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MOST IMPORTANT DECISION CONCERNING BUILDING DEFECTS IN MANY YEARS

Adrian Mueller
Partner **I** Senior Lawyer
B.Com LLB FACCAL
Email I LinkedIn

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MOST IMPORTANT DECISION CONCERNING BUILDING DEFECTS IN MANY YEARS

On 3 August 2018, the NSW Court of Appeal handed down the most important decision concerning building defects in many years. The Court's decision is a good one for owners corporations as it extends the scope of the statutory warranties concerning the quality of residential building work that are given by builders and developers to owners corporations under the home building legislation. The decision means that builders and developers can be held liable for design defects.

What was the case about?

The case of *The Owners – Strata Plan No. 66375 -v- King* [2018] NSWCA 170 concerned defective residential building work that was undertaken to convert a warehouse complex originally built in 1928 into a mixed use strata development in Camperdown, Sydney.

Mr and Mrs King owned the warehouse site. In about 2000, Mr and Mrs King, or a company controlled by them known as Meridian Estates Pty Ltd (**Meridian**), engaged a builder, Beach Constructions Pty Ltd (**Beach**), to carry out residential building work associated with the conversion of the warehouse to a mixed residential and commercial strata building. The building work undertaken by Beach was defective and contained various omissions.

After the work done by Beach was completed, the Kings registered a strata plan to subdivide the site. In 2007, the owners corporation created on registration of the strata plan sued Beach (as builder), the Kings (as developer) and Suncorp Metway Insurance Ltd (as the home warranty insurer) for compensation to cover the cost of repairing the defective and incomplete work.

During the case, Beach went into liquidation and the owners corporation resolved its claim against the insurer. The owners corporation's claim against the Kings was unsuccessful because the Supreme Court held that the Kings did not sign and were not parties to the contract with Beach to undertake the residential building work to convert the warehouse into a mixed use building. This meant the Kings were not developers as a result of which they did not owe the owners corporation any warranties as to the quality of the work done by Beach.

What was the appeal about?

The owners corporation appealed against the Supreme Court's decision to the NSW Court of Appeal. The Court of Appeal had to determine the following three key issues:

1. Were Mr and Mrs King parties to the contract with Beach for the residential building work associated with the conversion of the warehouse into a mixed use building?

2. Is a builder or developer liable to an owners corporation for design defects such as the absence of fire sprinklers from void areas adjacent to apartments?
3. Is the scope of a developer's liability to an owners corporation for building defects under the home building legislation the same as the builder's liability to the owners corporation?

Were the Kings developers?

The owners corporation could not produce a copy of the building contract with Beach that had been signed by Mr and Mrs King. Despite that, the Court of Appeal concluded that Mr and Mrs King did sign, and were parties to, the building contract with Beach. The Court reached that conclusion because:

- the building contract with Beach named Mr and Mrs King and Meridian as principals;
- site meeting minutes between Beach and Mr and Mrs King's architect indicated that the building contract had been signed by Mr and Mrs King;
- Mr and Mrs King's lender required a contract for the building work to be signed before it would advance the loan monies to Mr and Mrs King or Meridian and those monies were eventually loaned to the Kings or a company associated with them.

Therefore, because Mr and Mrs King signed, and were parties to, the building contract with Beach, they were also developers of the site for the purpose of the *Home Building Act 1989* (**HB Act**). This meant the Kings owed the owners corporation warranties as to the quality of the work done by Beach that are set out in the HB Act as if they had done the work to convert the warehouse to a mixed use building themselves.

Were Mr and Mrs King Liable for Design Defects?

The Statutory Warranties

A builder and developer responsible for residential building work give the owner of the land on which that work is done and the successors in title to that owner (such as an owners corporation), warranties as to the quality of the work. These warranties are contained in section 18B of the HB Act. They included (at the relevant time):

(a) a warranty that the work will be performed in a proper and workmanlike manner and in accordance with the plans and specifications set out in the contract;

(b) a warranty that all material supplied by the builder will be good and suitable for the purpose for which they are used and, unless otherwise stated in the building contract, will be new;

(c) a warranty that the work will be done in accordance with, and will comply with, any law.

The Design Defects

The work done by Beach was defective. The defects in that work included waterproofing defects. The work done by Beach also included omissions such as the absence of handrails to stairs in common areas leading to some of the apartments, a lack of thermal detectors in the car park and kitchens of retail units, and the absence of sprinklers in voids above bathrooms, ensuites, laundries and in sub-floor voids of apartments (**design defects**).

The design defects existed because the plans and specifications which were prepared by the Kings architect and included in the contract between the Kings and Beach did not show or require handrails, thermal detectors and sprinklers to be installed in those parts of the building. The key question that arose in the Court of Appeal was whether or not Beach and the Kings could be liable for the design defects even though the plans and specifications for the building work did not require Beach to install the handrails, thermal detectors and sprinklers in the locations in which they were missing.

The Requirement for the Work to Comply with the BCA

Meridian obtained development consent from the Local Council to permit the work necessary to convert the warehouse to a mixed use building to be undertaken. It was a condition of the development consent that all of the work comply with the Building Code of Australia (**BCA**). Section 76A of the *Environmental Planning and Assessment Act 1979* (as it was then known) required (as a matter of law) that development work be carried out in accordance with the conditions of the development consent.

This meant that:

- the warranties in section 18B of the HB Act required the work done by Beach to comply with the law;
- the law (here the development consent and the planning legislation) required the work done by Beach to comply with the BCA; and
- therefore, the work done by Beach needed to meet the requirements of the BCA.

Are the Warranties Inconsistent?

The plans and specifications set out in the contract for the work did not require the handrails, thermal detectors and sprinklers to be installed in the locations in which they were missing, but the BCA did.
This scenario drew attention to a potential inconsistency between two of the statutory warranties in the HB Act: the warranty that the work will be performed in accordance with the plans and specifications set out in the contract; and the warranty that the work will comply with any law.

Was the builder simply required by those warranties to perform the work in accordance with the plans and specifications set out in the contract or did the builder also need to ensure that the work complied with the law?

Ultimately, the Court of Appeal decided that the warranties are not inconsistent and that the builder and developer warrant *both* that the work will be carried out in accordance with the plans and specifications and that it will comply with the law.

The Decision

The Court held (by a majority of 2-1) that the warranties in section 18B of the HB Act are cumulative and that each of those warranties can be considered independently from each other.

This means that if those warranties are complied with, the work will be carried out in a proper and workmanlike manner and in accordance with the plans and specifications in the contract, the materials will be good and suitable and new (unless otherwise stated in the contract), the work will comply with any law and the result of the work will be a dwelling reasonably fit for occupation as such.

The majority of the Court of Appeal held that the work must comply with the law even if the plans and specifications set out in the contract do not. The Court concluded that a builder and developer could not avoid the requirement to ensure that the work complied with the law by including in the contract plans for the construction of the building that did not comply with the requirements of the BCA.

The Court reasoned that if a builder has to rely on the expertise of another building professional such as an architect or a fire safety consultant to satisfy the builder's warranty that the work will comply with the law, then the builder should negotiate contractual protection for his potential statutory liability.

Ultimately, the Court decided that the two statutory warranties in question can be read together. The builder warrants *both* that the work will be carried out in accordance with the plans and specifications *and* that it will comply with the law. In other words, the builder warrants that the construction of the work in accordance with the plans and specifications will comply with the law.

This meant that the Kings and Beach were liable for the design defects even though the plans and specifications included in the building contract did not require Beach to install the handrails, thermal detectors and sprinklers in the locations from which they were missing because the BCA required those items to be installed in those locations. In other words, the statutory warranties impose on a builder liability for failing to identify defects in plans and specifications which it did not prepare.

However it is important to be mindful that the conclusion in the case only applies where the BCA has the force of law where, for example, it is a condition of a development consent that building work be done in accordance with the BCA.

Is the Developer's Liability the same as the Builder's?

The Court (by a majority of 2-1) determined that where there is a contract between the developer and builder, section 18C of the HB Act requires the creation of a notional (or make believe) contract between the developer and the owners corporation *on the same terms as the actual contract between the developer and the builder*.

This means that, generally, the scope of the liability of the builder and developer to an owners corporation for a breach of the statutory warranties in the HB Act will be the same. The majority of the Judges did not agree with the opinion expressed by the Judge in the minority that the scope of the developer's liability to the owners corporation should be broader than that of the builder because the notional (or make believe) contract between the developer and the owners corporation should be more open ended.

Conclusion

The decision in the *King* case broadens the scope of the liability of builders and developers to owners corporations under the HB Act.

The decision confirms that builders and developers can be held liable for design defects in residential building work involved in the construction of a new building, or the refurbishment of an existing building, that is done pursuant to development consent issued by a Local Council. The case also confirms that a builder and developer can be held liable for the omission to undertake work that, whilst not identified in building plans and specifications, must be undertaken by law.

The case underscores the broad nature of the warranties given builders and developers to owners corporations under the home building legislation. It means that builders and developers responsible for the construction of new residential or mixed use buildings can be held liable for design flaws that, for example, result in fire and life safety defects.

Ultimately, the case delivers a clear message that the home building legislation requires a builder and developer to ensure that residential building work both will be done in accordance with plans and specifications contained in the building contract and will comply with any applicable laws.

Adrian Mueller
Partner I BCOM LLB FACCAL
adrianmueller@muellers.com.au

About JS Mueller & Co

JS Mueller & Co has been servicing the strata industry across metropolitan and regional NSW for over 30 years. We are a specialist firm of strata lawyers with in depth and unmatched experience in, and comprehensive knowledge of strata law and levy collection.

02 9562 1266
enquiries@muellers.com.au
www.muellers.com.au