

## BASIS FOR AWARDING DAMAGES FOR DEFECTIVE BUILDING WORKS

Scott Carver Corporation Pty Ltd v SAS Trustee Corporation (Formerly State Authorities Superannuation Board) [2005] NSWCA 462 (Unreported, 21 December 2005)

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This is a decision of the Court of Appeal regarding the basis for awarding damages for defective building works.

The court upheld, in circumstances where the defects concerned were found not to have affected the value of the property, which had been sold, that damages for defective building works are measured by the cost of rectification works.

### FACTS

The Respondent, SAS Trustee Corporation owned 70% of a commercial development in Chatswood known as the 'Zenith Centre', comprising two office towers. The remaining 30% was owned by Pitpro Pty Ltd.

In about 1989, SAS and Pitpro decided to undertake a major renovation of the Zenith Centre, which involved connecting the two office towers by way of a glazed pavilion (Project). In January 1990, architect Scott Carver Pty Ltd won the design competition for the Project. Practical Completion was achieved on 21 November 1991. Total expenditure on the Project was about \$9.9 million.

In July 1996, Pitpro transferred its 30% interest in the Zenith Centre to SAS, including any rights that Pitpro had against parties involved in the Project. About a year later, in June 1997, SAS commenced proceedings in the Supreme Court against various contractors and consultants, including Carver, who had worked on the Project, claiming that various aspects of the Project works were defective. The Supreme Court subsequently referred those proceedings to a Referee for determination in accordance with Part 72, rule 2 of the Supreme Court Rules (now Division 3, rule 20.14, Uniform Civil Procedure Rules).

In October 1998, SAS sold the Zenith Centre to a trust, of which Perpetual Trustee Co Ltd

(Perpetual) was the trustee. The sale was not an arm's length transaction, as SAS held a 50% interest in the Trust which acquired the Zenith Centre. A valuation prepared for the purchaser (effectively Perpetual) by JWL Advisory Services Pty Ltd (JWL) determined that the Zenith Centre was worth \$170 million. SAS agreed to sell the development for that amount, less a discount of \$2.3 million, on account of certain defects. SAS did not spend any funds on rectification works, either before or after the sale was concluded. The sale was structured in this way so as to preserve the value of SAS's cause of action against Carver and others for defective building works.

In May 2002, after the sale and purchase was concluded, a Referee heard SAS's claims against the contractors and consultants who had worked on the Project, including Carver, for defective works. The Referee was asked to consider, among other allegations, a general claim that SAS should not be entitled to recover any damages because:

- SAS had not performed any rectification works
- there had been no diminution in the value of the property, as determined by JWL, as a result of the defects, and
- SAS had sold the property.

The Referee noted JWL's expert valuation evidence was that the proper way to value the property, taking into account the defects, was to determine when rectification expenditure would occur, and include those amounts in a discounted cashflow. The Referee accepted the expert valuation evidence that there had been no diminution in the value of the Zenith Centre, based on income stream, as a result of the defective works. However, the

Referee said that the value of the completed Project works must be diminished as a result of the defects, as measured by the cost of the rectification works. For this reason, the Referee concluded that SAS was entitled to damages, in accordance with the principle in *Bellgrove v Eldridge* (1954) 90 CLR 613. That is, damages for breach of contract for building work are measured by the cost of rectification work, subject to the qualification that rectification must be a reasonable course to adopt.

In November 2003, a Master of the Supreme Court adopted the Referee's finding that SAS was entitled to damages, represented by the cost of rectification work. Carver and others appealed this decision to the Court of Appeal. One of the seven issues on appeal was whether SAS could recover any damages, having regard to the Referee's factual findings as to the value of the Zenith Centre and the fact that it had been sold.

Hodgson JA questioned JWL's method for valuing the Zenith Centre based on the effect of the defects on future income stream, and noted the Referee's finding, that the defects did not reduce the value of the property, had not been challenged in proceedings before the Master. His Honour went on to say that:

I accept that Bellgrove does not require that damages for breach of contract by reason of defective building works must in all cases include the cost of rectification. ... If by reason of subsequent events, the owner suffered a different loss or no loss, then the underlying principle expressed by Deane J in *Amann [Commonwealth v Amann Aviation Pty Ltd]* (1994) 174 CLR 64 ('Amann') at 116 [that damages for breach of contract should put the Plaintiff in the same position it would have been in if

the contract had been performed] does mean that the damage must be measured by the loss actually suffered.

The court found that the sale of the Zenith Centre to the Trust did not, of itself, displace the Bellgrove measure of damages as rectification costs. In making this proposition, Hodgson JA referred to various cases where the value of damages awarded differed from the actual rectification costs. Among those cases considered, Hodgson JA referred to *Central Coast Leagues Club v Gosford City Council* (Giles CJ CommD, 9/6/98), where orders made by the Land & Environment Court required more extensive work on the property than merely rectification of the defective work, and *Hyder Consulting (Australia) Pty Ltd v Wilh Wilhemsen Agency Pty Ltd* [2001] NSWCA 313 where an owner undertook under took a redevelopment of the premises in such a way that the actual cost of rectification was less than tenders it had obtained to carry out the rectification works in isolation.

Hodgson JA at para 47 stated that:

If it were shown that the price received on a sale was unaffected by the defects, or that it was reduced by an amount less than the cost of rectification, this could displace the Bellgrove measure. But this was not shown in this case. On the contrary, the price was reduced by an amount in excess of the cost of rectification, by reason of the defects. The Referee found that this was done, in a sale not at arm's length, to preserve the value of the cause of action; but while I accept that such a consensual reduction could not give rise to damages claimable by SAS, I see no reason why it cannot prevent the sale from displacing the Bellgrove measure of damages.

The court found that the Referee and the Master were correct to award damages on the basis of the costs of rectification, notwithstanding the factual findings that the defects had no impact on the value of the Zenith Centre and that it had been sold.

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