Builders, duty of care and vulnerability

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A NSW Court of Appeal decision raises questions for builders and developers about how builder negligence can be pursued in commercial strata schemes.

Retail, industrial and commercial strata schemes may have a cause of action against builders in negligence following the NSW Court of Appeal decision in *The Owners – Strata Plan No. 61288 v Brookfield Australia Investments Ltd* [2013] NSWCA 317.

In September 2013, the court overturned McDougall J's first instance decision on several grounds and found the owners corporation of a commercial building vulnerable because there was no way it could have protected itself from the builder's negligence.

The decision also assists residential strata schemes in all states and territories to sue builders for negligent building work.

Background

Solicitors acting for owners corporations in building defect disputes once made a practice of pleading both negligence and breach of statutory warranties in claims against builders. That practice was called into question last year by two Supreme Court of NSW decisions handed down by McDougall J – *The Owners – Strata Plan No. 72535 v Brookfield Australia Investments Ltd* [2012] NSWSC 712 and *The Owners – Strata Plan No. 61288 v Brookfield Australia Investments Ltd* [2012] NSWSC 1219. In these cases his Honour held that builders did not owe a duty of care to residential strata schemes and commercial strata schemes, thereby removing a key avenue of recourse used by owners corporations in claims against builders.

Facts

The Owners – Strata Plan No. 61288 v Brookfield Australia Investments Ltd [2013] NSWCA 317 (Brookfield appeal) was an appeal from the latter of McDougall J's first instance decisions in which the owners corporation of The Mantra Chatswood Hotel, a serviced apartment business managing units in Strata Plan No. 61288, brought a claim for negligence against Brookfield Australia Investments Ltd (the builder) seeking compensation for pure economic loss arising from the cost required to repair building defects. The owners corporation lost the case, with his Honour holding that the builder did not owe it a duty of care.

That decision left the owners corporation with no redress, as the statutory warranties contained in Part 2C of the *Home Building Act* were not available to it. Those warranties are implied into contracts for "residential building work" only, whereas The Mantra Chatswood Hotel, being constituted solely by serviced apartments, did not fall within its protection. Appealing the judgment was therefore the only remaining legal recourse for the owners corporation, and the success or failure of the case was clearly to have significant repercussions on thousands of other strata schemes that might find themselves similarly out of luck with *Home Building Act* warranties. Equally, the scope for builders to carry on their business protected from certain avenues of legal action hung in the balance.

The appeal

The Court of Appeal considered three bases on which the trial judge had refused to find a duty of care, overturning all three. First, McDougall J had held that there was no room for a tortious duty of care, purporting to follow High Court authority in *Astley v Austrust Ltd* [1999] HCA 6 (*Astley*) that where parties have negotiated contractual rights comprehensively, "there is no reason for the law to intervene by imposing some general law duty of care". On appeal, Basten JA held that this authority was wrongly applied, as the passage was premised on an assumption inconsistent with that conclusion of the trial judge, and in any case, *Astley*

accepted that there could be concurrent duties in tort and contract (although a contract between the parties can exclude or limit the tortious duty). The contract in this case had no express term which referred to, regulated or excluded the tortious duty.

The Court of Appeal considered that there was in fact room for a tortious duty to be owed to the owners corporation, but only if "there was a general law duty owed to the original owner with whom the builder contracted to construct the building".[2] The court reached this view by exploring afresh the doctrine of vulnerability and how it applies to successive title holders: "The fact that successive owners (and in particular the appellant) may be vulnerable is relevant in circumstances where the original owner is not."[3]

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The second basis on which McDougall J had declined to uphold a duty of care was that the owners corporation was "inviting the courts to go where the legislature did not". Again, the Court of Appeal held his Honour's reasoning to be erroneous, as it was predicated on an illegitimate method of statutory interpretation, namely, using delegated legislation (the Home Building Regulation) to construe its own constitutive statute (the *Home Building Act*). Since it is the Act that gives rise to the regulation in the first place, and not vice versa, generally the regulation cannot be used to interpret the Act. By contrast, the Court of Appeal observed – by way of obiter dictum – that "whether general law principles in tort are in any way affected by the operation of Part 2C [of the *Home Building Act*] may be doubted",[4] a proposition strengthened by the fact that Leeming and Macfarlan JJA both felt the need to make the point in their separate judgments.

Where we are left by this reasoning is that it is doubtful that the statutory warranties implied into building contracts for residential building work by dint of Part 2C of the *Home Building Act* have any effect on the general law duty of care. Although the consequences of this were not fully spelt out in the decision, it would appear that residential strata schemes (as well as commercial strata schemes) are owed a general law duty of care and can sue a builder in negligence (although it should be noted that the Court of Appeal did not directly address McDougall J's reasoning in the first Brookfield case,[5] and in particular, the question of whether an owners corporation which has the benefit of statutory warranties may be considered as vulnerable).

The third basis on which McDougall J had held against the owners corporation was that it would require "a novel duty of care"[6] more appropriately laid down in a higher jurisdiction. The Court of Appeal demurred at this suggestion, holding that his Honour had overstated "the expansion for which the appellant was contending" – and as the court noted, similar claims have been upheld in Canada, New Zealand, Singapore and Victoria.[7]

Vulnerability

The Brookfield appeal is just as interesting for what it has to say about the duty of care owed by builders to owners corporations as it does about the doctrine of vulnerability, as indeed, a central deciding factor in the case was how a commercial entity, such as serviced apartments, could be vulnerable. It was the owners corporations' submission that "it was vulnerable because of the manner of its creation and because it had no ability to control the work undertaken by the builder, nor carry out any appropriate inspection or investigation before acquiring the common property."[8] Brookfield's response was that the owners corporation was, rather, "the alter ego of the beneficial owners of the lots which were, at the point of registration of the strata plan, vested in the developer. Accordingly the appellant on that view, was no more vulnerable than the developer".[9]

In the leading authority on the issue, *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* [2004] HCA 16, McHugh J – while excluding the operation of seminal case *Bryan v Maloney* [1995] HCA 17 (*Bryan v Maloney*) from commercial premises – made the following observation: "The reasoning in *Bryan v Maloney* – or by analogy its material facts – may not lead to the conclusion that the common law recognises an identical or similar duty in respect of the builder of commercial premises. That requires further analysis. But it does not mean that the ratio decidendi of *Bryan v Maloney* does not automatically determine the result of this appeal."[10]

Here we see the Court of Appeal undertaking that "further analysis".[11] Its question was, did the builder owe a duty with respect to pure economic loss to the developer? Yes, according to the joint judgment. While the developer took steps to protect itself, it was nevertheless relying on the exercise of responsibility by the builder, and there was no reason to treat the developer as otherwise than vulnerable.

So what then of the owners corporation, as the successor in title to the developer? In keeping with the theme, the builder's argument that the owners corporation was the alter ego of the developer did not assist them in persuading the court that the owners corporation was not vulnerable. The logical leap required here is a small one as the position of the owners corporation was no better than the (vulnerable) developer who had "realistic opportunities to protect itself in a physical sense".[12]

Further, the proposition that investors "who bought the respective lots from the developer could have protected themselves under the contracts of purchase by insisting on a clause covering liability for latent defects"[13] was not a practical one. By "protection", the court observed that this probably referred to taking out insurance (if reasonably available), although there is no authority which identifies this as a significant element required to establish vulnerability. Further, it is probably more appropriate for the builder to obtain such insurance, given it is liable for such loss.[14]

Extent of loss

Having held that the owners corporation was vulnerable, and that the builder did owe it a duty of care, we are left with only a question of degree: what is the extent of the liability of the builder? The most important aspect of this decision is Basten JA's formulation of the form of the duty: "Accepting that the general law does not impose a general duty of care to avoid economic loss, and that the decision in *Bryan v Maloney* does not in terms dictate the outcome in the present case, there are significant features which militate in favour of the existence of a duty of care covering loss resulting from latent defects which (a) were structural, (b) constituted a danger to persons or property in, or in the vicinity of, the serviced apartments, or (c) made them uninhabitable. The existence of a duty expressed in those terms should be accepted."[15]

NEED TO KNOW

Builder negligence

- **Retail, industrial and commercial strata schemes may have a cause of action against builders in negligence.**
- **As there is a single common law of Australia, the authority is likely to be followed elsewhere unless it is distinguished on a ground peculiar to a particular state.**
- **The builder's liability for pure economic loss could extend to the cost of mitigating risks or rectifying defects.**

The question of how far this duty extends and when it applies will be the major new battleground in the law of building defects. Based on the formulation above, while the liability of a builder to a later owners corporation is not equivalent to the contractual obligations of the builder to the developer, the liability for pure economic loss at least extends to "the cost of steps reasonably taken to mitigate the risk of physical damage or personal injury", and would cover the expense of rectifying defects which could cause property damage, including lot property. Thus, the ubiquitous leaking balcony or window giving rise to water damage within the property would fall within the scope of this liability.

Conclusions

Although the case is not binding in other states and territories, it is certainly persuasive. As there is a single common law of Australia, the authority is likely to be followed elsewhere unless it is distinguished on a ground peculiar to a particular state. Therefore, it should also assist commercial strata schemes in Victoria, ACT and Queensland as well as many residential strata schemes in Queensland and the ACT (as statutory warranties in Queensland are only available to duplexes and detached dwellings and, in the ACT, to buildings of three storeys or less).

Practitioners should also note that it runs against the general thrust of the position paper on the *Home Building Act* released by the NSW Government on 24 September 2013, which can be characterised as improving legal protection for builders and reducing protections for owners corporations.

It is likely the builder will consider appealing the decision. Although the decision of the Court of Appeal is quite unambiguous, given the complexity and contentiousness of this area of the law, it is likely that leave will be granted. In particular, it is suspected that some participants in the construction industry will have difficulty with the finding that developers are vulnerable and this conclusion will likely be the subject of some scrutiny. If so, the High Court will be in a position to have the last say on the issue and hopefully clarify the question once and for all – until then, builders and owners corporations alike will wait with bated breath. □

ENDNOTES

1. *The Owners – Strata Plan No. 61288 v Brookfield Australia Investments Ltd* [2012] NSWSC 1219. See also "No duty of care owed to commercial owners corporations", *LSJ*, December 2012
2. *The Owners – Strata Plan No. 61288 v Brookfield Australia Investments Ltd* [2013] NSWCA 317 at [100] as per Basten JA.
3. Ibid.
4. Ibid at [106] as per Basten JA.
5. *The Owners – Strata Plan No. 72535 v Brookfield Australia Investments Ltd* [2012] NSWSC 712.
6. Above n.1 at [91] as per McDougall J.
7. Above n.2 at [108]-[113] as per Basten JA.
8. Ibid at [76] as per Basten JA.
9. Ibid.
10. Ibid at [114] as per Basten JA citing *Bryan v Maloney* [1995] HCA 17 at [71] as per McHugh J.
11. Above n.2 at [115] as per Basten JA.
12. Ibid at [122] as per Basten JA.
13. Ibid at [123] as per Basten JA.
14. Ibid at [126] as per Basten JA.
15. Ibid at [129] as per Basten JA. □