DLA PIPER

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LITIGATION UPDATE

COURT CONFIRMS THE IMPORTANCE OF CONTRACTUALLY PROTECTING RIGHTS AGAINST DEFECTIVE WORKS UNDER CONTRACTS OF SALE - A LESSON TO SELLERS, PURCHASERS AND CONTRACTORS

THE RECENT DECISION OF THE SUPREME COURT OF NEW SOUTH WALES IN TZANEROS INVESTMENTS PTY LIMITED V WALKER GROUP CONSTRUCTIONS PTY LIMITED [2016] NSWSC 50 HAS CONFIRMED THAT PURCHASERS OF COMMERCIAL PROPERTY ARE NOT OWED A DUTY OF CARE BY THIRD PARTY CONTRACTORS IN RESPECT OF BUILDING DEFECTS IF THE PURCHASERS ARE NOT CONSIDERED TO BE VULNERABLE. THE DECISION FURTHER CONFIRMS THAT ASSIGNMENT OF CONTRACTUAL WARRANTIES CAN BE EFFECTIVE TO ASSIGN ACCRUED CAUSES OF ACTION AND, SEPARATELY, THAT THE MEASURE OF DAMAGES FOR DEFECTIVE WORK WILL GENERALLY BE THE COST OF RECTIFICATION WORKS THAT ARE REASONABLE AND NECESSARY TO ACHIEVE CONFORMANCE WITH WHAT WAS REQUIRED UNDER THE CONTRACT, TOGETHER WITH DAMAGES FOR BREACH OF CONTRACT.

INTRODUCTION

On 12 February 2016, the Supreme Court held in its decision in *Tzaneros Investments Pty Limited v Walker Group Constructions Pty Limited* [2016] NSWSC 50 (**Tzaneros v WGC**) that the first respondent, Walker Group Constructions Pty Limited (**WGC**), a contractor for the design and construction of a terminal in Port Botany, was liable to pay the costs of rectification of defective works to the subsequent purchaser of the leasehold interests in the terminal. WGC was however entitled to recover those costs from AMT Engineers Pty Limited (**AMT**), the design engineer contracted to design the pavement, who was held to owe a duty of care to WGC in relation to those defective works.

This cases raises several issues that are often contentious in construction claims, including the duty of care owed by third parties (such as a builder) to subsequent purchasers of a building, the assignment of warranties where there is an accrued cause of action and the measure of damages in

defect cases. We discuss how these three issues arose in *Tzaneros v WGC* and the guidance provided in the Supreme Court's decision.

BACKGROUND OF THE DISPUTE

In early 2013, WGC entered into a design and construct contract with P&O Trans Australia Holdings Limited (P&O) (**D&C Contract**), the then lessee of the land in Port Botany owned by the Sydney Ports Corporation. The contract required WGC to, amongst other things, build a container terminal, which was undertaken by WGC in 2003 and 2004, and included the laying of various types of "*heavy duty container grade pavement*". AMT designed the pavement.

On 1 April 2004, Smith Bros Trade and Transport Terminal Pty Ltd (**Smith Bros**) acquired leasehold interest in the terminal at Port Botany. The leasehold interest was then transferred (together with associated assets) to the appellant, Tzaneros Investments Pty Ltd (**Tzaneros**) on 2 December 2005. On the same date, Tzaneros entered into a deed with P&O and its subsidiary, Smith Bros, with P&O and Smith Bros purporting to assign the building warranties connected to the D&C Contract for the terminal to the Tzaneros.

Cracks and spalling began to develop in the pavement shortly after it had been poured and before practical completion of the terminal works. By the time the terminal was sold to Tzanerous it was apparent that a number of the cracks were structural. Many concrete slabs were either replaced or repaired by P&O, however the repairs were only temporary and deemed to be ineffective or inadequate by independent experts retained by Tzaneros and WGC. Tzaneros proceeded to engage contractors to manage the pavement failure and subsequently raised a claim against WGC and AMT for $14,819,256.72 in relation to the defective concrete paving, being the claimed cost of replacing the pavement.

THE COURT'S DECISION

Upon viewing the site, the Court agreed with the independent experts that the repairs were inadequate and that Tzaneros was entitled to damages from WGC for costs in relation to replacement of the pavement.

Assignment of the warranties

The Court confirmed that the assignment of warranties can be effective to assign an accrued cause of action. In this case, it was not disputed that WGC had breached the contractual warranties in the D&C Contract, rather, WGC disputed Tzaneros' entitlement to sue in respect of those breaches, on the contention that the assignment was only effective to assign the contractual right of performance under the D&C Contract, and was not effective to assign any cause of action that had already accrued at the time of assignment. WGC sought to characterise that differentiation as the assignment of rights in respect of latent defects (which were assigned) and patent defects (which were not). The court rejected this attempted distinction.

The Court determined that the assignment of warranties must be interpreted in context. In this case, the vendor and purchaser must have contemplated the possibility of the cracking in the pavement giving rise to future claims for breach of warranty as, at the time of sale, the paving defects were clearly visible and an important part of the terminal. In the specific context, the Court considered that the assignment of "*all of the benefits*" of the warranties in the sale agreement therefore naturally included the benefit of the right to sue WGC in respect of breaches that had already occurred.

The Court's decision should serve as a reminder to parties that contractual warranties are capable of assignment and that this may include accrued causes of action. Where such assignments occur, parties should look to the context of their assignment and ensure to properly reflect their intended assignment of rights.

Measure of damages

The Court's decision also confirms the principle stated in *Bellgrove & Eldridge* [1954] 90 CLR 613 insofar as it determined that the measure of damages in defect claims is the cost of reasonable and necessary rectification works required to make the works conform with the what was required under the contract, together with damages for breach of contract.

The Court recognised that there is an exception to this principle in circumstances where it would be unreasonable to rectify the defects in question. The

test of unreasonableness would only be satisfied in "*fairly exceptional circumstances*" such as where the party making the claim is "*merely using a technical breach to secure an uncovenanted profit*"[1], or, as the court approvingly cited from Ipp JA in *Scott Carver Pty Ltd v SAS Trustee Corporation* [2005] NSWCA 462 at [120], where "*the cost of remedying the defect is out of all proportion to the achievement of the contractual objective*." However, the 'unreasonable' exception did not apply in this case.

The Court confirmed that once it was accepted that the assignment of the warranties to Tzaneros was effective to assign an accrued cause of action, that assignment could not be said to negatively affect the application of the *Bellgrove v Eldridge* principle. Under the assignment Tzaneros was put in the shoes of P&O and it was entitled to recover the amount that P&O would have recovered if it still held leasehold interests in the terminal and the warranties had not been assigned.

Further, the Court determined that the subsequent sale of the terminal to The Trust Company (Australia) Limited in 2015 did not affect the right of Tzaneros to recover damages to which it was entitled prior to the sale as the sale contract provided that Tzaneros would repair the pavement.

Vulnerability in apportionable claims

As acknowledged by Ball J, the question of whether a claim against a contractor may be apportionable to a third party subcontractor where the claim relates to a failure of the relevant works to meet contractual specifications, as opposed to a failure by the contractor to take reasonable care), requires consideration of whether the third party subcontractor owed a duty of care to the appellant.

The Court followed the decision of the High Court in *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* [2004] HCA 16 as affirmed in *Brookfield Multiplex Ltd v Owners – Strata Plan No 61288* [2014] HCA 36, holding that a purchaser is not vulnerable to the failure of a third party to take reasonable care when the purchaser is in a position to protect itself by, for instance, taking assignment of the vendor's rights against third parties in respect of any building defects. Where a purchaser is not considered to be vulnerable and the relationship between the contractor, owner and subsequent purchaser has been clearly defined by contract, any third party subcontractor excluded from such clearly defined contractual relationship will unlikely be found to owe a duty of care to the purchaser, or be considered to be a concurrent wrongdoer under section 32 of the *Civil Liability Act 2002* (NSW).

Generally, in circumstances where it is open to the purchaser to seek a warranty in either the contract for the purchase of property or by taking assignment of the rights of the vendor in respect of any defects in the building, or the purchaser is in a position to arrange for appropriate inspection of the property, the purchaser will not be considered to be a vulnerable party. Accordingly, it was determined by the Court that Tzaneros was not a vulnerable party and therefore was not owed a duty of care by AMT.

AMT was, however, held liable to pay WGC the equivalent amount for which WGC was liable to pay Tzaneros, as AMT was held to have breached its contractual and tortious duties towards WGC, to which it owed a duty of care as a professional advisor in accordance with *Brickhill v Cooke* [1984] 3 NSWLR 396.

CONCLUSION

When acquiring built property, **purchasers** should be aware that they are responsible for protecting their own interests against the economic consequences of third party negligence in respect of any building defects. At minimum, a purchaser should always conduct thorough inspections and seek the appropriate warranties and assignment of rights under the contract of sale.

Owners of property should also be aware that any right to which they were entitled against parties to a contract of sale before on-selling the property will not be effected by the sale, provided such entitlements remain reasonable and necessary. For instance, the seller's right of recovery from the contractor for rectification works under the original contract of sale will not be effected by subsequent sale of the property in circumstances where the seller (a) has an obligation to carry out rectification works under the subsequent contract of sale and (b) was paid a lower price that took the defects into account.

[1] *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* [2009] HCA 8; (2009) 236 CLR 272 at 288

Finally, **contractors and builders** should be mindful of their continuing liability to subsequent purchasers of property after the vendor's rights have been assigned under the contract of sale. However, such liability for economic loss related to defects in the works will be limited to the liability of the purchaser in either rectifying the defects or on-selling the property. The liability of the contractor will therefore be a measure of what rectification is reasonable and necessary in order for the works to conform with the contractual plans and specifications. Importantly, this decision is also good news for contractors and builders of commercial property, confirming that they generally will not owe a duty of care to subsequent purchasers beyond the duty defined in the contract.

MORE INFORMATION

This update was authored by:

Gitanjali Bajaj
Partner
T +61 2 9286 8440
gitanjali.bajaj@dlapiper.com

Lena Chapple
Solicitor
T +61 2 9286 8142
lena.chapple@dlapiper.com

Billie Stevens
Graduate
T +61 2 9286 8130
billie.stevens@dlapiper.com

www.dlapiper.com

1203092557