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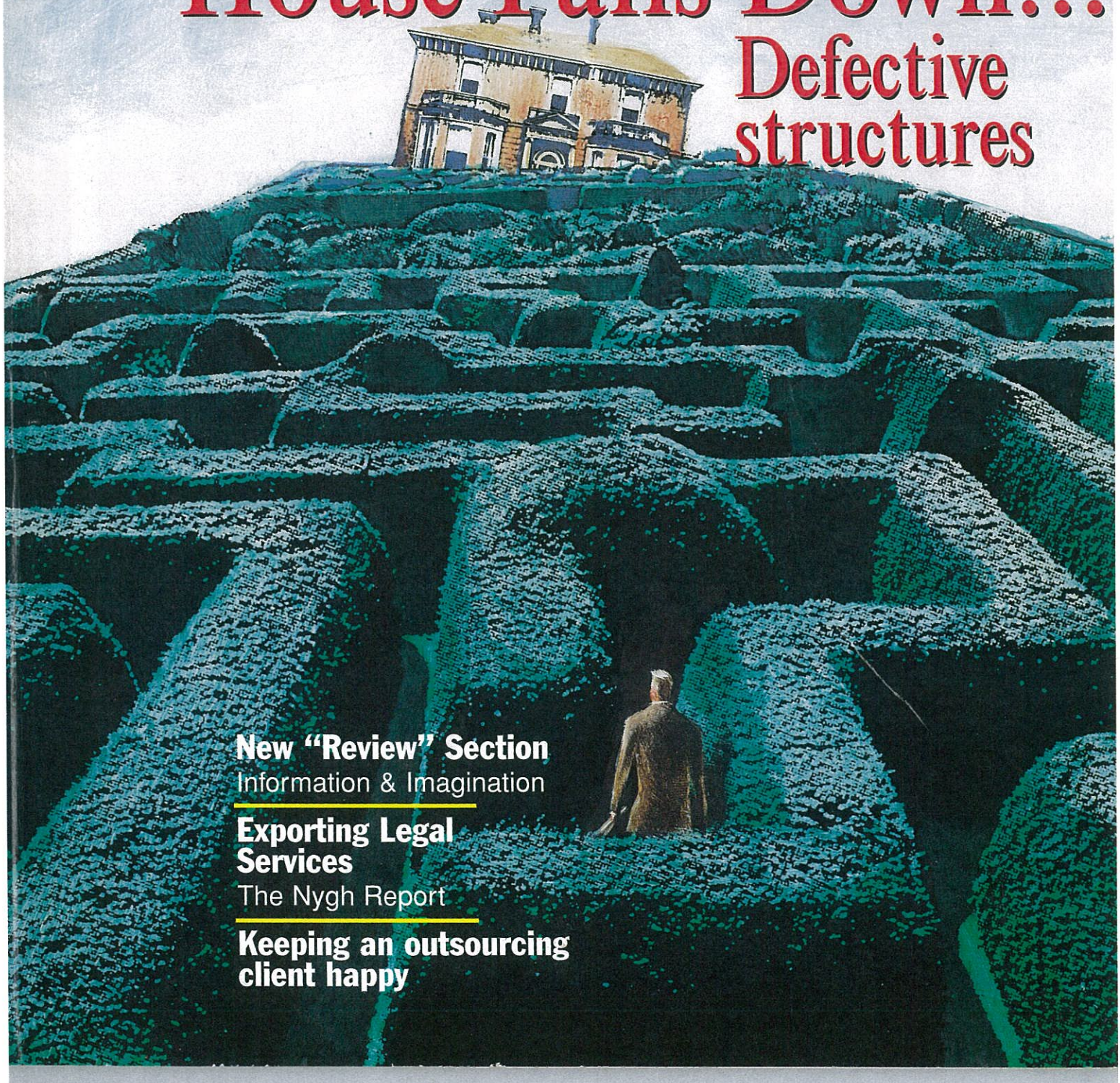
When a House Falls Down... Defective structures



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When a house falls down it ushers in much huffing and puffing over who can be sued and for what.

Through the Labyrinth of defective structures

An American film star, his Australian film star wife and their adopted children move into their new house in Point Piper. They have just bought it from a Mr Wong, a Hong Kong businessman, for an undisclosed sum. Mr Wong had bought it only three years earlier from a well-known Sydney racing identity who had built it in the late 80s.

It was an impressive property. It had absolute water frontage and was five storeys high. The garage was on the top storey at street level giving the two BMWs the best of views. The crowning glory of the property was its state-of-the-art, helium-powered escalator.

The well-known racing identity had employed a builder/architect friend, Henry, to design and construct the property and left all the arrangements up to Henry. Henry showed him the plans which he approved; Henry sorted things out with the council; Henry got in the people to carry out the work; Henry arranged the specialist escalator installers. All the well-known racing identity had to do was to sign a contract with Henry and make sure Henry was paid on time.

One day, shortly after our film stars moved in, quite unexpectedly and without any warning, the earth began to move. The house slipped two metres down the hillside. They panicked and ran out into the street. One of their Oscars fell off the mantelpiece and landed on one of the children's heads. She managed to keep going but had a big bump on her head the next day. Once they all reached the street, they realised that the BMWs had been thrown off the garage roof. Over time, they discovered that the mansion had become totally unfit for human habitation and would cost two million dollars to repair. As a result, our film star family wasted no time in selling it but the best price they could get resulted in a loss of two million dollars compared to the price they would have got for it in a sound condition. They discovered that Henry had built the house on bad foundations. It had always only been a matter of time before the foundations would fail and the proper-

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ty would slip.

Who can we sue?

Being American, the first thing our film star friend did was to call a lawyer. Their lawyer, on hearing the story, was filled with both horror and delight, horror because he knew he was entering into the law of defective structures and delight when he realised how many chargeable hours it would take him to get to the bottom of it. The first question he was asked was who he could sue. He looked at all the possible defendants. They were: the well-known Sydney racing identity; Mr Wong; Henry; and the council.

He noted almost straight away that the only person our film star friends had any kind of contract with was Mr Wong. Sadly, Mr Wong was nowhere to be found. He had been traced as far as a dingy nightclub in Hong Kong but there the scent ran cold. But after flicking over a few pages of a few text books, our lawyer friend realised that even if Mr Wong could have been found, it would not have mattered. This was because of the doctrine of *caveat emptor* which, he discovered by looking at his dictionary of legal Latin, meant "buyer beware" or in other words that it was up to them as buyers to satisfy themselves about what they were buying. Our film star friends' lawyer, who acted on the purchase as well, quickly looked back through the conveyancing file and discovered, with a sigh of relief, that he had made all the usual requisitions and carried out all the necessary searches and enquiries at the time and found nothing untoward. In the absence of the vendor's fraud, our film star friends had no recourse against Mr Wong under the contract for the purchase of the property. Our lawyer friend decided he need not notify LawCover.

So he cast his net wider. The only construction contract anywhere to be found was between the well-known racing identity and Henry. That did not help his client. What other remedy might there be? He turned to the law of negligence. He suspected the answer was there somewhere but to be sure, he spent a few chargeable hours going back over the case law. Where to start, he asked himself? Where else? If in doubt: *Donoghue v Stevenson* [1932] AC 562, the case of the woman who sued the manufacturer of her ginger beer for personal injury when she found a semi-decomposed snail in the bottle. (I digress here to point out that I was once fortunate enough to be involved in a case where someone was suing a manufacturer of tomato sauce after finding a condom in the bottle. I have always had a suspicious feeling that the condom was placed there by a law student with a sick sense of humour. I also recall that a good deal of expert evidence was led in the case as to whether or not the condom had been used.)

Be that as it may, our lawyer friend discovered Lord Atkin's speech in *Donoghue v Stevenson* where he stated the basic principle: "You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour."

So the test was reasonable foreseeability. He remembered that from law school. He wrote it down just in case. But what was the definition of "injure"? He found it there as well. It meant: "injury to the consumer's life or property."

In other words, there was a claim for any reasonably foreseeable injury to someone's life or property. So where does this leave his client, he asked himself? It meant they could recover compensation for the damaged BMWs and the child's bump on the head. They were property and life under these definitions. But our lawyer friend asked himself: is not the house itself property? If they could recover for that, it would be tantamount to Mrs Donoghue recovering for the value of the ginger beer itself and not only for the injury caused to her. The House of Lords in *Donoghue v Stevenson* said a claim like that could only be brought against the person who sold the ginger beer because they were the only people that Mrs Donoghue had had a contract with.

He asked himself: who would the claim for the BMWs and bump on the head be brought against? It could not be the racing identity or Mr Wong because neither of them did anything towards building or designing the house except to pay for it. The answer must be Henry, he exclaimed in triumph. It was reasonably foreseeable to Henry when he was building the house that, if he were negligent, then the injury which in fact occurred could occur. He trawled through the books and realised he was right. He satisfied himself that he had got somewhere. But he realised the film star family might look elsewhere for a lawyer if he could not find some way of recovering the two million dollar loss as well as the loss of the BMWs and the compensation for the bump on the head.

So he started burning the midnight oil, and this is where he really began to earn his fees. He asked himself: what if nothing was damaged when the house slipped? The house was still standing; it even looked habitable; but it was likely to slip again at any time and it needed two million dollars worth of work to prevent that. His clients were obliged to answer truthfully any requisitions asked of them when they came to sell the house. It either would have cost two million dollars to fix or they would have lost two million dollars on the sale. Either way they would have lost two million dollars. This was pure economic loss, our lawyer friend realised,

not damage to property. He had come back to that question.

Our friend's difficulty was that he had always held the instinctive view that reasonable foreseeability itself should be the sole test in negligence, whether the loss is physical or economic. He always thought that if the loss was foreseeable, that should be that. He realised that this would open the floodgates to a certain extent but, he thought, that was the nature of things. However, he realised, things were not that simple.

Can we sue for economic loss?

He was still left asking: is economic loss recoverable or not? Can our film stars sue someone for the two million dollars? Over the last 20 years or so there have been plenty of judicial pronouncements on the issue. The difficulty is in deciphering them. For example, the High Court of Australia's decision last year in *Bryan v Maloney* [1995] 128 ALR 163 involved five judges, three of whom gave a joint judgment, one of the remaining two concurred but for different reasons and the final judge came to a dissenting view for yet further reasons. You can imagine our lawyer friend tearing his hair out.

What all the courts throughout Australia, England and Wales, the United States, Canada and New Zealand have in common is a belief that something more than reasonable foreseeability is required to establish a claim in negligence for economic loss. There has developed a notion of proximity. It is the definition of proximity which has been such a fruitful area for lawyers.

The High Court of Australia in the decision of *Bryan v Maloney* was prepared to accept that, at least in our film star family's situation, there is sufficient proximity between the owner for the time being and the builder to allow a claim for economic loss. In short, our lawyer friend can breathe a sigh of relief. His client has a claim.

The case involved, surprise, surprise, a claim against a builder by a subsequent purchaser of a house which slipped due to inadequate foundations. They subjected the facts to very close analysis and found sufficient proximity in two areas. Firstly, the house itself: "... the nature of the property involved, namely a dwelling house, constitutes an important consideration supporting the conclusion that a relevant relationship of proximity existed ... It is a permanent structure to be used indefinitely and ... is likely to be ... the most significant investment which the purchaser will make during his or her lifetime."

This factor is very specific: it relates to a claim in respect of a house and does not give any help in deciding whether there is a claim in respect of any other defective structure. The second factor the court looked at had two elements: "the assumption of responsibility on the one part (i.e., the builder) and known reliance on the other (the building owner)."

In other words, a relationship of proximity was said to exist sufficient to establish liability due to the fact that the builder knew that a subsequent owner would rely upon his performance and the builder assumed that responsibility. These last concepts are of a more general nature and may give some guidance for future situations.

But before too much heart is taken from these last points, be aware of the following comment from the joint judgment of Mason CJ, Deane and Gaudron JJ: " ... the decision in this case is not directly decisive of the question whether a relevant relationship of proximity exists in other categories of case ..."

Indeed there are commentators who say that the decision may not be applied in a commercial setting as a commercial property owner does not have the same level of reliance as a private domestic purchaser. But our lawyer friend was not worried about that. He knew his clients could claim against Henry for the two million dollars.

Now let us presume that Henry has passed on to a better place or has gone off with Mr Wong to the darker side of Hong Kong. Can our owners sue the council? The High Court in *Sutherland Shire Council v Heyman* said: " ... as a general rule, the ordinary principles of the law of negligence apply to public authorities rendering them liable for damage caused by a negligent failure to act when under a duty to act ..."

But, again, beware. The facts of that case were, surprise, surprise, very similar to our film stars' facts and it was held that the owner could not claim from the council. This was because the council did not have a statutory duty in that case to satisfy itself that the designs would stop the building slipping into the harbour or, in that case, down the hill. In other words, it is important to look in detail at the council's duties before trying to pin liability on them.

Another issue arises out of the decision of *Brian v Maloney*. What is the relationship between contract and tort in these circumstances?

In this country at least there is no absolute bar to a claim in negligence between contracting parties. On the contrary, often, the fact that two parties have come together in sufficient proximity to form a contract can sometimes be strong evidence that a duty of care exists. At the same time, however, the courts will not allow claims in negligence to circumvent the intentions of the parties as evidenced by the contractual matrix. Almost all the recent reported Australian cases on this issue have found against parties seeking to claim for negligence in similar circumstances. The correct statement of the principle is: "the existence of a contractual relationship could in some circumstances constitute a factor favouring the recognition of a relationship of proximity or may in other circumstances militate against recognition of a relationship of proximity and confine and even exclude the existence of a duty of care". (Patrick Mead: *Building and Contraction Law:* vol. 2; Feb 1996, p. 20)

"In this country at least there is no absolute bar to a claim in negligence between contracting parties. On the contrary, often, the fact that two parties have come together in sufficient proximity to form a contract can sometimes be strong evidence that a duty of care exists."

Extending it further, let us presume that the building contract between Henry and the well-known Sydney racing identity, for some reason, limited Henry's liability significantly. Should the tortious claim by the film star family against Henry be equally limited? If not, you would have the situation where a third party purchaser had greater rights than an owner/proprietor in a building contract. However, the majority of judges in the High Court, despite specifically addressing the issue, commented in a way which made it entirely possible that a builder's liability to a third party will be held to be greater than its liability under contract to the owner.

Now I return to the state-of-the-art helium-powered escalator. What if it exploded and destroyed the house. The House of Lords considered the issue of complex and inherently dangerous structures in *Murphy v Brentwood* and concluded that:

"It is unrealistic to regard a building or chattel which has been wholly erected or manufactured and equipped by the same contractor as a complex structure in which one part of the structure or part of the chattel is regarded as having caused damage to other property when it causes damage to another part of the same structure or chattel, since the reality is that the structural elements in a building or chattel form a single indivisible unit of which the different parts are essentially interdependent and to the extent that there is a defect in one part of the structure or chattel it must to a greater or lesser degree necessarily affect all other parts of the structure. Defects in ancillary equipment, manufactured by different contractors, such as central heating boilers or electrical installations may give rise to a liability under ordinary principle of negligence."

"The House of Lords formed the view that it was very unlikely for the complex structures theory to apply to most structural aspects of a building including foundations."

In other words, the House of Lords formed the view that it was very unlikely for the complex structures theory to apply to most structural aspects of a building including foundations. However, they considered that it might well apply in respect of a dangerous boiler or poorly installed electrical wiring which then failed and caused damage. Whether it would apply to a helium-powered escalator is irrelevant given that they do not exist. But bear in mind that the complex structures theory is not really a new idea as it has always been the case since *Donoghue v Stevenson* that a claim could be made for damage to property from a manufacturer in that way.

This leaves us thinking what can be done in a risk management context. The first thing to consider is that, given the views expressed by the majority in *Brian v Maloney*, it may be that the decision will not apply in a commercial situation. In that situation then, from the perspective of a commercial purchaser, it would be advisable to carry out exhaustive investigations or, if possible, obtain some kind of warranty from the builder (which is not a realistic option). There does not seem to me to be a way of attempting to increase the level of reliance that a commercial purchaser can place upon the original builder and thus fall within the *Bryan v Maloney* analysis.

What about from the builder's perspective? How can he limit his risk in respect of third party purchasers? He can attempt to pass the risk to the original building owner. However, commercial considerations will often prevent this. If it is a realistic option, the risk may be passed by obtaining an indemnity in respect of any future third party claims from the original owner or from an insurer. The doctrine of privity of contract will frustrate any other attempt to minimise the builder's risk.

So, we are left with our film star friends. They have got their two million from Henry and have walked away unscathed except for a bump on the head. What do they do? After paying their lawyer, and celebrating over a nice ginger beer at the airport, they give up on Australia forever, send orders to their British lawyers to sell that nice little house they bought from Mr Murphy in Brentwood and return to their mansion in Hollywood, stopping in at their attorney's office on the way – just in case. ❑