
- 8.5.3 The Contractor shall comply with any direction under this sub-clause 8.5 within the reasonable times, if any, the Employer's Representative directs. If the Contractor fails to begin the work required to comply with the direction within the reasonable time directed, if any, or to complete it as soon as practicable, the Employer may have the work done by others and the Contractor shall, on request, pay the Employer its cost of doing so.
- 8.5.4 Alternatively, the Contractor and the Employer's Representative may, with the Employer's consent, agree that the Employer will accept the Defect, either in whole or subject to any change to the Works Requirements that the Employer's Representative directs. In this case, the Contract Sum shall be reduced by the amount that, in the opinion of the Employer's Representative, is the resulting decrease in the value of the Works to the Employer. If the Employer's Representative notifies the Contractor that the Employer will not accept a Defect, this shall be conclusive.
- 8.5.5 If a Defect deprives the Employer of substantially the whole benefit of the Works or any Section or other material part of the Works, the Employer's Representative may reject the Works or the relevant part of the Works (as the case may be) and [without limiting the Employer's other rights], the Contractor shall pay the Employer all sums the Employer has paid the Contractor for the Works or the relevant part, together with the Employer's financing costs and the cost of dismantling and removing the Works, clearing the Site and returning the Works Items to the Contractor.

Contractual remedy

8.6 **Defects Period**

- 8.6.1 As soon as practicable after Substantial Completion of the Works or any Section, the Contractor shall complete any outstanding work and rectify any Defects that the Employer's Representative directs before the end of the Defects Period. In doing so, and in doing any tests after Substantial Completion, the Contractor shall cause as little disruption as possible to occupants and users of the Works.

Damages

- Causation
- Remoteness
- Mitigation
- Limitation

CONTRACT
TORT

Damages for defective work

- cost of cure
- diminution in value
- loss of use
- wasted spend
- third party liability
- distress & inconvenience
- other consequential losses

Limitation

CONTRACT
TORT

- When does the period end? When does it start?

- CONTRACT: On breach. Usually completion.
- TORT: When *damage is manifest*: capable of being discovered & proven
Brandley v Deane [2017] IESC 83

Economic loss: *McGee v Alcorn* [2016] IEHC 59.

'*Brandley v Deane* was not concerned with economic loss - at least as that term is conventionally understood.' *Smith v Cunningham* [2023] IESC 13, Murray J.

'The Court must undertake a pragmatic case-by-case analysis, asking itself when a real and meaningfully measurable loss was sustained, at what point the balance between the benefits and burdens of a transaction became adverse to the interests of the plaintiff, and when a lay person would understand actionable damage for which a person would commence proceedings to have occurred.'

- England differs: Time starts to run on occurrence of physical damage; if there is no damage: on completion. *URS Corp Ltd v BDW Trading Ltd* [2023] EWCA Civ 722; *Vinci Constr UK Ltd v Eastwood and Partners (Consulting Engineers) Ltd* [2023] EWHC 1899 (TCC)

Insurance differentiates defect from resultant damage

- Contractors all risks cover can exclude cost of making good defects in the Works but not damage caused by such defects to other sound parts of the Works
- Contractor's public liability cover can exclude
 - defective workmanship or materials but not resulting damage
 - loss or damage due to design for a fee or for which a fee would normally be charged [design] [defective workmanship, materials or design but including its consequences]
- Professional indemnity cover can exclude contractual liability that would not apply in the absence of a contract

PWC PERMITTED EXCLUSIONS

Latent defects cover

- Property, not liability, insurance. First party.
- Set up early. Technical audit.
- Single premium, mostly paid on completion.
- Lasts 10-12 years.
- Covers inherent (structural) defects in design, work or materials, water ingress, undiscovered at completion.
- Covers cost of curing the defect and resulting damage (up to the sum insured).
- Possible extensions for
 - systems (M&E)
 - lost rent or profit
 - waiver of subrogation against professional team

Two closing points

- Defects liability through the lens of the contract.
- Defects liability is often not insured.

Questions?

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