Carter Newell LAWYERS

Constructive Notes ®

May 2017

Forget your perfect offering - There is a crack in everything![1]

Philip Glaister, Special Counsel

Miichael Elliott, Associate

Introduction

On 1 March 2017, the New South Wales Court of Appeal handed down the decision of *Walker Group Constructions Pty Ltd v Tzaneros Pty Ltd,*[2] which has provided beneficial judicial commentary on a suite of issues:

- The construction of contracts;
- Assignment of building warranties;
- The limits of the principle in *Allianz v Waterbrook*;[3] and
- Causation and betterment.

Material facts

Walker Group Constructions Pty Ltd (**Walker**) was responsible for the design and construction of a container terminal at Molineux Point, Port Botany (**Terminal**).

The Terminal was built in 2003 and 2004 on land owned by Sydney Ports Corporation, which land was (at the time) leased to P&O Trans Australia Holdings Ltd (**P&O**).

A contract for the design and construction of the Terminal (**D&C Contract**) was entered into between Walker and P&O. A related entity, Walker Corporation Ltd engaged AMT Engineers Pty Limited (**AMT**) to design the concrete pavement that formed part of the Terminal.

On 1 April 2004, P&O transferred their leasehold interest in the Terminal to Smith Bros Trade and Transport Terminal Pty Ltd (**Smith Bros**). On 2 December 2005, Smith Bros transferred its leasehold interest to Tzaneros Pty Ltd (**Tzaneros**). On the same day, by a Deed between P&O, Smith Bros and Tzaneros, P&O purported to assign to Tzaneros the warranties granted by Walker in connection with the construction of the terminal (**Deed**). Walker provided a letter of consent to the assignment.

The D&C Contract provided for the construction of five warehouses and the laying of various types of pavements. Following the laying of the pavements, cracks and spalling began to manifest in some of the pavement types.

Tzaneros sued both Walker and AMT (the designer of the pavements) claiming the costs of replacing the defective pavements.

Matters for determination

The pertinent issues for determination by the Court of Appeal were:

1. Whether, on a proper construction of the terms of the Deed and the letter of consent from Walker, there was an assignment by P&O to Tzaneros of any accrued cause(s) of action for breach of the building warranties.
2. Whether construction of the relevant documents by reference to the surrounding circumstances was permissible.
3. Whether Tzaneros acquired the Terminal with knowledge of the defects and therefore suffered no loss as a consequence of those defects.
4. Whether Tzaneros was entitled to recover damages for the cost of full replacement of the pavements.
5. Whether a reduction of the damages awarded to Tzaneros was appropriate by reason of betterment of the replacement pavements.

Decision

Issues 1 and 2: Assignment

The Deed assigned to Tzaneros *absolutely all of the benefit of the Building Warranties with effect from* 2 December 2005.

Walker contended that the assignment was ineffective in respect of any claim for the defective pavement works, as that cause of action against it had arisen prior to the assignment. To that end, Walker submitted that in order for a cause of action, as distinct from the benefit of the contract, to be assigned, there must be express assignment of that right, and that there was no such express assignment of accrued rights expressed in the Deed.

Separately, pursuant to Clause 9.1 of the D&C Contract, a valid assignment under the Deed was subject to obtaining the consent of Walker.

Walker contended that the question of which assignment it consented to was crucial to the construction of the assignment provisions in the Deed.[4] Whilst the consent provided by Walker was in similar terms to the assignment contained in the Deed, Walker submitted that its consent did not apprehend the assignment of accrued rights against it, and this was evidenced by:

- Material establishing that prior to the Deed being executed, P&O and Walker had an informal understanding that the issues concerning cracks in the pavements had been resolved between the parties;[5]
- Correspondence between the parties agreeing to the removal of the words in the Deed *"for the avoidance of doubt ['Building Warranties'] includes any cause of action…"*;[6] and
- The assignment taking effect from the *sale date* (2 December 2005) rather than from the date of completion of the works.[7]

The court emphasised that the meaning of the terms in a commercial contract (or for that matter, a Deed) is to be determined by what a reasonable business person would have understood those terms to mean, taking into account the language, surrounding circumstances and commercial purposes of the contract.[8]

In applying those principles, the court held that on its face, the express assignment of all the benefits of the building warranties would include a right to sue for an existing breach, as well as any future breaches.

The court noted that this construction was consistent with the recitals in the Deed and the terms of the consent granted by Walker, and that to permit a construction which excluded the right to sue for past uncompensated breaches would produce an uncommercial result.[9]

In considering Walker's construction argument, the court held that recourse may be had to deleted words or clauses in a contract for the purpose of construing ambiguous language.

Evidence of the deletion of words can only be used to negate an inference sought to be drawn

from the surrounding circumstances, where the evidence shows that the parties mutually concurred in rejecting that meaning.[10]

However the terms of the assignment in the Deed, considered in context, were not considered to be ambiguous.

Even if those terms were ambiguous, then for the exception in *Codelfa* to apply it would be necessary to show that the parties to the Deed had mutually agreed in rejecting a construction that the assignment extended to past breaches. There was in the present case no suggestion of any such mutual agreement.[11]

The assignment was therefore held by the court to be effective with respect to the causes of action accrued against Walker.

Issue 3: Knowledge of defects attaching to the assignee

Walker sought to rely on a principle said to be derived from the decision of *Allianz* that a successor in title who acquires a building with full knowledge of its defects suffers no loss as a consequence of those defects. Walker contended that Mr Tzaneros was a director of P&O from 16 October 2001 to 1 August 2004 and the sole director of Tzaneros at the time of the acquisition.

Walker submitted that Mr Tzaneros had accompanied a civil engineer in P&O's employ on an inspection of the Terminal in 2004 and that he was aware of heavy cracking, medium cracking and heavy spalling in the pavements as at December 2004.

Tzaneros denied that it had full knowledge of the defects or their significance, and that in any case the principle stated in *Allianz* did not apply in the case of an assignee suing on a contractual warranty. Tzaneros submitted that it sued on assigned rights standing in the shoes of P&O, not for loss as a subsequent purchaser suing on an extended statutory warranty.[13]

The court accepted Tzaneros' contentions, finding that where there had been an assignment of contractual warranties, including the right to sue for past breaches, the assignee is entitled to recover damages of the same kind that assignor could have recovered and steps into the assignor's shoes for the purpose of pursuing the right vested in the assignor. It is irrelevant whether the assignee knows of the breaches or otherwise.[14]

Further, the court found that the principle in *Allianz* requires that the successor have full knowledge of the existence of the defects and their significance. The court was not satisfied that Tzaneros had such knowledge. The court added that the principle in *Allianz* does not extend to an assignee who has constructive knowledge by reason of failing to properly investigate the extent of a patent defect.[15]

Issues 4 & 5: Damages entitlement and betterment

Under the D&C Contract, the pavements were required to have a minimum life of 20 years.

Walker submitted that damages had been inappropriately assessed at first instance on the basis of a *complete* (rather than piecemeal) replacement using a revised scope of work that resulted in Tzaneros having the benefit of a pavement with a design life of 50 years. Walker further submitted that the award of damages, rather than compensating Tzaneros, gave it a substantial windfall and an uncovenanted profit.[16]

Walker submitted that some portions of pavement did not presently require replacement and would not, even with projected future usage of those portions, be necessary.

On that issue, Walker added that there was no need for wholesale replacement using reinforced concrete, but rather replacement/rectification of discrete areas based on actual damage arising from historical and current usage.

Once again, in making a finding against Walker, the court held that it was not unreasonable for

Tzaneros to recover the total cost of replacement of the pavements. The whole of the pavements suffered from defective design. The fact that certain panels may or may not in fact crack did not alter that position. Tzaneros could decline to bear the risk at future cracking and rather seek compensation sufficient to ensure the pavements were repaired in conformity with the contract.[17]

Walker also contested that the damages award gave rise to betterment, as it provided Tzaneros with a product of a higher lifespan (as well as quality and value) than Walker was originally obliged to supply.

The court held on the facts here that no allowance should be made for any betterment. The contract provided for a pavement with a minimum life of 20 years and it would not be expected that the pavement would become unusable immediately upon expiration of that period. The proposed replacement had been designed to ensure the Terminal could continue in operation thus avoiding consequential loss that would otherwise have flowed from the breach.[17]

Concluding observations

The decision by the New South Wales Court of Appeal is instructive in terms of the scope and assessment of compensable damages in circumstances where a complainant seeks rectification of failed works to a greater durability and standard than was required under the contract.

The decision is, however, perhaps most beneficial in the guidance afforded concerning the assignment of warranties designed to transfer the benefit of rights in respect of breaches or failures arising both before and after the date of assignment.

The issues considered and the court's rulings emphasise that parties must be cautious in their negotiations and documentation of rights which are to be assigned. To the extent that any rights are not intended to be assigned by the transaction, express words should be used to clearly and unequivocally express that position in the instrument recording the arrangements between the parties.

.....

[1] Leonard Cohen *Anthem* (1992).
[2] [2017] NSWCA 27.
[3] [2009] NSWCA 224.
[4] Para 79.
[5] Para 84.
[6] Para 85.
[7] Para 87.
[8] Para 96 - 97; also see *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640; [2014] HCA 7; *Mount Bruce Mining Pty Limited v Wright Prospecting Pty Limited* (2015) 256 CLR 104; [2015] HCA 37.
[9] Para 97 – 103.
[10] Para 117 - 118.
[11] Para 119.
[12] Para 138.
[13] Para 152; see also *Renold Australia v Fletcher Insulation* [2007] VSCA 294.
[14] Para 155 - 158.
[15] Para 160.
[16] Para 242.
[17] Para 204 - 205.

Authors

Philip Glaister
Special Counsel

P: (07) 3000 8382
E: pglaister@carternewell.com

Michael Elliott
Associate

P: (07) 3000 8401
E: melliott@carternewell.com