Recent Developments in Pure Economic Loss, a look at 2 recent Court of Appeal decisions and the Court's approach to vulnerability as an indicia of the existence of a duty of care, Laina Chan[1]

In *The Owners – Strata Plan No 61288 v Brookfield Australia Investments Ltd* [2013] NSWCA 317 (**the *Brookfield case***), developers had contracted with the builder to design and construct a 22 storey building consisting of both residential apartments and serviced apartments in Chatswood.[2] It emerged that there were latent defects in the building. The primary issue was whether the builder owed the Owners Corporation, a subsequent owner, 'a duty to take reasonable care to avoid reasonably foreseeable economic loss to the appellant in having to make good the consequences of latent defects cause by the building's defective design and or construction.'[3] At first instance McDougall J held that the builder did not owe a duty of care to the Owners Corporation.[4] In a surprising outcome, the NSW Court of Appeal unanimously overturned this judgment and upheld the appeal.

The significance of vulnerability

Basten JA examined the leading authorities on salient features in pure economic loss and noted the importance of vulnerability in determining the existence of a duty of care. Vulnerability can be the lack of the physical or legal capacity of a plaintiff to protect itself from economic loss arising from the negligent conduct of the putative tortfeasor. In a practical sense, it may include the inability of the plaintiff to obtain insurance against the economic loss suffered.[5]

The weight given to vulnerability as an indicia of the existence of a duty of care for pure economic loss is in contrast to the approach taken in a recent decision of the Court of Appeal of Western Australia.[6] In *Apache Energy Ltd v Alcoa of Australia Ltd No 2* [2013] WASCA 213, the Western Australian court of appeal was called upon to determine whether the court at first instance had erred in refusing to summarily dismiss Alcoa's claim for damages for pure economic loss. Alcoa (the respondent to the appeal) had sued three co-owners and operators of facilities for the production of gas (the appellants to the appeal) for pure economic loss when its supply of gas was interrupted as a result of explosion and fire at the facilities. The fire had resulted from the rupture of a 12inch sale gas pipeline. One of the defendants, Apache Energy, was the operator of the facilities. The other defendants were the licensees of a licence granted by the State of Western Australia to operate the pipelines in the Facilities, including the 12inch sale gas pipeline. All defendants had been put on notice of corrosion prior to the pipeline ruptured. Alcoa sued for economic loss caused by having to acquire energy supplies at a cost of $100 million above the price of the original gas sales agreement between it and the 3 defendants.

[1] Member of Melbourne TEC Chambers and Ninth Floor Wentworth Chambers, Sydney
[2] [2013] NSWCA 317 at [2]
[3] Ibid., at [12]
[4] Ibid., at [5]-[6]
[5] Ibid., at [35]. Cf the approach of McHugh J in *Perre v Apand* (1999) 198 CLR 190 at 230[130]
[6] Ibid., at [32]

The primary issue on the strike out application was whether the defendants owed Aloca a duty of care. Aloca relied on its inability to prospectively protect itself from the want of care of the defendants as key to establishing a duty of care. However McLure P held at [20] that vulnerability is not a necessary condition of a duty of care to avoid pure economic loss, and that *"there is no fixed or certain scope of the concept of vulnerability. The nature and degree of vulnerability sufficient to support a duty will vary from case to case, category to category."*[7] McLure P held that the issue was not sufficiently clear on the issue to allow it to be determined summarily. This is an interesting and novel approach to take. Since vulnerability was identified as a key indicia in *Perre v Apand*[8] and *Woolcock St Investment v CDG Pty Limited*[9], vulnerability has been considered to be the key to whether a duty of care should arise in the circumstances of a particular case and this is reflected in the approach of Basten JA in the *Brookfield case.*[10]

In *the Brookfield case*, the New South Wales court of appeal assumed the following elements:

(a) the respondent was negligent in its construction of the building in the respects particularised in the schedule of defects;

(b) those defects (or at least some of them) were "latent" in the sense that they could not have been discovered by a purchaser exercising reasonable care;

(c) the defects were caused by conduct of the respondent before the registration of the strata plan;

(d) responsible owner, and

(e) the defects arose in the common property and were therefore within the responsibility of the appellant.[11]

The appellant relied upon the following factors as a basis for a finding of liability against the builder:

(a) the economic loss suffered as a consequence of the latent defects was reasonably foreseeable to a party in the position of the builder;

(b) exercising reasonable skill and care in the construction of the building in accordance with the contractual specifications was a responsibility which the builder took upon itself;

(c) the developer relied upon the builder to exercise such skill and care and indeed obtained contractual warranties that it would;

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[7] See also: judgment of Buss JA in *Apache Energy Ltd v Alcoa of Australia Ltd No 2* [2013] WASCA 213 at [239] and McHugh J in *Caltex Oil (Australia) Pty Ltd v The Dredge 'Willemstad'* (1976) 136 CLR 529 at [123]

[8] (1999) 198 CLR 180 at 194[10]-[11] per Gleeson CJ; 225[118]-[119] per McHugh J

[9] (2004) 216 CLR 515 at 530[23] per Gleeson CJ, Gummow, Hayne and Heydon JJ and 549[80] per McHugh J

[10] See also *Barclay v Penberthy* (2012) 246 CLR 258 and the definition of vulnerability given by Kieffel J at 321 [175]; 'Vulnerability is not to be understood as meaning only that the plaintiff was likely to suffer damage if reasonable care was not taken, but rather as referring to the plaintiff's inability to protect itself from the consequence of a defendant's want of reasonable care, either entirely or at least in a way which would cast the burden of the loss upon the defendant.'

[11] op cit fn 5 at [49]

(d) the registration of the strata plan creating the appellant was an inherent part of the development with respect to which the respondent agreed to design and construct the building — at least with respect to the common property there was no question of an indeterminate class of persons to whom the builder might be liable: there was only one known body corporate, being a creature of statute;

(e) the scope of the liability of the builder with respect to the defects was the same as the scope of its liability to the developer under the contract;

(f) being a creature of statute, the appellant had no ability to negotiate the terms upon which it undertook its functions with respect to the strata plan, and

(g) there was no statutory regime inconsistent with the imposition of liability on the builder in the circumstances of the case.[12]

The respondent relied upon the following factors in resisting the duty of care:

(a) to find a duty of care in these circumstances would be an extension of the general law;

(b) to find a duty would be to impose on the builder a "transmissible warranty of quality" (adopting language used by Brennan J in dissent in *Bryan v Maloney*, but traceable to Lord Keith of Kinkel in *Murphy v Brentwood District Council* [1991] AC 398 at 469) which is a matter for the legislature, not the courts, because of the economic impact of such a step;

(c) the only relevant indicia of a duty in the present case is that economic loss is a reasonably foreseeable consequence of negligence by the builder, but that is not a sufficient basis for establishing a duty;

(d) to the extent that a statutory duty exists with respect to residential building work, pursuant to the *Home Building Act*, but not to commercial buildings, it would be inappropriate for the court to expand the statutory scheme to an area where the legislature decided it should not operate, and

(e) the appellant was not in any relevant sense vulnerable, because it was the consequence of a sophisticated commercial arrangement between two well resourced commercial entities, namely the developer and the Stockland Group, which were well able to negotiate on equal terms with any company tendering to design and construct the building, in relation to liability for defects.[13]

In the judgment at first instance it had been significant to McDougall J in holding that the builder did not owe the Owners Corporation a duty of care that the building contract had been negotiated at arm's length between parties of equal standing. Further, McDougall J relied upon the apparent policy decision of the legislature to withhold the protection of statutory warranties from the owners of serviced apartments.[14] Finally, in the absence of precedent, McDougall J considered that there

[12] ibid., at [50]
[13] ibid., at [51]
[14] Ibid., at [88]

was therefore no room for a tortious duty of care to arise. However, the Court of Appeal pointed out the failure of McDougall J to consider the question of vulnerability in reaching his conclusion.[15]

McDougall J had relied heavily upon the principle in *Astley v Austrust Ltd* (1999) 197 CLR 1, that where the parties have negotiated in full their rights and obligations, there is no reason for the law of negligence to intervene. It is suggested that this is in fact consistent with the approach of the High Court in *Woolcock St Investment v CDG Pty Limited*[16] and *Perre v Apand*[17] in considering whether the element of vulnerability existed in the circumstances of the case.

The approach of the New South Wales court of appeal

On appeal Basten JA held that the existence of a concurrent liability in tort and contract in accordance with principle in *Voli v Inglewood Shire Council* (1963) 111 CLR 74 did not preclude a finding that the general law duty could be excluded or limited by the contract between the parties.[18] However, as a matter of construction, Basten JA was satisfied that the contract between the parties did not operate to exclude any liability for defects that may arise otherwise than during that period,[19] Basten JA held in obiter that while the principle stands that no general law duty of care can arise with respect to successive owners unless there is a general law duty owed to the original owner with whom the builder contracted, this does not mean that a general duty of care cannot be owed to parties who are not privy to the contract.[20] This however was not the situation with which the court of appeal was faced.

In light of the assumptions upon which the Court of Appeal proceeded, the key issue for Basten JA to determine was the vulnerability of both the developer and the Owners Corporation. After a detailed analysis of vulnerability, Basten JA concluded that the builder owed both the original developer and the Owners Corporation as successive owner, a duty of care. His reasoning was as follows.

As a preliminary step, Basten JA was satisfied that the developer was vulnerable in the relevant sense and was owed a duty of care by the builder. At the time of the creation of the Owners Corporation, the developer remained the beneficial owner of all the common property in the strata plan. Therefore any duty owed to the developer did not cease when the appellant came into existence, as the developer was still the equitable owner of the property.[21] Secondly, assuming that the Owners Corporation was the successor in title to the developers, then its position was equally if not more vulnerable to that of the developers, due to an inability to inspect the progress of building work. In relation to the question of legal protection, Basten JA noted that the builder and the developer had agreed on a clause for protection in relation to latent defects. The Owners Corporation did not enjoy any such protection. Basten JA held that *"[i]t seems inconsistent with the concept of vulnerability, in relation to the existence of a liability on the part of the respondent in tort, to say that the purchasers were not vulnerable because they could have insisted upon a contractual*

[15] Ibid., at [89]
[16] (2004) 216 CLR 515 at 533[31] per Gleeson CJ, Gummow, Hayne and Heydon JJ
[17] (1999) 198 CLR 190 at 226[120] -228[123] per McHugh J. Note that the case of *Voli* has been treated as authority for the principle that an architect owes its client a concurrent duty of care in both contract and tort
[18] Ibid., at [97]
[19] Ibid., at [98]
[20] Ibid., at [100]
[21] Ibid., at [121]

right as against the builder or the developer." [22] This is a curious position to take in light of the fact that the High Court in *Woolcock* held that this is in fact relevant to the issue of whether a plaintiff is vulnerable in the relevant sense.[23] In a concurring judgment McFarlane JA added that a successor in title should not have to show that it could not have negotiated a contractual protection to show that a duty of care was owed to it.[24]

Finally, in relation to insurance, Basten JA held that there is no authority which identifies this as a significant element in the concept of vulnerability. Basten JA went on to say that *"[i]t is true that a property owner may be expected to take reasonable steps to obtain insurance, if such is reasonably available, in respect of its own liabilities and any potential for unrecoverable loss. However, if the builder is liable for such loss, it is reasonable to expect that it would obtain appropriate insurance. The duty for self-protection through insurance should properly be determined after identifying where liability lies, rather than as part of the exercise of determining where liability lies."*[25]

Comment

The approach of the New South Wales Court of appeal in the *Brookfield case* is consistent with its current liberal approach on the circumstances in which a duty of care will arise in pure economic loss cases.[26] The approach appears to be very much merit based. However, it does not appear to be consistent with the approach of the High Court in both *Perre v Apand* and *Woolcock. The Brookfield case* is currently the subject of a special leave application and it will be interesting to see what the High Court has to say in relation to the current approach of the New South Wales Court of Appeal to the existence of a duty of care in pure economic loss cases.

[22] Ibid., at [125]
[23] (2004) 216 CLR 515 at 533[31] per Gleeson CJ, Gummow, Hayne and Heydon JJ. See also *Perre v Apand* (1999) 198 CLR 190 at 226[120] -228[123] per McHugh J
[24] Ibid., at [136]. His honour also considered the judgment in *Barclay v Penberthy* (2012) 246 CLR 258 as authority for this proposition.
[25] Ibid., at [126]. This is consistent with the approach of McHugh J in *Perre v Apand* (1999) 198 CLR 190 at 230 [130].
[26] See *Provident Capital Ltd v Papa (No 2)* [2013] NSWCA 156; *Zakka v Elias* [2013] NSWCA 119 and Chan L, *A Penumbral Duty of care – is a principled approach possible?* (2013) 21 TLJ 1