Fitness for purpose warranties vs. detailed specifications

Date : 1 April 2015
Author/s : Tina Middis

The design of a Project is critical to its success and will affect the value, safety, functionality, reliability and life cycle costs of the works. A construction contract cannot specify every element of the design, as there will always be some room for interpretation such as the placement of a screw by a Contractor. Design risk is managed in many different ways, practically and through drafting techniques. Generally in a construct only contract, design risk is assumed by the Principal and in a design and construct context the design risk is assumed by the Contractor. However there is a growing trend where Contractors are being held liable for a Principal’s design through fitness for purpose warranties and/or duties to warn of defective design.

In Australia a fitness for purpose warranty will be implied into a design and construct contract as a matter of law where the following conditions are present: (a) the Principal makes known to the Contractor the particular purpose for which the work is required, (b) it is within the course of the Contractor’s business to perform such contracts, (c) there is no inconsistent term in the contract and (d) the Principal has relied on the Contractor’s skill and judgement.1 Regardless of whether the warranty is express or implied, a fitness for purpose warranty is an absolute obligation for the Contractor to ensure that the works will perform the task for which it is required by the Principal. A Principal only needs to show that the works failed to produce a result in order for the warranty to be breached. There is no need for the Principal to show that the Contractor has been negligent.2

In some cases an express fitness for purpose warranty may have the effect of extending the scope of work of a construct only Contractor, as not only must the Contractor ensure that the works comply with the specifications or drawings attached to the construction contract, but they must also do all things necessary in order to ensure that the works are fit for purpose. A curious situation arises where the works are in accordance with the specifications or drawings, but are not fit for purpose. In Canada the Courts have held that a Contractor will assume the risk of defects in the Principal’s design, even if their works complied with the contract, in circumstances where a warranty of fitness for purpose has nevertheless been breached.3 The Canadian Court has stated that in relation to the works not being fit for purpose:

“...any risk involved in the undertaking was accepted by those who were prepared to tender in accordance with the specifications....There is a danger attached to such clauses. Contractors may refuse to bid or, if they do so, may build in contingencies. Those who do not protect themselves from unknown potential risk [of the specifications leading to works which are not ‘fit for purpose’] may pay dearly.”4

Until recently, this was not the case under English law. The courts of England had historically held that a fitness for purpose warranty could not be upheld in a situation where the Principal had provided detailed specifications and drawings.5 In Stabb J’s judgement in Mowlem v BICC (1978) 3 Con LR 64 at 72, he stated:

“...design [is] a matter which the structural engineer is alone qualified to carry out and which he is paid to undertake, and over which the contractor has no control...he cannot alter the faulty design without being in breach of contract....yet if he complies with the design he would still be in breach. I decline to hold that the specification...makes the contractor liable for the mistakes of the engineer....”

However the High Court in England has recently followed Canadian authorities and held that a service life warranty in respect of the foundations of a wind turbine overrode the express term of the Contract which required the Contractor to design the foundations in accordance with an international standard specified by the Principal. The international standard contained an error of which the Contractor was unaware and when the Project was completed the foundations of the wind turbine were found to be defective requiring remedial work with a value of approximately €26.25 million. The Court held that the service life warranty overrode the requirements of the specification, and therefore despite what the terms of the Contract (and specification) required the Contractor to perform, the Contractor should have ensured that the works were fit for purpose presumably by ignoring the defective specification provided by the Principal.6

There is also a line of English and Canadian authority which suggests that a Contractor has a duty to warn a Principal of any defects in the design provided by the Principal.7 In the English cases the duty to warn is linked to the possibility of danger of personal injury or death if the defect were to materialise, whereas in the Canadian...
courts the duty appears to be absolute regardless of danger where the Contractor knows that the Principal has relied on the Contractor in relation to design issues. The duty to warn arises out of an implied duty to act with due care and skill having regard to the degree of reliance placed by the Principal on the Contractor. In the Plant Constructions case, a Contractor was held to be in breach of its duty to warn, despite the fact that it had raised its concerns with the Principal in relation to the design and being told by the Principal’s agents to continue the work in accordance with the requirements of the Contract. The Court in that case stated that the Contractor should have taken a further step, such as refusing to perform the works, given the magnitude of danger in the defective design.

As far as we are aware, neither of these lines of authorities have been the subject of case law in Australia to date. But given the adversarial nature of the Australian construction industry, it is only a matter of time before these issues will be judicially considered. Obviously they raise a number of issues in relation to the clear allocation of design risk under a construction contract and the mitigation of such risk. Practically it is difficult for a Contractor within a short tender period to be able to sufficiently and thoroughly check the tender design and specification for errors or discrepancies. Contractors are also reluctant in the current climate to qualify their tenders in relation to such risks, as such qualifications would normally be considered by Principals as non-conforming. As most construction contracts exclude a Contractor from being able to modify design without the Principal’s consent, a Contractor may find itself in a situation where it believes that a design is defective, but can do nothing about it because the Principal refuses to allow or pay for a variation to the design to “fix” the issue, or by “fixing” the issue of its own accord the Contractor could potentially be in breach of an express term of the contract.

An added complication is that a Contractor’s professional indemnity insurance policy will generally only cover a Contractor’s liability in negligence, and would not without further consent and probably an additional premium, cover the Contractor’s liability under a contractual fitness for purpose warranty.

The use and acceptance of a fitness for purpose warranty in a construction contract therefore needs to be carefully considered, both in terms of the wording of the warranty, and any inconsistent terms of, or errors in, the specification or drawings. Aspirational language should be avoided, and clear criteria should be used to measure the achievement of such a warranty. The duration of the warranty should be specified and there should be appropriate qualifications in relation to known design issues, fair wear and tear, maintenance of the works once completed and any intervening damage that may occur. Alternative methods to reduce such design risk is the use of clear and quantifiable output specifications without the need for such warranties (therefore changing the focus from the purpose of the works to the achievement of specified performance criteria), or utilisation of a design, construct and maintenance procurement model (which makes the Contractor accountable to some degree for whole of life outcomes), or the use of an early Contractor involvement mechanism in the design process (which may allow early intervention to address design errors, inconsistencies and buildability issues).

Without using design risk mitigation strategies, protracted disputes may occur where a Principal claims that a Contractor should be held liable for the Principal’s defective design.

Tina Middis, Special Counsel
Telephone  +61 2 8915 1031
Email  tina.middis@addisonslawyers.com.au

© ADDISONS. No part of this document may in any form or by any means be reproduced, stored in a retrieval system or transmitted without prior written consent. This document is for general information only and cannot be relied upon as legal advice.

1 Norris v Hanson & Hanson [1998] SASC 6882, [38].
2 Viking Grain Storage Ltd v TH White Installations Ltd (1985) 33 BLR 103, 117 – 118.
3 Steel Co. of Canada v Willand Management Ltd [1966] 1 SCR 746, 753 – 754.
4 Ibid, 754.
5 Bowmer & Kirkland Ltd v Wilson Bowden Properties (1996) 80 BLR 131, 142.
6 MT Højgaard a/s v E.ON Climate and Renewables UK Robin Rigg East Limited [2014] EWHC 1088, [74].
7 Plant Constructions plc v Clive Adams Associates [2000] BLR 137 (CA), 147
8 Brunswick Construction Ltd v Nowlan (1974) 21 BLR 27.
9 Plant Constructions, above n 6.