# Construction Bulletin

November 2013

**Welcome to Wotton + Kearney's November 2013 edition of its "Construction Bulletin".**

The Bulletin is intended to provide an informative account of recent developments and topical issues in construction law. It has been compiled by Wotton + Kearney's dedicated Construction Focus Group (CFG).

The CFG aims to issue 3 Bulletins a year with our next one due to be published in March/ April 2014.

We would welcome any feedback you might have in relation to the Bulletin, or if you wish to discuss any of the articles (or an issue of construction law generally), you will find our list of key contacts on the last page.

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## Perpetual issues in construction - proportionate liability

*Written by Justin Carroll, Senior Associate, and Michael Fung, Solicitor*

### Introduction

Section 3A(2) of the **Civil Liability Act 2002 (NSW)** (**CLA**) provides that, with the exception of Part 2 of the CLA (which deals with damages for personal injury), parties to a contract are not prevented from "*making express provision for their rights, obligations and liabilities under the contract with respect to any matter to which this Act applies and does not limit or otherwise affect the operation of any such express provision*".

Although it has been considerably qualified since the nineteenth century, the doctrine of freedom of contract remains central to contract law. That doctrine embodies the notion that individuals should be free to choose with whom they contract and on what terms they contract. Section 3A(2) of the CLA preserves that freedom by providing that parties to a contract may exclude the operation of the proportionate liability regime in Part 4 of the CLA from the determination of their liabilities under contract.

In the recent decision of ***Perpetual Trustee Company Ltd v CTC Group Pty Ltd (No 2)*** [2013] NSWCA 58 (**Perpetual (No 2)**), the doctrine of freedom of contract and section 3A of the CLA were both in issue in a way that has direct implications for an insured under a policy containing a clause excluding liability assumed under contract.

### Facts

In the earlier decision of ***Perpetual Trustee Co Ltd v CTC Group Pty Ltd*** [2012] NSWCA 252, CTC Group Pty Ltd (**CTC**), a mortgage originator, was found to have breached its obligations under a Mortgage Origination Deed (**MOD**) to Perpetual Trustee Company Ltd (**PTC**), the mortgagee under loans arranged by CTC. Later, CTC sought to argue that its liability to PTC was limited by the operation of the proportionate liability regime under Part 4 of the CLA. Had that argument been accepted, CTC's liability would have been limited to its contribution to PTC's loss which would have forced PTC to sue other tortfeasors where CTC's liability did not provide PTC a full redress for its loss.

PTC resisted CTC's submission by arguing that a contractual indemnity in the MOD made provision for the rights and liabilities of PTC and CTC in a manner that was inconsistent with the incorporation of the proportionate liability regime into the MOD.

The indemnity in the MOD provided that CTC agreed to indemnify PTC "*against any liability or loss arising from and any costs, charges and expenses incurred in connection with... (d) any breach by* [CTC] *of any of its warranties or obligations under or arising from this deed or failure to perform any obligation under this deed...*".

One of the warranties that PTC alleged CTC to have breached under the MOD was that CTC would exercise reasonable care to identify borrowers and to ensure that they had authorised the making of applications submitted by CTC to PTC's agent.

### Decision

Macfarlan JA (with whom Meagher and Barrett JJA agreed) considered that, if the proportionate liability regime limited CTC's liability to PTC as CTC contended, CTC's liability would have been so limited as to deprive PTC of its contractual right to a full indemnity for its loss. As it was clear that the contractual indemnity in the MOD made express provision with respect to a matter covered by the proportionate liability regime, and was inconsistent with that regime's operation, it followed that the regime did not apply to PTC's claim for indemnity under the MOD.

The Court of Appeal's decision is consistent with the earlier decision in ***Aquagenics Pty Ltd v Break O'Day Council*** [2010] TASFC 3. There, the Full Court of the Supreme Court of Tasmania observed in relation to an identical provision to section 3A in the Tasmanian Act that the fact that a concurrent wrongdoer might emerge who is not a party to the contract between the principal and a contractor does not mean that the contractor can limit its liability to the principal pursuant to the proportionate liability regime. The plain purpose of section 3A of the CLA was to "*ensure the primacy of express provisions of a contract as to the parties' rights, obligations and liabilities under the contract over any provision in relation to the same matter in the Act*".

### Conclusion

As the decision in ***Perpetual (No 2)*** shows, where an insured enters a contract containing terms that operate inconsistently with the operation of the proportionate liability regime, the insured may be found to have contracted out of the operation of that regime. That will be so irrespective of any subjective intention on the part of the insured that the proportionate liability regime was to apply to the contract.

Where that occurs, an insured cannot subsequently assert that it did not intend that to be the effect of the contractual term. Under Australian law, parties are generally free to contract on whatever terms they like and their contractual intentions will be construed from the terms of the contract, rather than from what they say their intentions were.

For that reason, insureds need to be alive to the potential effect that provisions in construction or consultancy contracts to which they are a party may have on their insurance cover. The most obvious example which comes to mind is an insured offending an "*assumed liability*" exclusion where the proportionate liability regime would otherwise have applied. Where an insured is in doubt as to that effect, it should seek legal advice. ■

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## Victorian Building Authority – new authority, new power, new impacts on construction litigation

*Written by Connor Burdon-Bear, Solicitor*

### Overview

On 1 July 2013, the Victorian Building Authority (**VBA**) commenced work as the new integrated regulator of both the plumbing and building industries, replacing the Building and Plumbing Industry Commissions. The VBA is also earmarked to regulate architects.

At a recent presentation to the Building Dispute Practitioners Society (**BDPS**), the Honourable Attorney-General, Robert Clark MP, outlined the role of the VBA in the context of the Government's Domestic Building Consumer Protection Reform Strategy (**the Strategy**). The changes to be implemented as a part of the Strategy include enhancing dispute resolution processes, broadening the scope of domestic building insurance and strengthening the regulation of registered builders.

The Strategy and its reforms will be implemented progressively throughout 2013 and 2014. The Strategy will:

+ expand the scope of domestic building insurance;

- improve domestic building practitioner registration and re-registration standards;
- expand the scope of regulation to include corporations and partnerships;
- expand the disciplinary powers of the regulator;
- improve oversight of building surveyors and the building permit system;
- provide greater access to information for consumers in relation to building practitioners and their associated disciplinary history; and
- enable the VBA to issue rectification orders where building work is assessed as defective or incomplete by a VBA inspector.

Arguably these changes represent the most significant changes in 10 years in the building industry.

Of particular interest is the power of the VBA to issue rectification orders, and the proposed changes to domestic building insurance.

### VBA rectification orders

The VBA will provide a conciliation service. If a resolution cannot be reached, consumers will be able to seek a binding rectification order from the VBA. A rectification order will be issued if a VBA inspector determines that the works are defective or incomplete.

Currently an inspector has the power to prepare a report outlining the defects in a building with recommendations for rectification. However, he or she is unable to make a binding rectification order.

An inspector will also be able to make orders in relation to building standards or contractual requirements. This is qualified in circumstances where the inspector believes that the issues require an assessment beyond their skill and competence. If this occurs, the inspector may issue a determination in relation to those aspects within their skill and expertise and the remaining aspects of the dispute may be heard by the Victorian Civil and Administrative Tribunal (**VCAT**).

Rectification orders can include an order for a consumer to make outstanding payments to a builder in the event that an allegation of defective work is not upheld, or does not justify the monies being withheld.

If a builder fails to comply with a rectification order, they may receive "*demerit points*", partial suspension or other sanctions. The partial suspension system should create significant incentive for builders to comply with a rectification order because they will be unable to enter into new contracts/works until the rectification order is complied with. Partially suspended builders will be able to continue to work under existing contracts.

Builders will be able to appeal a rectification order to the VCAT. Interestingly, the VBA will not be the named party in the appeal; rather, it will be the consumer. The VCAT will have the power to order costs against a party that unjustifiably seeks a review of a rectification order, namely, if a party appeals a rectification order to the VCAT and does not achieve a better result than the original order.

### Domestic building insurance

Currently, domestic building insurance in Victoria is triggered in the following limited circumstances:

- when the builder becomes insolvent;
- when the builder dies; or
- when the builder disappears.

The previous Baillieu government released figures which noted that in the 2010/ 2011 financial year, more than 53,000 Victorians paid approximately $87.8 million in builders warranty insurance premiums with a total of 3 claims being paid totalling $108,476.

The Strategy proposes the broadening of the circumstances which will trigger builders warranty insurance to where a project is incomplete, or there is a defect and:

- the builder or building entity has died, disappeared or is insolvent;
- the VBA has certified that a rectification order has not been complied with or that order has been successfully appealed to the VCAT, and the building contract has been completed (with the exception of an incomplete rectification order) or terminated;
- the builder or building entity has been partially suspended, suspended or de-registered and cannot complete the project; or
- the builder is certified as permanently and significantly incapacitated and no substitute arrangements are available.

Further, the maximum benefit amount will increase from $200,000 to $300,000. Claims for non-completion of building work will still be limited to 20 per cent of the original contract amount.

These changes are naturally expected to result in increased premiums. However, the trade off may be that successful claims against builders will reduce the current pressure placed on associated building practitioners, such as engineers and surveyors, where traditionally recoveries against builders haven't been available. ■

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## Will your dispute resolution clause cause a dispute?

*Written by Gemma Houghton, Senior Associate, and Hayden Gregory, Paralegal*

### Introduction

In ***WTE Co-Generation & Anor v RCR Energy Pty Ltd & Anor*** [2013] VSC 314, the Victorian Supreme Court considered an application to stay proceedings because of a non-compliance with a contractual dispute resolution clause.

### Background

RCR Energy Pty Ltd (**RCR Energy**) was engaged to supply a co-generation facility (a heat/electricity generation plant), which would be fired by paper mill residues. WTE Co-Generation (**WTE**) alleged a breach of the contract and ultimately commenced proceedings against RCR Energy in the Victorian Supreme Court.

### Proceedings

In response, RCR Energy filed an application seeking a stay of the proceedings until the parties complied with the contractual dispute resolution clause contained within the contract.

The clause in question provided as follows:

> *"If a difference or dispute (together called a 'dispute') between the parties arises 'in connection with the subject matter of the contract...then either party...shall give the other... written notice of a dispute...In the event the parties have not resolved the dispute then [within a further 7 days] a senior executive representing each of the parties must meet to (attempt to resolve the dispute or to agree on the methods of doing so.)"*

WTE argued that the clause was uncertain and unenforceable, or alternatively that the parties had effectively agreed not to comply with the clause.

### Decision

The Court held that a contract may validly include agreements to negotiate and that the question in this case was whether the clause of the contract was sufficiently certain such that it required a dispute resolution process to be followed prior to commencement of proceedings.

The Court stated that, in interpreting dispute resolution clauses, it would endeavour to construe contracts in a manner that would give commercial effect and would uphold the agreement reached by the parties.
The Court set out a number of principles which apply to construing the application of a dispute resolution clause. Of particular note:

- equity will not order specific performance of a dispute resolution clause;
- dispute resolution clauses should be construed robustly to be given commercial effect;
- business people should be bound by contracts entered into using their commercial judgment, even if broad and general so long as they are sensible and ascribable;
- for the promotion of efficient dispute resolution, dispute resolution clauses should be upheld if the content is enforceable;
- the trend of recent authority is to favour construing resolution clauses which enable the clauses to work as the parties intended and are slow to declare provisions void for uncertainty;
- the process for dispute resolution does not need to be overly structured;
- agreements to agree may be incomplete if they lack essential terms;
- agreements to negotiate will be upheld if the clause has certain content; and
- obligations to undertake discussions in an honest and genuine attempt to reach an identified result is not incomplete.

In this instance, the Court found that the dispute resolution clause was uncertain because it failed to outline the method for resolving the dispute. The clause was an agreement to agree on the process of the dispute resolution to be employed and was therefore not enforceable.

### Implications

Dispute resolution clauses in commercial agreements can play a very important role in preserving contractual relations and avoiding expensive litigation, provided that they are enforceable.

This decision demonstrates that courts will broadly construe dispute resolution clauses in commercial agreements. However, if parties want to rely on dispute resolution clauses, they should take care that they sufficiently prescribe the dispute resolution process or method.

### How do I make sure my dispute resolution clause is enforceable?

Dispute resolution clauses should clearly outline the process for how disputes will be resolved. This can be achieved by ensuring the clause:

- contains all the relevant terms;
- sets out the dispute resolution method to be employed;
- does not depend on further agreements;
- leaves no options for alternative different dispute resolution unless there is a method to determine which process is to be used. ■

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## An extension of the duty of care to subsequent owners for defective building works

*Written by Paul Spezza, Partner, and Jennifer Jones, Senior Associate*

### Summary

In two decisions of the Supreme Court of NSW delivered in 2012 (***Owners Corporation Strata Plan No 72535 v Brookfield Australia Investments Limited*** [2012] NSWSC 712 (**The Star of the Sea**) and ***Owners Corporation Strata Plan No 61288 v Brookfield Multiplex Limited*** [2012] NSWSC 1219 (**Chelsea**)) McDougall J considered the duty of care owed by a builder to subsequent owners of a property (specifically a Strata or Owners Corporation) in relation to latent defects.

In both cases, McDougall J held that no general duty of care existed which led to the result that the Owners Corporation in ***The Star of the Sea*** had a remedy against the builder under the **Home**

**Building Act 1989** (NSW) (**HBA**) but the Owners Corporation in ***Chelsea*** which comprised serviced apartments did not.

The NSW Court of Appeal has now determined the appeal from the decision in ***Chelsea*** and found the existence of a general duty of care extending to pure economic loss provided the principles that must be established to recover such loss are established[1].

## The Supreme Court decision

***Chelsea*** concerned a development of serviced apartments which were designed and constructed by Brookfield Multiplex Limited (**Brookfield**) pursuant to a contract with the developer, Chelsea Apartments Pty Ltd (**the developer**). Latent defects in the common areas were discovered and the Owners Corporation sought redress against Brookfield.

At first instance, McDougall J found that Brookfield did not owe the Owners Corporation a duty of care in circumstances where:

+ a detailed contract had been negotiated between Brookfield and the developer to the extent that he found no underlying duty of care owed by Brookfield to Chelsea as the original owner of the development;
+ in providing residential owners with statutory warranties under the HBA, Parliament had excluded from its scope serviced apartments and the Court should not impose a duty contrary to legislative policy;
+ his Honour was not persuaded of any authority to establish a duty of care in these circumstances and a court of first instance could not establish the existence of a novel category of duty of care.

## The Court of Appeal decision

The Court of Appeal decision from the first instance judgment in ***Chelsea*** was delivered on 25 September 2013.

Basten JA conducted a detailed analysis of relevant authorities on the existence of a duty of care for pure economic loss. He concluded that:

+ the contract between Brookfield and the developer did not expressly exclude a tortious duty of care and accordingly there was a concurrent tortious duty of care between Brookfield and the developer alongside Brookfield's contractual obligations[2];
+ McDougall J had placed too much reliance on the terms of the **Home Building Regulation 1997** in force under the HBA when construing the HBA and it was wrong to derive the statutory intention underlying the legislation from delegated legislation[3];
+ The decision in ***Bryan v Maloney*** (1995) 182 CLR 609 was authority for the existence of a duty of care owed by a builder to a subsequent owner in certain circumstances, subject to an analysis of established principles relating to claims for pure economic loss;
+ the Owners Corporation was 'vulnerable' in the sense that it could establish a duty of care extending to pure economic loss in circumstances where:
    + the development was a significant financial investment to the developer and subsequently the Owners Corporation as subsequent owner of all of the common property;
    + the developer sought to protect itself from the defects complained of by virtue of the contract between it and Brookfield but the Owners Corporation and unit owners were not party to that contract;

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[1] ***The Owners – Strata Plan No 61288 v Brookfield Australia Investments Ltd*** [2013] NSWCA 317.

[2] Basten JA further observed that, even if the contract had expressly excluded the tortious duty of care that would not affect the operation of the general law duty of care with respect to persons who were not a party to the contract (for example persons who came onto the premises and were injured due to the negligence of the builder).

[3] In supporting observations, Macfarlan JA found nothing in the HBA to suggest that it was intended to abrogate any common law rights of action, rather that the HBA was intended to supplement, rather than limit, existing rights.

+ the Owners Corporation did not exist at the time the building works were carried out and, unlike the developer, had no means of attempting any form of self-protection;

+ the nature of defects was such that they were not readily identifiable or discoverable by the developer or subsequently the Owners Corporation;

+ the duty of care extended to defects in respect of which rectification was reasonably required in order to avoid the possibility of personal injury or damage to property; and

+ this was because if personal injury or property damage eventuated, it would give rise to a claim in tort against the builder and therefore recovery for pure economic loss was available on the basis that the work required constituted the cost of steps reasonably necessary to mitigate that risk.

## Conclusion

The Court of Appeal decision represents a substantial expansion on the common law duty of care owed by builders. The decision will be of particular concern to professionals in the building industry in that it will likely result in an increase in claims in tort, and concurrent claims in tort and contract, concerning defects in residential and non-residential buildings.

While the effects of the decision may be ameliorated by the potential for contracting parties to expressly exclude tortious duties of care, the application of that duty will be unavoidable unless such contracts are carefully drafted.

An application for special leave is likely, so watch this space. ■

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