

DIMINUTION IN VALUE OF WORKS DUE TO DEFECTS

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DIMINUTION IN VALUE OF WORKS DUE TO DEFECTS

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With much love and respect

To my beloved Parents

Haji Hashim Long and Patimah Norizan Mohd Yasin

Brothers and Sisters,

&

Mohamad Sharfiq Zaini

For being there whenever I need them most

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ABSTRACT

Defect is one of the major causes of dispute in construction projects. In the context of construction, a defect or defective work is work that is not in accordance with the contract. It is common for standard forms of contract to make express provision for dealing with the defects or defective work. This provision provides the action that can be taken by the employer in the event of contractor's default in rectifying the defects. One of the alternative is the employer may ascertain the diminution in value of the works if in his opinion that the defects should be inconvenient to be rectified. However, there is no definition of an appropriate deduction and rule to assess the diminution in value of the said works. At what point is the deduction is determined? Hence, this research intends to identify the basis of how the courts measure the diminution in value for construction defects. This research was carried out mainly through documentary analysis of law cases and law reports on diminution in value. Results show that there are several measures that the courts used in assessing the diminution in value. They are based on the difference between the value of the buildings without the defects and the value with the defects, cost of repair, cost of reinstatement and cost of rectification. The date of assessment is also different for the cases analyzed. It is recommended that the principle to ascertain the diminution in value of the works due to the defects should be included in the standard form of contract. The purpose is to provide the guideline on how to measure the diminution in value of defective works.

ABSTRAK

Kecacatan adalah salah satu punca utama pertikaian dalam projek pembinaan. Dalam konteks pembinaan, kecacatan atau kerja yang rosak adalah kerja yang tidak mengikut kontrak. Kebiasaannya, Borang Kontrak menyediakan peruntukan berkaitan dengan kecacatan atau kerja yang rosak. Peruntukan ini menyediakan tindakan yang boleh diambil oleh majikan sekiranya kontraktor lalai dalam memperbaiki kecacatan. Salah satu alternatif adalah majikan boleh menentukan susut nilai kerja-kerja jika pada pendapatnya bahawa kecacatan tersebut tidak patut atau sukar untuk dibaiki. Walau bagaimanapun, tiada definisi potongan yang sesuai dan kaedah untuk menilai susut nilai tersebut. Bagaimanakah pengurangan tersebut ditentukan? Oleh itu, penyelidikan ini bertujuan untuk mengenal pasti asas mahkamah mengukur susut nilai untuk kecacatan pembinaan. Kajian ini telah dijalankan melalui analisis kes undang-undang dan laporan undang-undang. Keputusan menunjukkan bahawa terdapat beberapa langkah yang digunakan mahkamah dalam menilai susut nilai. Langkah-langkah tersebut adalah berdasarkan perbezaan antara nilai bangunan tanpa kecacatan dan nilai dengan kecacatan, kos pembaikan dan kos pengembalian semula. Tarikh penilaian juga berbeza bagi kes-kes dianalisis. Adalah dicadangkan bahawa prinsip untuk menentukan susut nilai kerja-kerja disebabkan oleh kecacatan hendaklah dimasukkan dalam Borang Kontrak. Tujuannya adalah untuk menyediakan garis panduan mengenai cara untuk mengukur susut nilai bagi kerja-kerja yang rosak.

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LIST OF ABBREVIATIONS

AC	Appeal Cases
All ER	All England Law Reports
AMR	All Malaysia Reports
App.Div	Appellate Division
BLR	Building Law Reports
Cal.	California Reports
Cal. App	California [CA] Appellate Reports
CCH	Commerce Clearing House
Ch	Chancery Law Reports
CIDB	Construction Industry Development Board
CLJ	Construction Law Journal
Cont. Cas. Fed.	Contract Cases, Federal
Con LR	Construction Law Reports
CLR	Commonwealth Law Reports
DCA	District Court of Appeal
EG	Estate Gazette
EGD	Estate Gazette Digest
EWCA	England and Wales Court of Appeal
Exch	Court of Exchequer
Fla.	Florida Reports
HL	House of Lords
LGR	Local Government Reports
Lloyd's Rep	Lloyd's List Reports
LR, CP	Law Reports, Common Pleas
MLJ	Malayan Law Journal

N.E	North Eastern Reporter
NIHC	Northern Ireland High Court
N.J. Super	New Jersey [NJ] Superior Court Reports
NSWCA	New South Wales Court of Appeal
N.Y	New York [NY] Reports
PAM	Pertubuhan Arkitek Malaysia
PWD	Public Works Department
QB, QBD	Law Reports: Queen's Bench Division
SGHC	Singapore High Court
SLR	Singapore Law Reports
WLR	Weekly Law Reports
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CHAPTER 1

INTRODUCTION

1.1 Background of the Study

It is unsurprisingly that defects are one of the major causes of dispute and construction litigation.¹ Professor Anthony Lavers said:

*“Defects will occur in buildings. It is one of the great certainties in construction, the equivalent of death and taxes in life more generally”.*²

The term defects in construction always in disagreement since it tends not to be defined in construction contracts.³ The first effort to define a defect arose in the case of *Yarmouth v France*⁴ with respect of a carthorse that was considered unfit to

¹ Barret, K., “Defective Construction Work.”, London: Wiley-Blackwell, 2008, pp. 118.

² Cohen, L., “Building defects; the legal position!”, Retrieved on June 1, 2011 from www.blaketurner.com/documents/building%20defects.pdf

³ Holmes, C. & Wilshire, K., “The rectification of defects”, 2010, Retrieved on June 1, 2011 from www.kensingtonswan.com/.../The_rectification_of_defects.pdf

⁴ (1887) 19 QBD 647

be driven.⁵ The Plaintiff was injured in an accident whilst driving the cart that was pulled by the horse in question. The Court considered that the horse constituted plant and if it was unfit for the use for which it was intended then it was defective.

The issue in the somewhat later case *Tate v Latham*⁶ of was whether the absence of a guard on a circular saw was a defect and the condition of the machinery under Section 1(1) of the Employers' Liability Act 1880. It was held that "defect" means the absence of something essential to completeness. The absence of the guard to the saw constituted a defect in this respect.

The other examples include *McGiffin v Palmers Shipbuilding & Iron Co Ltd*⁷ where an obstruction protruding from a furnace did not render the furnace defective and the curious decision in *Jackson v Mumford*⁸ which decided that the word defect did not include a design defect.

In construction, defect is defined as a component supplied or constructed which is in some respect not in accordance with the contract or as some action having consequences not authorized by the contract.⁹ As defined by the California Jury Instructions, the construction defect is:

'Failure of the building or any building component to be erected in a reasonably workmanlike manner or to perform in the manner intended by the manufacturer or reasonably expected by the buyer which proximately causes damage to the structure.'

⁵ Cohen, L., "Building defects; the legal position!", Retrieved on June 1, 2011 from www.blaketurner.com/documents/building%20defects.pdf

⁶ (1897) 1 QB 502

⁷ (1882) 10 QBD 5

⁸ (1902) 51 WR 91

⁹ Robinson, N. M et al, "Construction Law in Singapore and Malaysia." Kuala Lumpur: Butterworths Asia, 1999, pp.159-160.

Most of the standard forms of contract include defects liability provision. The clause will impose the obligations upon the contractor to make good defects. This would ordinarily be to the contractor's advantage given that this is likely to be less costly than providing an indemnity to the employer against the cost of having another contractor to remedy the defective work.¹⁰ Examples of the clauses relating to the defects that have been spelt out are;

- i. PWD 203A 2007
 - a. Clause 35.0 – Materials, Goods and Workmanship
 - b. Clause 36.0 – Inspection and testing of materials, goods and equipment
 - c. Clause 48.0 – Defects after completion
- ii. PAM 2006
 - a. Clause 6.0 – Materials, Goods and Workmanship to conform to description, testing and inspection
 - b. Clause 15.0 – Practical completion and defect liability
- iii. CIDB 2000
 - a. Clause 15.0 – Quality in construction
 - b. Clause 27.0 – Defects liability after completion

To carry out the works in a defective manner amounts to a non-compliance with the contract. Any defect in the work is a breach of contract on the part of contractor.¹¹ The employer then has two separate remedies in dealing with this matter. The employer may use the defects liability in the contract to compel the contractor to rectify or alternatively it may sue the contractor in court or arbitration proceedings, claiming damages for breach of contract.

¹⁰ Cohen, L., "Building defects; the legal position!", Retrieved on June 1, 2011 from www.blaketurner.com/documents/building%20defects.pdf

¹¹ Chappell, D., "The JCT Design and Build Contract 2005". London: Blackwell Publishing, 2006, pp. 139

The defects liability period clause is inserted for the benefit of both parties. It allows period of time for defects to be remedied with the minimum fuss.¹² Defects liability period runs from the date of practical completion for a specified period. The duration is usually fixed as stated in the contract particulars but sometimes adjustable.¹³ It will last for a stipulated period of time inserted in the contract; failure to name a period will mean that the period will be 6 or 12 months from the date of practical completion.¹⁴

Since any defect in the work is a breach of contract on the part of contractor, without such period, the employer would not have contractual remedy. More importantly, if there were no defects liability period or rectification period, the contractor would have no rights to enter the site to remedy the defective work.¹⁵

Whether the contractor has a right as well as an obligation to rectify defects and therefore avoid liability for damages was considered by the Court of Appeal in *Kaye v Hosier*.¹⁶ While recognizing the answer is likely to be dependant on the wording of the contract, the court held that in most cases the contractor will not only have to return to the site to rectify but also probably the right to do so.

¹² Ibid, pp.138

¹³ Barret, K., "Defective Construction Work.", London: Wiley-Blackwell, 2008, pp. 119.

¹⁴ Ibid

¹⁵ Ibid.

¹⁶ (1972) 1. WLR 146

1.2 Problem Statement

During the defect liability period, the contractor is obliged to return to site and rectify the minor defects and omissions existing at practical completion and the defects notified to it during the defects liability period. Defects may be notified at any time up to the end of the defects liability period and must generally be rectified within a reasonable time at contractor's own cost. Failure of the contractor to rectify such defects, it will be in breach of contract and the employer may employ others to effect the necessary repairs and recover the full cost from the builder.¹⁷

In the standard form of contract, usually it provides the action that can be taken by the employer in the event of contractor's default in rectifying the defects. There seems a little doubt that if the contractor refuses to make good the defects on the schedule or if it does not expressly refuses but simply does not make good, the employer would be able to instruct the contractor not to make good and the appropriate deduction is to be made from contract sum.¹⁸

Alternatively, the employer may ascertain the diminution in value of the works if in his opinion that the defects should be inconvenient to be rectified.¹⁹ The amount of such diminution then shall be deducted also from the contract sum or amount due to the contractor.²⁰ However, there is no definition of an appropriate deduction.²¹ At what point is the deduction is determined? It is often contended by the employer that it is the cost to the employer of having the defect rectified by the others. The contractor on the other hand will argue that the deduction should be the cost which the contractor would have expended on making good.

¹⁷ Barret, K., "Defective Construction Work.", London: Wiley-Blackwell, 2008, pp. 118

¹⁸ Chappell, D., "The JCT Design and Build Contract 2005". London: Blackwell Publishing, 2006, pp. 142

¹⁹ Lim Chong Fong, "The Malaysian PWD Form of construction contract.", Selangor: Sweet & Maxwell Asia, 2004, pp. 107.

²⁰ Ibid

²¹ Ibid

A similar problem can arise in diminution in value. In the case of diminution in value, it is thought that the amount of diminution would not be the same as the cost of rectification.²² In *Ruxley Electronics & Construction Ltd v Forsyth*,²³ the plaintiff sued for compensation for the defective pool but then lost an appeal about the correct approach to the assessment of compensation. The question then arises. How does such diminution to be assessed?

1.3 Objective of the Study

The objective of this study is to identify the basis of the courts measure the diminution in value for construction defects.

1.4 Scope of the Study

The approach adopted in this research is case law based which covers the following areas:

- i. Only construction defects cases are chosen
- ii. The cases narrowed down to the case on the diminution in value cases.

²² Lim Chong Fong, "The Malaysian PWD Form of construction contract.", Selangor: Sweet & Maxwell Asia, 2004, pp. 107.

²³ (1995) 73 BLR 1

Selected standard forms of contract will also be referred to and they are as follows:

- i. PWD Form 203A (Rev 2007)
- ii. PAM Contract 2006 (With Quantity)

1.5 Significance of the Study

Once the building work is complete, the concepts such as defects liability period, making good defects, retention and final certificate come to mind and they are sometimes subject to the misconception. The extent to which these concepts come into play at all and their precise scope and effect depends entirely upon the contractual terms of the contract.

In essence, this research is expected to provide an overview about the defects in construction. This study also can be used as a basic guidance for those who are involved in the construction industry, such as arbitrators, employers, architects, contractor's consultants and etc in regards to the scope and extent of defects that might appear in construction.

This study also may assist especially the aggrieved party to realize the legal measure adopted for recovery of damages upon breach of contract for defective building work by defaulting party. This study may provide the rules that the court will be used in awarding the damages to the aggrieved party in defective works. All these together, this research is then will help to create awareness among the industry players regarding to this aspect

1.6 Research Methodology

In order to achieve the research objective, a systematic research process had been drawn up and adhered to. The research process consists of four major stages, namely, identifying the research issue, data collection, data analysis and writing. Each stage is shown in detail below. (Refer to Figure 1).

1.6.1 Identifying the Research Issue

The initial stage is to identify the area of study and research issue. Initial literature review was done in order to obtain the overview of the particular research topic. It involved reading on various sources of published materials for example, articles, journals, seminar papers, related cases, previous research and other related research materials. Then, the next step is to formulate a suitable objective and designing a scope of study.

1.6.2 Data Collection

The second stage is to develop research design and data collection. The main purpose of research design is to determine the important data to be collected and the method to collect it. The data will be collected through documentary study on the Court cases form MLJ, Building Law Report and other law journals form Lexis Nexis. Next data also will collected through published resources, like books, journals, articles, varies standard form of contract and related statutory are the most

helpful sources in collecting primary and secondary data. Data collection stage is an important stage where it leads the researcher towards achieving the main objectives.

1.6.3 Data Analysis

During this stage, the case laws collected and all the relevant information will be specifically arranged and analyzed and also interpreted based on the literature view is converted into information that is useful for the research. Researcher will carefully review the relevant case laws collected and also with special attention on the facts of the case, issues and judgments presented by each case law.

1.6.4 Writing

In the last stage, process of writing up and checking will involves to complete the report. A conclusion will be made up and at the same time recommendations that related to the problem may be made in this stage. The author had also reviewed the whole process of the research to identify whether the research objective has been achieved.

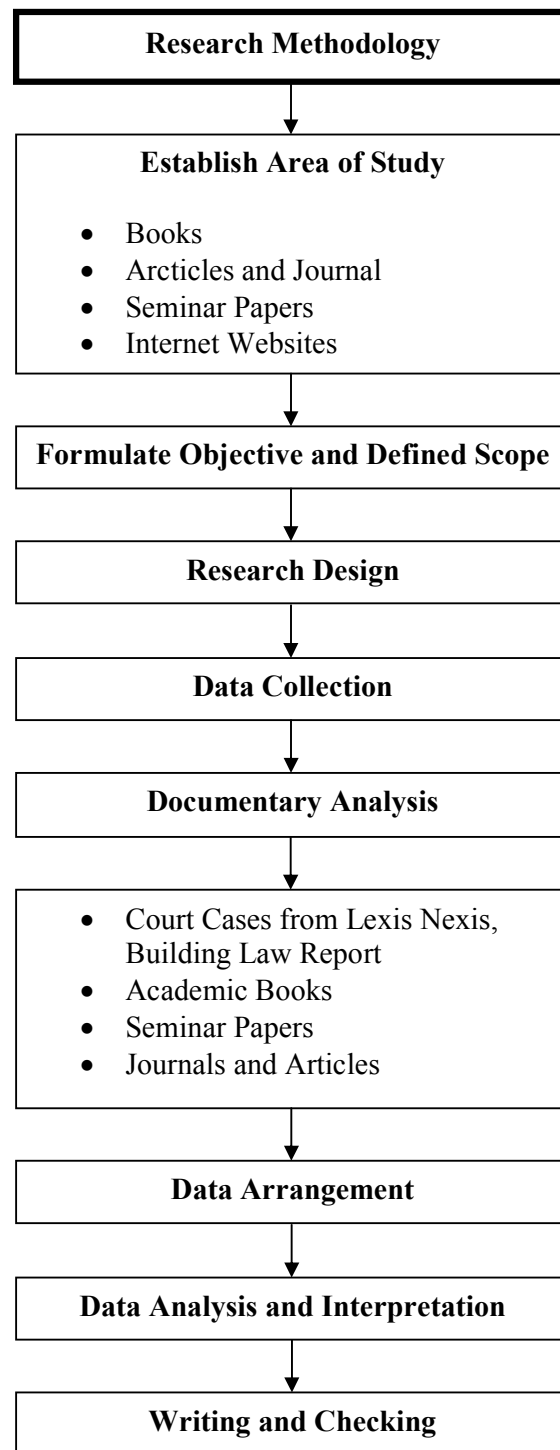


Figure 1.1: Research methodology and methods of approach

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