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Developers' liability

It was a developer's nightmare: all 94 properties on their estate were affected by inadequate foundations. Shortly after construction the owners were reporting that because of cracking the properties were unsaleable, difficult or impossible to mortgage and they could not obtain any insurance against the risk of subsidence.

What went wrong?

The estate was built on a former landfill site in the North-East of England, and the properties had piled foundations. Following a court case Encia (the piling contractor) was found liable for failure to exercise reasonable skill and care in the design and construction of the piles. The developer, Shepherd Homes, bought back five of the properties, re-piled 20 and planned to re-pile another ten. In the latest litigation ten other properties were considered. These suffered from a variety of internal and external cracking and sagging of floors. The judge said that on inspection the cracking looked minor, but accepted that it had blighted the whole estate.

Claims against the developer

- NHBC Build Mark policy: the developer argued that for one of the properties the owner had not given notice in writing as required. The judge treated this sympathetically. The owner had gone to the site office to complain about cracking at the junction between the ceiling and wall in some of his rooms. He had been given tape to cover up the cracks and some paint. The judge said that because the developer was already aware of defects generally and it was likely that some record had been made of this visit to the site office, that would satisfy the requirement to notify in writing.
- Defective Premises Act: the judge held that the actual damage did not make the properties unfit for habitation but said that any significant defects in the foundations, as in this case, satisfied the criteria for the lack of fitness for habitation.
- Contracts for sale: these provided that the works were to be completed in a good and workmanlike manner. The judge said that this requirement covered all the works, and not just those carried out after the contracts were signed. He also said that this phrase included both design and workmanship. That was implied in the wording and was not excluded by the "entire agreement" clause. The developer's attempts to restrict liability by their interpretation of the relevant clauses in the contracts for sale were held to be unreasonable under the Unfair Contract Terms Act in any event, and therefore unenforceable.

What losses were recoverable?

The claimants said that they were entitled to the re-piling costs so that their properties would have a certain future and could be sold on in the normal way. This argument was rejected because although the cracking was significant it was still very fine cracking and there was a low probability of significant future movement. The claimants were awarded compensation for the diminution in value of their properties and the costs of repairing the cracking, which may need to be repeated occasionally until settlement finally ceases in around 20 years' time.

For some properties damages were awarded on the basis that the properties were not mortgageable, i.e. a satisfactory engineer's report could not be provided to the mortgage lender.

A small amount was also allowed for distress and inconvenience, based generally on £150 per owner per year. This covered not only the inconvenience caused already but that which would be suffered when the properties were re-pointed etc in future years.

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What this means for you
If you are unfortunate enough to find yourself in this kind of situation, this case is not good news. The court was obviously sympathetic to the innocent owners and tried hard to find a remedy which gave them some compensation. The entire agreement clause in the contract for sale did not give the developer the protection it may have expected. For construction on difficult ground, such as a former landfill site, it may be worth taking extra steps to check that the design is adequate: prevention is far cheaper than cure. ■

Gillian Birkby, Partner

Going GAGA about AGAs?

This time last year, we reported on a court case (*Good Harvest v Centaur Services Limited*) that threw into doubt the value of an AGA given by the outgoing tenant's guarantor. However, a recent decision (*Victoria Street v House of Fraser*) has turned the tide back in favour of landlords.

First, let's take a step back and remind ourselves how the Landlord and Tenant (Covenants) Act 1995 (**1995 Act**) works. Historically, a tenant remained liable throughout the term of the lease for breaches of the tenant's covenants. It did not matter that the tenant had long since assigned the lease to someone else. Even if there had been several subsequent assignments, the tenant remained on the hook. This was clearly unfair. If the current tenant defaulted, the landlord could look to recover from whichever of its previous tenants had the deepest pockets, even if that tenant was in no way connected to the current tenant and was in no way to blame for the current tenant's default.

The 1995 Act abolished privity of contract in leases but allows landlords to require, as a condition of the assignment, that the outgoing tenant guarantees the assignee's obligations in the form of an authorised guarantee agreement (**AGA**). An AGA lasts for one assignment only. On the second assignment, the tenant is released. The 1995 Act contains a wide anti-avoidance provision, which says that any attempt to circumvent the legislation will be void. In the absence of privity of contract, AGAs are critically important to landlords. If the current tenant defaults, the landlord can invoke the AGA and require the outgoing tenant to make good the landlord's loss. But what if the outgoing tenant is itself of dubious financial standing, such that the landlord insisted upon (and obtained) a guarantor for that tenant at the time the lease was granted? Can the landlord insist that the guarantor guarantee the AGA?

It is surprising, considering its importance to landlords, that it took more than 14 years to get an answer to that question. Sadly, for landlords, the decision in *Good Harvest* was that the guarantor could not be required to guarantee the AGA. As the court saw it, the 1995 Act makes it clear that, subject to the ability to call upon the outgoing tenant to give an AGA, the outgoing tenant and any "other person bound by a covenant of the tenancy" are released on an assignment.

The 1995 Act allows the landlord to require the outgoing "tenant" to enter into an AGA. However, there is no mention of guarantors. The judge concluded that, if Parliament had intended guarantors to be bound, the legislation would have said so. Moreover, the court said that there was no difference between a guarantor **voluntarily** agreeing to guarantee the AGA and a guarantor that is **required** to guarantee the AGA by the express terms of the lease. For intergroup assignments, this was a particularly worrying development as, on an intergroup assignment, any attempt to extend a parent company guarantee to the assignee would be void.

But the story does not end there. In *Good Harvest*, the guarantor had agreed in the AGA to guarantee the performance of the tenant covenants by the **assignee**. In many AGAs, however, the guarantee is drafted so that the guarantor guarantees the **outgoing tenant's** obligations rather than those of the assignee (i.e. a form of sub-guarantee, or "**GAGA**"). You might be thinking that the outcome is ultimately the same: the assignee defaults and the landlord recovers from the outgoing tenant's guarantor. Whether the guarantee is of the assignee's obligations under the lease, or of the outgoing tenant's obligations under the AGA, is immaterial. Luckily for landlords, however, the Court of Appeal decided in the recent *House of Fraser* case that a GAGA does not fall foul of the 1995 Act.

So, where does this leave landlords? As long as the AGA is drafted properly, a landlord will be able to join the guarantor into the AGA. Of course, if the outgoing tenant refuses to enter into an AGA, something which is common in sales by a liquidator or administrator, the landlord is in difficulty because, as we have seen, the landlord cannot require the guarantor to directly guarantee the **assignee's** obligations, only those of the outgoing tenant. In other respects, though, order has been restored and landlords are now in a much better position than was the case this time last year. ■

Roy Perrott, Professional Support Lawyer

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Going underground

From 1 October 2011, water and sewerage companies in England and Wales will take over responsibility for "private sewers" and "lateral drains".

In order to appreciate what effect this is going to have on property owners, we first need to understand what sewers and lateral drains are.

A sewer is a pipe that carries waste water away from more than one property. A lateral drain is the section of a pipe that serves one single property but lies outside the property's boundary. A lateral drain ultimately connects to a sewer.

All properties – i.e. both residential and commercial – will potentially be affected by the changes. It is estimated that around 8.6 million properties in England and Wales – nearly half of all properties – are connected to a private sewer.

Responsibility for the repair and maintenance of private sewers and lateral drains currently lies with the individual property owners. This responsibility extends until the point at which the pipe connects to the public sewer.

All private sewers and lateral drains connected to the public sewerage network before 1 July 2011 will transfer to the relevant water company on 1 October 2011. Water companies are billing this as "good news" for property owners as the change of law will mean that ownership and maintenance for private sewers and lateral drains will be transferred to the water company. The main advantage to property owners is that this change brings peace of mind and clarity regarding ownership.

Government consultation papers have stated that the following sites are not likely to fall within the transfer regulations: caravan parks, council provided traveller sites, airports, ports, railway stations and "some commercial or industrial sites". Shopping centres and industrial estates have been cited in a ministerial statement to Parliament as examples to illustrate the latter.

Because little is known about the extent and condition of current private sewers and lateral drains, this makes it hard for the water and sewerage companies to calculate an exact cost for their new responsibilities. The Government estimates that the transfer could increase customers' bills by between £3 and £14 per year.

Pumping stations are excluded from the upcoming transfer on 1 October 2011 (these will instead transfer on 1 October 2016), as are private sewers and lateral drains which:

- are occupied by a railway company; or
- are situated on or under Crown land and the relevant body has opted out of the transfer.

Property owners need to be aware that, as a result of the transfer, water companies will have statutory powers under the Water Industry Act 1991 to enter private property to carry out maintenance of the newly acquired drains and sewers. Water companies' requirements regarding building close to or over public sewers will also apply to these newly transferred pipes.

It should be pointed out that, even beyond the transfer on 1 October 2011, property owners will still be responsible for any internal plumbing within the curtilage of their property and also the section of pipe leading to the public sewer. There is a right of appeal against the transfer to Ofwat, the regulator of the water and sewerage industry in England and Wales. However, anybody wishing to appeal must do so within two months of receipt of publication of the water company's sewer adoption notice.

These new laws will also affect property developers in that any new pipes and drains which are intended to connect into the public sewerage system will have to comply with national mandatory standards of construction and the developer will have to enter into an adoption agreement with the water and sewerage authority before the sewer can be connected.

The main change here from the existing regime is that it will no longer be possible to connect to the public sewer without an adoption agreement. There are concerns within the property industry that this could lead to delays on new schemes. ■

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