BUILDING DEFECTS IN MULTI-UNIT DEVELOPMENTS

By

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Introduction

1. It became apparent following the global economic crash and the banking crisis which followed, that some buildings constructed in the days of the Celtic Tiger and certified as compliant, were inadequately designed and / or defectively constructed. This had negative consequences for property owners and occupiers and certain high profile multi-unit schemes such as Priory Hall[1], Beacon South Quarter[2], Longboat Quay[3], Gallery Quay[4] amongst others, made national and international headlines for issues relating to structural defects and failure to meet the requisite fire protection standards. These defects left some occupants of the buildings in potentially life threating situations and impacted on their health and well-being. The potential cost to remedy defects was substantial and in many cases unaffordable and a result the value of the property was diminished substantially and in some cases rendered worthless. Many of the multi-developments affected were built before the Multi-Unit Development Act 2011 (hereafter "MUD Act") was enacted. In many cases the legal interest in the estate remained vested in an insolvent developer, which then became held by a receiver, leaving property owners trying to work out who to pursue and on what basis to pursue them.

2. This paper considers possible causes of action against developers / receivers, builders/ designers and vendors by apartment owners in multi-unit developments and Owner Management Companies (hereafter OMC).

3. Where building defects affect individual buildings, a property owner might typically consider causes of action for breach of contract, a general claim in negligence, negligent misstatement, nuisance or defective product liability. Due to both the physical and contractual structure of multi-unit developments, some of these causes of action are often not actionable by individual apartment owners. The type of building defects typically associated with apartment blocks are failure of the superstructure causing damage from water ingress, incorrectly or poorly specified materials and failure to install the appropriate fire protection. In these scenario's the management company is

[1] Burns S, "Four Celtic Tiger developments that had fire and safety issues", *Irish Times*, 24th January 2018.
[2] *Ibid.*
[3] *Supra* note 1.
[4] O'Connor N, "Concerns at apartment block as building defects uncovered", *Irish Independent*, 24th February 2014.

normally best placed to pursue apartment owners claims as a collective. The OMC can engage with or pursue the vendor / developer / receiver but remedies are not simple to pursue and one of the main reasons is that too much time has elapsed between practical completion and the identification of building defects. While various attempts to litigate matters beyond the standard causes of action have not been entirely successful, practical solutions to these issues must be considered.

4. The ultimate legal responsibility for paying for the cost of remedial work lies with the property owner but this does not mean the only option available is to levy the property owner with these costs. In fact, this should be the last resort a property owner should be faced with, after other possible solutions have been given due consideration. One of the key issues in establishing where recourse may lie is to consider the contractual structure and the possible contractual links, between the different parties involved in a development. These parties can include the owner of the land, the developer, the funder / receiver / liquidator, the management company, design team, contractors, subcontractors and property owner/s. Contracts include the development agreement, management agreement, contract for sale / lease, building agreement, appointment of contractors, collateral warranties, structural defects indemnities or any other legal document that forms part of the process from inception through to sale and onto post construction warranties.

5. The expiration date for structural defect warranties[5] are worth noting as property owners and OMC's have found themselves unable to make a claim due the expiry of warranty policies and / or out of time from taking legal action. Structural defect warranties are typically for a period of 10 years from the date of practical completion[6].
6. It is often the situation that discovery of the building defects are sequential following investigation of complaints and follow up surveys. Different types of defects may or may not fall within building warranties, or may have different causes of action in different areas of law. For example, the source of an initial building defect might be water ingress seeping through a defective roof or vertical concrete slab. On further investigation it may be discovered that there is insufficient or no fire protection[7] between apartments. The issue here is that the building defect causing the water ingress is structural and may

[5] Premier Guarantee Scheme and Homebond are the two providers of structural warranty policies in Ireland, which are normally 12 years in duration, where multi-unit developments are concerned.
[6] https://www.homebond.ie/home_buyers
[7] The Fire Services Act 1981 is the main piece of fire safety legislation that applies to multi-unit dwellings.

be covered by the structural warranty[8] while the fire protection issues are no structural and is not covered by the structural warranty. This means a property owner may have to pursue the receiver / developer, the owner or the contractor directly for the costs of these remedial works.

7. In the absence of express contractual provisions, the common law regulates claims for building defects. When a party suffers loss or damage arising from a defect to a building or structure, it may pursue damages by either suing in contract or tort, or pursuing claims under both the law of contract and negligence.

8. Liability for defects arises in contract law where a party has a direct contract with a builder or designer, such as a design appointment, a construction contract or a collateral warranty. A designer or contractor will be liable for defects under a contract for the period of time that it is liable for breach of contract. This is either six years[9] or 12 years[10], depending on whether the contract was executed as a deed. Pursuant to the Statute of Limitations 1957, unless a contract expressly provides otherwise, time is deemed to run from the date of the breach of contract and not the date of occurrence of the damage[11]. In most actions for breach of contract against a contractor, the date of the breach is held to be the date of practical completion under the contract, as it is at this point that a contractor is obliged to deliver a completed structure to the employer[12].

9. Alternatively, a builder or a designer may be found to owe another party a duty of care in negligence, which allows a plaintiff to pursue an action in circumstances where it has no direct contractual relationship with a builder or designer. For an action in negligence, the limitation period is six years[13] from the date that the cause of action arises. Depending on the particular facts relevant to a claim for defects, a plaintiff may prefer to pursue a contractual claim instead of a negligence claim in order to take advantage of a longer liability period.

10. The issue of when a cause of action accrues was recently considered in the Supreme Court by McKechnie J in November 2017[14] and will be discussed in detail by Richard Lyons SC, later in the conference.

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[8] Homebond or Premier Guarantee Scheme
[9] Section 11(1)(a) Statute of Limitations 1957
[10] Section 5 Statute of Limitations 1957.
[11] Sorohan, "Construction-Ireland Latent Defects: key issues", Arthur Cox, March 05 2012.
[12] *Ibid.*
[13] Section (2)(a) Statute of Limitations 1957.
[14] *Brandley v Dean* (Supreme Court, McKechnie J, 15 November 2017).

Management Agreement

11. The purpose of owner management companies (OMCs) is to own and manage the common areas of multi-unit developments for the benefit of the owners of the units within the development. Section 7 of the MUD Act provides an express legislative statement to the effect that transfer of the common areas of a multi-unit development will not absolve developers of their obligations in respect of planning and building control legislation as regards adequacy of completion. Pre MUD Act, multi-unit developers tended to seek to retain control of the OMCs until the last apartment in the scheme was sold. After the common areas were transferred to the OMC the management agreement contained no obligation to construct the common areas in good and substantial and workmanlike manner. Where a developer has gone into liquidation or receivership before common areas have been transferred potential control issues in respect of the OMC arise also. Another consideration is where the OMC has been formed and is dealing with a development company or a receiver that has failed, refused, or neglected to transfer the common areas or, alternatively perhaps, where the common areas are in the name of the developer/ owner/ receiver and haven't been transferred to the OMC. In Longboat Quay, Dublin City Council (hereafter 'DCC') took over from Dublin Docklands Development Authorities', who owned the common areas and had an interest in 37 apartments bought under the affordable housing scheme[15]. DCC were also a party to the management agreement. Concerns over fire safety in the complex arose and eventually Dublin Fire Brigade issued a fire safety notice ordering that work, including the installation of a smoke ventilation system and fire-stopping materials, be done. The developer was a company owned by Bernard McNamara, Gendsong, which had gone into receivership. According to the Irish Times, between them the receiver and DCC paid €3.1m to undertake the fire safety works, which meant the 299 apartment holders did not have to pay anything towards the cost of these works.

12. While individual apartment owners can institute legal proceedings against the OMC for damage caused from building defects this ultimately will cost them more by increases in levies and service charges. A more successful outcome might be achieved where property owners come together and mandate the OMC to act on their behalf. This has been the situation in multi-unit development where the apartment holders mandated the OMC to represent them, to deal with the provider of the structural warranty in

[15] Kelly O, "Deal Worth €3.1m agreed to remedy Longboat Quay Defects", *Irish Times*, 19th December 2016.

circumstances where there were significant amounts of water ingress caused by defects to the roof slab. While the structural warranty policy provider was not obliged to accept the OMC mandate they did accept it and engaged with the OMC in negotiation to agree a payment to rectify the structural defects.

13. The original builder will normally provide a structural defects indemnity guaranteeing to rectify structural defects that appear within a period of up to two years. While useful against early structural problems, problems may only become evident after the two years.[16]

Receiver / Developer

14. The OMC should attempt to assess the receiver's resources, who sometimes have substantial funds available to them but may not want to engage with the property owners or the OMC. Where there are substantial defects to fund the property owners / OMC will need to consider how to successfully access and benefit from the receiver's resources.

15. A receiver can be appointed over the development company or is sometimes appointed over the entire block, part of the block or certain apartments within the block owned by the developer. Where the block of apartments is fully or part sold and occupied, the common areas may have transferred over to the Owners' Management Company (OMC) under the MUD Act[17] However, sometimes the common areas have not transferred and remain under the control of the receiver / developer. Before 2011 in many cases completion of the management agreement only took place after the sale of the last unit in the property. Subject to the MUD Act, even where ownership of the common areas has transferred to the OMC, where legal title of the common areas has transferred, this does not relieve the receiver / developer the receiver from their obligation to finish the common areas[18]. This provision maintains a cause of action for antecedent breaches and afford the OMC further options to get the receiver to engage but does not afford a new cause of action against the receiver. The OMC could also refuse to accept transfer of the common areas in circumstances where the OMC wanted to complete the transfer and they have established the nature and cost to rectify structural or other building defects.

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[16] Igoe P, "How can apartment owners avoid the hit for building defects?", *Irish Times*, 23rd March 2017.

[17] Section 5 MUD Act 2011

[18] Section 7 MUD Act 2011

16. The OMC could also refuse to co-operate with receivers in the sale of the remaining units. Section 6 of the Mud Act provides that the OMC shall at the request of the developer (or receiver), "*join in a deed of conveyance or transfer relating to a residential unit"*. In some developments the OMC have refused to agree to join in a deed of conveyance, thereby frustrating the receiver in completing the sale of apartments that formed part of the receivership. The receiver may initiate proceedings against the OMC in order to complete the transfer or complete the sale of apartments, however there is engagement and momentum for both sides to engage in negotiation not only on these matters but also issues relating to building defects.

17. In *Palaceanne Management Ltd v Allied Irish Bank pl*[19] a dispute arose about easements to the common area of a block of 9 apartments, where the bank held a mortgage over two of the apartments but refused to pay towards the cost to remedy structural and other defects with the development. At an earlier point in time, purchasers of some of the other apartments had brought separate proceedings against the developers because of the building defects and were awarded substantial damages. However, the developers were insolvent and subsequently were made bankrupt. In an attempt to get the bank to pay their apportionment the management company initiated proceedings to stop the bank having a right of way across the common areas. In the High Court it was held that the bank did not have any entitlement to the use of the rights of way over the common areas and as a result, the two apartments held by the bank stood in landlocked isolation. On appeal however, it was decided the assignee of the two apartments did retain their rights of way across to common area to access the two apartments.

18. In circumstances where the common areas have not been transferred to the OMC there may be a cause of action in nuisance against the receiver or whatever other party holds ownership. Private nuisance primarily relates to an interference over the use and enjoyment of land. For an action for nuisance to succeed the property owner must prove actual damage which may consist of either physical damage to the property, a substantial interference with the enjoyment of the land or an interference with servitudes.[20] Substantial interference in the enjoyment of land refers to personal inconvenience and interference with a person's enjoyment, quiet, personal freedom, or anything injuriously affects the senses or the nerves[21]. Nuisance will focus on the

[19] [2017] IECA 141
[20] Canny, *Construction and Building Law* (Round Hall, Sweet & Maxwell, 2001), at 84.
[21] *Ibid*

conduct of the defendant and the gravity of the harm resulting from the nuisance or likely to result from it. In *Basinview Management Ltd & Ors v Borg Developments & Ors*[22] the management company took an action in nuisance by reason of the fact that dishwater or some similar effluent coming from a leak in the above apartment and discharged from a pipe in the common area had caused damage to other apartments in the development.

Collateral Warranties - Design Team / Builders

19. A collateral warranty is a contract under which an architect, engineer, building contractor or sub-contractor warrants to a third party that it has fulfilled its obligations under its professional appointment, building contract or subcontract[23]. They are necessary to protect the interests of third parties who are not parties to the building contract but who an interest in ensuring that the works are properly carried out. In the normal course collateral warranties extend to two third parties but can extend to more by agreement with the design professional or/ and builder.

20. In the absence of a warranty directly with the design team and builder, the beneficiary would have no comeback against the professional directly for loss arising from the negligence of the professional, for example if there is a design flaw in the building. In the normal course beneficiaries of these warranties include the ultimate purchasers or lessees of the property, and the institution funding the development or the appointed receiver.

21. Typically, in a multi-unit development the "third party" does not include the apartment owner or the OMC and this can cause problems when there are building defects and the developer / receiver are not willing to use the collateral warranties in favour of resolving the defect issues on behalf of individual property owners or the OMC. In this scenario, where mandated by apartment owners to act on their behalf, the OMC should enter into negotiations with the developer / receiver to assign their rights under the collateral warranties to the OMC. Alternatively, the developer / receiver could seek to obtain agreement from the design team and builder, to extend the collateral warranties to the OMC as a third party. In many cases, due long delays in transferring common areas collateral warranties cease to be actionable.

Vendor / Employer Contracts / Development Agreements

[22] [2012] IEHC 380

[23] Keane P, "Contractual Relations in Design and Construction", Reddy Charlton McKnight Solicitors.

22. There are different types of development agreement, which includes sale by a landowner to a developer with the landowner maintaining control over what is developed, a joint venture between the landowner and developer or a more straightforward arrangement where the owner the lands develops the apartments and sells them directly to the purchasers. Vendor / employer contractual arrangements can be considerably more complex and vary for each development.

23. In *O'Donnell v Ryan*[24] the vendor (land owner) granted a "building lease agreement", which licensed the developer to enter and build a mixed-use development, including 26 apartments on the land but no estate or interest in the lands was conferred to the developer. Payment was in the form of a "site fine" totalling €50,000 per site plus VAT to be paid on the sale of each individual apartment. The apartment sales were made between the intending purchaser and the developer in accordance with the Law Society Standard Building Agreement and Contract for sale by way of a long lease for 950 years by which certain assured easements were demised and certain rights and easements were reserved to the benefit of the common areas.

24. Many of the development agreements had some common features insofar as the common areas were concerned. In *O'Donnell,* apartments were sold by way of long lease, the internal shell only of the apartment being demised to the purchaser[25]. As part of the scheme of disposal the vendor procured the incorporation of a management company with a memorandum and articles of association which provided for the apartment owners having control of the company once all of the apartments have been disposed of. The vendor entered into an agreement for the sale of the common areas, which generally include the external common areas such as car parking areas, the structure of the building and the internal common areas, at a nominal price but subject to the leases of the apartments. In this way, the apartment owners, through the medium of the management company, became the owners of the common areas.[26]

25. *O'Donnell* concerned the Riverwalk development in Ratoath, Co. Meath whereby the 26 apartment commenced proceedings against amongst others, the vendor / land owner, for recovery of monies paid by the insurers on foot of a building defects guarantee for structural defects and separately damages in respect of other alleged fire safety and

[24] [2017] IEHC 607

[25] The write understands that in one multi-unit development at least, a provider of a structural defect warranty is disputing the exact point at which the apartment owners demise and the common areas, starts and ends.

[26] *Heidelstone Company Ltd -v- Trustees Act* [2007] 4 IR 175, at 177.

acoustic defects not covered by the guarantee. While the application was brought by the vendor to strike out the grounds against him on the basis they were bound to fail or were vexatious and frivolous, the judgment of Baker J is instructive on different causes of action brought against the vendor.

26. The last of the apartments had been sold in 2006 and the common areas conveyed to the management company. It is notable that the vendor held title to the reversion and the common areas as a bare trustee following the sale of the last unit and had no beneficial interest in the common area and the reversion from 2006[27]. The proceedings were brought based on breach of covenant for quite enjoyment, non-derogation from grant, alleged implied terms, interference with assured easement, trust and negligence.

27. Express covenant for quite enjoyment

The plaintiff claimed that the building defects amounted to a breach of the covenant for quite enjoyment in the (long) lease between the vendor and the apartment owner. In her judgment Baker J found that the covenant for quite enjoyment did not import a warranty as to fitness for purpose or as to the state or condition of the building, even where the premises was not fit for purpose at the time of sale. The Court also found that because the vendor held a bare legal title in reversion he did not have the retained ownership and control of the premises[28].

28. Non-derogation from grant

It was also pleaded that the vendor derogated for the grant effected by the lease by constructing an unsuitable or defective apartment structure. The Court found that the lease had one express covenant which was a covenant for quite enjoyment and after identifying the nature and extent of the grant, which was solely for quite enjoyment, and an obligation to maintain the common areas could no therefore be imported into the lease and that this obligation was in fact an obligation assumed by the management company under the express terms of the lease and by the developer (not the vendor) under the building agreement[29].

29. Alleged implied terms

In addition to the foregoing, the breach of contract claim included that certain obligations were to be implied into the lease. These obligations included that the vendor would

[27] *O'Donnell v Ryan* [2017] IEHC 607, at 10.
[28] Supra note 29, at 17.
[29] Supra note 29, at 21.

construct the plaintiff's apartment so that its constructional integrity, performance and safety would not be compromised or would not cause or represent a danger to the purchaser[30]. A further implied obligation was that the apartment would be of merchantable quality as defined by the Sale of Goods and Supply of Services Act 1893 to 1980, would be fit for purpose, and would be constructed with reasonable skill, care and diligence, using suitable material.

Baker J found that the vendor was not a party to the building contract because he divested himself of the right to possession of the beneficial interest, objectively tested he would and could not have agreed to term imposing on himself an obligation to ensure the buildings were structurally sound, as he retained to right to enter upon the lands to inspect same[31]. The claim in relation to the Sale of Goods and Supply of Services Act was also rejected on the basis that the purchase lease was not a contract to supply services and the definition of goods in the Acts are "chattels personal"[32].

30. Interference with assured easement

The plaintiff argued that express easements granted by the demise could import a class of obligation whereby responsibility for maintenance for:

> "*essential means of access retained in the landlord's occupation to units in a building of multi-occupation, in the absence of being placed on the tenants … required that it be placed on the Landlord*."[33]

This argument was rejected on the basis that the lease expressly covenanted that the maintenance of the common area was placed on the management company, and the covenants to repair the reserved property and all the structures thereon were that of the developer and not the vendor. In addition, the express terms of the lease precluded an argument that the lessor assumed an obligation to repair and maintain servient lands, which was not one generally recognised as falling upon a servient owner[34].

31. Trust

The Court rejected the argument that the vendor held his interest on trust for the purchasers of the leases on the basis that this was the interest of the Lessor in the

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[30] *Ibid.*
[31] Supra note 29, at 23.
[32] *Ibid.*
[33] *Liverpool City Council v Irwin* [1977] A.C. 239, at 256.
[34] Supra note 29, at 25.

purchase leases. The Lessor could not be said to be holding as trustees for the lessees in those circumstances. In addition, the beneficial owner was the management company and it was not a party to the proceedings. Therefore, a claim based on trust could not be maintained by the apartment owners[35].

32. Negligence

In response to the duties of care alleged to be owed by the vendor to the plaintiff purchaser, the court found that the vendor was not a developer in the true sense, where he might have retained ownership and control of the common areas. Furthermore, it was found that the degree of control which the vendor had over the development, or was capable of having as a right, came nowhere near the degree of proximity which could arguably be required to establish a claim in negligence. The vendor was no more than a bare trustee holding title at the direction of his principal, he did not enjoy a beneficial right to possession sufficient to import a duty of care as alleged.

33. The Court did find however that even if the vendor and owner of the reversion in a development scheme might not in all cases have a liability to the ultimate purchasers arising from the ownership, the vendor as a matter of fact may have engaged in a number of acts relevant to matters directly at issue. Baker J went onto say that these acts may not have occurred as a result of the vendors ownership as a bare trustee of the common areas and reversion, but because he actively engaged in certain matters in the estate which might show the vendor exercised a degree of de facto control not arising from his bare legal title.

Security for Costs

34. Most OMC's form themselves as companies limited by guarantee. This allows them to have an unlimited number of members and the element of profit is eliminated. Where an application for security for costs is made, it is important for management companies to have collected service charges, build up a reserve fund and have up to date management accounts, in order to defeat a security of costs application, should one be brought against them.

35. Section 52 of the Companies Act 2014 has removed the word "sufficient" from the requirement to pay "sufficient security" for the defendants' costs., which was formerly a

[35] *Ibid.*

requirement under section 390 of the Companies Act 1963, in relation to a limited company plaintiff[36].

36. The caselaw dealing with this area has led to a large degree of uncertainty as to the amount of security for costs that a Court is likely to award if making the order. Traditionally, the Irish Courts tended to award an amount of costs equivalent to one third of the costs which would probably be incurred by the defendant if required to defend the case as per Kingsmill Moore J in *Thalle v Soares*[37]. However, in a number of cases, including *Flannery & Anor v Walters & Ors*[38], the Courts applied a discretion to award not just one third of the defendant's expected costs, but the full amount of the reasonably estimated costs. The caselaw indicates therefore that while generally applying a one-third rule, the Courts have a discretion to depart from that rule in certain circumstances and have on occasion ordered that corporate plaintiffs pay full security for defendants' costs.

37. In *Pebble Beach Owners Management Company Ltd v Neville & Ors*[39], the owners of a management company of a development of holiday homes in Tramore., Co Waterford brought an action against the auditors for the management company for failing to ensure the management company kept proper books of account, failing to ensure the transfer the common areas to the management occurred at the appropriate time and failure to ensure the appropriate portion of the management charges were transferred to the management company. The auditors successfully brought a security for costs application against the management company after Baker J found that there was no surplus "or any significant surplus" in the management funds to meet the estimated costs of a successful defence of the proceedings[40]. The management company had not up to date accounts and the Court was therefore unable to assess the most up to date financial position of the management company and its ability to pay the defendants' costs.

Conclusion

Legacy issues relating to the transfer of estates and common areas in multi-unit developments have created a myriad of issues for apartment holders and management companies to resolve building defect issues and the funding of remediation works. The ultimate legal responsibility for funding remediation works lies with the apartment owner

[36] Casey, Dillon, "Developments in the law relating to security for costs", Dillon Solicitors (16 April 2016).
[37] [1957] IR 182.
[38] [2015] IECA 147.
[39] [2016] IEHC 446.
[40] *Pebble Beach Owners Management Company Ltd v Neville & Ors* [2016] IEHC 446, at 15.

but there practical solutions that should be considered by all parties. Mandated OMC's are normally the best placed to engage with developers / receivers to negotiation practical solutions. All contracts in the development process need to be reviewed including insurance policies, structural guarantees and collateral warranties. While some of the causes of action available to owners of single use dwellings are not open to apartment holders, there are viable solutions to be negotiated with vendors / developers / receivers. Lack of time and limitation periods are arguably the largest threat to litigation by apartment holders and management companies.