Who Bears the Cost of Investigating for Defects

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Defective works on construction projects are currently a hot topic in Hong Kong, with problems with piling and reinforcement hitting the headlines in the newspapers. Employers, alerted to potential problems, may seek to carry out investigations to check for defective works. But in such circumstances who pays the cost of such investigations and does it make any difference if the works are subsequently proven to be defective?

A recent case in Scotland may be of some assistance in answering these questions. The case was that of Johnston v W H Brown Construction (Dundee) Ltd, 11 June 1999.

Johnson was the employer who engaged W H Brown Construction as the contractor to construct an office block. The contract used was the Scottish Building Contract with Contractor's Design, January 1993 revision.

After completion of the works, but during the Defects Liability Period, the employer became concerned that there were defects in the external building envelope and instructed a firm of architects, HRP, to investigate. The report identified a number of areas in which HRP considered that the building did not conform to the Building Regulations, and consequentially the Contract Specification.

Without conceding liability, the contractor undertook remedial works at their own expense.

The employer commenced an action for damages for breach of contract, seeking recovery of the costs incurred in instructing HRP and a firm of solicitors to advise them on the contractual aspects of the defects. The pursuers also claimed GBP52,982 in respect of management costs.

The contractor argued that the employer was not entitled to recover the costs of engaging a third party in respect of defects appearing within the Defects Liability Period, and that such defects should simply be dealt with under the contract mechanism.

In this respect Clause 16.2 of the Contract provided that any defects appearing during the defects liability period which were due to the contractor's failure "shall be specified by the Employer in a Schedule ... which he shall deliver to the contractor as an instruction of the employer" within a specified time for the contractor to make them good.

The defects clause was thus similar to Clause 15(2) in the Hong Kong HKIS Private Form of Contract and GCC Clause 56(2) in the Hong Kong Government Forms of Contract.

It was admitted that in some circumstances an employer might recover consequential damage at common law. However, the action in the present case did not concern consequential damage, and did not flow from a breach but in the course of the operation of a contractual provision.

The court held that the contract confers powers or imposes duties on the employer to issue instructions to the contractor. These include the preparation and delivery, after practical completion but not later than 14 days after expiration of the Defects Liability Period, of a Schedule of Defects, such action being contractually characterised as an instruction (Condition 16.4).

The costs of exercising such powers or performing such duties, including costs incurred in investigation and preparation thereof, are costs which prima facie are to the account of the employer. Such costs

were therefore not recoverable and in this respect it made no difference whether defects were discovered or not.

This seems entirely logical. All forms of contract provide that either the employer or more normally his agent the Architect or the Engineer will perform certain duties during the currency of the contract. Such duties would include issuing and valuing variations, rejecting works not in accordance with the contract, and of course preparing a list of defects in the defects liability, or maintenance periods. It would be absurd to suggest that the employer can then send a bill to the contractor for the Architect or the Engineer to carry out such duties.

Similarly the costs of taking legal advice on the contractual position regarding the defects were not recoverable. This point was made clear in Shanks v Gray 1977 S.L.T. (N) 26, where it was held that the costs of taking legal advice prior to the submission of a claim are not recoverable as common law damages even if the claim is proved to be well founded.

This point of course applies equally to contractors raising claims and in a previous article I clarified that in general a contractor cannot recover the costs of preparing a claim, which costs would of course include for taking legal advice on the contractual positions.

In the course of the judgment the court went on to consider whether the situation would have been any different outside the Defects Liability Period, and this will be of great interest to contractors in Hong Kong at the present time.

The court, by reference to Shanks v Gray, stated that if defects were discovered after the expiry of the Defects Liability Period, the employer's only remedy would be an action of damages for breach of contract, and he would have no remedy under the contract itself by instructing the contractors to remedy the defects. If, in that situation, the Employer instructed architects to ascertain the nature and extent of the defects, the Court considered that he would not be able to recover the cost of so doing in the subsequent action for damages.

This judgement therefore may have significant relevance to the types of problems recently experienced in Hong Kong where an employer investigates suspected defects, discovers some, and then seeks to recover the cost of that investigation from the contractor. On the basis of this judgment the employer would appear precluded from doing so.

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