

### REASONABLENESS OF RECTIFICATION

#### WESTPOINT MANAGEMENT LTD V CHOCOLATE FACTORY APARTMENTS LTD [2007] NSWCA 253

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The NSW Court of Appeal has affirmed the principle in *Bellgrove v Eldridge* that an owner is entitled to the costs of rectification of building defects provided that such a course is a necessary and reasonable one to adopt. The fact that a defective property has been sold without loss to an owner and that owner has no intention of rectifying those defects does not necessarily of itself disentitle an owner from recovering rectification costs in respect of that property.

#### FACTS

The Westpoint group undertook a project to convert a building at Stanmore, once used for the manufacture of chocolates, into residential units for sale to the public on completion.

Chocolate Factory Apartments Ltd (CFA), when under Westpoint control, purchased the building financing the purchase by equity funding and by borrowings. The equity funding was arranged by the establishment of three investment companies in which the public bought shares. The investment companies in turn bought shares in CFA which ultimately came under the control of the investment companies.

CFA entered into a construction contract with Westpoint Constructions Ltd (Constructions) under which Constructions was to design and build the residential units.

After the units were completed, they were sold. In 2004 (and after the units had been sold) CFA commenced court proceedings inter alia to claim damages from Constructions for defective building work by Constructions. This case note will focus on the claim for damages by CFA against Constructions although there were other elements present in these proceedings including

a cross claim by Constructions against CFA.

#### THE REFEREE'S FINDINGS

The proceedings were referred to a referee for inquiry and report under the then Part 72 r 2(1) of the Supreme Court Rules. The referee found in favour of CFA but concluded that the damages recoverable by CFA did not include the reasonable cost of rectification of certain items of defective and incomplete work.

The referee noted at paragraph 71 of his first report that:

... there are a number of matters alleged which, although they are matters which do not conform to the plans and specifications, nonetheless have not been shown as requiring the payment of money to have them repaired or as having brought about a diminution in the value of the property or as causing any other form of financial loss to the proprietor, such as to have caused CFA to have suffered damages ...

and further, at paragraph 72 of his first report, that:

... there was no evidence that the failure to conform to the plans and specifications led to any diminution in their value or delay in selling them, such as to cause interest to continue to run for a longer period. Nor was there any evidence that any purchaser required the 'rectification' of any of these matters ...

and finally concluding at paragraphs 103 and 104 of his first report that:

103. However, my present view is that all the authorities prior to SAS require the establishing of damage, which may sound either in the cost of remedying the defective or incomplete work or the diminution in value of the property by virtue of that work. Where such loss is established, the authorities make it clear that

it may be recovered. Where, on the other hand, there is no loss, the authorities make it equally clear, as I read them, that save perhaps for nominal damages, there can be no recovery of damages.

104. I consider that the preponderance of the authorities favour this view and, in those circumstances, in so far as it has not been possible to demonstrate that certain of the work constituted any loss either by way of the necessity for completion, rectification or diminution in value, CFA has failed to establish its entitlement to damages in relation to those alleged discrepancies between the plans and specifications and what was built.

On 2 September 2005 Justice McDougall adopted the first report and gave judgment in accordance with the referee's conclusions.

CFA appealed to the New South Wales Court of Appeal, the main issue being whether the referee was in error in concluding CFA was not entitled to damages for ten items of work and whether McDougall J was in error in adopting the first report despite the referee's error.

### **BELMGROVE V ELDRIDGE (1954) 90 CLR 613**

The referee, McDougall J and the Court of Appeal all considered the leading case of *Bellgrove v Eldridge* (1954) 90 CLR 613 regarding the principles of assessment of damages for defective building work. In *Bellgrove v Eldridge*, the High Court of Australia found that damages for breach of the obligation to construct in accordance with the contract and specifications are measured by the cost of rectification, where it is necessary to undertake that rectification to produce conformity

and where it is reasonable to adopt that course.

However, where rectification may be necessary to produce conformity but it is not reasonable to do so, the true measure of loss is any diminution in value produced by non conformity with the contract and specifications. It is a question of fact as to whether, in any particular case, rectification is both necessary and reasonable.

*Bellgrove v Eldridge* concerned defective foundations which seriously threatened the stability of the plaintiff's house and it was held that she was entitled to recover the cost of demolition and re-erection. The court also adverted to any lack of intention to carry out the rectification work and held that it was immaterial that the plaintiff elected to keep her existing house (instead of demolishing it) and keep the cost of erecting another (instead of paying to build another).

### **CONSIDERATION BY THE COURT OF APPEAL**

The Court of Appeal tested the conclusion by the referee that CFA was precluded from recovering rectification costs because there was no evidence of loss. Firstly, Giles JA did not consider that the sale of the units by CFA of itself displaced the entitlement to damages according to the rectification measure. Giles JA referred to *Director of War Service Homes v Harris* (1968) Qd R 275, in which Gibbs J reasoned that whether an owner was under a legal liability to remedy building defects did not affect a builder's liability to pay damages. Gibbs J noted that it was possible that the owner of a defective building may decide to remedy the defects before sale to obtain the highest possible price on the sale, or sell subject to a condition that he or she will remedy the defects. However, the fact of sale 'might

be one of the circumstances that would have to be considered in relation to the question whether it would be reasonable to effect the remedial work'. In this case, Giles JA noted that the sale of the units and the fact that purchasers were not asking for rectification were relevant for their bearing on whether it was reasonable to carry out the rectification work.

Giles JA came to a similar conclusion regarding the relevance of the plaintiff's intention to carry out the rectification work, noting that if the likelihood of the plaintiff carrying out the rectification work was a consideration in the award of damages there would be the potential for expensive and time-consuming factual enquiries. Referring to Lord Jauncey's judgment in *Ruxley Electronics and Construction Ltd v Forsyth* (1996) 1 AC 344, Giles JA was of the opinion that the plaintiff's intention to carry out the rectification work was not of significance in itself. Rather, the question of why the plaintiff intends or does not intend to carry rectification work will be relevant as to the light it sheds on whether the rectification is necessary and reasonable. Thus, if supervening events mean that the rectification work cannot be carried out, it can hardly be found that the rectification work is reasonable in order to achieve the contractual objective, as achievement of the contractual objective is no longer relevant. If sale of the property to a contented purchaser means that the plaintiff did not think and the purchaser does not think the rectification work needs to be carried out, it may well be found to be unreasonable to carry out, the rectification work. An intention not to carry out the rectification work will not of itself make carrying out the work unreasonable, but it may be evidentiary of

unreasonableness; if the reason for the intention is that the property is perfectly functional and aesthetically pleasing despite the non-complying work, for example, it may well be found that rectification is out of all proportion to achievement of the contractual objective or to the benefit to be thereby obtained.

However, in this case, CFA's intention not to carry out rectification work and to pay any damages received to its shareholders did not mean that it had no compensable loss.

More generally, the Court of Appeal held that the referee's approach to declining to allow rectification costs to be claimed for certain defects was not in conformity with the Bellgrove v Eldridge principles. The referee should not have made the threshold question whether a loss had been established and then concluded that a loss had not been established because there was no necessity for completion, rectification or diminution in value. The correct approach on Bellgrove v Eldridge was that CFA was entitled to rectification damages unless the rectification work was unnecessary and unreasonable.

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Giles JA then turned to the referee's findings with respect to the items in issue on appeal. Where the referee had not asked whether rectification was reasonable in order to achieve the contractual objective but had simply declined to award damages simply because the rectification work had not been carried out, Giles JA held that the referee's report was erroneous.

However, the referee did make a finding of fact that it was not reasonable to carry out rectification work in respect of skirting boards. The difference

between the cost of the skirting boards specified and the skirting boards installed was \$500 whereas CFA's claim was for the cost of removing the installed skirting boards and replacing them with the correct skirting boards, estimated at \$112,815. In the light of the cost differential, Giles JA agreed with the referee's finding that rectification was not necessary or reasonable in order to achieve the contractual objective.

### MCDougall J'S ADOPTION OF THE REPORTS

The Court of Appeal observed that while McDougall J had set out correctly a statement of what Bellgrove v Eldridge established, McDougall J had failed to perceive the divergence between this and the referee's conclusions. The Court of Appeal held that although the referee had made some references to necessity and reasonableness, the referee did not apply a criterion of reasonableness in conformity with the Bellgrove v Eldridge principles. The court found that McDougall J made an error of law in his misapprehension of the referee's report as well as in adopting the report so far as the referee found that rectification costs should not be awarded in respect of the defects in contention (with the exception of McDougall J's disposal of the item with respect to skirting boards). However, it did not follow that CFA was entitled to have its judgment increased by the amounts of the claims. McDougall J's orders to this extent were set aside and the proceedings were remitted to his Honour for further consideration in accordance with the Court of Appeal's reasons.

### IMPLICATIONS

The Court of Appeal has made it clear that whether rectification costs are available in relation to defective building work must be

assessed with reference to the criterion of reasonableness and necessity laid down in Bellgrove v Eldridge.

The fundamental purpose of Bellgrove v Eldridge in allowing rectification costs is the achievement of the contractual objective. That is, in assessing damages for breach of contract, an owner is entitled to be placed in the position it would have been in had the contract been performed. This fundamental purpose must be borne in mind when applying Bellgrove v Eldridge. However, if the rectification cost is out of all proportion to the achievement of the contractual objective, then diminution in value is recoverable.

Whether an owner has suffered no loss in selling the property or has no intention of completing the rectification work are indicia to be considered in determining whether rectification work was reasonable and necessary but are not determinative of themselves.