

DEFECTIVE WORK CLAIMS

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INTRODUCTION

A defective work claim is the most common claim made by owners. Unless otherwise stated in the contract, defective work entitles a building owner to rectify the defective work and/or claim damages against the builder in contract and/or at common law.

The first part of this paper deals with the three identified periods within which a defective work claim may be made.

The second part will discuss the developing area of assessment of damages related to a defective work claim. The third part deals with grounds of defending a defective work claim.

The aim of the paper is to outline what information must be sourced and principles followed to make or break a defective work claim.

TIME TO MAKE DEFECTIVE CLAIMS

There are three distinct periods in the progress of a building contract in which defective work claims can be made. The first period falls prior to the achievement of practical completion. The second period is subsequent to practical completion and during the defects liability period. The third period is after the issuance of the final certification of the building works.

Prior to practical completion

Different views have been expressed as to the status of defective work prior to practical completion. The suggestion that defects prior to practical completion were temporary disconformities¹ has not had many supporters. In fact, it is generally accepted that a contractor will be in immediate technical breach of contract whenever works fail to comply with contractual descriptions or requirements.²

Hudson's Building Contracts states the position as follows:

'On grounds of both principle and practicality, a contractor will be in immediate breach of contract whenever his work fails to comply with the contract descriptions or requirements, although no doubt, as envisaged by Lord Diplock, the damages will be at best nominal in a case where he can show that he intends to rectify at some more convenient time before completion without affecting the quality of remaining work'

Notwithstanding the above, under most standard form contracts when defective works are discovered during the progress of the works, there are express provisions that prescribe the process by which the builder can be directed to rectify the defective work.

Vigilance on the part of the Principal is required to avoid a later argument by the contractor that the principal by failing to enforce the contractual requirements before the work is covered up has waived its right to insist on strict compliance with the contract.

AS2124-1992

Clauses 30.3 – 30.6 of the AS2124-1992 standard form provide for the rectification of defective or non-conforming material and work. Clause 30.2 provides that in these circumstances, the Superintendent may direct the Contractor to remove material from site, demolish the work, reconstruct, replace or correct the work, or not to deliver the material or work to the site.

Pursuant to Clause 30.3, the time within which the contractor is to carry out the rectification of the defective work is within the direction of the Superintendent.

Under the AS2124-1992 standard form, the Principal may have the

rectification works carried out by another contractor and the costs incurred thereto shall be a debt due from the contractor to the principal, if the contractor fails to rectify the defective work within the period of seven (7) days from notification by the Superintendent.

AS4000-1997

Under the AS4000-1997 standard form, clause 29.3 is similar in effect to the provisions under AS2124-1992.

However, under the AS4000-1997 standard form the Principal is expressly entitled to deduct the cost of rectification works from the progress payment (as opposed to merely being a debt due) and have rectification works carried out by another builder if the contractor fails to rectify the defective work within the period of eight (8) days from notification by the Superintendent.

PC-1 1998

Under the PC-1 1998 regime, the Contract Administrator is able to instruct the contractor to carry out rectification of a defect as a variation. If the defective work is not attributable to the contractor, the contractor is entitled to full payment as if it were a variation and to claim extension of time.

However, if the defective work is due to the contractor's breach there is no entitlement to extension of time and the cost of rectifying the defect and the value of the variation, and the increase or decrease of the original Contract Price is determined by the Contract Administrator.

To make or break a defective work claim made during the progress of the contract, attention should be focussed on the specific timing, notification and evidentiary requirements set out in the contract.

Further, both parties need to be fully appraised as to their right

and liabilities in relation to issues of time and cost.

Defects liability period

A defects liability period commences on the date of practical completion and continues for a period as stated in the contract. It should be observed that most defects liability period provisions in standard form contracts constitute both a right on the part of the Principal and an obligation on the part of the Contractor but do not limit defects claims to the defect liability period.

It is the Principal's entitlement to require the contractor to return to the site and rectify the defects during this period. It is also the right of the principal (subject to the provisions of the particular contract) to have the defective work rectified by another contractor at the original contractor's expense in certain circumstances. This would ordinarily mean that the Principal is entitled to deduct the costs of that rectification from the retention money held by the Principal.

However, it is commonly appreciated that it would be much more efficient for the original contractor to carry out the rectification of the defective work. In the circumstances, the main obligation on the contractor throughout the defects liability period is that upon being given reasonable notice, to attend the site and rectify the defective work. The contractor's obligation to rectify defective work during the defects liability period is at its own expense.

AS2124-1992

Under the AS2124-1992 standard form Contract, Clause 37 expressly provides that whilst the Principal may have the work of rectification carried out at the original contractor's expenses,

... most defects liability period provisions in standard form contracts constitute both a right on the part of the Principal and an obligation on the part of the Contractor

the Principal retains any other rights that it may have against the contractor in respect to the defective work.

Though it is not clearly worded, it may be arguable that where the principal actually incurs expenses in relation to rectification of the defective work, such costs and expenses will be 'a debt due from the Contractor'.

It is noted that the Superintendent can only issue a direction to the contractor to rectify defective work any time prior to the 14th day after the expiration of the defects liability period.

ABIC MW-1 2003

Under Clause M14.1 of the ABIC MW-1 2003 standard form contract, if the contractor fails to rectify the defective work within the time nominated, the principal may use another contractor to rectify the defective work at the expense of the original contractor.

Under Clause M16.1 of the ABIC MW-1 2003 standard form contract, the obligation to rectify defective work continues until the defective work is rectified and does not come to an end when the defects liability period is over.

Though the contractor's obligation to rectify may continue past the defects liability period, the architect cannot issue a fresh instruction to rectify defective work after the end of the defects liability period, unless the instruction relates to the rectification of a latent defect and the final certificate has yet to be issued.

AS4000-1997

Clause 35 of the AS4000-1997 standard form expressly provides that the Superintendent may notify the contractor to rectify a defect during the defects liability period within a specified period.

If the rectification is not commenced or completed within the specified period, the principal may have the rectification carried out by another builder without prejudice to any other rights and remedies the principal may have. Clause 35 further provides that the Superintendent shall certify the rectification costs as moneys due and payable to the Principal.

IMPORTANT ISSUES

The important issues surrounding the making or breaking of a defective work claim made during the defects liability period are as follows:

- (1) the validity of the notice to rectify defective work issued by the Principal or superintendent;
- (2) the determination of whether the instruction to rectify relates to defective work or is a variation;
- (3) the reasonableness of the time allowed to carry out rectification works;
- (4) the accrual of the principal's right to direct that rectification works be carried out by another contractor; and
- (5) the liability as to the costs of rectification of the defective work.

Final Certification

The issuance of a final certificate under a building and construction contract does not terminate the builder's obligation for damages arising out of defective work claims.

The Victorian Supreme Court in *Alucraft Pty Ltd v Grocon Ltd* (No 2) [1996] 2 VR 386, considered the effect of a final certification. In this case, the plaintiff was a subcontractor to the defendant for the supply and installation of aluminium and steel windows, which were the alleged defective works.

The matter was brought to court more than four years after the issuance of the final certificate

on account of the plaintiff's claim for outstanding payments. The defendant counterclaimed for the cost of rectification of the defective works.

His Honour Smith J. held that although the proprietor had issued a final certificate there remained a risk that the works would require rectification.

It is important to keep in mind that in relation to claims for breach of contract, the statutory limitation period of six years runs from the date of breach, which will occur within the construction period.

For tortious claims in negligence, time runs from the date the damage becomes manifest. Manifestation of damage could occur during the contract or some years after the contract is discharged.

OWNERSHIP OF BUILDING NOT REQUIRED

In House of Lords in Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1993] 3 All ER 417, the Court held that the recovery of damages for breach on a contract was not dependent or conditional on the plaintiff having a proprietary interest in the subject matter of the contract at the date of the breach.

The House of Lords held that the owner could recover damages for defective work even though the owner suffered no actual damage as the building had been sold for full value before the damage was discovered.

The Full Court of the Supreme Court of Queensland considered a similar proposition in Director

of War Service Home v Harris [1968] Qd R 275. In this case the defective works carried out by the defendant for the plaintiff were not discovered until after the houses were sold.

Sir Harry Gibbs, with whom Stable and Hart JJ agreed, said:

'If the owner subsequently sold the building, or gave it away, to a third person, that would not affect his accrued right against the builder to damages...'

The owner is therefore still entitled to recover as damages the cost of rectification of the defective works. However, it was noted that the fact that the buildings had been sold might be a consideration in relation to the assessment of damages.



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Kevan Heathcote

ASSESSMENT OF DAMAGES UNDER DEFECTIVE WORK CLAIM

A defective work claim is usually for the cost or estimated cost of rectification of the defective work. Sometimes, instead of the cost of rectification the courts award the plaintiff the difference in value between what the intended value of the work and the actual value of the work on account of the defective work.

Whilst most standard form contracts specifically deal with the rectification of defective works, the principal's entitlement to damages at common law for breach of contract for defective work is not usually precluded.

However, the Principal's entitlement to damages for defective works for breach may be controlled by the contract and be subject to the relevant contractual notice requirements being issued by the Superintendent or the Principal (whichever is applicable).

The Supreme Court of NSW in *Turner Corporation Ltd (receiver and manager appointed) v Austotel Pty Ltd* (1997) 13 BCL 378 held that the entitlement to recover the cost of work performed by others at the request of the principal is subject to the issuance of the notice required by the contract prior to the rectification of the defective work being performed.

Damages under the contract

The damage reviewable may be limited by the provisions of the contract.

AS2124-1992

Under the AS2124-1992 standard form contract, if the Superintendent directs a variation due to defective work, that variation is to be valued as

prescribed in Clause 40.5 of the contract.

Further, regard shall be had to any increase or decrease caused by the variation, in the value to the Principal of the works.

Clause 40.5 states that the amount payable by either the Principal or the contractor is to be ascertained by the Superintendent based on the enumerated methods under the clause.

AS4000-1997

Clause 29.3 and 35 of AS4000-1997 provides that the Superintendent shall certify the cost of rectification work by another builder as a debt due and payable to the Principal.

Damages at common law

Generally where one party breaches a contract s/he must indemnify the other in damages.

Burns v MAN Automotive (Aust) Pty Ltd

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such a breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

COST OF RECTIFICATION

The High Court's decision of *Bellgrove v Eldridge* (1954) 90 CLR 613 is the leading authority on the measure of damages for defective and incomplete work. In this case the plaintiff cross-claimed against the builder for the cost of demolition and rebuilding of the house as a

result of faulty construction of foundations.

The High Court affirmed that the general rule was that the measure of damages was the difference between the contract price of the work and the cost of making the work conform to the contract.

At paragraph 617, the High Court said:

'In the present case, the respondent was entitled to have a building erected upon her land in accordance with the contract and the plans and specifications which formed part of it, and her damage is the loss which she has sustained by the failure of the appellant to perform his obligation to her. This loss cannot be measured by comparing the value of the building which has been erected with the value it would have borne if erected in accordance with the contract; her loss can, prima facie, be measured only by ascertaining the amount required to rectify the defects complained of and so give to her the equivalent of a building on her land which is substantially in accordance with the contract' (emphasis added)

However, the general rule was subject to two qualifications. At paragraph 618 – 619, the High Court said:

'We prefer, however, to think that the building owner's right to undertake remedial works at the expense of a builder is not subject to any limit other than is found in the expression "necessary" and "reasonable"...' (emphasis added)

'Many examples may, be given of remedial work, which though necessary to produce conformity would not constitute a reasonable method of dealing with the situation and in such cases the true measure of the building owner's loss will be

the diminution in value, if any, produced by the departure from the plans and specification or by the defective workmanship or materials'

As to what is both 'necessary' and 'reasonable' in any particular case is a question of fact.

Depending on the facts of a particular case the owner may seek the cost of rectification and/or repairs even though these costs may far exceed the difference in value between what was contractually specified and what was actually built.

In *Alucraft Pty Ltd (in liq) v Grocan Ltd* Grocan did not recover damages from a subcontractor where Grocan had been paid in full and neither Grocan nor the proprietor had any intention to rectify.

DIMINUTION IN VALUE

Instead of the cost of rectifying defects the courts may sometimes award the owner the difference in value between what the work would have been worth had it been performed in accordance with the contract and its actual worth.

As opposed to cost of rectification, assessment under the diminution in value may involve a sum that would be ordinarily lower than the cost of rectification.

If by rectifying, the owner could avoid a greater loss (diminution in value) the failure to rectify would be a failure to mitigate damage. Persons suffering loss from another's breach are under an obligation to minimise that loss and are not entitled to recover from the person in breach any damage exceeding the damage had there not been a failure to mitigate.

In *D Galambos & Son Pty Ltd v McIntyre* (1974) 5 ACTR 10 at 11, Woodward J stated as follows:

'Where it would be reasonable to perform remedial work in order to mend defects or otherwise to produce conformity with the plans and specifications which were part of the contract, the measure of damages is the fair cost of that remedial work. Where the defect is such that repair work would not be a reasonable method of dealing with the situation (usually because the cost of such work would be out of proportion to the nature of the defect), then the measure of damages is any diminution in value of the structure produced by the departure from plans and specifications or by defective workmanship.'

In *Ruxley Electronics and Construction Ltd v Forsyth* [1996] 1 A.C. 344, the House of Lords decided that the fact that the diminution in value was nil did not automatically entitle the owner to claim the cost of restoration.

LOSS OF AMENITY OR NON-PECUNIARY LOSS

Damages for what appears to be non-pecuniary loss on account of breach of contract for defective works is another measure of assessing damages.

In *D Galambos & Son*, the award of damages was in relation to the prevention of the owner from enjoying or using part of the building as intended.

In doing so, Justice Woodward referred to authority affirming that "damages may be recovered for substantial inconvenience and discomfort caused by breach of contract. The difference between 'mere annoyance and injury to feelings, on the one hand, and physical inconvenience, on the other' was stressed"³

In *Ruxley Electronics and Construction Ltd v Forsyth* [1996] 1 A.C. 344, Lord Mustill made the following observations in relation to the proposition that there are

only two measures of damage available, namely reinstatement or loss of value:

'The proposition that these two measures of damage represent the only permissible bases of recovery lie at the heart of the employer's case.

But the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of the promisee's position which full performance will secure.

This excess, the "consumer surplus", is usually incapable of precise valuation in terms of money because it represents a personal, subjective and non-monetary gain. Where it exists, the law should compensate the promisee if the performance takes it away.'

In *Chas Drew Pty Ltd v JF & P Consulting Engineers Pty Ltd* damages for loss of profits based on inordinate delays were given against a supervising engineer.

Smit J held in *Gimtak v Cathie* [2001] VSC 88 at [41] (2 April 2001, Smit, J) that costs in carrying out attempted repairs if reasonably incurred can be claimed.

In *Auburn Municipal Council v ARC Engineering Pty Ltd* the attempted repairs of a pavement was claimed in addition to complete replacement.

In *Bellgrove v Eldridge* damages included

- (i) the cost of demolishing plus
- (ii) the costs of re-erecting the house together with;
- (iii) certain consequential losses, less
- (iv) the demolition salvage and
- (v) moneys unpaid.

In *Jandon Constructions v Lyons* footings defects, demolition and rebuilding was unreasonable to fix.

Retired persons carrying out work themselves are entitled to be paid for their time in correcting defects.

Mohr J in *Carosella and Carosella v Ginos & Gilbert Pty Ltd* held that demolishing and rebuilding, not cosmetic rectification, was justified. Damages included a diminution in the enjoyment where part of the building was not suitable for use as intended.

In the New South Wales Court of Appeal case of *Auburn Municipal Council v ARC Engineering Pty Ltd*:

Hutley JA took the view that where demolition and reconstruction of a building are necessary, damages are different for an engineer who does not contract to design a structure which will produce a desired result but only to exercise skill for that purpose. The engineer was liable for the cost of the poor design but not the cost of building a satisfactory design.

In *Greaves & Co (Contractors) Ltd v Baynham Meikle and Partners*, a design engineer did contract to produce a result – that the building would be reasonably fit for loaded trucks.

In *Morton v Douglas Homes Ltd*, the defendants were liable for repairs and for the diminution in value after repairs. *Chas Drew Pty Ltd v JF & P Consulting Engineers Pty Ltd* the supervising engineer was held liable for loss of profits where there were inordinate delays in the development of a multi-stage residential housing project.

In *Director of War Service Homes v Harris* it was held that:

‘The owner of a defective building may decide to remedy the defects before he sells it so that he may obtain the highest possible price on the sale; he may sell subject to a condition that he will remedy the defects; or he may resolve to put the building in order after it has been sold because he feels morally, although he is not legally bound to do so. These matters

are nothing to do with the builder, whose liability to pay damages has already been accrued.’

A claim for mental distress was rejected by Giles J in *Kennedy v Collings Constructions Co Pty Ltd* but not because he held that such a claim was not at all maintainable at law. However, in *Watts v Morrow* it was held that a plaintiff is not entitled to recover general damages for mental distress not caused by physical discomfort or inconvenience resulting from the defendant’s breach of contract.

In *Burke v Lunn* damages were awarded for physical inconvenience and time spent by the building owner in rectifying and arranging to rectify defects. An amount as compensation for inconvenience and upset was allowed by Davies J in *Christopher John Denton and Mary Jane Denton v Dama Pty Ltd t/as Design and Management Associates*.

Retired persons carrying out work themselves are entitled to be paid for their time in correcting defects.

In *Boncristiano v Lohmann* the Victorian Court of Appeal considered an appeal against an award of \$500 for inconvenience and \$1000 for mental distress. Winneke P (with whom Charles and Batt JJA agreed) held (at 94):

‘It now appears to be accepted, both in England and Australia, that awards of general damages of the type to which I have referred can be made to building owners who have suffered physical inconvenience, anxiety and distress as a result of the builders’ breach of contract, but only for the physical inconveniences and mental distress directly related to those inconveniences which have been caused by the breach of contract.’

MITIGATION

A duty to mitigate damage does not require what is unreasonable. It was unreasonable to delay repairs in *Dodd Properties (Kent) Ltd v Canterbury City Council*. This was also referred to by Dawson J in *Johnson v Perez*. It would seem that a defendant cannot rely on the plaintiff's failure to mitigate the consequences of the defendant's wrongful act when that wrongful act itself made it impossible for the plaintiff to take the necessary steps in mitigation. This is certainly so in the case of a deliberate wrongful act of a defendant.

In *London Congregational Union Inc v Harriss & Harriss (a firm)* the plaintiff was held to have acted reasonably by not repairing for five years because of financial difficulties and because the defendants were denying liability.

DEFENDING A DEFECTIVE WORK CLAIM

Some of the common defences by a contractor to allegations of defective work claims include:

- (a) new design now required;
- (b) a proprietor may not under the guise of recovering as damages for the cost of completing the work, recover the cost of executing work significantly different from the contract work. *Smail (as trustee of the assigned estates of L M Wilson and G R Wilson) v D L Starbuck Pty Ltd*;
- (c) contradictory or confusing details;
- (d) provision of required information out of sequence;
- (e) incompatibility of details;⁴
- (f) work carried out on the instruction of the building owner and/or superintendent⁵;

(g) waiver or estoppel on the part of the principal or superintendent⁶;

(h) proof of absence of an express term requiring particular quality, no implied warranty⁷; and

(i) lack of reliance⁸. (see discussion below)

In *Cable (1956) Ltd v Hutcherson Bros Pty Ltd (1969) 123 CLR 143*, the principal claimed against the contractor for defects in the design and construction. Although it was a 'turnkey' contract, the principal's consulting engineer participated in the design process and the final determination of the design related to the alleged defective work.

The High Court of Australia held that the Principal's claim for defective design and construction against the contractor in a turnkey contract failed on the basis of lack of reliance upon the contractor. One of the factors that contributed to this conclusion was that the involvement and role of the Principal's consulting engineer in the final determination of the design of the works.⁹

From a builder's perspective, defending a defective work claim would necessarily translate to a high cost and time consuming process. This is regardless of the timing of the making of the defective work claim by the Principal and/or the Superintendent.

For sake of practicality and in preparation for a possible defective work claim by the principal, it would be in the interest of the builder to do the following:

- (1) establish the ambit of its contractual responsibility in relation to design;

A duty to mitigate damage does not require what is unreasonable.

The entitlement to make a defective work claim after the issuance of the final certificate is largely a claim for damages for breach of contract rather than a claim made intra contract.

(2) be clear as to any express and/or implied representation made in documentation relating to and part of the contract as to the quality of workmanship;

(3) be aware of any express and/or implied statements in the contract as to the purpose of the works;

(4) be clear as to any express, implied and/or actual reliance on the part of the principal as to any of the contractor's obligation, skill or expertise; and

(5) establish a contemporaneous documentation procedure to ensure all directions, instructions, notifications, possible waivers are recorded in a timely and relevant manner.

CONCLUSION

Standard form contracts generally provide for specific timing and notification procedures related to defective work claims made prior to practical completion and during the defects liability period. The entitlement to make a defective work claim after the issuance of the final certificate is largely a claim for damages for breach of contract rather than a claim made intra contract.

As with the process of making a defective work claim, most standard form contracts contain express provisions relating to the valuation of rectification works ordered as a result of a defective work claim.

Quite apart from the methods enumerated in these standard form contracts, there are two main methods of assessing damages at common law for breach of contract for defective work. As discussed, a third method of awarding damages is that for loss of amenity or non-pecuniary loss.

As with all disputes, the viability and success of any of these claims and defences (that is if they are specifically included in the pleadings) is largely dependent on the facts and evidence of any particular case.

Finally, the time, effort and money involved in dealing with a defective work claim may be largely pre-empted or minimised if contract documentation is vetted and prepared for each individual project, and by setting out effective and feasible methods of risk allocation, clear obligations in relation to standards and quality and actual and/or implied reliance on skill and expertise.

REFERENCES

¹ Per Lord Diplock in *Kaye v Hosier* (1972) 1 All ER 121

² In *Duncan Wallace, Hudson's Building Contracts*, 11th ed, Sweet & Maxwell, London, 1995 at [5.027]

³ *D Galambos & Son Pty Ltd v McIntyre* (1974) 5 ACTR 10 at 14

⁴ *Dorter and Sharkey, Building and Construction Contracts in Australia Law and Practice*, 2nd ed, Lawbook Co, Sydney, 1990 at [11.30]

⁵ *Elanore Country Club Ltd v V J Summersby & Pearce & Sons (Excavations) Pty Ltd* (1988) 4 BCL 309

⁶ *Apex Realty Pty Ltd v Walker Bros & Preece Pty Ltd* (1958) 76 WN (NSW) 34

⁷ *Helicopter Sales (Aust) Pty Ltd v Rotor-Works Pty Ltd* (1974) 132 CLR 1

⁸ *Cable (1956) Ltd v Hutcherson Bros Pty Ltd* (1969) 123 CLR 143

⁹ *Dorter and Sharkey, Building and Construction Contracts in Australia Law and Practice*, 2nd ed, Lawbook Co, Sydney, 1990 at [11.50]