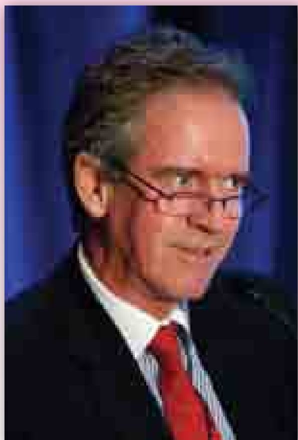
SPECIAL TOPIC

DEFECTS IN COMMERCIAL BUILDING AND ENGINEERING STRUCTURES -LIABILITY TO A SUBSEQUENT PURCHASER FOR PURE ECONOMIC LOSS.



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Lawyers working in construction disputes and liability insurance are often presented with a situation where an owner of commercial premises or some other non-domestic structure (a "building") has discovered latent defects in it a long time after purchase. A building constructed with defective footings is the obvious, and well-litigated, example. A person in this position is commonly referred to in the courts' judgments as a "subsequent owner". I adopt the same expression in this paper. Construction of the building was carried out when it was owned by someone else, referred to in this paper as a "previous owner". This primer restates the legal considerations attending this complex issue.

The builder of a house owes a duty to a subsequent owner to take reasonable care to avoid a reasonably foreseeable decrease in its value arising from the consequences of latent defects caused by the house's defective construction.[1] The need for a subsequent owner to rely on this common-law principle has largely been obviated by the existence of statutory warranties, in favour of a subsequent owner, in respect of a house which turns out to be defective.[2] The warranties are required to be supported by an insurance policy, procured by the builder, indemnifying the relevant building owner for a prescribed period.[3]

In the case of a building, however, and assuming the subsequent owner does not have the benefit of any contractual warranties from the previous owner, the subsequent owner will need to rely on the law of negligence.

'Pure economic loss' is financial loss which is not accompanied by an injury to a person or damage to property. An action in negligence offers to a subsequent owner a right of recovery against the builder of, or a relevant consultant associated with, the construction of a building ("**third party**" or "**third parties**"),[4] where the subsequent owner suffers a particular kind of pure economic loss, that is to say, the diminution in the value of the building when latent defects in the footings first become manifest by reason of consequent 'damage' to the fabric of the building. Subject to reasonableness,[5] the economic loss will be measured by the amount which will necessarily be expended in remedying the inadequate footings, and the consequential effects.

Legal practitioners therefore need to be mindful of principles relevant to whether a duty of care is owed to a subsequent owner by relevant third parties. These principles have undergone such a marked reformulation within the last 10 years, that this restatement may be useful.

There is another reason why practitioners need to be familiar with law relating to liability in negligence for pure economic loss. One may find oneself acting for a defendant builder and, pursuant to Part IVAA of the *Wrongs Act 1958*, would wish to avoid or lessen the builder's potential liability to a plaintiff, who is either the original owner (who engaged the builder) or a subsequent owner, in respect of pure economic loss. In most cases, this will involve one successfully arguing at trial (and often, also on an interlocutory basis) that a relevant third party also breached a duty of care owed to the plaintiff to avoid causing pure economic loss to the plaintiff.[6] It is equally important for the person on the other side of the bar table, who is acting for a third party sought to be joined in this manner, to know the applicable principles.

Given the modern approach by lawyers towards pithy, summarised advice, free of extensive case references,[7] what follows is a purposeful 3000 word 'scorched earth' summary of the law in this area. Footnotes are provided, but clients will generally not wish to be burdened by support for the propositions you make: they will assume you have it.

Physical Damage

Where a building has been damaged by "some external cause"[8] there will often be little difficulty in establishing that a duty of care is owed by the person responsible for causing the damage.[9] A breach of a duty of care will generally be found to exist where say, a house partially collapses, due to inadequate footings, resulting in injury to the owner or another person lawfully in the house or its vicinity, or damage to other property of the owner or other person.[10] This will be a case of ordinary physical injury or damage having being caused by the collapse.[11] Also, where a latent defect in the work of one contractor causes damage to a part of the building constructed by another contractor there will also be sufficient physical damage so as to differentiate the situation from one in which pure economic loss has been caused.[12] Whether a duty of care is found to exist in these situations is likely to be resolved principally by reference to the concept of reasonable foreseeability in the context of the neighbourhood principle, causation (sometimes described as 'causal proximity') and reasonableness having regard to the relationship between the parties.[13]

Pure Economic Loss

Pure economic loss, on the other hand, is loss which arises in the absence of 'physical damage' to the building. Construction defects, such as defectively constructed footings, become manifest when there are cracks in the walls and sloping floors. It may be thought that such outcomes constitute physical damage.[14] It can however be confidently said that, in Australia, this is not the case: where, for example, a builder fails to comply with plans and specifications for a building, so that it contains latent

defects, the person who is the owner at the time those defects become 'manifest' (at a time when steps can be taken, in respect of such defects, to prevent 'damage' to person or property), will have suffered the pure economic loss of discovering that the building is worth less than was paid for it.[15] This is the time when damage occurs for the purpose of accrual of the cause of action. The damage, in the nature of pure economic loss, will be regarded as having occurred when it is "discoverable by reasonable diligence".[16]

Historical Background-Vulnerability Supersedes Proximity

The High Court has consistently said that the categories of case in which the requisite duty of care with respect to pure economic loss is to be found are properly to be seen as "special".[17] They commonly involved an element of known reliance (or dependence) or the assumption of responsibility, or a combination of the two.[18] Prior to the late 1990s these notions were expressed as playing a prominent part in deciding whether the required (but now discredited) relationship of 'proximity' existed between the plaintiff and the defendant. Proximity was then seen as a "unifying" concept, so as to enable a plaintiff to recover economic loss where it was found to exist.[19]

In a series of decisions since 1997 the doctrine of proximity was progressively rejected by the High Court.[20] It was said in one of these decisions, for instance, that the concept of proximity "gives little practical guidance in determining whether a duty of care exists in cases that are not analogous to cases in which a duty has been established".[21]
The twin concepts of known reliance and assumption of risk are, perhaps arguably, matters that are now considered by the Courts when the "vulnerability"[22] of the plaintiff falls to be assessed. It is by reference to vulnerability[23], and to other criteria that have since been developed (described below), that the High Court has therefore limited the loss that would otherwise be recoverable if foreseeability and causation were used as the exclusive criteria of whether a duty of care is owed.[24]

The Close Relationship Test-Salient Features to be Considered

New principles have emerged for the determination of whether a duty of care, to avoid causing pure economic loss to another, exists in a particular case. The test has been generically described as the "sufficiently close relationship test"[25] by which it is "necessary to ask, by reference to the facts of the particular case, whether the relationship is of sufficient closeness to give rise to a duty of care"[26]. The Courts now make this enquiry by identifying "salient features" of the particular relationship.

Chief among the "salient features" that were identified, for example, in the well- known Caltex decision,[27] so as to give rise to a finding that a duty of care was owed to the plaintiff Caltex, was the defendant's knowledge that to damage the pipeline was inherently likely to produce economic loss to the plaintiff.[28] In *Perre v Apand*[29] McHugh J listed five features considered by his Honour to be "relevant in determining whether a duty exists in all cases of liability for pure economic loss".

They are:

- reasonable foreseeability of loss;
- whether there would be indeterminacy of liability;
- the preservation of the autonomy of the individual in legitimately protecting or pursuing his or her social or business interests;
- vulnerability to risk; and
- the defendant's knowledge of the risk and its magnitude[30].

Vulnerability-How Has the Concept Been Applied?

Prime among these features[31], is the concept of vulnerability to risk. This is a reference to a plaintiff's "inability to protect itself from the consequences of a defendant's want of reasonable care, either entirely or at least in a way which would cast the consequences of loss on the defendant".[32] The Court in *Woolcock* was not satisfied on the pleaded facts, or the agreed facts set out in the Case Stated before the Court, that the appellant (the subsequent owner of the building) was vulnerable to the economic consequences of any negligence of the respondents in the latter's design of the foundations of the building. A subsequent owner of a building, the Court said, has the means of protecting itself from economic loss arising from the condition of the building.[33] In *Woolcock*, the majority judgment suggests, the subsequent owner must plead (and demonstrate) that the obtaining of relevant warranties, or the undertaking of appropriate investigations, were impracticable in the circumstances.[34] Whether or not the defendant is considered to be vulnerable will act as the Court's prime control on whether or not a case falls within a category of case in which a person will be found to owe a duty of care to avoid causing relevant pure economic loss.

Duty Owed Must Be Owed By Third Party to the Previous Owner

In order to determine whether a duty of care is owed by a third party to a subsequent owner to avoid causing pure economic loss of the type under consideration, the Court is required first to enquire whether any duty of care owed to the previous owner (in relation to the building work in regard to avoiding ordinary physical injury) extended to the avoidance of pure economic loss being suffered by the previous owner. In many cases this loss is of the kind ultimately sustained by the subsequent purchaser when the inadequacy of the construction (for example, the construction of the footings) becomes manifest.[35] If there is no such duty, then a duty will not be owed to a subsequent owner. The conclusion that a builder or third party owes a subsequent owner a duty to take reasonable care to avoid the pure economic loss that was suffered therefore "depends upon conclusions reached about the relationship"[36] between the previous owner and the builder or other third party.

Bryan v Maloney illustrates this approach. It was a case involving defectively constructed footings to a house, and was one of the last in a series of decisions in which the High Court described the "overriding requirement of a relationship of proximity [as representing] the conceptual determinant and the unifying theme of the categories of case in which the common law of negligence recognises the existence of a duty to take reasonable care to avoid reasonably foreseeable risk of injury to another".[37] The Court found that there was nothing to suggest that the relationship between the builder and the previous owner was not characterised by an assumption of responsibility by the builder, and known reliance by the previous owner on the builder,[38] and that the builder's duty of care extended to avoiding the previous owner incurring mere economic loss of the type ultimately sustained by the subsequent owner. The Court was then able to conclude that given foreseeability and 'causal proximity' between the loss and the builder's lack of reasonable care[39], together with the same assumption of responsibility by the builder and known reliance by the subsequent owner, that the builder owed a duty to the subsequent owner to avoid economic loss being suffered by the subsequent owner.[40]
In Woolcock[41] the respondent, a firm of consulting engineers responsible for designing the footings of an office and warehouse complex in Townsville was found not to have owed a duty of care to the previous owner. Putting to one side the fact that the appellant was not considered to be vulnerable, the necessary "anterior step" of the subsequent owners (the appellants) demonstrating that the respondent owed a duty of care to the previous

owner was not made out. In *Gunston v Lawley*[42] an architectural draftsman engaged by the builder, who had in turn contracted with the previous owner who was a developer (as opposed to a lay person), was found not to have owed a duty of care to the previous owner, and therefore not to the respective subsequent owners, to avoid their suffering pure economic loss in relation to their respective houses[43].

In *Moorabool Shire Council & Anor v Taitapanui & Ors*[44] it was not in dispute that a a surveyor, exercising his functions under the Building Act 1993, owed a relevant duty of care to the original owners of the house at the time of his engagement. The surveyor was also found to have owed the subsequent owners a duty of care to avoid economic loss of the type in fact incurred by the subsequent owners 2 years after completion (and 2 owners removed from the original owners), which was in the nature of serious structural deficiencies as a result of the footing system adopted being insufficient to support the external walls. The Court stated that "foreseeability of loss and unbroken chain of causation are necessary elements" of the duty care with respect to pure economic loss,[45] but that something more is also required. In that case, it was found that the surveyor's issue of a building permit carrying with it the representation that the authorised building work was not in breach of the *Building Act 1993* and Regulations had statutory implications that went beyond the owners at the time when the permit was issued.[46] Other salient features recited by the Court in favour of the existence of a duty of care included:

- the surveyor's assumption of responsibility;
- the vulnerability of the subsequent owners;
- the practical content of the duty of care being identical (whether owed to the previous owner or to the subsequent owners);
- the surveyor's awareness of the risk;
- the fact that the duty of care was compatible with the surveyor's statutory obligations which he willingly undertook; and
- there being no risk of indeterminacy of potential liability.[47]

The absence of actual reliance by the subsequent owners was held not to be a bar to the existence of a duty of care.

Relevance of the Contract between the Previous Owner and the Builder

In order to come to the conclusion that a duty of care is owed to avoid causing pure economic loss the Court will consider the relevance of the written contract (such as may exist) between the builder and the previous owner. The law recognizes the existence of concurrent duties in contract and tort.[48] In some circumstances, the existence of a contract will constitute a factor supporting the existence of such a duty between the parties to the contract. In other circumstances the terms of the contract may militate against, or even exclude, the existence of a duty of care.[49]. Where a contract is "non-detailed and contains[s] no exclusion or limitation of liability" then neither the existence nor the content of such a contract will preclude the existence of liability of the builder to the previous owner (and therefore to a subsequent owner) under the ordinary law of negligence.[50]

In *Woolcock* the subsequent owner (the appellant) was unable to demonstrate that the consulting engineer respondent owed a duty to the previous owner to avoid causing economic loss. In particular the contractual relationship between the respondent and the previous owner did not satisfy the elements of assumption of liability and known reliance.[51] It was a case, unlike *Bryan*, where the previous owner entrusted the design of the building to the engineer under a simple non-detailed contract. It was a relationship where the previous owner asserted control over the investigations which the engineer undertook for the purpose of performing its work, so much so that contrary to the engineer's recommendation, the previous owner instructed the engineer to proceed without soil tests and to use structural footing sizes provided by the builder.[52]

It is also doubtful whether a contractual exclusion in favour of the builder, having the effect of excluding or modifying any duty of care between the builder and the previous owner would directly operate to discharge the builder from a duty of care that would otherwise exist "to persons who are strangers" to the contract.[53] This is because the builder's duty to such persons is "cast upon him by law, not because he made a contract, but because he entered upon the work".[54] The terms of the building contract are not, however, an irrelevant consideration: as the Court said in *Bryan*, there would be difficulty in holding that a builder owes a duty of care to avoid causing economic loss to a subsequent owner if performance of the duty would have required the builder to do more or different work than the contract with the original owner required or permitted.[55]

The terms of the sale and purchase contract between the previous owner and the subsequent owner may also go to the question whether the subsequent owner was vulnerable. The Court in *Woolcock* was expressly mindful that the material before the Court was silent about whether the subsequent owner could have sought warranties for freedom from defects, or the assignment of any rights which the previous owner may have had against any claim for defects in the building. In these circumstances, the material did not sufficiently demonstrate that the subsequent owner was vulnerable.[56]

Conclusion

The categories of cases in which there is a duty of care to avoid causing pure economic loss continue to be seen as 'special'. Foreseeability and causation continue to play a part in the Court's deciding whether there is a duty of care upon a builder or consultant to avoid the pure economic loss which occurs to a building owner (or a subsequent owner) when it suffers a diminution in the value of a building when latent defects in the footings first become manifest by cracks in the walls, sloping floors and the like. These are not enough. More recently the Court will also consider whether the relationship is of sufficient closeness to give rise to a duty of care. A number of 'salient features' have emerged in order to determine this requirement, necessitating a detailed factual enquiry. The broader concept of vulnerability, the consideration of which in any particular case will include an assessment of known reliance or dependence upon the defendant and/or the assumption of responsibility by the defendant, has emerged as the key concept for consideration.

1. *Bryan v Maloney* [1995] HCA 17 182 CLR 609.
2. See, for example, section 8 *Domestic Building Contracts Act 1995*. But see also 10 year limitation period contained in section 134 *Building Act 1993*.
3. In respect of structural defects, 6 years from the completion date.
4. *"The discussion in Woolcock...seems to have assumed without question that an engineer-like a builder-could [also] owe a duty of care to the first owner and-potentially, at least-to a subsequent owner, to avoid economic loss"*: see *Moorabool Shire Council & Anor v Taitapanui & Ors* [2006] VSCA 30 at [24] per Maxwell P.
5. See *Bellgrove v Eldridge* (1954) 90 CLR 613.
6. See section 24AJ *Wrongs Act 1958*, as subsequently interpreted in a number of decisions including *Chandra v Perpetual Trustees Victoria Ltd & Ors* [2007] NSWSC 694; *Dartberg Pty Ltd v Wealthcare Financial Planning Pty Ltd & Anor* [2007] FCA 1216; Atkins v Interprac and Crole [2007] VSC 445; *Atkins v Interprac and Crole* (No 2) [2008] VSC 99 and *Gunston v Lawley* [2008] VSC 97 at [19]-[39].
7. See, for example, "*Savvy Clients Reject Wordy Advice*" by Kate Gibbs in The New Lawyer 21 July 2009

8 See *Bryan v Moloney* (supra) at [12].
9 See Law of Torts by Balkin & Davis, 3rd edition, page 432.
10 See *Bryan v Maloney* (supra) at [15].
11 See *Bryan v Moloney* (supra) at [17].
12 See *Bryan v Maloney* (supra) at [12] referring to *Murphy v Brentwood District Council* [1991] 1 AC at 470, 497.
13 See discussion in Law of Torts by Balkin & Davis (supra) at paras 7.4-7.14.
14 Such an approach characterises the United Kingdom decisions: see, for example, the judgment of *Lord Wilberforce in Anns v Merton Borough Council* [1978] AC 728 at 759-760 and *Pirelli General Cable Works Ltd v Oscar Faber & Partners* [1983] 2 AC at 16, but cf. *Junior Books v Veitchi Co Ltd* [1983] 1 AC 520 D & F *Estates Ltd v Church Commissioners for England* [1989] AC 177 at 207 and *Murphy v Brentwood District Council* (supra).
15 Law of Torts by Balkin & Davis (supra) at p 433. See also *Sutherland Shire Council v Heyman* (1985) CLR 424 and *Bryan v Moloney* (supra)
16 See *Hawkins v Clayton* [1988] HCA 15 at [40] per Deane J.
17 Council of the *Shire of Sutherland v Heyman* [1985] HCA 41 at [9]-[10] per *Deane J and Hawkins v Clayton* (supra) at [23] per Deane J
18 See *Bryan v Moloney* (supra) at [7] per majority; see also *Hawkins v Clayton* (supra), per Deane J at [p 95 of ALRs]
19 See *Sutherland Shire Council v Heyman* (1985) 157 CLR at 466-468, 501-502, *San Sebastian Pty Ltd v Minister Administering Environmental Planning and Assessment Act* 1979 (1986) 162 CLR 340 at 355; approved in *Hawkins v Clayton* (supra) at [15] per Brennan J and [23] per *Deane J and Bryan v Maloney* (supra) at [6]-[7].
20 See cases referred to in *Woolcock Street Investments Pty Ltd* (supra), footnote 31 therein.
21 See *Sullivan v Moody* [2001] HCA 59 at [47]-[50].
22 See *Woolcock St Investments Pty Ltd v CDG Pty Ltd* [2004] HCA 16 at [24] per majority
23 See *Moorabool Shire Council & Anor v Taitapanui & Ors* [2006] VSCA 30 at [35] per Maxwell P
24 See discussion in Woolcock St Investments Pty (supra) at [18] per majority.
25 See *Moorabool Shire Council & Anor v Taitapanui & Ors* [2006] VSCA 30 at [15] per Maxwell P.
26 See *Moorabool* (supra) at [21] per Maxwell P. See also cases referred to in footnote 41 to *Bryan* (supra).
27 See *Caltex Oil (Australia) Pty Ltd v The Dredge 'Willemstad"* [1976] HCA 65 at [45]
28 Cited with approval in *Woolcock Street Investments Pty Ltd* (supra) at [23] per majority.
29 *Perre v Apand Pty Ltd* [1999] HCA 36.
30 (supra) at paras [105]-[137].His Honour subsequently adopted the same principles in his consideration of the facts in Woolcock (supra) at [74]-[88].
31 Viz. a "key issue"; see Woolcock at [80] per McHugh J.
32 See discussion, and case examples, in Woolcock (supra) at [23] (per majority); see also para [80] per McHugh J
33 See *Woolcock* at [80]-[87] per McHugh J
34 See *Woolcock* at [31]-[33] per majority.
35 See *Bryan v Maloney* (supra) at [11] per majority.
36 See *Woolcock* (supra) at [14] per majority.
37 See *Bryan v Maloney* at [8] per majority. But see subsequent developments in the decisions referred to in footnote 31 to *Woolcock*.
38 See *Bryan v Maloney* (supra) at [11]-[14].
39 At [16] per majority.
40 At[15]-[20] per majority.
41 (supra)
42 See [2008] VSC 97
43 See [2008] VSC 97 at [19]-[39]. The architectural draftsman was, therefore, not a *"concurrent wrongdoer"* within the meaning of Part IVAA of the Wrongs Act 1958. The subsequent owners were therefore not successful in maintaining their apportioned judgment, given below, against the architectural draftsman
44 See [2006] VSCA 30.
45 At [71].
46 See discussion at [149]-[158].
47 At [159]-[177].
48 See *Bryan v Maloney* at [9]-[10], per majority.
49 See discussion in *Bryan v Maloney* (supra) at [10] per majority.
50 See *Bryan v Maloney* (supra) at [10].
51 See *Woolcock* at [14], [15] and [25]-[27].
52 See *Bryan v Maloney* at [2]
53 See *Bryan v Maloney* (supra) at [15].
54 See *Voli v Inglewood Shire Council* [1963] HCA at [11]-[12]
55 See *Woolcock* at p 635.
56 See *Woolcock* at 635.

SPECIAL TOPIC

THE LENIENCY AFFORDED TO ENGINEERS IN DETERMINING WHETHER THEY OWE A DUTY OF CARE TO AVOID NEGLIGENT ACTS WHICH CAUSE PURE ECONOMIC LOSS*

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It is unclear when, if at all, a duty to take care to avoid negligently causing pure economic loss is owed by one party to another. This is despite numerous recent High Court cases addressing the issue. This essay considers the duty owed by engineers for such loss and reviews the current approach taken by the courts. The BHP case[1] forms a central part of the discussion and is used to illustrate that the judiciary's excessive focus on establishing the plaintiff's 'vulnerability' – with less attention placed on the importance of the plaintiff's reliance on the engineer – unfairly favours the engineer.

I INTRODUCTION

The duty of care owed by engineers [2] for negligence causing pure economic loss does not have a clearly defined scope. [3] While there is an established duty of care to avoid negligent actions causing harm to persons or property, [4] it is less clear whether, and if so, when, a duty of care is owed where the engineer's negligence merely causes economic loss. This uncertainty is reflected in the absence of a set of general principles applicable to all economic loss cases. [5]

Nevertheless, a plaintiff's vulnerability to harm has emerged as the key feature for determining when the duty of care to avoid causing mere economic loss is owed. While vulnerability is a very relevant consideration, it is respectfully submitted here that in the important case of *Woolcock Street Investments Pty Ltd v CDG Pty Ltd,* [6] the High Court