



CONSTRUCTION LAW UPDATE No. 708

Damages for defective work

Introduction

What damages should a builder of defective work pay when the project has been sold without proven loss to the owner?

The NSW Court of Appeal recently considered this question as part of the appeal in the Chocolate Factory Apartments case, *Westpoint Management Ltd v Chocolate Factory Apartments Ltd* [2007] NSWCA 253. Apartments had purchased an old chocolate factory in Stanmore NSW for redevelopment into 87 apartments with a view to selling the apartments on completion. After the project was completed and sold, Apartments made a claim against the builder for defective work. Other related claims were made that are not dealt with in this update.

The claim for damages arose from a failure by the builder to comply with the plans and specifications by installing finishes of a lower standard to those specified.

The referee's report

The dispute had been referred to an independent referee, who had delivered a report to the Court. Apartments had opposed the adoption of the report. In the main, the report was favourable to the builder and adverse to Apartments. In 2005, Justice McDougall heard the parties and ruled that the report be adopted. The recent decision arises from an appeal by Apartments against the decision of Justice McDougall. While the decision deals with a number of issues, this update addresses only the issue of assessment of damages for defective work.

The defects

Apartments claimed the defects included the installation of a skirting board with an incorrect profile, a reduced saleable mezzanine floor space and inadequate mechanical ventilation. While there was debate as to whether some of the claimed defects were proved, the Court proceeded to review the law on the assessment of damages for defective work.

Approximately 3,500 lineal metres of skirting board had been installed in the apartments. The material cost of the installed boards was \$0.10 per metre less

than the board specified; a total of \$350 difference in material cost for the whole project. However, Apartments claimed the cost of rectification determined by the estimated cost of removing the installed skirting boards and replacing them with the specified boards - a sum of \$112,815.

It is necessary to briefly summarise the law on the assessment of damages for breach of a building contract.

Bellgrove v Eldridge - assessment of damages

In 1954, the High Court considered the case of *Bellgrove v Eldridge* where a builder had constructed a house with defective foundations, using a lean concrete mix and lean mortar that was likely to cause "grave instability". The builder claimed that he could rectify the works by underpinning and other methods, but the expert evidence inclined to the view that complete demolition and reconstruction would be necessary to properly rectify the works. Alternatively, the builder said that the owner could sell the house "as is" for appreciably more than land value and others could then rectify it at a lesser cost. The High Court awarded the owner the full cost of demolition and reconstruction, stating the following principles for assessing damages for breach of a construction contract:

1. if it is necessary **and** reasonable to undertake the rectification work, the true measure of loss is the cost of rectification;
2. in this circumstance the loss is not measured by comparing the value of the building actually erected with the value it would have had if erected in accordance with the contract;
3. if it is necessary to rectify to produce conformity with the contract, but **not** reasonable to do so, the true measure of loss is any reduction in value produced by the non conformity;
4. in any particular case, it is a question of fact whether rectification is both necessary and reasonable.

In the *Bellgrove* case, the High Court determined that it was both necessary and reasonable that the rectification work be performed. The expert evidence supported the conclusion that the only satisfactory way of rectification was to demolish and rebuild the home. The Court noted the owner might not demolish and rebuild the house and could end up living in the defective house as well as receiving payment sufficient to demolish and rebuild the home. The Court said that this was immaterial – the owner was entitled to compensation for the breach of contract in accordance with the principles set out above. It was necessary for the Court to reach finality by its award.

Applying the principles to the apartments

The NSW Court of Appeal considered these principles against the background of the Chocolate Factory Apartments and the claims for compensation for defective work.

Sale of the apartments

In relation to the Chocolate Factory Apartments, the fact that Apartments had sold the development after completion was not material to its claim for rectification of the defective work, although it might be relevant in determining whether it was reasonable to rectify. The Court referred to *De Cesare v De Luxe* where Chief Justice Doyle of the SA Supreme Court said that the fact of sale was immaterial to the entitlement to recover the cost of rectification, at least in circumstances where the sale price had been depressed because of the defects.

The referee had concluded that at least the installation of the incorrect skirting boards resulted in non conformity with the contract; it was necessary to rectify to bring about conformity.

Was rectification reasonable?

The fourth principle in *Bellgrove* notes that it is an issue of "fact" as to whether or not it is both necessary and reasonable to rectify defects. The referee found as a matter of fact that it was not reasonable to carry out the rectification works.

For example, in the case of the skirting boards, there had been no complaint by any purchaser as to the different profile and it would cause massive disruption to the occupiers to remove and replace them. There was no evidence that the sale of the apartments had been adversely affected either as to time or price by the non conformance.

The Court in considering the appeal did not disturb this finding of the referee. Having concluded that it was not reasonable to rectify the defects, the referee, following the principles set down in *Bellgrove*, turned to consider whether evidence of diminution in value led to a possible award of damages.

Diminution in value

The referee noted that Apartments had not led evidence that there was any diminution in value of the units, nor that they had taken longer to sell because of the defects. It is apparent that Apartments elected to run its claim on the basis that it was not required to prove diminution in value, basing its argument entirely on the cost of rectification.

Accordingly, because Apartments failed to lead evidence of any diminution in value, it was not entitled to damages for the breach of contract. The Court of Appeal declined to interfere with the finding of the referee and dismissed the appeal.

Conclusion

The law on the assessment of damages for breach of contract remains unchanged and in accordance with the principles set out in *Bellgrove v Eldridge*.

The failure to obtain and produce evidence of diminution in value was fatal to the claim for damages by Apartments.

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