



Defects Liability Insurance

While most new build properties do not require any significant repairs, in some instances owners of new homes have been left with large financial burdens to rectify structural defects when no defects liability insurance policy, or other form of protection, has been in place. At present, there are no mandatory requirements to provide cover for latent structural defects for a set period of time after a new property is completed. Latent structural defects are faults with the construction of a property that have been concealed in the works and may not become apparent for many years.

This issue was the subject of a Requête brought forward by Deputy Perrot during the last political term, which was discussed by the former Policy Council at its meeting on 12th October 2015. The Requête, set out in detail at the end of this report, proposed that the Environment Department be charged with investigating and reporting on the feasibility of introducing legislation that would afford better protection for buyers of new build residential accommodation in the event of structural defects arising in their properties. The Policy Council was supportive of the Requête but considered it was a matter that could be progressed by the Policy & Resources Committee in due course, rather than by way of a Requête. Having received an assurance that the issue would be addressed, Deputy Perrot agreed to withdraw his Requête.

This report outlines the background to the work, the research that has been carried out, and the conclusions based on those findings. At this stage the Policy & Resources Committee is of the view that no legislation is required, but instead any change should be industry-led demonstrating best practice. As such the Committee will write to the relevant professional bodies to encourage them to raise awareness of the options available to purchasers.

Background

The motivation for the Requête came from issues arising from problems with a block of flats in St Peter Port. A number of apartments were built on the site and following the sale of the final property both the development company and the building company went into liquidation. No defects liability insurance policy or form of warranty was provided to the owners of these apartments at the time of purchase.

A number of years after the construction of the development, the director of the management company of the building, on behalf of the owners of the apartments, contacted the States of Guernsey. The letter stated that a number of significant defects, including poor ventilation and water ingress, had become apparent in the building since construction had been completed. At the time of the complaint, each of the owners had been required to pay a significant amount of money towards the cost of rectifying the defects. An undated, unsigned “report” prepared by an unidentified individual who did not disclose his or her qualifications was included with the letter providing details of alleged defects in the building. The letter also stated that the owners believed that States of Guernsey Building Control officers should have identified many of the defects as part of their inspections during the construction of the building. It was suggested that these officers were negligent in carrying out their duties.

The position of the States of Guernsey was that it did not accept any liability in respect of matters connected with the apartments in question and that there was no provision in The Building (Guernsey) Law, 1956 or under customary law for any express or implied statutory duty or other duty of care on the part of the States of Guernsey. Express reliance was also placed on the doctrine of *caveat emptor*. It was also suggested that the owners of the apartments should address their concerns to the builders and relevant surveyors used at the time of the purchase of the properties.

To date no further correspondence has been received with regard to the block of flats. However, Deputy Perrot, his fellow requérants and the former Policy Council all considered that there was merit in exploring whether legislation to make defects liability insurance policies for new build properties compulsory was necessary.

Size of the problem

At the present time there has only been one instance, which Building Control has been formally involved in, where purchasers have been left with significant costs to repair latent defects in a property, which is the instance referred to in this report. The main problem in this instance was that both the developer and the builder ceased to exist following the sale of the final apartment, and so in the absence of a survey being conducted, and due to the lack of any warranty or defects liability insurance being in place, there was nobody for the purchasers’ complaints to be addressed to other than Building Control.

While other complaints have been made to Building Control in recent years regarding latent defects, these have all been dealt with privately between the purchaser of the property and the developer and/or builder who completed work on the property. None of these other instances have resulted in an insurance claim being made against the States, and the outcome of these complaints is not known.

Building Control do not currently hold any statistics to indicate how many similar instances, if any, have occurred where a lack of a warranty or any defects liability insurance has resulted in large financial costs for purchasers of new build properties. Without this data it is not possible to quantify the number of households that would potentially be aided through the introduction of legislation to make defects liability insurance compulsory.

Measures adopted in other jurisdictions

There are many different ways to ensure that the owners of a new build property are protected from the financial burden of having to rectify any hidden defects which occur post-completion, and governments across the world have taken different approaches to provide consumer protection. Many of the measures adopted in other jurisdictions are already available to individuals purchasing property in Guernsey.

United Kingdom

There are various legal provisions in place in the UK which provide protection to owners of new build properties. Minimum contractual liabilities are governed by law, and standard contracts such as those by the Joint Contracts Tribunal are widely used in relation to the construction of properties. Collateral warranties¹ are another form of contract under which a professional consultant such as an architect, a building contractor or a sub-contractor warrants to a third party (such as the funder or the purchaser) that it has complied with its professional appointment, building contract or sub-contract. Third Party Rights, as set out in the Contracts (Third Party Rights) Act 1999, can also provide a person who is not a party to a contract to enforce the benefit of a term of that contract.

These provisions provide some construction security, as they allow the funder to claim for any losses directly from the person who caused the loss, such as a contractor in breach of a building contract. The use of contracts also provides funders or owners with the opportunity to claim for pure economic loss, such as damage caused to a building due to a defect in that building, which would be unlikely to succeed through the law of tort in England and Wales.

Contract law also provides property owners with joint and several liability: this allows the plaintiff, in this case the purchaser, to pursue all parties, in this case the builders and/or contractors, either jointly or severally for the total cost of the claim to rectify any latent defects. This covers against the risk of one of the parties involved in the construction of a building becoming insolvent before a claim is made, as the owner can put in a claim against other parties involved for the total cost of the damages.

¹ Practical Law, *Collateral Warranties and Third Party Rights on Construction Projects: a Quick Guide*, [online], available at: <<http://uk.practicallaw.com/4-502-4310>>

With regard to insurance regimes for latent defects, there are no mandatory schemes in place, however there are voluntary schemes which provide securities against a contractor's insolvency before the completion of a property and building defects cover post-completion. Mandatory professional indemnity insurance also exists for architects, voluntary professional indemnity insurance for other professional consultants (although this is usually a requirement for registration with a professional body), and voluntary third party liability insurance and contractor's all risks insurance (these are frequently required in standard construction contracts).

Of the voluntary schemes which exist to provide latent defects insurance the most widely used is the Buildmark cover offered by the National House Building Council (NHBC), which provides a ten-year warranty program to rectify any structural defects found in a property in the first ten years after completion. Buildmark cover provides protection for pre-completion insolvency, damage and defects cover as well as access to a resolution service for the first two years after completion and insurance cover for rectifying physical damage in specified areas of the home in year's three to ten of ownership². The premium ratings for insurance provided via the NHBC are paid by the builders, and are based on claim records and the length of time a builder has been on the NHBC Register.

In order to encourage builders to maintain high standards, the fees will be significantly less for builders who have been registered for a long time and have a good claims record, as opposed to a builder with a large amount of claims³. Whilst this is a voluntary scheme, NHBC Buildmark now covers more than 80% of all new homes built in the UK, which in the year 2013-2014 covered more than 1.6 million properties. NHBC also acts as the insurance company to deal with any claims arising through its Buildmark cover, and in the financial year paid out £79 million in insurance claims, with one third of these claims relating to problems with the foundations and substructure of properties – this equates to a cost of approximately £49 per house for the financial year⁴.

Whilst not all of the provisions available in the UK to provide protection to consumers are mandatory, the widespread use of the NHBC Buildmark scheme in parallel with other voluntary insurance policies and the use of contractual clauses to apportion liability provide a wide range of protection for consumers with regard to latent defects within new build properties.

² NHBC, Warranties and Cover, *What does Buildmark cover?*, [online], available at: <<http://www.nhbc.co.uk/NewsandComment/Library/filedownload,16303,en.pdf>>

³ NHBC, *Premium Rating: An explanation of the scheme*, [online], available at: <<http://www.nhbc.co.uk/NHBCPublications/LiteratureLibrary/RegistrationandCustomerServices/filedownload,15866,en.PDF>>

⁴ NHBC, 2014, *Annual Report and Accounts 2013/14*, Milton Keynes: NHBC House

Jersey

It has become standard practice in Jersey for collateral warranties to be given by the parties undertaking the work to those who will ultimately occupy, own or fund the development⁵. Collateral warranties allow the owner, tenant, or funder of a building to be able to claim against either the contractor and/or any of the professional team used by the contractor in the course of construction of the property. When used, collateral warranties usually limit the liability period for contractors to ten years, however if the format used follows the collateral warranties issued under English Law then the liability period can last up to twelve years.

The use of collateral warranties provides individuals in Jersey with a means of rectifying any latent structural problems with new build properties and conversions as they allow for the apportioning of liability.

EU Member States

Provisions for providing security and guarantees within the construction sector have led to different approaches being taken in different EU Member States⁶. The overarching aim however remains the same: to protect funders of developments and property owners or tenants from facing significant financial burdens if any significant structural defects occur with a property.

In nearly all EU countries there are specific provisions in legislation or the Civil Code under which constructors can be held liable for any defects – these provisions are usually quite strict and the plaintiffs are not required to prove who is at fault for a defect occurring within a defect liability period. Most countries have a specific liability regime applicable to the construction industry; however in countries where this is not the case, construction liability rules tend to reinforce standard liability rules in the context of construction. In countries where there is no legislation, this is usually because standard contract forms or clauses are in use, which have been approved by the professions/stakeholder groups concerned: in general the lower the involvement of legislation, the greater the role of standard contract forms. The importance of contracts within the construction industry of EU Member States can be summarised as follows:

- In countries where contracts are important – standard contractual clauses tend to substitute any legislation which forms a contractual liability regime.

⁵ Mourant Ozannes., 2011, *Collateral Warranties*, [online], available at:
<<http://www.mourantozannes.com/media/453770/collateral-warranties.pdf>>

⁶ ELIOS, 2010, *Liability and insurance regimes in the construction sector: national schemes and guidelines to stimulate innovation and sustainability*, Official Journal of the European Union, 02/12/2008

- In countries where contracts are of medium importance – legislation defines the minimum rules of contractual liability, but there is still a degree of contractual freedom in forming liability.
- In countries where contracts are of low importance – the main aspects of contractual liability are governed by legislation.

Joint and several/in solidum liability is also in place in most EU countries, including the UK, and this means the plaintiff can pursue all parties jointly or severally for the total cost of the claim. This covers against the risk of insolvency of one of the parties involved, as the plaintiff can put in a claim against other parties involved in the construction of a building.

The duration of liabilities varies greatly in EU states, from 5 years (Portugal) to the whole useful life of the building (Romania). Some countries have statutory or contractual minimum “defects warranty periods”, during which time the contractor is under a duty to repair any defects discovered during this period. The length of time this minimum warranty period lasts varies from three months to five years, but in many countries it is strict and applies regardless of the fault or negligence of the contractor. In some countries there are also extended periods for gross negligence, intentional damages, criminal actions etc.

Insurance cover for latent or hidden defects is common in the EU – the guarantee usually lasts for 10 years, and the constructor is liable for fixing any defects found within that period. Mandatory cover exists in some countries, although it applies to different types of buildings in different countries. There are also different types of cover, such as property damage cover and liability cover. In most cases this is available in the form of an insurance policy. In other countries voluntary cover is available, e.g. NHBC Buildmark cover in the UK. This is mainly available for dwellings and is provided by housing warranty schemes, and in most countries the leading schemes have been created as joint initiatives between public authorities and associations representing construction industry stakeholders.

There are also additional insurance policies which can provide cover within the EU. Professional Indemnity Insurance is legally mandatory in some countries, and in other countries it is in widespread use due to market demand and the requirements of professional bodies. Some companies impose an obligation on participants to construction projects to also have Third Party Liability Insurance.

The cover that is provided differs across EU Member States, however all of these countries offer some form of protection to owners and funders of new build properties with regard to liability for latent structural defects.

Measures currently available in Guernsey

Consultation with various bodies has highlighted the following measures available to buyers of new build properties. The first two options, building surveys and defects liability insurance, are considered to be the principal options accessible to purchasers. A full explanation of each option is provided, and a summary table of this information is provided at the end of this report.

Building Surveys

When buying a property, including new build properties and conversions, purchasers should have a homebuyers survey carried out by a professional surveyor in addition to any valuation required for finance purposes. Surveyors will have a Professional Indemnity Insurance policy in place, and in the case of any faults becoming apparent the purchaser could be covered by this insurance. Architects, Structural Engineers and Mechanic and Electrical Consultants involved in a development should also be covered by these insurance policies and this would cover instances of defects arising due to a fault in design or, in some cases where the designer is responsible for formally inspecting the works, adherence to specification and execution of the work. However, it is important to note that professional negligence cover does not stay with the building but with the client and so is not passed on during the sale of a property. If the development company is liquidated following the sale of the new build properties then any remaining liability period would end unless these obligations were extended to the purchaser by way of a collateral warranty.

Defects Liability Insurance

Defects liability insurance for buildings can be put in place by developers. This cover should be taken out before any construction work takes place, and technical audits will be carried out throughout the construction period with the policy being issued on completion. The premium for this insurance will be paid prior to or at build completion and once this payment has been made the policy will be in force and non-cancellable for the cover period, which is usually 10 or 12 years depending on the cover that has been chosen. It is also possible for a defects liability insurance policy to be issued in arrears following the completion of building work, that is to say a purchaser could take out cover once they have bought the property, but options for this and the cover that would be provided may be limited and the policy would be more expensive to purchase.

Defects liability insurance can provide security to property owners, as once the policy is in force it will remain valid even if the developer or contractor who originally took out the policy ceases to exist, as cover is automatically transferred to the future owners of the property. This security also extends to subsequent owners of the property, as if the property is sold

while the policy is still in force cover will be transferred to the new owners for the remainder of the policy. However, it is important to note that defects liability insurance does not provide a total solution to all latent defects in a building, as it is limited to certain structural issues and ingress of water through the external envelope of the building. Inclusion of this cover in the sales of new build properties is also likely to increase their cost: as a guide this insurance would cost, on average, from 1% of the total build cost, depending on any additional cover that was included in the policy. Many large scale developers in the island are now offering this cover for their new build developments.

Legal Expenses Insurance

If a defects liability insurance policy is not in place a purchaser can have legal expenses insurance put in place, either as part of their household insurance policy or as an add on to the policy. This insurance covers contractual disputes involving a house purchase, so while it would not provide cover for the actual defect it would cover expenses involved in taking legal action against the parties responsible for the defect. This cover is not a standard feature of household insurance policies but can be obtained using an insurance broker.

Collateral Warranties

Collateral warranties can extend the liability obligations that exist between contractors and developers to the purchasers of a property. They can also provide a direct agreement between the purchaser and individuals involved in the construction of the property who may have been employed by the contractor, such as sub-contractors, plumbers, electricians etc. Collateral warranties, when extended to purchasers, provide them with intellectual property rights that will allow them to obtain copies of the building plans. They also provide purchasers with step in rights, so that if a company involved in the construction of a property were to go bust they would be able to employ someone else to complete the work. Collateral warranties also provide purchasers with a contractual obligation from those involved in the construction of a property, so in the case of negligence or latent defects the contractor (or other companies involved) would be required to rectify any defects in the property.

Collateral warranties are more often used in larger scale developments, and their use in Guernsey is becoming more widespread. They can provide similar protection for purchasers as latent defects insurance; however, there are limitations to their use. As they are a warranty that exists directly between the purchaser and a company involved in the construction of a property, if the company (builder, plumber, electrician etc.) was to go into liquidation then the warranty would be terminated. The companies providing the warranty can also limit their liability in the event of any defects becoming apparent. For example, if a building company had only been involved in one quarter of the work to construct a property then they could ask for their liability to be limited to one quarter of the cost of rectifying any defects. This can

provide protection to companies involved in construction, as they would not be liable for the total costs. However, this could also leave the purchaser with costs for rectifying defects if one or more of the companies involved in the construction of a property had been liquidated. Additionally, practical enforcement of a collateral warranty can take time and most building contractors are reticent to return to a site to rectify works after leaving the site.

Contracts

The use of contracts can also provide protection to purchasers, as liability clauses can be included in either the construction contract or added to the conditions of sale of the property. Although building contracts have not routinely been used in Guernsey in the past, standard contracts such as those produced by the Joint Contracts Tribunal can be used in any construction work that is undertaken on the island.

Consultation

Building Control, the States' Insurers, the Construction Industry Forum and the Guernsey Property Forum were all contacted as part of a targeted consultation. This consultation sought views on whether it would be desirable to introduce legislation on this matter, and whether there would be any other implications arising from the introduction of any legislation. The Guernsey Property Forum did not have any comments to make on the issue.

The consultation indicated that the problems which motivated former Deputy Perrot to bring forward a Requête are not exceptional. The feedback the Committee has received suggests that the problems with the development referred to above has served to raise awareness of such risks with developers, vendors and purchasers and parties are now aware of the need to ensure that appropriate arrangements are in place, such as defects liability insurance, to mitigate such risks.

The general view of the groups who responded is that legislation should not be introduced to make defects liability insurance mandatory for new build properties, as they believe that there is already sufficient protection in place for purchasers through contractual obligations and existing insurance policies, including Professional Indemnity Insurance for professionals such as Building Surveyors and Architects. The Construction Industry Forum noted that it is now common practice for developers to put in place 10 year insurance policies to cover purchasers for any latent defects that can be traced back to faults in the construction of a property, indicating that responsible companies within the industry have taken steps themselves to resolve the problems associated with latent defects in properties.

Building Control also explained that it would not be possible to introduce a scheme similar to the National House Building Council (NHBC) Buildmark Cover in the UK, as the NHBC are a

private provider of building control allowed under UK law, but there is not any equivalent legislation in Guernsey. A private provider of building control would not be a viable option, as the States of Guernsey would still need to maintain a Building Control service to carry out the non-chargeable public safety and entertainment licensing, building regulation enforcement and legislation development roles required of it.

Conclusion

Latent defects within new build and conversion properties can cause significant problems and leave property owners facing significant costs to rectify the defects if adequate protection measures, such as latent defects insurance or collateral warranties, are not in place. The Policy & Resources Committee recognises the problems that latent defects within buildings can cause, and empathises with the purchasers of the block of flats in question for the difficulties they have experienced. When considering the introduction of any new legislation the Policy & Resources Committee has to ensure that such action is proportionate and appropriate for the situation. On this occasion, based on the research carried out and advice received from industry representatives, the Committee found that such action was not fully justified, and concluded that the need for the introduction of mandatory measures to provide cover for latent structural defects for a set period of time after a new property is completed was not a priority at this time.

The Policy & Resources Committee are of the opinion that change should be industry-led without the need for burdensome legislation. The Committee will write to Advocates, estate agents and the Construction Industry Forum to inform them of the outcome of this report and to encourage them to ensure their clients are informed of the property purchase protection options available to them.

Measure	Pros	Cons	How widely is it used?
Building Surveys	<p>Purchasers could be covered by a surveyor's Professional Indemnity Insurance if any faults become apparent.</p> <p>Purchasers could also be covered by this insurance if defects occur due to a fault in design or inspection of works – architects, structural engineers, and mechanic and electrical consultants should also be covered by Professional Indemnity Insurance.</p>	<p>Professional negligence cover does not stay with the building but with the client and so is not passed on during the sale of a property.</p> <p>If the development company is liquidated following the sale of the new build properties then any remaining liability period would end unless these obligations were extended to the purchaser by way of a collateral warranty.</p>	<p>There are no statistics to illustrate how many purchasers have a homebuyers survey carried out, but it is generally recommended that a survey be carried out in addition to any valuation required by a bank or mortgage lender.</p>
Defects Liability Insurance	<p>Non-cancellable cover for 10-12 years.</p> <p>Cover remains even if the developer or contractor who originally took it out ceases to exist.</p> <p>Cover is automatically transferred to future owners following sale of the property.</p>	<p>Limited to certain structural issues and ingress of water.</p> <p>Inclusion of this cover is likely to increase the property price – cover costs from 1% of the building price, depending on any additional cover included.</p>	<p>Many large scale developers in Guernsey are now offering this insurance, but there are no statistics to indicate how many.</p>
Legal Expenses Insurance	<p>Can be included as part of household insurance or as an add on policy.</p> <p>Covers contractual disputes involving a house purchase – such as expenses involved in taking legal action against the parties responsible for a defect.</p>	<p>Does not provide insurance cover for any actual defects in a property.</p>	<p>There are no statistics to show how many house owners have this cover, but it is not a standard inclusion in household insurance.</p>

Measure	Pros	Cons	How widely is it used?
Collateral Warranties	<p>They extend the liability obligations that exist between contractors and developers to the purchasers of a property.</p> <p>They provide a direct agreement between the purchaser and individuals involved in the construction of the property.</p> <p>They provide them with intellectual property rights that will allow them to obtain copies of the building plans.</p> <p>They provide purchasers with step in rights, so that if a company involved in the construction of a property were to go bust they would be able to employ someone else to complete the work.</p> <p>They provide purchasers with a contractual obligation from those involved in the construction of a property, so in the case of negligence or latent defects the contractor (or other companies involved) would be required to rectify any defects in the property.</p>	<p>The warranty is terminated if the company providing it goes into liquidation.</p> <p>Companies providing the warranty can also limit their liability in the event of any defects becoming apparent – for example if a company did one quarter of the work on a property they can limit their liability to one quarter of the cost to rectify it.</p> <p>Practical enforcement of a collateral warranty can take time and most building contractors are reticent to return to a site to rectify works after leaving the site.</p>	<p>More often used in larger scale developments, and their use in Guernsey is becoming more widespread.</p>

Measure	Pros	Cons	How widely is it used?
	They provide similar protection for purchasers as latent defects insurance.		
Contracts	Liability clauses can be included in either the construction contract or added to the conditions of sale of the property to provide cover for any latent defects.		Building contracts have not routinely been used in Guernsey in the past, but standard contracts can be used in any construction work that is undertaken on the island.

THE HUMBLE PETITION of the undersigned members of the States of Deliberation
SHEWETH THAT:-

1. During the course of 2012 it was brought to the attention of a number of States' Members that structural defects had occurred in respect of a block of flats in Saint Peter Port built some eight or so years before.
2. The cost of repairs in respect of such defects was significant.
3. The flats had been constructed by a single purpose building company which had been liquidated when the last flat was sold.
4. The single purpose building company had not put into effect a latent defects liability insurance policy for the benefit of the owners for the time being of the flats.
5. As a consequence of the foregoing the flat owners have been placed in positions of substantial difficulty.
6. Your petitioners are aware that some, but not all, builders and/or developers in Guernsey do put in place defects liability insurance.
7. Your petitioners are of the opinion that no new residential building should be sold without the benefit of a defects liability policy.
8. Your petitioners are also of the opinion that the Environment Department ought to be charged with the responsibility of investigating the feasibility on introducing legislation along the lines of the discussion document appended hereto, by consulting both the local trade and the insurance industry.

THESE PREMISES CONSIDERED, your petitioners humbly pray that the States may be pleased to resolve that the Environment Department be directed:

- (1) To act in accordance with the opinion expressed in paragraph 8 of this Requête;
- (2) To report to the States thereon.

AND your Petitioners will ever pray.

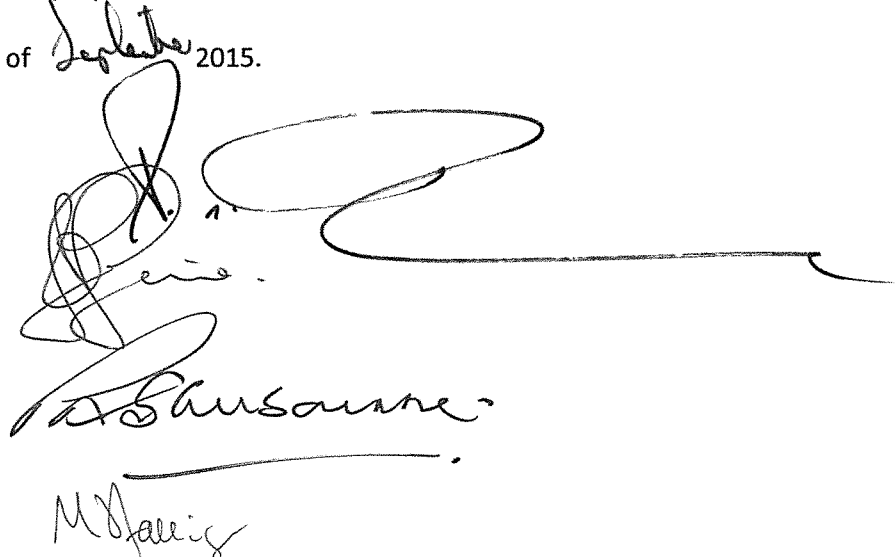
Guernsey, this 30th day of September 2015.

Roger Perrot, Deputy

Andrew Le Lievre, Deputy

Peter Sherbourne, Deputy

Matthew Fallaize, Deputy



The block contains four handwritten signatures corresponding to the names listed on the left. The first signature is for Roger Perrot, the second for Andrew Le Lievre, the third for Peter Sherbourne, and the fourth for Matthew Fallaize. The signatures are written in dark ink and are somewhat stylized.

Richard Conder, Deputy

A handwritten signature in black ink, appearing to read 'R Conder', written in a cursive style.

Christopher Green, Deputy

A handwritten signature in black ink, appearing to read 'C Green', written in a cursive style.

Kevin Stewart, Deputy

A handwritten signature in black ink, appearing to read 'K Stewart', written in a cursive style.

DISCUSSION DOCUMENT

For the purposes of this discussion, what is sought is protection of buyers of new-build residential accommodation.

New-build is to include conversions, as there are many instances of houses being turned into blocks of freehold flats.

It is suggested as follows.

Legislation should be enacted whereby warranties are implied into every building contract – along the lines that the builder must carry out the work in a proper and workmanlike manner, using all reasonable skill and care, and in accordance with all relevant plans and specifications and all requirements and codes of practice contained in or resulting from Guernsey law, using good and suitable materials.

Further legislation should be enacted to the effect that no sale of a newly constructed dwelling may take place in the Conveyancing Court unless the vendor produces an insurance certificate. Such certificate would have to be issued by an approved insurer (as approved, perhaps, by the Guernsey Financial Services Commission) for the benefit of the owner for the time being of the dwelling, commencing on the date of completion of the dwelling and ending on the 10th. anniversary thereof (or later), confirming that such owner was covered by structural defects liability insurance upon such minimum terms as the States by ordinance from time to time should prescribe.

The date of completion of the dwelling, for the purposes only of the issue of an insurance certificate, would be the date certified by the States' Building Control department.