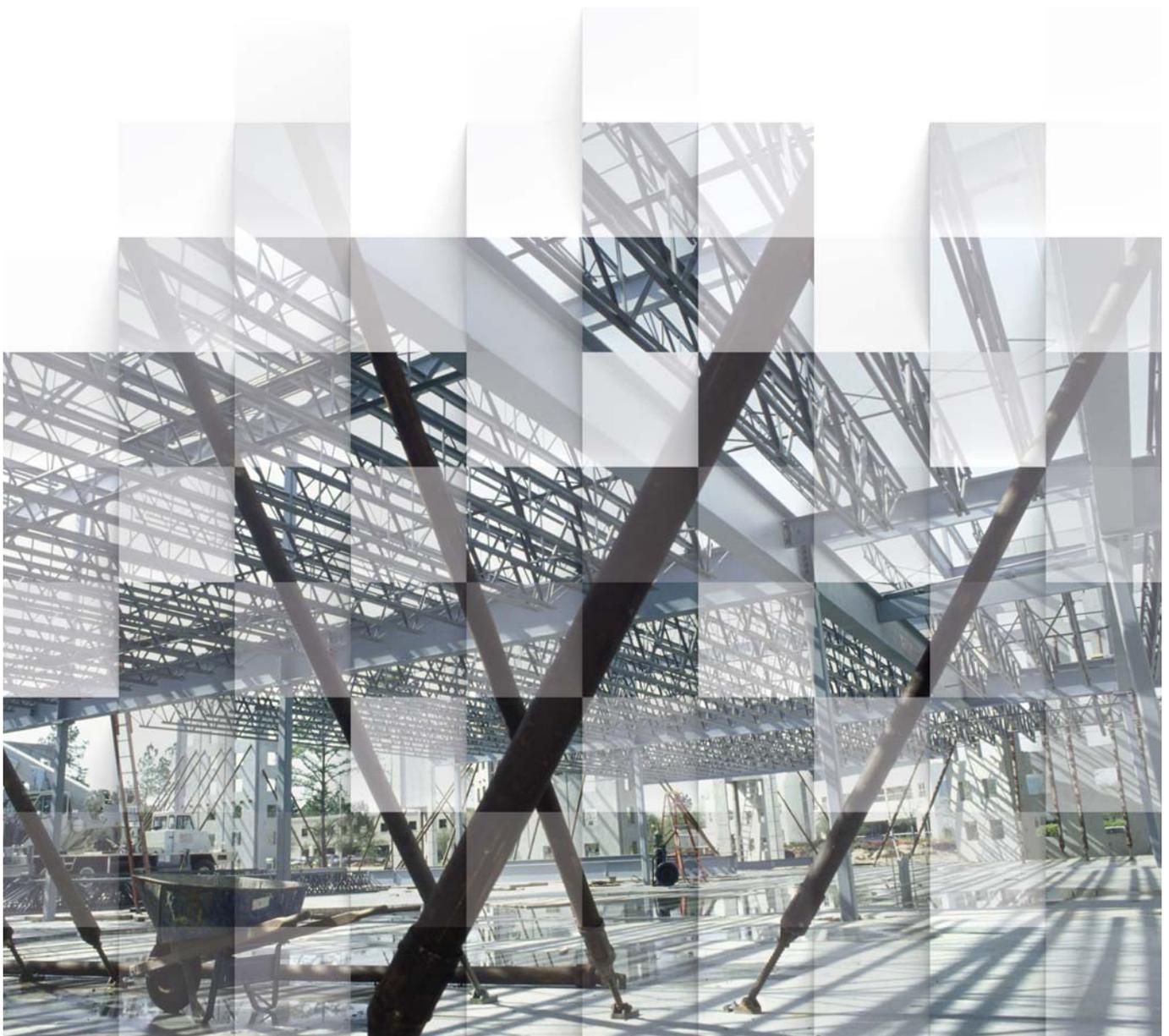


Defects during the project life cycle: FIDIC and UAE law

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Defects affect construction projects throughout their life-cycle – from design to construction to use. UAE law and the FIDIC Red Book, the most common form of construction contract adopted in the UAE, have numerous provisions to address defects. Whilst the contractual and legal implications of defects usually require intense investigation and are necessarily fact-specific, Reed Smith's UAE construction team presented the following hypothetical case study at a recent discussion forum to illustrate some of those implications. The analysis that follows the case study captures that discussion.

Case Study

In 2005, Big Developments entered into a construction contract (FIDIC Red-Book 1999) with Trusted Contracting for delivery of "the biggest hospital in the world" to be owned and operated by Big Developments in Dubai. The project was a low rise development but featured a tall residential tower. The tower would be partially used for accommodating hospital staff, but many units would also be sold to third party purchasers.

Big Developments entered into a separate contract with the consultant, Bling Buildings, for the design of the project and supervision of the construction works.

There was intense pressure to deliver the project in time for the Dubai Healthcare Expo in 2008. The construction went smoothly except for one major complication towards the end of the project that infuriated Big Developments – Trusted Contracting installed a fire sprinkler system in the hospital building which was not compliant with the Civil Defence Regulations. This was discovered during a Civil Defence inspection and the sprinklers had to be removed and replaced in the entire building, which jeopardised the completion date.

The project was miraculously completed on time and handed over in 2008.

A few years later things started to go wrong:

- 1 In 2009 residents of the tower complained to Big Developments that water was leaking through their ceilings. It appeared to be coming from bathrooms in the floor above.
- 2 In 2010 a thick fungus was discovered growing in a gap between the interior and exterior walls of the entire hospital. Big Developments was undergoing a corporate restructure and did not have time to take any actions. The hospital had central air-conditioning but sometimes patients opened the windows because they wanted fresh air. By 2011, the fungus was out of control, producing a foul odour and was clearly visible. All the walls in the hospital were affected.
- 3 In 2014, Big Developments sold the project to Better Developments who engaged So-So Contracting to perform a major upgrade of the cardiology wing which looked dated. The original concrete slab had a few small cracks but a new layer was placed over it. Less than a year after the upgrade, much larger cracks appeared in the floor.

What is a defect?

It seems obvious enough, but there is no universal or simple definition of what a defect is. Most standard form contracts, such as the FIDIC Red Book, do not actually define the term 'defect'. It is perhaps easier to start with what a defect isn't, and work backwards. The following principles are a useful starting point:

- *"Nothing built is ever perfect; and the law does not require perfection"*
- *"Nothing built lasts forever; failure is an expected result"*
- A defect is not fair wear and tear, which is caused by normal ageing of a building.
- A defect is not a problem caused solely by poor maintenance or lack of maintenance (though these could exacerbate a defect).

Defects can be in the design (where a design does not meet standards of care or does not comply with building regulations) or in the construction (where work is not executed according to specifications or does not meet acceptable standards of workmanship) or where materials and equipment are not fit for purpose.

There is an important distinction between a defect and the manifestation of a defect (although both are problems) – not all manifestations of a problem are the result of a defect (e.g. a crack might be a symptom of a bad design or poor workmanship but in some circumstances, it may be fair wear and tear).

For completeness, the term 'defect' is not defined in the UAE Civil Code or FIDIC, although there are a number of references to defects throughout the Code and the contract form, as well as references to the standards of work expected. It is worth noting that under Article 880 of the UAE Civil Code, contractors are obliged to construct a building that is free from total or partial collapse and defects threatening its stability and safety for 10 years after delivery of the works.

Turning to the case study (in which a number of hypothetical companies will be referred to) there is thick fungus appearing inside the hospital walls two years after handover. It is a problem, but is it a defect?

- Mould is a common problem in the UAE due to the hot climate. Serious health issues can arise.
- Mould is usually the manifestation of a design or workmanship defect (or combination of both), but can sometimes be purely the result of poor maintenance, including incorrect use of, or poorly functioning, air-conditioning units.
- Designers in the forum leapt to the defence of designer Bling Buildings, arguing that a cavity in the

walls was not an abnormal design feature because buildings need to breathe.

- The defect might have come from poor workmanship, such as failure to properly seal the cavity. Unsupervised, unskilled labour may have led to this issue.
- Involving facilities management specialists at the design stage can contribute to a stronger design and avoid future problems arising. There is a growing awareness in Dubai of this preventative step.

Preventing and addressing defects: before and during the construction period

Even before entering into the contract, a rigorous tender clarification process can help to identify defects or gaps in the design. This process should give employers an incentive to ensure that the design is sufficiently developed for meaningful review at the tender stage.

The FIDIC Red Book contains a number of provisions that should have helped Big Developments avoid or address defects during construction. Clause 7 provides the employer and/or the engineer the right to:

- Approve material samples before use
- Inspect the manufacture of plant
- Inspect production and manufacture of materials
- Inspect work before it is covered up
- Conduct tests

If the material, plant, or workmanship is defective or otherwise not in accordance with the contract, the engineer could have rejected Trusted Contracting's material, plant or workmanship and require Trusted Contracting to remedy the defect at its own time and cost.

When the inspection revealed that the fire sprinklers were not in accordance with the contract, Trusted Contracting might have argued that Big Developments should bear the time and cost consequences of replacement, including acceleration, since Big Development's engineer would have had multiple opportunities to object to the fire sprinklers and instead approved them.

While this is a common argument, absent special circumstances it generally fails. Sub-Clause 4.1 provides that Trusted Contracting's primary obligation is "to execute and complete the works in accordance with the contract..." The engineer's sign-offs are of little help. Under Sub-Clause 3.1, the engineer does not have authority to relieve Trusted Contracting of its contractual obligations.

Defects liability period (DLP)

Trusted Contracting's obligation to remedy defects does not end with the taking over of the works by Big Developments. Clause 11 of the FIDIC Red Book provides for a period after taking over, during which Big Developments may notify Trusted Contracting of defects and require that Trusted Contracting rectify them. Usually this period is one year, but it sometimes is extended to two years.

Going back to the case study, Big Developments should notify Trusted Contracting that there is water leaking from the bathrooms above and require rectification. If Trusted Contracting does not repair the defects, Big Developments would be expected to carry out the work and charge the costs against the retention.

Trusted Contracting may inspect the leaks and determine that, in fact, there isn't a material or workmanship defect, but rather there is a design defect. In that case, Trusted Contracting may refuse to do the work without additional compensation.

Contractual liability for defects under UAE law

Under UAE law, Big Developments could bring a breach of contract claim against Trusted Contracting for latent defects that are discovered after the expiry of the DLP.

Article 95 of the Commercial Transaction Law provides for a 10-year statute of limitations for bringing breach of contract claims that runs from the date when the obligations are due.

Therefore, Big Developments may be able to bring a claim against Trusted Contracting if the fungus manifests after the DLP and if Big Developments could not have discovered the defect giving rise to the fungus during the DLP.

Decennial liability

Articles 880 to 883 of the UAE Civil Code govern 'decennial liability'. These provisions provide rights to employers/developers against contractors and supervising engineers/architects in the case of total or partial collapse of a building, or where a defect threatens the stability and safety of the building. If the architect does not supervise the execution, the architect is held liable only for defects in the design.

Contractors and supervising architects are held jointly liable for 10 years and it is not permitted to contract out of decennial liability. Once a building has collapsed or a defect has been discovered, the employer has three years in which to bring a claim.

Decennial liability is a strict liability standard, which means that an employer is not required to show any wrongdoing by either the contractor or the architect in

order to recover compensation from them. That said, 'strict' does not mean 'absolute' liability. The contractor and architect may each defend themselves against a claim for decennial liability by proving that the collapse or defect arose from an 'extraneous cause'. For example, the contractor might show that the fault was with the design or the architect might show that the fault was with the contractor. Perhaps the fault came from a third party. In the extreme, imagine that a crane falls on a building and the building collapses. The crane falling is an extraneous cause of the collapse, not a cause from the design or construction. The same logic can be applied to less extreme circumstances.

The application of decennial liability provisions under the UAE Civil Code is complicated in cases of major renovations and multiple owners, as contemplated by the case study. When the hospital project is sold by Big Developments to Better Developments in 2014, small cracks have already formed in the original concrete slab of the cardiology wing, approximately six years after handover and within the 10-year decennial liability period. So-So Contracting performs a renovation of the floor, concreting over the cracks, and larger cracks appear less than a year after the renovation. The following considerations arise:

- Assuming the cracks threaten the stability and safety of the building, what is the underlying source of the defect? The rework by So-So Contracting? Or the original work by Trusted Contracting? Or the original design by Bling Buildings? Ultimately, this is a factual question that would come down to expert evidence. There may be multiple causes, including major defects in the original work and design, as well as the rework, which together have caused the building to be structurally unsound and unsafe.
- If the rework is extensive, Trusted Contracting and Bling Buildings would probably have an argument that there was an intervening, extraneous cause (i.e. the rework by So-So Contracting) and that any chain of causation between an original defect (if it was a cause) and the loss suffered, has been broken. Although decennial liability is strict, the UAE courts have recognised some defences to decennial liability, including force majeure or extraneous causes, such as the actions of a third party after handover. Arguably, a major renovation by a third party could be viewed as an external or intervening cause.
- Assuming the structural defect is isolated to the rework, Better Developments could sue in decennial liability for structural defects in the rework because Better Developments takes on a developer role in respect of the renovation. However, if the structural defect stems from the original work by Trusted Contracting or the original design by Bling Buildings, Better Developments (as the new owner/end user) would have difficulty in

making a direct claim against Trusted Contracting and/or Bling Buildings because, on the face of Article 880, this provision is not open to any third party (i.e. a new owner/end user) who has no contractual relationship with the contractor or supervising engineer/architect to sue in decennial liability. The protection is for the employer/developer only (not the end user, even if this is another developer).

- As an end user, Better Developments is not without legal recourse against Trusted Contracting and/or Bling Buildings. Better Developments could sue them in tort for negligent design/construction. There is also an argument that decennial liability rights run with the property pursuant to Article 251 of the Civil Code. This is untested but there could be a public policy argument that the intent of decennial liability is to protect against the effect of structurally unsound buildings. Therefore, Article 251 should be applied to allow decennial liability rights under Article 880 to run with the property.
- Better Developments would be wise to mitigate against the risk of purchasing a structurally unsound building under its sale and purchase agreement (SPA) with Big Developments. Better Developments should insist upon a strict warranty guaranteeing the structural stability and safety of the building for at least 10 years. This will create a chain of liability so that Better developments can sue Big Developments under warranties in the SPA and Big Developments can sue Trusted Contracting and/or Bling Buildings under statutory decennial liability.
- Would Big Developments lose its rights to make a claim in decennial liability by selling the hospital to Better Developments before the 10-year statutory decennial liability period expires? Article 880 does not address this scenario. It was drafted in the eighties well before the UAE boom in construction and major projects, and did not contemplate multiple sales of a development within 10 years after delivery of the works. However, it is not possible to contract out of Article 880 and Big Developments would have a good argument that the sale could not deprive its rights under Article 880.
- Both Big Developments and Better Developments should be mindful that a decennial liability claim must be made within three years of discovery of the defect. The UAE courts have indicated that the discovery of the defect is considered the point at which there is actual knowledge of the occurrence of the damage, and certainty with regard to it. This is a matter of fact within the discretion of the trial court. A developer will run a risk if they turn a blind eye to the cracks, or bury their head in sand and refuse to enquire about the cause of the cracks for

a number of years. If a developer enlists an engineer who confirms a structural defect, the three-year period for bringing a claim will likely run from the time of receiving that report.

Strata Law

In Dubai, Law 27 of 2007, Law of Ownership of Joint Properties (Condominiums), was intended to protect owners of jointly owned property from the consequences of defects.

Under the law, the developer remains liable to the unit owners or owner association for repairing or correcting any defects of the structural parts of the joint property for 10 years after the date of the completion certificate. Likewise, the developer remains liable for repairing or replacing defective installations, such as mechanical and electrical works, for one year.

In practice, we expect that pursuing rights under this law would be difficult although the Dubai Land Department has been issuing guidelines and regulations over time to make the law more effective. Owners associations, however, are not generally formed and the costs for individual unit owners in pursuing claims against developers would be expected to be prohibitive.

In the case study, the third party purchasers could consider action against Big Developments in 2009 if the water problems arose from the defects covered by the Dubai law and Big Developments did not action to correct them.

Reed Smith UAE construction discussion series

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