Article Information

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Liability for Defects when New Builder Takes Over: Lichaa v Boutros [2021] NSWCA 322

If a subsequent builder completes a building project started by an earlier builder, to what extent, if any, will the first builder be excused from liability for defects existing in the first builder's work?

The NSW Court of Appeal considered this issue recently in *Lichaa v Boutros*,[1] an appeal from a decision of the District Court. In short, the first builder should not assume that it can escape liability for the defects, particularly where the first builder's work can be differentiated from that of its successor.

Facts

Mr Boutros (**Builder 1**) was engaged by Ms Lichaa (**Home Owner**) to construct a second storey on her existing residence. Following a dispute, the Home Owner barred Builder 1 from entering the site (which was found to be a repudiation of the contract). The Home Owner subsequently engaged a replacement builder (**Builder 2**) to finish the job.

The Home Owner sued Builder 1 in the District Court seeking the costs of rectifying defects in Builder 1's work. The District Court judge dismissed the Home Owner's case, following which the Home Owner appealed to the Court of Appeal on the ground that the District Court judge provided inadequate reasons for dismissing her claim.

Liability for defects – Builder 1 or Builder 2?

As the project was residential building work, both builders owed the Home Owner the statutory warranties under s 18B of the *Home Building Act 1989* (NSW) (**HBA**).

Builder 2's quote included "repair [of] existing works incorrectly done". The District Court judge found that the contract with Builder 2 was mostly beyond the scope of Builder 1's contract, and that it was possible to differentiate between Builder 1's work and Builder 2's work.

Builder 1 submitted that Builder 2 assumed responsibility for Builder 1's work when Builder 2 took over, because:

- rectification of the existing works was part of what Builder 2 had been contracted to do; and
- The Home Owner had elected to have Builder 2 complete the works without any of Builder 1's work being altered or demolished.

The Court of Appeal determined that a failure by Builder 2 to fulfil a promise to repair defects caused by Builder 1 might make Builder 2 liable to the Home Owner, but this did not excuse Builder 1 from liability or prevent the Home Owner from pursuing Builder 1 for defect rectification costs.

At trial the parties' experts disagreed as to whether demolition of Builder 1's work would have been necessary had the Home Owner's claim succeeded. The Home Owner's expert said it was, while Builder 1's expert said it was not (the latter being preferred in the District Court).

In the Court of Appeal, Builder 1 argued that if demolition was unnecessary, then the Home Owner had failed to prove any loss arising from the defects. Builder 1 argued that demolition was an extreme solution and sought to rely on the

"unreasonableness" exception in *Bellgrove v Eldridge* (***Bellgrove***),[2] in which the High Court recognised that, although demolition will sometimes be necessary in order to produce a compliant building, demolition "must [also] be a reasonable course to adopt". Builder 1 argued that *Bellgrove* permits repairs to be done in "the cheapest possible way".

The Court of Appeal rejected Builder 1's characterisation of the unreasonableness exception in *Bellgrove* as permitting repairs to be done in "the cheapest possible way". Rather, the Court of Appeal held that the rectification work must "give the owner what was contractually promised, subject to the requirement of necessity and reasonableness", and the test of unreasonableness "is only to be satisfied by fairly exceptional circumstances", such as where the principal seeks to rely on a "technical breach" to secure a profit that was not contemplated by the contract: *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* at [17].[3]

Ultimately, the Court of Appeal agreed with the Home Owner that the District Court judge gave inadequate reasons for concluding that demolition was unnecessary. The Court of Appeal observed that, although demolition is unfortunate, it is often the "natural" consequence of defects of a foundational or structural nature (absent the builder establishing a relevant failure of the principal to mitigate its losses). The Home Owner was entitled to be put in the position she would have been in had Builder 1 performed the contract according to its terms: *Wenham v Ella*.[4]

A failure to mitigate must be pleaded

Builder 1 submitted that he was not given the opportunity to rectify the alleged defects, and that the Home Owner failed to mitigate her loss because she did not direct Builder 2 to rectify the defects before further work was carried out on the property.

The Court of Appeal held that a plaintiff's failure to mitigate its loss must be specifically pleaded, whether or not the claimed failure was based on statute, citing *ECS Group (Australia) Pty Ltd v Hobby*.[5] Builder 1 was found not to have pleaded the Home Owner's alleged failure to mitigate.

Outcome of the appeal

The Home Owner succeeded in establishing that the District Court judge provided inadequate reasons and therefore a substantial wrong or miscarriage had occurred, necessitating a new trial limited to certain questions.

Conclusion

A builder on a project should not assume that it will be excused from liability for defects in circumstances where a subsequent builder takes over, particularly where the first builder's work can be differentiated from that of the subsequent builder. This is so even if the subsequent builder has agreed in its contract with the principal to rectify defects existing at the time of the takeover.

Builders who contend that the principal has failed to mitigate its loss must specifically plead this allegation, and the pleading may need to be expressed as being "in the alternative" if the builder's primary pleading is that it denies liability for the defects or denies that the work is defective.

If an original builder's work is defective and the defective work is of a structural or foundational kind, it may result in other non-defective work also being necessarily demolished, so as to put the principal in the position it would have been in but for the defective work.

This article has been written for general educational purposes only, and is not to be taken as legal advice. Should you require legal advice on your specific situation, ***please contact Robert Riddell on +61 2 9253 3858 or rriddell@piperalderman.com.au.***

[1] [2021] NSWCA 322 per Rein J (with whom Macfarlan and Gleeson JJA agreed).

[2] (1954) 90 CLR 613.

[3] (2009) 236 CLR 272.

[4] (1972) 127 CLR 454 at 471.

[5] [2014] NSWCA 193. The principle in *ECS Group* is consistent with *Uniform Civil Procedure Rules 2005* (NSW) r 14.14. *ECS Group* does not address the duty to mitigate imposed by HBA s 18BA(1), but that section makes clear that the party alleging a failure to mitigate bears the onus of establishing it (which implies that the alleged failure to mitigate must be pleaded).