Diminution of value or the cost of cure: assessing the "normal" measure of damages in leaky building claims

Johnson v Auckland Council [2013] NZCA 662

Mr and Mrs Johnson purchased a leaky home in a mortgagee sale. They were aware at the time of purchase that the house might leak. The house had a code compliance certificate and the Council admitted to negligence in failing to identify the defects and in issuing the certificate.

High Court judgment

Woodhouse J did not take a favourable view of the plaintiffs' evidence or claim. He held that the Johnsons took a calculated risk in proceeding with the purchase and discounted damages by 70% for contributory negligence.

Importantly, Woodhouse J held that the normal measure of loss in a tort claim against the Council for negligent inspections and negligent issue of a code compliance certificate is the difference between the cost of purchase and the market value of the property in its affected state at the date of purchase. His judgment diverged from previous leaky building cases, where damages have usually been assessed based on the cost of repair.

Woodhouse J's assessment of the normal measure of loss was based on an analysis of English case law and the Supreme Court's judgment in *Altimarloch*[1], where the Court unanimously agreed that a purchaser's claim against a council for a negligent statement in a LIM report was restricted to the difference between the price paid and the value of the property (plus foreseeable consequential losses). While quantification of the claim against the Council was not directly in issue on appeal, the bench expressly approved the basis on which the claim had been assessed by the Court of Appeal.

Court of Appeal judgment

On 18 December 2013, the Court of Appeal overturned Woodhouse J's judgment in two keys respects:

1.   the discount for contributory negligence was reduced from 70% to 40%; and

2.   the Johnsons were entitled to damages based on the cost of repairs.

In relation to contributory negligence, the Court of Appeal identified a number of factual errors made by Woodhouse J, but was nonetheless satisfied that the Johnsons were aware that the property might be a leaky home and contributed to their own loss. The Court of Appeal held the Council was the major contributor, but reduced damages by 40% to take into account Woodhouse J's view that the Johnsons' level of blameworthiness was high. It may accordingly be inferred that 40% is a high watermark for contributory negligence claims.

The Court of Appeal went on to find that the normal measure of damages in a negligence claim for defects in buildings is the cost of repair. It listed a number of factors which supported a cost of repair approach: the house would not be habitable unless it was repaired, it was not a candidate for demolition, it was purchased as a family home, it was a unique property and there was not "a great deal of difference between the two measures of loss".[2]

The Court distinguished *Altimarloch* on the basis that it was a negligent misstatement claim, for which proof of reliance was necessary. For the reasons set out below, this distinction is not compelling.

Discussion

The Court of Appeal did not engage with Woodhouse J's primary point that the guiding principle for the measure of damages in a tort claim differs from that in a contract claim. In tort, plaintiffs should be returned to the position they were in prior to commission of the tort. In contract, plaintiffs should be put in the position that they would have been in, had the contract been performed (subject to considerations of reasonableness and proportionality).

Negligence occurs when a plaintiff suffers loss as a result of the defendant's breach of a duty of care. In cases involving the transfer of defective property, the loss normally occurs on the date of sale and the plaintiff is entitled to be placed in the position that he or she would have been in had the transfer not occurred. The measure of loss will normally be the difference between the sale price and the true value of the defective property, plus any consequential losses. This was the measure applied by Woodhouse J in *Johnson* and by the Supreme Court in *Altimarloch*.

In the case of latent defects in buildings, the courts have held that loss occurs when the defects are discovered, or are reasonably discoverable, and the economic value of the property is accordingly reduced.[3] In *Johnson*, however, the plaintiffs were on enquiry prior to their purchase of the property, so their loss occurred on the date of sale.

On orthodox principles, a purchaser who identifies defects in a property would not be able recover the cost of repair from a tortfeasor in the absence of special circumstances arising on the facts of that case. The purchaser is entitled to be returned to the position he or she was in before the defects were revealed. The change in position is a drop in the property's value post-purchase: he or she never had a defect-free house. While the purchaser presumably bought the property in the expectation that the house would be defect-free, expectation losses are normally confined to contract claims.

That said, the Court of Appeal in *Johnson* was undoubtedly correct in its view that the "normal" measure of loss applied in New Zealand cases involving latent defects in buildings is the cost of repair (including *Hamlin* and *Sunset Terraces*,[4] although the measure of loss was not directly in issue before either the Privy Council or the Supreme Court). Woodhouse J's point is that this practice of awarding repair costs is inconsistent with a principled application of the law of damages.

The law of negligence in construction defect cases has developed into something akin to a contractual warranty that buildings will comply with the Building Code. It is unsurprising, therefore, that the normal measure of damages looks to contractual, rather than tortious, principles.

It will be interesting to see whether *Johnson* is appealed and, if so, whether the Supreme Court favours the approach to damages in *Altimarloch* or whether the arguably special treatment of construction defect claims reflected in the *Sunset Terraces* line of authorities is preferred. Given the lack of agreement across the bench in *Altimarloch* on issues other than the measure of the tort claim (see the attached schedule), a restatement of the law of damages would be welcome.

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[1] *Marlborough District Council v Altimarloch Joint Venture Ltd* [2012] 2 NZLR 726

[2] The precise difference is not clear from the judgments. The cost of the remedial work would increase the claim by $200,000-$400,000 (depending on which party's evidence was preferred), but there were additional consequential claims for lost rental ($122,250) and financing costs.

[3] *Invercargill City Council v Hamlin* [1994] 3 NZLR 513 (PC)*; Trustees Executors Ltd v Murray* [2007] 3 NZLR 721 (SC)

[4] *North Shore City Council v Body Corporate 188529 (Sunset Terraces)* [2011] 2 NZLR 289

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MARLBOROUGH DISTRICT COUNCIL v ALTIMARLOCH JOINT VENTURE LTD [2012] NZSC 11

	Elias CJ	Blanchard J	Tipping J	McGrath J	Anderson J
Contract measure of damages	Loss of bargain: difference in the value of land with and without water rights ($400,000). Loss of bargain is the "normal" measure of damages in sale transactions.	Cost of cure ($1.055m).	Cost of cure ($1.055m). The "normal" measure of damages is the performance cost of the contract.	Cost of cure ($1.055m). The "normal" measure of damages in sale contracts is the loss of bargain/ difference in value. The "normal" measure in service contracts is the performance cost.	Loss of bargain ($400,000) (per Elias J).
Council owes duty of care	Yes (per Tipping J)	Yes (per Tipping J)	Yes	Yes (per Tipping J)	Yes (per Tipping J)
Council caused loss	No	Yes (until plaintiffs paid by vendors then no)	No	Yes	Yes (per McGrath J)
Tort measure of damages (not directly appealed)	Difference between the purchase price and the true value ($125,000).	Difference between the purchase price and the true value ($125,000).	Difference between the purchase price and the true value ($125,000).	Difference between the purchase price and the true value ($125,000).	Difference between the purchase price and the true value ($125,000) (per McGrath J).
Contribution allowed	No	No	No	Yes (50%)	Yes (per McGrath J)