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Construction and Engineering Update

26 May 2023

Cladding and Fire-related Defects Claims: "Show Me the Money"

It is with no great surprise that the issues associated with cladding and building safety in the UK have been heavily reviewed and greatly commented on since the Grenfell Tower tragedy on 14 June 2017. While this article does not intend to provide a comprehensive review and regulatory analysis of the developments over the last nearly six years, it raises questions as to whether further claims in this area are likely to arise in relation to historic, defective projects and where funding will come from to meet the significant remedial costs.

Recap on What Has Recently Happened

As has been heavily publicised, on 30 January 2023, Michael Gove's Department for Levelling Up, Housing & Communities (DLUHC) invited developers of residential and/or mixed-use buildings including a residential element, 11 metres or more in height, to sign the government's remediation contract, which would commit developers to finance and/or undertake repairs with regard to higher-risk buildings that had been developed or refurbished in the 30 years prior to the enactment of the Building Safety Act 2022 (the Remediation Contract). This followed the public pledge made by the developers last year in order to ensure that their commitments would be legally binding. The intention of the Remediation Contract was to ensure the safety of individuals and improve the standard of residential and mixed-used buildings by making them free from life-critical fire safety defects. It was estimated that developers would commit around £2 billion for remediation costs.

The deadline for signing the Remediation Contract was 13 March 2023. In the letter sent to developers, it was noted that the secretary of state has the "power to block developers who are eligible to join the scheme but decline to do so or have failed to meet its membership conditions from commencing developments for which they have planning permission, and from receiving building control approval for construction that is underway". To show the government's commitment to the Remediation Contract, it published its draft Responsible Actors Scheme Regulations on 26 April 2023, which would prohibit residential developers from operating freely in the English market if they refused to sign the Remediation Contract.

Following the DLUHC's deadline, it was noted that 39 developers (including the 10 biggest house builders in the country) had signed up. Others have followed, but there are some organisations that have yet to commit and there is growing commercial and political pressure being applied to those parties to sign up and be held accountable.

Although this initiative will not provide the answer for all occupiers of all defective dwellings, for many occupiers of buildings in need of remediation to address fire-related concerns, this will be welcome news. However, it is anticipated that those companies that have committed to the Remediation Contract and other parties on residential schemes where the developers are not signatories to the Remediation Contract will be considering how payment of, or contributions toward, these significant remedial costs might be sought from those originally responsible for the defective works. That raises questions as to how claims can be brought against those parties after such a lengthy passage of time since the construction of the building and who holds the purse strings to meet or contribute towards these very significant remedial costs. Until very recently, the significant periods of time that had elapsed since the design and construction of the building have meant that claims could not be brought, being statute-barred. That door seemed to be closed.

The introduction of the Building Safety Act 2022 (BSA) has now well and truly opened the door. The BSA has amended the limitation periods for claims arising out of the Defective Premises Act 1972 (DPA) with regard to works already completed from six to 30 years (and from six to 15 years for future works) and provides the ability to pursue a party in relation to defective work to dwellings that cause the dwellings to be unfit for habitation. This is a significant period of time and is a somewhat unique piece of legislation in that it has retrospective effect, which is rarely seen in the UK. It will likely cause concerns for the original parties to the development's design and construction unless, as part of their lines of defence, they can successfully argue that the court should not permit such a historic claim on the basis that it would breach the defendant's protections under the Convention on Human Rights: a potential area of very real debate by parties in court.

The pathway has, therefore, opened, at least in some instances, the door to bring claims under the DPA against developers, contractors, subcontractors, suppliers and designers when recourse may not previously have been available. We are already seeing cases come to court where the DPA is being relied upon and, in some instances, parties seeking to update their existing court pleadings to address and rely upon the DPA, which has seen some administrative skirmishes arise as to the entitlement of a party to revise its case.

Show Me the Money

Of course, having a right to bring a claim is but one part of the equation. A key issue is whether the defaulting party, if a judgment can be successfully obtained, has the financial resources to meet the claims. With claims now potentially being backdated by approximately 30 years, and in an industry that is already under increased commercial pressures with spiralling inflation, supply chain pressures, resource issues, etc., there are concerns within the construction industry as a whole as to how these remediation works will ultimately be funded.

The Role of Professional Indemnity Insurance

In relation to claims regarding poor design, as opposed to workmanship, there is often the hope or expectation that the defaulting party's professional indemnity insurance (PII) will provide cover and respond to the claim. However, it is no secret that there has been a discernible hardening of the PII market in the last few years, with no sign of slowing down any time soon. This is not just visible in the construction industry, but also in other professional industries.

The construction industry's PII premiums and excesses have been on an upward trajectory following Grenfell, due to building envelopes being considered high-risk insurance issues. There have also been greater exclusions and, in some cases, total exclusions included within PII policies relating to cladding and fire safety claims.

However, the demand for remediation works continues to rise to ensure that, as a whole, the construction industry complies with the fire safety conditions. There are, therefore, an ever-growing number of claims that are gradually coming to light and concerns from the professionals involved in the original projects as to how they may fund the remediation costs if they are uninsured.

In response to these issues, the Construction Leadership Council initiated an annual survey in 2021 to engage with the construction industry and bring to the government's attention the key issues faced by designers. The 2021 survey was completed between February and March 2021 and revealed the following:

1. Around 68% of the respondents surveyed had some form of restriction on the level of cover or scope of cover relating to cladding or fire safety
2. Around 46% of the respondents surveyed had a total exclusion in place for cladding claims, and around 34% of the respondents surveyed had a total exclusion in place for fire claims
3. More than a quarter of the respondents surveyed had lost their jobs as a result of inadequate PII
4. Around 28% of the respondents surveyed had changed the nature of their work due to inadequate PII
5. Premiums had increased nearly fourfold at the last renewal, having doubled the year before

These results indicated real and clear concerns faced by designers in the construction industry regarding their PII policies. Based on this, a further survey was conducted by the Construction Leadership Council between March and May 2022.

This survey showed very little change in relation to the PII policies and, instead, revealed:

1. With regard to the level of cover or scope of cover relating to cladding or fire safety, it still remained the case that around 68% of respondents had some form of restriction
2. Around 34% of the respondents surveyed had a total exclusion in place for cladding claims and around 24% of the respondents surveyed had a total exclusion in place for fire claims
3. Nearly a quarter of the respondents surveyed lost their jobs as a result of inadequate PII
4. Around 30% of the respondents had changed the nature of their work in light of changes in their PII arrangements
5. Around 42% of respondents said that the experience of buying PII was significantly worse than their last renewal
6. Nearly one in five (17%) of the respondents were paying more than 5% of their turnover for their annual premiums

It is noted that there is a slight drop in 2022 from 2021 in the number of respondents who had a total exclusion in place for cladding and a total exclusion in place for fire claims. It is difficult to say why this drop may have occurred, as it would have been anticipated that the position of the market on such policies would have tightened. This could be as a result of a reduced number of respondents, compared to the previous year. However, as is evident from the Construction Leadership Council's surveys, there were ongoing concerns by construction designers throughout 2020 to 2022 in relation to their PII. The majority of the policies would not respond to potential claims made in relation to cladding and/or fire-related issues. The surveys also highlighted the implications that the hardening PII market was having on the construction industry, as professionals were losing their jobs and businesses were forced to change the nature of their work, due to inadequate PII. A change of direction may be required by designers going forward, but it will not alleviate concerns as to historic claims.

There is also the yet-to-be-addressed issue as to how the PII market will respond to claims dating back almost 30 years. Will new policies stand behind such claims or will there be further exclusions to claims that extend beyond the historic, shorter periods? In a world when the PII market is looking to limit its exposure, will it conceivably look to widen its risk?

It will be interesting to see whether the Construction Leadership Council commences another DPA survey in the upcoming weeks to obtain a further snapshot of the current issues faced by construction designers and, in due course, how the issues and related claims brought about by way of the Remediation Contract and the DPA impact upon designers.

This potential limitation around whether PII cover will respond (which may not be an available option for workmanship issues in any event) means, however, that financial recourse via that route may not be available and, as such, a claiming party would usually rely upon the strength of the defaulting party's balance sheet, which may not always be sufficiently robust to withstand such claims.

BLOwing a Hole in the Corporate Veil

It would not be unusual for a development to have been structured in such a way as to look to limit or entirely exclude the risk of claims being brought against the developer's holding or other group companies. Special purpose vehicles with little assets often are being created for this purpose. Until now, in the absence of some form of guarantee from the parent company, looking at recourse against the parent company has generally not been an option. The BSA has effectively 'BLOwn a hole in the corporate veil. There is now the potential for the court to extend relevant liabilities for one company to an associated company (i.e. sister or parent company) by making a Building Liability Order (BLO). The BLO has the potential to be an extremely useful tool in a claimant's armoury, with consideration now potentially being given not only to the strength of covenant of the primary, defaulting party, but also, potentially, to one of its related companies.

What Next?

Of primary importance is that the dwellings in need of remediation are finally addressed and in short order. Measures brought about by way of the Remediation Contract should provide some comfort and assistance, but it will not be the answer to all problem developments. It is anticipated that claims will continue to be considered and, indeed, are likely to grow. This will be brought about in part by signatories to the Remediation Contract looking to the market to seek a contribution or full payment from defaulting members of the original supply chain and the DPA opening historic claims and being able to explore avenues to those original, defaulting organisations, as well as to other corporate stakeholders of those developments.

The tightening of the PII market, together with likely workmanship-related claims, may very well mean that those parties who may otherwise be liable to pay or contribute cannot meet the claims due to the lack of strength of their own balance sheet. However, the introduction of the BLO may provide an opportunity to explore the potential to require others within the group organisation to contribute.

All in all, there is likely still a long way to go.

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