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Insurance law update

October 2014

CASE NOTE

Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288

In a decision that is highly relevant to those insuring people involved in the building industry – whether they be builders, other trades, architects, construction managers, developers or owners etc - the High Court has unanimously allowed an appeal by Brookfield Multiplex Ltd ("**Brookfield**") from a decision of the Court of Appeal of the Supreme Court of New South Wales.

THE FACTS

Brookfield entered into a design and construct contract with Chelsea Apartments ("the Developer") to build a 22 storey complex featuring a mix of serviced and residential apartments. The developer sold the serviced apartments to a number of individual owners pursuant to standard form contracts, each containing the original design and construct contract. The Owners Corporation Strata Plan 61288 ("**the OC**") was formed in respect of the serviced apartments within the complex. There was no contractual relationship between the OC and Brookfield.

Chelsea was a mixed residential and commercial development in Sydney. The properties (essentially apartments) were variously purchased by a variety of investors and prospective residents. In the normal fashion an Owners' Corporation ("OC") was duly established.

Some years after the project was completed, a number of alleged latent defects were subsequently identified within the common property, allegedly caused by defective design and/or construction of the building by Brookfield. A live issue in the dispute, at least from an insurance perspective, was whether the alleged defects were in fact due to defective design or simply bad workmanship on the part of Brookfield. The OC incurred costs to undertake rectification works. The OC brought proceedings against Brookfield on the basis of a claim for pure economic loss for the costs incurred to rectify the defects.

PREVIOUS DECISIONS

At trial, the duty of care issue was the primary aspect in dispute. The Supreme Court of New South Wales held that Brookfield did not owe a duty to take reasonable care to avoid a reasonably foreseeable economic loss suffered by the OC in having to make good the consequences of latent defects.

The basis for the decision not to impose a duty of care was that the parties to the original contract, Brookfield and the Developer, were of equal bargaining power and had defined their relationship within the terms of the contract. The Court concluded that as no duty of care arose in respect to the Developer, no duty passed to the successive title owners such as the OC.

The Court of Appeal of New South Wales had overturned an earlier decision in favour of Brookfield at trial finding that a duty of care did arise on the part of Brookfield to avoid causing the OC (the subsequent owner) economic loss through latent defects in the common property which were structural, dangerous, or caused the serviced apartments to become uninhabitable. This duty had passed to the OC as the successor in title to the Developer, which displayed sufficient vulnerability.

HIGH COURT DECISION

Brookfield was granted special leave to appeal the decision of the Court of Appeal, whilst the OC was granted special leave to make a cross-appeal to extend the duty of care beyond the one found by the Court of Appeal.

The High Court in four separate judgements, unanimously allowed the appeal finding that the builder did not owe this duty of care to the OC.

In doing so the High Court focussed on the nature and the content of the contractual arrangements between the parties including detailed provisions in the contacts for dealing with and limiting defects liability. In particular, the design and construct contract contained provisions with respect to the quality of the work to be carried out by Brookfield and required Brookfield to remedy defects or omissions in the work within the defects liability period and, in relation to latent defects, after the defects liability period had expired. Further the standard form contract annexed to the design and construct contract conferred on purchasers specific contractual rights in relation to defects in the property, including the common property. These terms were accepted by presumably prudent subsequent purchasers upon purchase. The High Court also looked at the "sophistication" of the parties and the relationship between the developer and the OC in this case, when finding that the facts "all militate against the existence of an asserted duty of care" to the developer or OC.

The High Court found that there was a "sharp distinction" between the proximity/vulnerability test as considered in *Bryan v Maloney and Woolcock Street Investments Pty Ltd v CGD Pty Ltd* and the present case. The OC did not in this case have limited capacity to protect itself from economic loss arising from Brookfield's conduct given "the contractual and statutory matrix in which the duty of care was asserted." Nor, given the contractual obligations in relation to repairs, could the subsequent owners be regarded as vulnerable.

Gageler J went further than his colleagues when expressly stating in his judgement that "*the continuing authority of Bryan v Maloney should be confined to a category of case in which the building is a dwelling house and in which a subsequent owner can be shown by evidence to fall within a class of persons incapable of protecting themselves from the consequences of the builder's want of reasonable care. Outside of that category of case it should now be acknowledged that a builder has no duty in tort to exercise reasonable care in the execution of building work to avoid a subsequent owner incurring the cost of repairing latent defects in the building.*" His Honour's reasoning was to the effect that subsequent purchasers have the ability and "freedom" to choose the terms and price upon which they will or will not purchase a property. It can be expected, therefore, that they can protect themselves against incurring economic loss of that nature.

The High Court also commented that even if the builder did not owe a duty of care to the original owner (in this case, the developer), that was not necessarily fatal to an argument that the builder did not owe the OC a duty of care, although in the words of French CJ, it was an "important factor". This leaves the possibility open that there may be circumstances where the builder does not owe the original purchaser a duty of care, but a duty of care may be found to be owed to the subsequent purchaser. The High Court did not comment on when those circumstances may arise, but it will probably be very limited circumstances.

IMPLICATIONS

The implications of the decision are not limited to builders alone. They are also relevant to builders, professionals and other trades, all of whom may owe a duty of care to subsequent purchasers to avoid pure economic loss in some circumstances. The Courts will look to the subsequent purchaser's ability to protect themselves from the builder's/trade's/professional's negligence before concluding whether such a duty of care is owed. A Court is much more likely to conclude that such a duty is owed to a subsequent purchaser who is not in a strong position to protect themselves from the negligence of the builder/tradesperson/professional, than to a subsequent purchaser who is in a strong position. There is no hard and fast rule as to who a duty will be owed by, but it seems that where the building in question is a commercial development it is far more likely that the relevant parties will have been in a position to protect themselves and therefore that no duty is owed to them.

AN UNDERWRITER'S PERSPECTIVE

Although not directly engaged in the appeal, Hunt & Hunt acted for London based Underwriters of Brookfield. As noted above, from the perspective of Underwriters for which Hunt & Hunt acted, the issues in dispute went well beyond the contended "duty of care" issue which enlivened the High Court appeal, to include whether the alleged defects were in fact due to defective design or workmanship. In particular Policy considerations such as the nature and extent of coverage available were relevantly enlivened. In short was the Policy "triggered" and if so, to what extent?

From Underwriters' perspective, the High Court decision meant that the Policy issues which necessarily enlivened Underwriters interests were left unresolved. In circumstances where Brookfield was found not to owe the OC a duty of care, the questions around whether and to what extent Brookfield's insurance would respond remain unanswered, there being no claim remaining for Underwriters to indemnify.

For tips on the practical application of the decision to claims handlers please click on our "Case Cracker" link here.

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