Ashurst Australia
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Property and Construction Update

Strata claims in the High Court

No duty to protect owners corporations from pure economic loss

WHAT YOU NEED TO KNOW

- The Full Bench of the High Court of Australia has delivered its decision in *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* [2014] HCA 36.
- The Court unanimously held that a builder of strata-titled apartments did not owe an owners corporation a duty of care in tort to avoid pure economic loss caused by latent defects in common property.

The Full Bench of the High Court of Australia has unanimously held in *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* [2014] HCA 36 that a builder of strata-titled apartments did not owe an owners corporation a duty of care in tort in respect of economic loss caused by latent defects in common property.

The facts

Brookfield built apartments for a developer pursuant to a design and construct contract. The apartments were purchased by investors and leased to a hotel company for running as serviced apartments. The Owners Corporation came into existence upon registration of the strata plan under the *Strata Schemes Management Act 1996* (NSW). Its functions and responsibilities were governed by that Act as well as the *Strata Schemes (Freehold Development) Act 1973* (NSW). Under the statutory scheme, the Owners Corporation held title to the common property on behalf of the investors as tenants in common and was responsible for maintaining and repairing it.

The contractual setting

The design and construct contract between Brookfield and the developer contained detailed provisions about the quality of the work to be done and established a defects liability period of 52 weeks with an exception made for latent defects. Brookfield was also required to maintain professional indemnity insurance with a run-off period of four years after issue of the certificate of completion.

The design and construct contract also specified a standard contract of sale between the developer and investors. That standard contract provided that the developer would cause the apartments and common property to be finished according to contract and "in a proper and workmanlike manner". It also obliged the developer to repair defects in the common property due to faulty materials or workmanship of which written notice was served on it by the Owners Corporation within seven months after registration of the strata plan.

The issue

The Owners Corporation alleged that there were latent defects in the common property and that it had suffered loss as a result. It sought to recover this loss from Brookfield as builder of the apartments. The parties had agreed at trial that the statutory warranties applicable to residential building work under Part 2C of the *Home Building Act 1989* (NSW) did not apply to the serviced apartments, so the Owners Corporation's claim was confined to common law negligence. Central to this claim was the allegation that Brookfield owed the Owners Corporation a duty of care in tort to avoid causing it pure economic loss.

McDougall J in the Supreme Court of NSW had held that no duty was owed. The NSW Court of Appeal disagreed and held that a duty *was* owed. Previous High Court authorities, including *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515 and *Bryan v Maloney* (1995) 182 CLR 609 were considered. *Woolcock* in particular required an assessment of the Owners Corporation's "vulnerability" to the economic consequences of Brookfield's actions.

The decision

All seven justices held that Brookfield did not owe the Owners Corporation the alleged duty of care. The Owners Corporation was not vulnerable in the sense required for such a duty to arise. The contractual setting was important to this conclusion.

French CJ explained that the existence of specific provisions about the developer's repair obligations in the standard contract with the investors meant that the investors were not vulnerable and so nor was the Owners Corporation which held the common property on their behalf. Furthermore, Brookfield's responsibilities were limited by the design and construct contract. His Honour stated that the position of the investors and the interaction of the relevant contractual and statutory frameworks were antithetical to Brookfield owing the Owners Corporation a duty of care.

Hayne and Kiefel JJ emphasised that the contractual arrangements between the developer and investors meant that the Owners Corporation could protect itself from any lack of care by Brookfield. Crennan, Bell and Keane JJ explained that each investor had bargained for protection against the risk of certain defects by purchasing the apartments from the developer under the standard contract of sale. The risk of deficient work was also placed squarely upon Brookfield by the design and construct contract between it and the developer. Their Honours considered that to supplement these contractual provisions with a duty of care in tort would alter the allocation of risks effected by the parties' contracts.

Gageler J held that, with the exception of a subsequent owner of residential premises who is proved to be incapable of protecting itself from a builder's negligence, the general rule is that a builder owes no duty of care in tort to protect a subsequent owner from incurring the cost of repairing latent defects: "*This is because, by virtue of the freedom they have to choose the price and non-price terms on which they are prepared to contract to purchase, there is no reason to consider that subsequent owners cannot ordinarily be expected to be able to protect themselves.*"

Implications

Though the existence of a duty of care in negligence depends upon the particular features of the parties' relationship, it had generally been assumed that the risk of liability in negligence could be substantially mitigated by sophisticated contractual arrangements. The NSW Court of Appeal's decision that Brookfield owed such a duty upset that assumption, causing significant uncertainty within the construction industry.

This unanimous decision from the High Court eases that uncertainty. It demonstrates the limited reach of "vulnerability" in a commercial construction setting, where sophisticated contractual tools are available to protect parties' economic interests. The case highlights how the detailed allocation of responsibility and risk in both construction and sales contracts can reduce builders' and developers' exposure to liability in tort, including that in negligence to subsequent owners for pure economic loss.

The High Court has also provided insight into the future of liability based upon *Bryan v Maloney*. In that case the Court held that the builder of residential premises owed a duty of care to a subsequent purchaser to protect it from pure economic loss resulting from negligently caused latent defects. All seven justices in *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* distinguished *Bryan v Maloney*, suggesting that a rise in the contractual sophistication of both residential and non-residential construction is likely to reduce the significance of that case in the future.

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