Defects in new developments—exploring tenant, contractor and sub-contractor liability

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Construction analysis: Obligations to repair defective work in new developments may be owed by tenants, contractors and sub-contractors. Clare Butler, solicitor at Laytons, considers the nature of these obligations, the difficulties that can arise and the issues identified in the recent case of Office Depot v UBS [2018] EWHC 1494 (TCC).

How might a tenant be liable for the costs of repairing defective work?

Tenants are commonly held responsible within the lease to keep and put the demised premises in a good state of repair and condition. This is particularly the case with newly-built or newly redeveloped buildings and longer-term leases. If the demised premises include the whole building, this could be a wide-reaching repairing obligation. The tenant bears the risk of a defective building where remedial works fail or aren't made. This risk increases once the benefit of any warranties has finished.

How does this compare with a contractor's or sub-contractor's liability?

The liability a contractor owes to a landlord/developer or main contractor will be limited to their respective contracts. This means the contractor's liability will last as long as the limitation period associated with the contract. The liability a contractor owes to a tenant will only arise if the parties enter into a collateral warranty in respect of the works. Again, the contractor's liability to the tenant will only last as long as the limitation period associated with that warranty.

What difficulties can this give rise to?

Where the parties' rights and obligations do not match up it can give rise to difficulties.

The tenant can be stuck in a defective property with no recourse, particularly as the lease term is likely to extend past the limitation of a warranty. The landlord/developer is able to sue the contractor under the contract but the issue for the tenant is that, unless the lease states otherwise, the landlord/developer does not have to take any action to rectify the defect even if it recovers money in relation to it.

The difficulty for the contractor is that it could potentially be sued twice for the same defect. The landlord/developer may make a claim under the contract and the tenant may make a claim under the warranty for the same defect.

What was the issue in Office Deport v UBS?

Office Depot v UBS [2018] EWHC 1494 (TCC), [2018] All ER (D) 91 (Jun)

In 2005 the tenant was granted a 20-year lease of a newly-constructed warehouse, which included a full repairing covenant in respect of the roof. Before entering into the lease the tenant obtained:

- a collateral warranty from the main contractor
- a collateral warranty from the sub-contractor

The warehouse suffered from water ingress and continued to do so despite repairs. In 2010 the landlord, UBS Asset Management (UK) Ltd (UBS) claimed under its design and build contract against the main contractor and settled for £2.8m. The main contractor passed the claim to the sub-contractor and settled for £4m. UBS later assigned the lease to UBS Triton General Partner Ltd.

The parties attempted to agree a schedule of remedial works to be carried out by the sub-contractor and paid for by the landlord but could not reach an agreement on liability, the scope of the works or the costs of the works.

The difficulty for the tenant was that it was obliged under the lease to carry out repairs, but it was unsure whether this responsibility included extensive roof repairs that the warehouse had potentially incurred from the start of the lease. The landlord was not prepared to clarify what it required from the tenant. It is the risk of the tenant to construe what the repairing obligation entails. The tenant was reluctant to repair the roof at great expense if it would later turn out the lease did not require it to. Similarly, it did not want to come to the end of the lease and then receive a claim from the landlord to repair the roof when it would be too late for it to rely on the warranties from the contractors.

The landlord knew that if it did claim against the tenant, the tenant would rely on its warranties to pass the cost of the repairs to the contractor. The contractor would then be entitled to an indemnity under its settlement agreement with the landlord. The landlord wanted to avoid using the money it had received under the settlement agreement and so did not want to make a claim against the tenant within the warranty limitation periods.

In 2017 the tenant commenced proceedings against the former landlord, the current landlord and the contractors, seeking a determination of the repairs it was obliged to carry out under the lease (before the limitation under the warranties expired meaning that it would be unable to recover its costs of repair from the contractor responsible for the defect). However, the court rejected the tenant's claims against the former and current landlord. The court did however permit the tenant to amend its claim against the contractors.

LexisNexis practical point: The court reached this decision on procedural grounds, in particular due to the fact that there was no dispute as to the tenant's repairing obligations and the court did not consider that its role was to grant a declaration just because one party sought it. For further information in this regard, see News Analysis: Grounds for granting declaratory relief and principles for amending particulars of claim (Office Depot International (UK) Ltd v UBS Asset Management (UK) Ltd)

Lessons to be learnt

The tenant should try to obtain a warranty for the length of the lease term. However, this would be fairly unusual once the lease is longer than 12 years and in any case is subject to agreement by the contractor, who has no obligation to do so. One suggestion is, if the tenant enters into an agreement for lease with the landlord, it could try to specify this extended warranty as a condition to entering into the lease.

The tenant should ensure the lease includes an obligation on the landlord to make all relevant claims in relation to the property (promptly) and use all monies received from such claims to rectify the defect (promptly).

The contractor should seek an indemnity when settling a claim with a landlord/developer to ensure it does not have to pay twice for the defect. This could be by way of including the tenant into the agreement.

Interviewed by Diana Bentley.

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