Westpoint Management Ltd v Chocolate Factory Apartments Ltd [2007] Adj.L.R. 09/20

Court of Appeal, Supreme Court, New South Wales before Giles JA; McColl JA; Campbell JA, 20th September 2007.

Judgment GILES JA:

1 The primary business of the Westpoint group of companies was the acquisition, development and re-sale of real estate throughout Australia. One of its projects was the conversion of a building at Stanmore, once used for the manufacture of chocolates, into 87 residential home units, and sale of the units to the public.

2 Chocolate Factory Apartments Ltd ("Apartments"), then under Westpoint control, purchased the building. Finance for the project was to be in part by equity funding and in part by borrowings. For the equity funding, three investment companies were established. Members of the public subscribed for shares in the companies, which then purchased shares in Apartments. At the end of the project Apartments was to be wound up and the profits distributed. In due course Apartments came under the control of the investment companies.

3 Apartments entered into a management agreement with Westpoint Management Ltd ("Management") dated 24 December 1999, under which Management was to oversee obtaining finance and the building conversion and sale of the units. Apartments entered into a construction contract with Westpoint Constructions Ltd ("Constructions") dated 31 August 2000, under which Constructions was to design and carry out the building conversion for the fixed price of $17,129,961.

4 The building conversion was completed and the units were sold. In 2004 Apartments brought proceedings in which it claimed from Management damages for breach of the management agreement, and from Constructions adjustments under the construction contract and damages for its breach. Constructions cross-claimed against Apartments claiming amounts payable under the construction contract.

5 The whole of the proceedings was referred to the Honourable J M N Rolfe QC for inquiry and report under the then Pt 72 r 2(1) of the *Supreme Court Rules*. The referee delivered interim reports dated 6 December 2004 and 6 April 2005. He concluded that Apartments should have judgment against Management for $1,769,842.59 and judgment against Constructions for $518,054.59, and that Constructions should have judgment against Apartments for $1,200,870.89. In each case interest was to be calculated and added to the judgment sum.

6 The reports came before McDougall J for consideration of their adoption pursuant to Pt 72 r 13 of the Rules. Apartments opposed their adoption, and submitted that the Court should decide the issues in the proceedings on the basis of the evidence taken before the referee. Management and Constructions submitted that the reports should be adopted save in certain particular respects.

7 On 8 August 2005 the judge published reasons in which he concluded that the reports should be adopted: ***Chocolate Factory Apartments Ltd v Westpoint Finance Pty Ltd*** [2005] NSWSC 784. On 2 September 2005 he adopted them and ordered that there be judgments in accordance with the referee's conclusions.

8 These appeals concerned some discrete issues arising in the adoption of the reports, considerably less than the issues raised before the judge. Management challenged their adoption by the judge so far as the referee assessed a figure for some of the damages to which Apartments was entitled for breach of the management agreement; it contended that the damages in question should have been assessed at nil. Apartments challenged their adoption by the judge so far as the referee found -

(a) that the damages recoverable from Constructions did not include the reasonable cost of rectification of certain defective and incomplete work; it contended that costs totalling $1,704,634 should have been awarded;

(b) that the damages recoverable from Management and adjustment under the construction contract recoverable from Constructions, both with respect to atrium glazing, should be assessed at $89,250; it contended that an additional $16,065 should have been awarded; and

(c) that the damages recoverable from Management with respect to installation of non-conforming shower screens should be assessed at $83,520; it contended that an additional $60,035 should have been awarded.

Relevant principles

9 In considering whether to adopt, vary or reject the referee's report the judge was not conducting an appeal, whether by way of a hearing de novo or a more limited rehearing. He was exercising a judicial discretion, in the manner described in ***Super Pty Ltd v SJP Formwork (Aust) Pty Ltd*** (1992) 29 NSWLR 549 and elaborated in subsequent cases. His Honour set out principles "distilled from the decisions" in [7] of his reasons. It was not submitted that he misdirected himself, and I will not repeat the basis on which he undertook consideration of the reports.

10 The appeals are against his Honour's discretionary decision. The question on appeal is not whether the referee was in error, but whether the judge erred in the exercise of his discretion: ***Nine Network Pty Ltd v Kennedy Miller Television Pty Ltd*** (**CA**, 18 June 1994, unreported); ***Mulligan v Benton*** [1999] NSWCA 339 at [34]; ***Abigroup Contractors Pty Ltd v Sydney Catchment Authority*** (2004) 208 ALR 630 at [16].

11 In the first of these cases, in a passage often partly or fully later cited, Gleeson CJ said -

"*In the exercise of the power of review given by the rules, the judge at first instance may fall into appealable error. If that can be demonstrated to the Court of Appeal, then ordinarily the judgment at first instance will be set aside and consequential relief granted. However, what the Court of Appeal is concerned with is error on the part of the judge. If the judge's decision to adopt (or vary or reject) the referee's report in whole or in part cannot be shown to be based upon a material error on the part of the judge, then there will be no ground for attacking the judgment based on that decision. If, on the other hand, that decision can be shown to be based upon a material error on the part of the judge*

then a different result will follow. If the point at issue is one of law, it may not be difficult to demonstrate such error. If the judge can be shown to have made an error in the approach taken to the exercise of the discretion conferred by the rules (as was contended unsuccessfully in Super Pty Ltd v SJP Formwork) then that also may constitute a ground for setting aside the judgment. It may even, in a given case, be possible to demonstrate that the judge's decision to adopt, or vary, or reject, the report was based upon an appealable error of fact made by the judge. An example might be a case where the judge embarked upon a consideration of new evidence, or a fresh consideration of evidence that was before the referee, and could be shown to have reached a wrong conclusion. The important point is that it is the judge at first instance who reviews what the referee did; the Court of Appeal, within the limits of the ordinary rules governing appeals, reviews what the judge did.

As will appear from the above, I do not suggest that it will only ever be possible to argue in the Court of Appeal that the judge at first instance has made an error of law, or that his or her discretion has miscarried. It is possible to imagine cases in which the judge may be shown to have made, himself or herself, an error of fact. However, if the judge, in the proper exercise of the discretion given by the rules, declines to consider afresh questions of fact that have been decided by the referee, then it is not open to the party aggrieved to invite this Court to re-visit those questions on the basis that, by virtue of the adoption of the referee's report the judge's decision is vitiated by any errors in it."

12 This appellate approach was common ground in the appeals, although the common ground was not fully reflected in the submissions.

The damages for breach of the management agreement

13 At the time the management agreement was entered into a construction contract had been prepared under which Constructions was to design and carry out the building conversion for the fixed price of $17,129.961. The prospectuses issued by the investment companies stated that it had been entered into. This was not correct: the construction contract had not been fully executed, and the referee found that a concluded contract had not been entered into. The draft contract became Ex Y before the referee.

14 There were lengthy further negotiations leading to entry into the construction contract of 31 August 2000. It was for the same fixed price of $17,129,961, and became Ex C before the referee. But the work required of Constructions, particularly in the standard of inclusions and finishes, differed from that envisaged by Ex Y.

15 The referee found that Management was in breach of the management agreement because it failed to advise Apartments, which by 31 August 2000 had come under the control of the investment companies, of the differences. The cost to Constructions had become less, and the referee said in the first report - "783. …

(i) Management owed an obligation, under the Management Agreement, to advise Constructions [sic: CFA] of the alterations in the scope of work and the extent to which, if at all, CFA was receiving a less expensive product to that which it was receiving had Exhibit Y been entered into and under the Prospectuses.

(j) The significance of this was that had CFA been aware of these circumstances, it may have been able to negotiate a lower price with either Constructions or another company for the carrying out of the work. However, whether or not it could have done so, the fact remains in respect of certain items it was paying a higher price for them than it would have been obliged to pay for the items installed. Whilst this did not have the result of diminishing the value of the apartments, so far as the evidence has disclosed, it did have the effect of reducing the profit margin to CFA. This, in the view to which I have come, did not have the effect of making Constructions liable for carrying out the Contract. However, it did have the effect, in my opinion, of making Management liable for its failure to advise CFA that installations of a lesser value were being utilised."

16 The referee said at [784] of the first report that he was satisfied that Apartments was entitled to "allowances" for eight items where there were differences between the work envisaged by Ex Y and that required under Ex C. The items were with respect to shower screens, dishwashers, "as built" drawings, skirting boards, air conditioning, timber flooring, atrium glazing and some repair work. Some of the allowances were also recoverable from Constructions; the referee said as part of [784] -

"*The items to which I have just referred total $832,600.00. In my opinion CFA is entitled to cover this amount by way of damages from Management. I also consider that it is entitled, in the alternative, to recover the amounts for dishwashers, 'as built' drawings, skirting boards and atrium glazing and repairs from Constructions, a total of $146,062.00. It is, of course, not entitled to recover those five amounts from both.*"

17 Although it was not elaborated in the referee's reasons, we were informed that the referee had been addressed on assessment of these damages as against Management as damages for loss of the chance of negotiating a lower price with Constructions or another company for carrying out the work. The referee had said at [177] of the first report, after finding that Management was obliged to advise Apartments "*whether the originally stipulated price remained the appropriate price*", that the difficulty which might confront Apartments was establishing what would have been the appropriate price. The parties' submissions on appeal were on the basis that the referee had implicitly found that it was a near certainty that a construction contract at a price reduced by the amounts of the allowances would have been entered into.

18 It appears that at a later point it was conceded by Management that a further $565,250 should be awarded as damages on the same reasoning. The total of $1,397,850 is not the figure stated in Management's written submissions as the damages in question; that figure was $1,251,788. It is not necessary to come to the correct figure in order to decide the appeal.

19 The judge recorded Management's submission against adoption of the reports in this respect, and his reasons for rejecting it, at [206]-[209] -

"*206 In substance, the referee found that where there was a lower standard of finishes or inclusions, the damages sustained by Apartments as a result of Management's breach of contract (in failing to advise it to seek to renegotiate the price under the design and construction agreement) equalled the difference in value between what was specified in or under exhibit Y and what was specified in or under the design and construction contract.*

207 Management's attack is, in principle, that this approach is erroneous; and that what was lost was no more than the chance to renegotiate. It submitted that, on the evidence, the value of that chance may have been substantially less than the actual difference in cost.

208 It may be that the referee did not in terms use the language of loss of chance. Nonetheless, he appreciated that his task was to estimate the damages flowing from the loss of the opportunity to renegotiate. There is no error in that approach. It was a question of fact for him, whether the amount of those damages was the amount of the difference in value, or some lesser amount (or nothing at all). There is no reason to interfere with his finding of fact that the damages were to be quantified in the sums that he found.

209 I therefore reject those challenges to the report."

20 Management submitted on appeal that, although it was correct that the assessment of Apartments' damages for the loss of the chance to negotiate a more favourable contract price was a question of fact for the referee, the judge erred in adopting the referee's finding because there was no evidentiary basis for finding that the amount of the damages was the difference in value between what was envisaged by Ex Y and what was required under Ex C. It said that there was no evidence from Apartments that, if advised by Management of the differences between Ex Y and Ex C and the reduced cost to Constructions, Apartments would have sought to negotiate to reduce the fixed price by the full reduced cost, or that it could or would have contracted with another construction company for the same reduced price. It said that on the evidence of Mr Norman Carey, who the referee noted had "the dominating controlling interest and power" in the Westpoint group, Constructions was reluctant to execute the construction contract, and that it followed that Constructions would not have agreed to any reduction in the fixed price of $1,729,961.

21 Thus Management submitted that Apartments' loss from Management's breach turned on the acts a third party, and that - "*The third party, either Constructions or the hypothetical alternative contractor, had 'unrestricted volition" to respond to any negotiations which the respondent may have instigated. Mr Carey's evidence demonstrated that, so far as Constructions was concerned, it would not have been receptive to any price reduction at all. And, as noted, the respondent made no attempt to prove the preparedness of any other contractor to undertake the job. Accordingly on the evidence before the referee, it was simply not open to him to find that the respondent had a real or substantial chance (as opposed to a speculative one) of negotiating any reduction at all in the price payable for the building work, let alone a reduction equivalent to 100% of the difference in the cost of the finishes which supposedly would have been provided under exhibit Y and those which Constructions was bound to provide under the Construction Contract.*"

22 Apartments did not contest that its damages were to be assessed as damages for loss of a chance. It emphasised that damages founded on hypothetical evaluations "defy precise calculation" (*Malec v J C Hutton Pty Ltd* (1990) 169 CLR 638 at 640 per Brennan and Dawson JJ) and that the assessment was factual, and submitted that there was ample evidence justifying the referee's implicit finding that it was a near certainty that a construction contract at a fully reduced price would have been entered into.

23 The referee reviewed Mr Carey's evidence at some length. Particularly relevant paragraphs of the referee's report are -

"*659 [Mr Carey] dealt, at least to some limited extent on the evidence admitted, with the review of what he referred to as 'the First Construction Contract'. He said, without objection, that during that process, Mr Beck said to him that CFA had proposed a new Construction Contract and that if Constructions would not sign it CFA would engage an alternative builder, to which he replied that given the amount of construction work completed and the Group commitment to the Project including the opportunity to develop the Project, 'that ultimatum leaves me with no alternative but to try to mitigate our potential loss by agreeing to enter into the new construction contract'. It was after that conversation that he executed the Contract, and after that, he, as the Managing Director of Corporation, monitored at a senior level the completion of the construction. …*

688 When the question of the second contract arose, Mr Carey said he was not happy about it because Constructions was put in a position, which was worse than the position it had been in before. Therefore, he asked Mr Sammut to give him an understanding of the difference between the two contracts ' … and clearly we were miles behind, and 10 or 11 months had gone and we hadn't gained any escalation on the contract price, so from Westpoint Constructions point of view we were well and truly behind the position we were put in in the first contract'.

689. The reason for the execution of the second contract in the terms, at least as to money, was that Mr Beck had told Mr Carey that Constructions had to sign it 'otherwise Chocolate Factory will look at engaging another contractor'. Mr Carey said in these circumstances it was necessary to mitigate a loss if it arose by proceeding with the second contract. Mr Carey said that as a result of CFA's attitude he took legal advice, but he did not recall taking the matter up with CFA because, if there was a major conflict, 'they could have simply ended up entering into a different building contract with a different builder, or the same building contract with a different

builder, and we would have been left high and dry': Tp 2940. In response to a question that there would have been rights to enforce, Mr Carey said, somewhat prothetically [sic: prophetically]: 'That effectively would give us a Court case on our hands, with 3 or 4 years and hundreds of thousands of dollars in fees.'

690 Mr Sammut compared the provisions of Exhibit Y and Exhibit C, before the Contract was entered into and came to the conclusion, which he expressed to Mr Carey, that under the Contract Westpoint would have been a lot worse off."

24 I do not accept that there was no evidentiary basis for the referee's implicit finding. Mr Carey was reluctant that Constructions enter into the 31 August 2000 construction contract, because he considered it significantly disadvantageous. He nonetheless agreed to that occurring. He did so even though he thought – whether rightly or wrongly does not for present purposes matter – that a more advantageous construction contract was already in place. The reason for his agreement, as found by the referee, was that otherwise Constructions would lose the construction work, which Mr Carey was not prepared to do "given the amount of construction work already completed and the Group commitment to the Project including the opportunity to develop the Project". Mr Carey felt he had no alternative. It was open to the referee to find that the same compulsion would have caused Mr Carey to agree to entering into a construction contract at the reduced price.

25 Such an agreement is by no means inherently unlikely. The conversion of the building and sale of the units was a project of the Westpoint group. Profit to Constructions was not the only source of reward to the group. Management was entitled to a monthly fee, to a percentage of project costs and to an incentive management fee according to a formula involving the net profit from the project. (It may be, although it is unclear and I therefore put it aside, that another Westpoint company, Westpoint Finance Pty Ltd, was by August 2000 involved as part financier and would also have earned profit for the group.) Delay to the project through engagment of another construction company would not have been welcome.

26 McDougall J declined to intervene in what he saw as the referee's finding of fact as to the value of Apartments' lost chance. I do not think error has been shown in his Honour's exercise of his discretion in this respect.

The damages for the cost of rectification of defective and incomplete work

27 The referee referred at [68] of the first report to a "matter of basic principle", how damages for defective or non-complying work were to be assessed. He noted Apartments' submission, founded on ***Bellgrove v Eldridge*** (1954) 90 CLR 613, that an owner was entitled to the costs of rectification to bring work to conformity with contractual requirements providing such a course would be a reasonable one for the owner to adopt, and its submissions that it did not matter that the property had been sold by the owner, that it was not demonstrated that the owner had suffered a lower price by reason of the defects, or that the owner had no intention of rectifying the defects.

28 The referee said that the submission "has to be addressed having regard to the factual situation". He continued, at [71]-[73] of the first report -

"71. First, it must be borne steadfastly in mind that CFA was carrying out this Project with a view to either selling the units off the plan or, alternatively, selling them as soon as possible after Practical Completion. Of course, in such circumstances, defects or other deviations from the plans and specifications may require rectification work or may, in some cases, lead to a diminution in the value of the property, such that, in either event, the proprietor is entitled to recover damages in respect thereof. However, in the present case, there are a number of matters alleged which, although they are matters which do not conform to the plans and specifications, nonetheless have not been shown as requiring the payment of money to have them repaired or as having brought about a diminution in the value of the property or as causing any other form of financial loss to the proprietor, such as to have caused CFA to have suffered damages. However, that, ie the absence of any damage or loss (other than perhaps nominal damages for breach of contract) in Mr Corsaro's submission, did not give rise to circumstances in which it was impermissible for CFA to recover damages.

72. Mr Corsaro sought to draw a distinction between what he referred to as 'amenity defects' and 'structural defects'. The first type of defect may be identified in the present case in various instances. They include the failure to install low voltage down lights and the provision of another type of lighting; the installation of non-conforming dishwashers; the failure to reduce parapet heights at Level 4 by about 200 mm; the installation of hollow rather than solid internal doors; the installation of non-conforming skirting boards and the installation of framed rather than frameless glass shower screens. The units were sold, notwithstanding, and there was no evidence that the failure to conform to the plans and specifications led to any diminution in their value or delay in selling them, such as to cause interest to continue to run for a longer period. Nor was there any evidence that any purchaser required the 'rectification' of any of these matters. CFA nonetheless and consistently with Mr Corsaro's submission, claimed the full cost of replacing and rectifying these various items to strict compliance with what it alleged to be the contractual requirements, notwithstanding that:

(a) It had sold all the units and was not being asked by any unit holder to do so;

(b) Under the contracts of sale any complaints by purchasers in respect of defects had to be made within 12 months of their taking possession;

(c) There was no evidence that there had been any diminution in the sale price of the units because of these alleged breaches, nor that they would have been increased but for them;

(d) There was no evidence that any purchaser was seeking to have these alleged defects remedied, let alone consenting to the obvious inconvenience of having any such work done;

(e) There was clear evidence that if CFA recovered money for the alleged breaches, it did not propose to remedy most of them, but rather to pay the money to its shareholders; and

(f) There was an obligation imposed on Constructions by the Home Building Act: Sections 18B and 18D to carry out defective work, which was required, and which obligation continued for seven years.

73. Accordingly, the submission that damages should be paid by Constructions for these alleged defects appeared to me somewhat strange as there was no evidence of any loss. I should make clear that I am not dealing with defective work, which did not comply strictly with the contractual obligations and which also required some rectification work for which CFA was liable. Thus, if a non-conforming door was not hung properly or a non-conforming skirting board was not affixed properly and CFA incurred cost in rectifying those defects, it would have suffered compensable loss. However, it was submitted by CFA that I was constrained by high authority to adopt its basic submission."

29 The high authority began with ***Bellgrove v Eldridge***. The referee considered at some length that case and ***Director of War Service Homes v Harris*** (1968) Qd R 275, ***De Cesare v Deluxe Motors Pty Ltd*** (1996) SASR 28 (including its consideration of ***Ruxley Electronics and Construction Ltd v Forsyth*** (1996) 1 AC 344 and ***Tito v Waddell (No 2)*** (1977) Ch 106), and ***SAS Trustee Corporation v Scott Carver Pty Ltd*** [2003] NSWSC 1097 (at that time under appeal to this Court).

30 The referee concluded, at [103]-[104] of the first report -

"*103. … However, my present view is that all the authorities prior to SAS require the establishing of damage, which may sound either in the cost of remedying the defective or incomplete work or the diminution in value of the property by virtue of that work. Where such loss is established, the authorities make it clear that it may be recovered. Where, on the other hand, there is no loss, the authorities make it equally clear, as I read them, that save perhaps for nominal damages, there can be no recovery of damages.*

104. I consider that the preponderance of the authorities favour this view and, in those circumstances, in so far as it has not been possible to demonstrate that certain of the work constituted any loss either by way of the necessity for completion, rectification or diminution in value, CFA has failed to establish its entitlement to damages in relation to those alleged discrepancies between the plans and specifications and what was built."

31 Later in the report the referee stated as one of the conclusions to which he had come - "*178. …*

(i) In so far as non-conforming work was done, whilst CFA is, in all probability, entitled to payment for any rectification to it of the type to which I have referred, it is not entitled to the damages it seeks (namely replacement cost) unless it can show loss (apart from that to which I have just referred) by a diminution in value, which was not alleged."

32 As has been seen, the items for which "allowances" were awarded mentioned in [16] above included allowances against Constructions totalling $146,062 with respect to dishwashers, "as built" drawings, skirting boards, atrium glazing and repairs. At least some of these were damages awarded for costs of rectification. Apartments submitted on appeal that the referee was in error, and the judge was in error in adopting the reports despite the error, in failing to award further damages in respect of ten items identified in sub-paragraphs (a) to (j) of a paragraph in its written submissions. The sub-paragraphs were -

"*(a) in respect of the relocation of the car park shutter - $25,003, which the Referee rejected at [931] to [936] of the Referee's 6 December 2004 report on the basis that the Appellant had to show the rectification costs had actually been spent;*

(b) in respect of internal doors - $102,079, which the Referee rejected at [937] of the Referee's 6 December 2004 report on the basis that the Apppellant:

(i) claimed the cost of redoing the work rather than the loss of value of the doors; and

(ii) it was unreasonable and unnecessary to rectify the doors.

(c) in respect of skirting boards - $112,815. There was no real contest before the Referee, or before the primary judge, that the skirting boards did not comply with the skirting board profile in the display apartment, which the Referee took as the appropriate standard for Construction's work. The claim advanced by the Appellant was referred to by reference to the evidence in paragraph 261 of Mr Ash's evidence.

(d) in respect of security system and access control - $75,086, which the Referee rejected at [937]-[940] of the Referee's 6 December 2004 report;

(e) in respect of mechanical deficiencies - $711,700, which the Referee rejected only on the grounds set out at paragraph [942] of the Referee's 6 December 2004 report, namely that the Appellant "[would] not spend [the amount] in rectifying the alleged defects and it will leave the present owners and occupiers to pursue claims against Constructions under the Home Building Act";

(f) in respect of falls to showers - $128,700 which the Referee rejected at [944] to [946] of the Referee's 6 December 2004 report on the same basis the Referee did not allow the Appellant damages in connection with the mechanical deficiencies;

(g) in respect of materials in pipes [sic] - $4,350, which the Referee rejected at [969 to [970] of the Referee's 6 December 2004 report on the same basis the Referee did not allow the Appellant damages in connection with the mechanical deficiencies;

(h) in respect of defects identified by Tyrrells - $226,600 which the Referee rejected at [971] to [974] of the Referee's 6 December 2004 report on the same basis the Referee did not allow the Appellant damages in connection with the mechanical deficiencies;

(i) in respect of defects identified by purchasers - $198,000 which the referee rejected at [975] to [977] of the Referee's 6 December 2004 report on the basis that the Appellant did not intend to carry out those works;

(j) in respect of the identification and management of defects rectification - $120,301 which the Referee rejected at [978] to [979] of the Referee's 6 December 2004 report on the basis that the Appellant did not intend to rectify the defective works and, therefore those costs would also not be incurred."

33 The total of the amounts in these sub-paragraphs is $1,704,634. It is not apparent that the submissions to the judge focussed on these items.

34 The judge dealt with damages for costs of rectification at [141]-[170] of his reasons.

35 His Honour said - *"148 The decision in **Bellgrove** establishes four things:*

(1) Damages for breach of the obligation to construct in accordance with the contract and plans and specifications are measured by the cost of rectification, where it is necessary to undertake that rectification to produce conformity and where it is reasonable to adopt that course.

(2) In those circumstances, damages are not measured by comparing the value of the building which has been erected with the value it would have been if erected in accordance with the contract.

(3) However, where rectification may be necessary to produce conformity but it is not reasonable to do so, the true measure of loss is any diminution in value produced by the non conformity with the contract, plans and specifications.

(4) It is a question of fact as to whether, in any particular case, rectification is both necessary (in the sense explained) and reasonable."

36 His Honour said that it was not material to the assessment of damages that the owner might not carry out the rectification work, and that the fact of sale was immaterial "at least in circumstances where it was possible to infer that the sale price had been depressed because of the existence of the defects" (at [150]). He said, noting the possibility that it might be regarded as inconsistent with ***Bellgrove v Eldridge*, that *Central Coast Leagues Club v Gosford City Council*** (Giles J, 9 June 1998, unreported) and ***Hyder Consulting (Australia) Pty Ltd v Wilh Wilhelmsen Agency Pty Ltd*** [2001] NSWCA 313 had held that rectification damages should not be awarded if it be found that the rectification work will never be carried out. He said, not entirely accurately because the referee had not referred to all the decisions -

"*152 The referee reviewed these and other decisions. I do not propose to cite all of them, because I think that what I have said is sufficient to show that the conclusion to which he came at R1/103, 104 is correct.*"

The paragraphs R1/103, 104 to which the judge referred are the paragraphs in the first report which I have set out at [30] above.

37 His Honour then said -

"*153 That leaves the application of the principles. As the High Court pointed out in Bellgrove, whether work is reasonable in a particular case is a question of fact. Apartments devoted substantial time to showing that the referee's conclusion, that it was not reasonable for the works to be carried out, was incorrect. Again, although it embellished those submissions with the usual phrases, they were in truth no more than an attempt to reargue, or be heard twice on, the whole of its case under this head. I am satisfied that the referee dealt appropriately with the factual issues, and that the conclusion to which he came – that, in the circumstances, it would not be reasonable for the rectification works to be performed – was open to him. Indeed, if I may say so, I think that it was clearly the correct conclusion.*"

38 In following paragraphs his Honour considered particular matters, saying in summary –

- *as an illustration, that the cost of rectification by replacement of skirting boards "is not, in Bellgrove terms, reasonable" (at [156]);*
- *that some submissions by Apartments concerning diminution in value were not accepted (they need not be described, since there was no reliance on diminution in value on appeal);*
- *that in particular cases the referee gave other reasons for finding against Apartments; and*
- *as to a particular item in respect of the mechanical ventilation system, that the referee's finding that if Apartments recovered the cost of rectification it would not spend it to carry out the work but would return it to shareholders "provides an appropriate basis for him to have concluded that performance of those works was not relevantly (for the purposes of the test in **Bellgrove)** 'reasonable': for the reasons identified by Giles CJ Comm D in **Central Coast Leagues Club**" (at [169]).*

39 His Honour concluded this part of his reasons -

"*170 In short, the referee dealt with this question (both generally and in relation to the particular issue of mechanical ventilation) by enquiring whether it was relevantly "reasonable" for the rectification works in question to be carried out. He concluded that it was not. **Bellgrove** makes it clear that that question is one of fact. Apartments has demonstrated no basis for interfering with the referee's conclusions on this question of fact.*"

40 Apartments submitted that the referee was in error because he had considered that it was not entitled to damages if it had not carried out the rectification work and did not intend to do so, and that the judge was in error in accepting that flawed approach to assessment of damages and regarding the referee's conclusion as factual conclusions in which he would not intervene. It said as well that the referee had failed to pay regard to evidence material to carrying out the rectification work. Constructions submitted that the referee was not satisfied that Apartments had suffered any loss or damage, or that rectification works were relevantly necessary and reasonable, and that the findings in these respects were factual findings which the judge was entitled to adopt in the exercise of his discretion.

41 Since the judge's decision this Court has considered what may be called the ***Bellgrove v Eldridge*** principles in ***Scott Carver Pty Ltd v SAS Trustee Corporation*** [2005] NSWCA 462 and ***Brewarrina Shire Council v Beckhaus Civil Pty Ltd*** [2006] NSWCA 361. Those cases refer to some further cases in which the principles have been discussed.

42 The fundamental principle in the assessment of damages for breach of contract is that the damages should put the plaintiff, so far as money can do so, in the position it would have been in had the contract been performed: ***Robinson v Harman*** (1848) 1 Exch 850 at 855. In ***The Commonwealth v Amann Aviation Pty Ltd*** (1991) 174 CLR 64 Mason CJ and Dawson J said at 80 - *"The award of damages for breach of contract protects a plaintiff's expectation of receiving the defendant's performance. That expectation arises out of or is created by the contract. Hence, damages for breach of contract are often described as 'expectation damages'."*

43 Since the remedy is for disappointed expectation, a plaintiff's position is not found solely in any monetary loss it has suffered. In a contract for the performance of building work, the plaintiff can recover the cost of rectifying defective or incomplete work because, by receipt of the money in substitution for performance, it is given the means of putting itself in the position it would have been in had the contract been performed.

44 This is the basis of ***Bellgrove v Eldridge***, in which defective foundations seriously threatened the stability of the plaintiff's house and it was held that she was entitled to recover the cost of demolition and re-erection. The damages provided her with the means of obtaining the performance expected under the contract. The primary measure of loss was the cost of the rectification work; the Court said at 617 - *"In the present case, the respondent was entitled to have a building erected upon her land in accordance with the contract and the plans and specifications which formed part of it, and her damage is the loss which she has sustained by the failure of the appellant to perform his obligation to her. This loss cannot be measured by comparing the value of the building which has been erected with the value it would have borne if erected in accordance with the contract; her loss can, prima facie, be measured only by ascertaining the amount required to rectify the defects complained of and so give to her the equivalent of a building on her land which is substantially in accordance with the contract."*

45 But recovery according to the rectification measure is subject to the rectification work being necessary and reasonable. If it is not, then the plaintiff is left to diminution in the value of the property as the measure of damages. There may or not be a diminution in value, and if there is not the plaintiff recovers nothing; but the alternative diminution measure arises only if the rectification work is not necessary and reasonable. So the Court said at 619 - *"Many examples may, of course, be given of remedial work, which though necessary to produce conformity would not constitute a reasonable method of dealing with the situation and in such cases the true measure of the building owner's loss will be the diminution in value, if any, produced by the departure from the plans and specifications or by the defective workmanship or materials."*

46 In ***Ruxley Electronics and Construction Ltd v Forsyth*** it was accepted that, if the rectification work was not necessary and reasonable and there was no diminution in value of the property, damages could be awarded for loss of amenity; see thereafter ***Freeman v Niroomand*** (1997) 52 ConLR 116 treating it as settled that a sum could be awarded as a solatium. No question of damages on this basis arises in the present case. It should be said, for completeness, that neither Apartments nor Constructions adverted to damages on other possible bases. In ***Alucraft Pty Ltd (in liquidation) v Grocon Pty Ltd*** (Victorian Supreme Court, Smith J, 22 April 1994, unreported) the builder claimed from a subcontractor the cost of rectification to bring steelwork to specification. The builder had denied any obligation to the proprietor to rectify the work, the proprietor had apparently accepted the work and had issued a final certificate, and the builder had been paid for the work. The builder did not intend to carry out the rectification work. His Honour considered, with respect correctly, that the builder was not in the same position as an owner, because the benefit it expected to derive from the subcontract was fulfilment of the head contract and payment under the head contract, not a building in conformity with the specification; he distinguished *Bellgrove* ***v Eldridge*** for that reason. On the assumption that, in accordance with ***Bellgrove v Eldridge***, the rectification measure of damages was prima facie to be applied, his Honour found that it would not be reasonable to assess damages "on the basis of the work being rectified", and assessed damages on the basis of the builder's loss being the money it paid for the defective work or alternatively the risk of being required by the proprietor to rectify the work or pay for its rectification. Apartments did not contend for a loss of either kind.

47 What rectification work is necessary and reasonable is a question of fact, see *Bellgrove v Eldridge* at 619. The illustration of an unreasonable course given in that case at 618 was demolition and re-erection of walls which should have used second-hand bricks but used new bricks of first quality. In ***Ruxley Electronics and Construction Ltd v Forsyth*** reconstruction of a swimming pool which was nine inches less deep than it should have been, but was perfectly serviceable as a swimming pool, was considered to be unreasonable. In ***Brewarrina Shire Council v Beckhaus Civil Pty Ltd*** rectification of the dry side of a levee was unreasonable when the levee would adequately perform its function and the rectification work would not increase its capacity to repel floodwater. In that case

Tobias JA said at [89], with the agreement of McColl JA and myself, that - " … *whether the rectification work is a reasonable course to adopt is dependent upon a finding of fact that the proposed work was reasonable in order to achieve the contractual objective. The rectification work would be unreasonable if it was out of all proportion to the achievement of that objective or to the benefit to be obtained therefrom*."

48 Reasonableness involves regard to the purpose of the building work, for example in *Brewarinna Shire Council v Beckhaus Civil Pty Ltd* having a levee to repel floodwater. As Lord Jauncey observed in ***Ruxley Electronics and Construction Ltd v Forsyth*** at 358, it is reasonableness in relation to the particular contract and not at large, so that - *"if I contracted for the erection of a folly in my garden which shortly thereafter suffered a total collapse it would be irrelevant to the determination of my loss to argue that the erection of such a folly which contributed nothing to the value of my house was a crazy thing to do*".

49 Sale of the property by the plaintiff does not of itself displace the entitlement to damages according to the rectification measure: ***Director of War Service Homes v Harris; De Cesare v Deluxe Motors Pty Ltd; Scott Carver Pty Ltd v SAS Trustee Corporation***. In ***Director of War Service Homes v Harris*** Gibbs J, with whom the other members of the Full Court agreed, said at 278 that sale did not affect the plaintiff's accrued right to rectification damages, although the fact of sale "*might be one of the circumstances that would have to be considered in relation to the question whether it would be reasonable to effect the remedial work*". His Honour said at 278-9 that, assuming it would be reasonable to do the work - " … *the owner would still be entitled to recover as damages the cost of remedying the defects or deviations from the contract (assuming of course that the contract price had been paid). In assessing those damages it would not be relevant whether the owner was under a legal liability to remedy the defects, or whether he had made a profit or a loss on the sale of the building, for the builder has no concern with the details of any contract that the owner might make with a third party. … The owner of a defective building may decide to remedy the defects before he sells it so that he may obtain the highest possible price on the sale; he may sell subject to a condition that he will remedy the defects; or he may resolve to put the building in order after it has been sold because he feels morally, although he is not legally, bound to do so. These matters are nothing to do with the builder, whose liability to pay damages has already accrued*."

50 In ***Scott Carver Pty Ltd v SAS Trustee Corporation*** Hodgson JA observed at [47] 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 Ipp JA said at [118] that Gibbs J had stated the position accurately, and at [121]-[123] that the details of the sale were not relevant. It is not necessary to resolve this possible divergence in the present case. So far as we were taken to the referee's findings, it was not shown that the prices at which the units were sold were unaffected by the defects of which Apartments complained. Rather, the referee said at [72(c)] of the first report, set out at [28] above, that there was no evidence of any diminution in the sale price of the units or that the sale price would have been increased but for the defects. No evidence of a fact does not establish the fact, and it was not submitted on appeal that an effect on sale prices bore upon assessment of Apartment's damages.

51 In ***De Cesare v Deluxe Motors Pty Ltd*** Doyle CJ accepted at 35 that Gibbs J was "*correct in saying that in principle the relevance of the sale of the building is limited to its relevance to the question of whether it would be reasonable to effect the remedial work*", and Nyland J cited Gibbs J with apparent acceptance. Their Honours did not elaborate on the relevance, but Doyle CJ observed at 32 that the sale of the building without the work being done did not suggest that the remedial work was unreasonable. The fact of sale of the units could go to whether rectification work was reasonable, for example, because achieving the contractual objective was not of any significance to Apartments or to the purchasers, whereby it would be open to find that rectification work to achieve the contractual objective was "out of all proportion to the achievement of that objective or to the benefit to be obtained therefrom".

52 What is the significance, if any, of whether or not the plaintiff will carry out the rectification work?

53 In ***Bellgrove v Eldridge***, having held that the remedial work of demolition and re-erection was reasonable, the Court said at 620 - "*It was suggested during the course of argument that if the respondent retains her present judgment and it is satisfied, she may or may not demolish the existing house and re-erect another. If she does not, it is said, she will have a house together with the cost of erecting another one. To our mind this circumstance is quite immaterial and is but one variation of a feature which so often presents itself in the assessment of damages in cases where they must assessed once and for all.* "

54 Ordinarily the court is not concerned with the use to which a plaintiff puts its damages, and if the likelihood of the plaintiff carrying out the rectification work were a consideration in the award of damages there would be the potential for expensive and time-consuming factual enquiries. On the other hand, adherence to the compensatory nature of damages suggests that, if the plaintiff will not put itself in the position it would have been in had the contract been performed, the plaintiff should not be given the means of doing so. For a (rather inconclusive) discussion of these tensions see, for example, Loke, "Cost of Cure or Difference in Market Value", (1996) 10 JCL 189 at 204-211.

55 In ***Tito v Waddell (No 2)*** at 332 Megarry VC, having accepted that a plaintiff's eccentricity of tastes should not preclude damages, said - "*Per contra, if the plaintiff has suffered little or no monetary loss in the reduction of value of his land, and he has no intention of applying any damages towards carrying out the work contracted for, or its equivalent, I cannot see why he should recover the cost of doing work which will never be done. It would be a mere pretence to say that this cost was a loss and so should be recoverable as damages*."

56 In ***Ruxley Electronics and Construction Ltd v Forsyth*** at 358 Lord Jauncey took this as saying that it would be unreasonable to treat as a loss the cost of carrying out work which would never in fact be done. His Lordship said at 359 - *"The appellant argued that the cost of reinstatement should only be allowed as damages where there was shown to be an intention on the part of the aggrieved party to carry out the work. Having already decided that the appeal should be allowed I no longer find it necessary to reach a conclusion on this matter. However, I should emphasise that in the normal case the court has no concern with the use to which a plaintiff puts an award of damages for a loss which has been established. Thus, irreparable damage to an article as a result of a breach of contract will entitle the owner to recover the value of the article irrespective of whether he intends to replace it with a similar one or to spend the money on something else. Intention, or lack of it, to reinstate can have relevance only to reasonableness and hence to the extent of the loss which has been sustained. Once that loss has been established intention as to the subsequent use of the damages ceases to be relevant."*

57 Lord Lloyd said at 372-3 -

"I fully accept that the courts are not normally concerned with what a plaintiff does with his damages. But it does not follow that intention is not relevant to reasonableness, at least in those cases where the plaintiff does not intend to reinstate. Suppose in the present case Mr Forsyth had died, and the action had been continued by his executors. Is it to be supposed that they would be able to recover the cost of reinstatement, even though they intended to put the property on the market without delay?

There is, as Staughton LJ observed, a good deal of authority to the effect that intention may be relevant to a claim for damages based on cost of reinstatement. The clearest decisions on the point are those of Megarry V-C in ***Tito v Waddell (No 2)*** *[1977] Ch 106 and Oliver J in* ***Radford v De Froberville*** *(1977) 1 WLR 1262 …*

In the present case the judge found as a fact that Mr Forsyth's stated intention of rebuilding the pool would not persist for long after the litigation had been concluded. In these circumstances it would be 'mere pretence' to say that the cost of rebuilding the pool is the loss which he has in fact suffered. This is the critical distinction between the present case and the example given by Staughton LJ of a man who has had his watch stolen. In the latter case, the plaintiff is entitled to recover the value of the watch because that is the true measure of his loss. He can do what he wants with the damages. But if, as the judge found, Mr Forsyth had no intention of rebuilding the pool, he has lost nothing except the difference in value, if any.

The relevance of intention to the issue of reasonableness is expressly recognised by the respondent in his case. In para 37 Mr Jacob says: 'The Respondent accepts that the genuineness of the parties' indicated predilections can be a factor which the court must consider when deciding between alternative measures of damage. Where a plaintiff is contending for a high as opposed to a low cost measure of damages the court must decide whether in the circumstances of the particular case such high cost measure is reasonable. One of the factors that may be relevant is the genuineness of the plaintiff's desire to pursue the course which involves the higher cost. Absence of such a desire (indicated by untruths about intention) may undermine the reasonableness of the higher cost measure.'

I can only say that I find myself in complete agreement with that approach, in contrast to the approach taken by the majority of the Court of Appeal.

Does Mr Forsyth's undertaking to spend any damages which he may receive on rebuilding the pool make any difference? Clearly not. He cannot be allowed to create a loss which does not exist in order to punish the defendants for their breach of contract. The basic rule of damages, to which exemplary damages are the only exception, is that they are compensatory not punitive."

58 Lords Keith, Bridge and Mustill agreed with the reasons of Lords Jauncey and Lloyd, without adding to this matter in their speeches.

59 Relevance of the plaintiff's intention to carry out the rectification work to reasonableness is accepted in, for example, *Chitty on Contracts*, 29th ed, at 20-016, and *Hudson's Building and Engineering Contracts*, 11th ed at 8-138. It appears to have been accepted in ***De Cesare v Deluxe Motors Pty Ltd*** – indeed, sale of the building may have relevance through whether or not the rectification work will be carried out. If truly going to reasonableness, I do not think consideration of whether or not the plaintiff will carry out the rectification work is inconsistent with ***Bellgrove v Eldridge***, since the regard to it is part of arriving at the plaintiff's compensable loss. Once there is compensable loss, the court is not concerned with the plaintiff's use of the compensation.

60 But the plaintiff's intention to carry out the rectification work, it seems to me, is not of significance in itself. The plaintiff may intend to carry out rectification work which is not necessary and reasonable, or may intend not to carry out rectification work which is necessary and reasonable. The significance will lie in why the plaintiff intends or does not intend to carry out the rectification work, for the light it sheds on whether the rectification is necessary and reasonable. Putting the same point not in terms of intention, but of whether or not the plaintiff will carry out the rectification work, whether the plaintiff will do so has significance for the same reason, and not through the bald question of whether or not the plaintiff will carry out the rectification work. That question is immaterial, see ***Bellgrove v Eldridge***.

61 So if supervening events mean that the rectification work can not be carried out, it can hardly be found that the rectification work is reasonable in order to achieve the contractual objective: achievement of the contractual objective is no longer relevant. If sale of the property to a contented purchaser means that the plaintiff did not think and the purchaser does not think the rectification work needs to be carried out, it may well be found to be unreasonable to carry out, the rectification work. An intention not to carry out the rectification work will not of itself make carrying out the work unreasonable, but it may be evidentiary of unreasonableness; if the reason for

the intention is that the property is perfectly functional and aesthetically pleasing despite the non-complying work, for example, it may well be found that rectification is out of all proportion to achievement of the contractual objective or to the benefit to be thereby obtained.

62 In ***Central Coast Leagues Club v Gosford City Council*** the rectification work would not be carried out because other more extensive work had to be carried out in order to comply with later court orders. I said that the fact that the work would not be undertaken gave occasion to conclude that it was not a reasonable course to adopt; the reason why it would not be carried out underlay that statement. In ***Hyder Consulting (Australia) Pty Ltd v Wilh Wilhelmsen Agency Pty Ltd***, in which the rectification work could not be carried out because other more extensive work had already been carried out, I referred to this at [99] as a holding that, if it was found that rectification work would never be carried out, no damages should be awarded. I accept, with respect, the reservations expressed by Hodgson JA in *Scott Carver Pty Ltd v SAS Trustee Corporation* at [40] – [44], and my words were apt to mislead; it is necessary to ask why the rectification work would never be carried out. In these cases the rectification work could not be carried out because of supervening events, and established that the plaintiff had not been deprived of the benefit of performance of the contract and thus had not suffered a compensable loss. In other cases, depending on their facts, whether rectification work would be carried out could come under consideration, but not because an intention not to carry out the rectification work itself precluded the award of damages.

63 In order to determine whether the judge relevantly erred in the exercise of his discretion, it is necessary first to test the referee's reasons against these *Bellgrove v Eldridge* principles.

64 Apartments was entitled to rectification damages unless the rectification work was unnecessary and unreasonable. With a qualification to which I will come, the referee did not so approach the assessment of damages for defective or non-complying work. He required that loss be established, and while speaking in [104] of the first report of the necessity for completion or rectification he appears to have considered that loss was not established because, in the light of the matters stated in his [72], there was no necessity for completion or rectification. Of the matters in [72], sale of the units and the fact that purchasers were not asking for rectification were relevant for their bearing on whether it was reasonable to carry out the rectification work, but Apartments' intention not to carry out rectification work did not mean that it had no compensable loss; still less did its intention to pay any damages to shareholders. Constructions' statutory obligation to purchasers certainly did not mean or contribute to absence of compensable loss. Occasion for purchasers to enforce the statutory obligation would suggest that rectification work was necessary and reasonable.

65 It does not seem to me that in [103] and [104] of the first report the referee had regard to the matters stated in his [72] as going to reasonableness in order to achieve the contractual objective. He treated them as independently precluding damages, and at least in part they could not go to reasonableness. It will be seen when I come to the items in issue on appeal that the referee treated sale of the units and lack of intention to carry out rectification work, as such, as displacing Apartments' entitlement to damages.

66 The qualification earlier mentioned is that, with respect to some of the items, he spoke of rectification work as unnecessary and unreasonable. There is no doubt, from the referee's consideration of *Bellgrove v Eldridge* and the other cases, that he was alive to the High Court's statement of that criterion, although it was not brought out in the referee's conclusions in [103]-[104] of the first report. But in my opinion the referee's findings so far as expressed in terms of necessity and reasonableness were infected by an erroneous approach to necessity and reasonableness discerned from his resolution of the "matter of basic principle"; or at least it can not safely be thought that it was not so infected, and his findings could not safely be adopted.

67 It is appropriate to go to the referee's findings with respect to the items in issue on appeal, before returning to the judge's consideration of the reports.

(a) Car park shutter

68 The referee declined to allow the amount of a quotation of $25,003 for relocation of the car park shutter because, at [936] of the first report - *"CFA has failed to establish on the balance of probability [sic] that the amount was spent and, in those circumstances, it is not, in my view, recoverable from Constructions"*.

69 This was not in conformity with the ***Bellgrove v Eldridge*** principles. The referee did not ask whether relocation of the car park shutter was reasonable in order to achieve the contractual objective, or any similar question, and did not apply the necessity and reasonableness criterion. He declined to award damages simply because the rectification work had not been carried out. This was erroneous.

(b) Internal doors

70 The internal doors installed in the units were hollow core doors rather than solid core doors as specified. The referee said, at [937] of the first report - *"It was not suggested that the doors were going to be removed and replaced; nor that there had been any complaint about them. If money was recovered it was to be passed on to the shareholders. The damages, in relation to this item, was based upon redoing the work, rather than on a cost comparison, and, in my opinion, not only would that be both unreasonable and unnecessary, but it would be calculating damages on a wrong basis. I say that because the correct basis would be the cost difference between hollow internal doors and solid internal doors. I do not propose to recommend any allowance in respect of the doors."*

71 The referee did describe replacement of the doors as unreasonable and unnecessary. Those epithets appear to have been used because there had not been any complaint about the doors, because it was not suggested that

they were going to be removed and replaced, and because any money recovered was to be passed on to the shareholders. The mere fact that the doors were not going to be removed and replaced did not make their replacement unreasonable, although lack of complaint may have warranted a finding that it was not reasonable. An intention to pass on damages to shareholders did not mean unreasonableness. The finding may have been correct, but the reasoning was not.

(c) Skirting boards

72 The allowances mentioned in [16] above included $500 with respect to skirting boards, apparently the difference between the cost to Constructions of the skirting boards specified and the skirting boards installed. We were informed that the difference was in the profile of the skirting boards. Apartments' claim was for the cost of removing the installed skirting boards and replacing them with skirting boards with the specified profile. There was evidence in the reference that the cost of removal of the existing skirting boards and their replacement with skirting boards of the correct profile was $112,815, and also that there had been no complaint about the type of skirting board and that removal and replacement "would entail massive disruption to the occupiers of the apartments".

73 We were not referred to any part of the reports in which the referee dealt with a claim to the $112,815. The judge's reasons included, as I have said, that the cost of rectification in this respect was not reasonable. Assuming in Apartments' favour that the referee was in error either in not dealing with this item or in his reason for declining to allow it, and that his Honour misapprehended the referee's error, in my view it is plain that replacement of the skirting boards was not necessary or reasonable in order to achieve the contractual objective. This item should not be dignified by further consideration.

(d) Security system and access control

74 It appears that the evidence before the referee included a quotation for $75,068 "for upgrading the security system to meet the building's original specifications" (at [939] of the first report). There was also evidence that Apartments had not undertaken the work and did not intend to do so if it recovered the amount claimed. The referee said, at [940] of the first report -

> *"940. Unfortunately, the submissions are very scanty in regard to this item, it is not being clear to me whether the security system was specified in the specifications for the Contract or in the specifications, which accompanied Exhibit Y. However, as the parties have chosen to leave the matter in this condition, it seems to me that the decision by CFA not to carry out the work, even if it recovers the money, means that in its view it is both unreasonable and unnecessary, such that there should be no allowance recommended."*

75 Apartments' decision not to carry out the work did not establish that the work was unnecessary or unreasonable. The reasons for the decision may have warranted that finding, but that is a different matter. In declining to award damages for the reason he gave, the referee was in error..

(e) Mechanical deficiencies

76 The claim was for the significant amount of $711,700 for rectification of the mechanical ventilation system serving the wet areas in the building. The referee said, at [943] of the first report -

> *"943. In my opinion, the proper inference is that the money, if recovered, will not be used to carry out the work, but will be returned to the shareholders. Further, I accept the submission that the warranties given under the Home Building Act are enforceable by the owners against Constructions. I, therefore, do not propose to make any recommendation in regard to this amount."*

77 This departed from the ***Bellgrove v Eldridge*** principles. Neither the intention to pay any damages to shareholders nor statutory rights against Constructions made the rectification work unnecessary and unreasonable, and the referee was in error.

78 As I have indicated, the judge referred specifically to adoption of the reports with respect to the mechanical ventilation system. He noted that it had been submitted that Apartments had not proved that there were any defects in the mechanical ventilation system, but did not take that matter further. His opinion at [169] that return of the money to shareholders rather than spending it on rectification was an appropriate basis for the referee to have concluded that the rectification work was not relevantly reasonable was not, with respect, founded on a correct understanding of ***Central Coast Leagues Club v Gosford City Council***. That Apartments would not spend the money on rectification did not make rectification work unreasonable in order to achieve the contractual objective, or displace damages in accordance with the ***Bellgrove v Eldgridge*** principles.

(f) Falls to showers

79 From [944]-[945] in the first report, $128,700 was claimed for rectifying the falls to showers in thirteen bathrooms. No rectification work had been undertaken and there was no evidence of complaint by a purchaser or occupant. The referee said at [946] of the first report, "*I have come to the same conclusion in relation to this item as I have in respect of Mechanical Deficiencies*".

80 Without elaboration, the referee was in error.

(g) Materials pipes

81 From [969] in the first report, $4,350 was claimed in some manner to do with insulating pipes; and Apartments had not carried out whatever the rectification work was, it probably would not do so and the money would probably go to shareholders. The referee said in that paragraph that he declined to allow the amount "having

regard to those facts; [Constructions'] obligations under the Home Building Act; the certification and acceptance of the works, and the proper assessment of loss and damage."

82 There was no finding of unreasonableness, and any implicit finding was not properly based on unlikelihood of Apartments carrying out the rectification work or statutory rights against Constructions. That the "certification and acceptance of the works" gave a contractual defence to Constructions was not mentioned in the judge's reasons or on appeal.

(h) Defects identified by Tyrrells

83 From [971]-[974] in the first report, $226,600 was claimed for rectification of "general defects" in the building, it seems "minimal and cosmetic" defects; the amount was in doubt, and some of the $226,600 may have been spent, but any amount recovered was likely to be distributed to shareholders. The referee said, referring to an answer about distribution to shareholders -

> *"974. That answer established, at least in relation to that item, that in so far as defective work required repair and in so far as CFA recovered for that, CFA did not propose to repair the defects. For the reasons I have given in relation to other similar items, and because CFA has not satisfied me that it has expended any of this money, I do not propose to recommend the payment of this amount."*

84 Again without elaboration, the referee was in error.

(i) Defects identified by purchasers

85 The claimed $198,000 may in part have been spent in fixing defects, but save for $4,000 (being the subject of one of the allowances mentioned in [16] above) the referee was not satisfied that it had been. The referee accepted at [977] of the first report that the balance, if recovered, would not be spent in fixing defects. Although not expressly, it is evident that the referee declined to allow the balance for that reason. Again without elaboration, in my opinion the referee was in error.

(j) Identification and management of defects rectification

86 From [978] of the first report, amounts totalling $120,301.24 were claimed for consultancy services the subject of this item. The referee expressed difficulty on the basis that in many instances Apartments did not intend to rectify defects, but said, at [979] of the first report, that he proposed "to reserve this question to be argued when the questions [sic] of costs is argued". In [12] of the second report the referee gave his reasons for deferring argument on costs and "the particular matter raised in paragraph 979".

87 Apartments' submission with respect to this item is misconceived. The referee did not reject its claim to the costs of identification and management of defects rectification. There was no question of adoption of the reports save so far as that matter was left for later argument.

88 Coming then to the judge's consideration of the reports, he did not perceive any divergence between his statement of what ***Bellgrove v Eldridge*** established and the referee's conclusions in [103]-[104] of the first report. He considered that the referee applied a criterion of reasonableness in performance of rectification work in conformity with the ***Bellgrove v Eldridge*** principles; this can be seen from his Honour's statements that the referee concluded that it was not reasonable for the rectification works to be carried out, and in particular his [170] set out at [37] above. For the reasons I have given, I do not think that is a correct understanding of the referee's report. Although he made some references to necessity and reasonableness, the referee did not apply that criterion, and as to a number of the items in issue on appeal gave reasons for declining to award damages quite at odds with the ***Bellgrove v Eldridge*** principles. I respectfully consider that the judge's exercise of discretion miscarried by reason of his misapprehension of the referee's reports. The exception is the judge's disposal of the item with respect to skirting boards, but I do not feel able summarily to conclude with the same confidence that rectification with respect to internal doors was unnecessary and unreasonable.

89 In the result, the judge erred in the exercise of his discretion in adopting the reports so far as the referee found that the damages recoverable from Constructions did not include the reasonable cost of rectification of defective and incomplete work the subject of items (a), (b) and (d)-(i). What is the result?

90 In its notice of appeal Apartments sought an order that the judgment in its favour be increased by the amounts the subject of the items. It does not follow from error in adopting the reports that it is entitled to have the judgments increased by the amounts the subject of the items last mentioned. It may be that, on a proper application of the ***Bellgrove v Eldridge*** principles, some or all of the rectification work was not necessary and reasonable in order to achieve the contractual objective; internal doors may be a candidate for that finding. There is at least a suggestion that there may be a contractual defence. It is evident that Apartments' proof of the cost of remedial work may be open to doubt, and it does not appear that the referee found positively the quantum of any of the amounts claimed.

91 The submissions on appeal did not go into these matters, and it is not appropriate that this Court consider them. The proceedings should be remitted to McDougall J for further consideration in accordance with these reasons.

The damages and adjustment with respect to atrium glazing

92 The allowance for the item with respect to atrium glazing mentioned in [16] above was $89,250. In addressing the item, at [784(g)] of the first report, the referee found that the atrium glazing "*did not take place*", and said that Apartments was entitled to a "*negative variation from Constructions*" in that amount and in the alternative was entitled to recover the amount from Management.

93 As to the recovery from Constructions, by a negative variation the referee appears to have meant a variation under the construction contract deleting the work and deducting its cost from the contract price: he referred in [783(d)] of the first report to entitlement to a negative variation under cll 6.6 and 10.4.3, and standard clauses so numbered in Ex Y deal with variations and were presumably found also in Ex C (which was not in the appeal papers). The parties' submissions treated the recovery from Management as part of the damages for loss of a chance earlier considered.

94 There is at first sight a puzzle. That Apartments was entitled to a negative variation with respect to atrium glazing was not in issue on appeal. Its entitlement had to be on the basis that the atrium glazing was work required under Ex C but was not carried out. That Apartments was entitled to damages for loss of a chance with respect to atrium glazing was also not in issue on appeal (although assessment of the damages was). Its entitlement had to be on the basis that the atrium glazing had been work envisaged by Ex Y, but was not work required under Ex C. There is an apparent inconsistency: was atrium glazing required under Ex C, or was it not required? I will return to it.

95 Apartments submitted on appeal that an additional $16,065 should have been allowed. Its argument went as follows. The evidence before the referee included a bill of quantities prepared for the Westpoint group in December 1999. The atrium glazing was priced at $89,250. Apartments said that the bill of quantities added 2.5 per cent for contingencies, 12 per cent for preliminaries and a 3.5 per cent "margin", and it submitted that if the atrium glazing was omitted "*there was no occasion for [Constructions] to receive a contingency, preliminaries and margin on work that it simply did not do*". It said that it so submitted to the judge, but that his Honour "*did not specifically deal with the matter in deciding to adopt the Referee's findings*".

96 The submission to the judge was in one paragraph of extensive written submissions. The paragraph began rather bluntly with the assertions that the referee "*has patently misunderstood the evidence*" and that "a *reasonable referee*" would have allowed a higher amount. Fearless advocacy is one thing, but this was rather discourteous. The submission was not as it was put on appeal. It conveyed that the allowance should have been increased by the three percentages (and also by 10 per cent for GST). It did not, however, explain why.

97 We were not referred to anything in the transcript of proceedings on the reference in order to appreciate how the matter was put to the referee, or to anything in the transcript of argument before the judge whereby the one paragraph was translated to a reasoned argument that, despite proper explanation before the referee, the referee had failed to recognise that the allowance should have included the various percentages.

98 It appears that the submission to the judge was within the "*complaints*" to which his Honour referred when he said -

> "***Twelfth ground: miscellaneous matters***
>
> *201 This comprises a grab bag of complaints including failure to apply* ***Jones v Dunkel*** *(1959) 101 CLR 298; misunderstanding of some aspects of the evidence; and failure to consider other aspects of Apartments' claim. It is nothing more than an attempt to reargue, or be heard twice on, findings that have been made contrary to the case for which Apartments contended before the referee."*

99 Constructions' written submissions on appeal asserted that the atrium glazing "was never required under the building contract dated 31 August 2000". If this were correct, the allowance of $89,250 should not have been made. There was no cross-appeal. This curiosity was raised with counsel for Constructions, who said he would return to it but did not. None of Apartments, Management or Constructions noted the inconsistency referred to in [94] above, or sought to clarify whether the atrium glazing was or was not part of the work required under Ex C.

100 The solution to the puzzle may be that recovery from Management with respect to atrium glazing was not part of the damages for loss of a chance, but was damages for breach of the management agreement by failure in administration of the construction contract. Whether or not that be so, the negative variation of $89,250 must have been on the basis that the atrium glazing was work required under Ex C. Since Ex C was not included in the appeal papers, Constructions' assertion to the contrary was not backed up. This Court should proceed on that basis.

101 Clause 10.4 provides that variations are to be valued "on a fair and reasonable basis" and with inclusion of "the value of pricing work, delay costs and expenses arising from the Variation". It is by no means clear that a negative variation would include the percentages; it would not be a straightforward exclusion of a non-contractual bill of quantities item. As damages for loss of a chance, the allowance was necessarily imprecise.

102 The judge dealt rather summarily with Apartments' submission, but it was presented in a manner which attracted the response that Apartments was simply seeking to reargue a finding by the referee. Such elaboration as there has been on appeal does not demonstrate that, as the matter was presented to his Honour, he erred in his treatment of it. I am not satisfied that his Honour's discretion miscarried in his adoption of the reports in this respect, or perhaps more correctly (although it was not put in this way) their adoption without variation by an increase of $16,065.

The damages for installation of non-conforming shower screens

103 The allowance for the item with respect to shower screens mentioned in [16] above was $83,520. The referee said, at [784(a)] -

> "*In my opinion, it is only necessary to consider the difference in cost between 87 shower screens, which, on CFA's submission should have met the requirements in Exhibit Y and 87 shower screens, which Constructions installed. I do not take into account the shower/bath screens, which were not specified in Exhibit Y, nor the costs of replacement, as*

that has not been shown to be necessary. What I am taking into account is the difference between the proposed finish in Exhibit Y and the actual finish in the Project.

The difference in price between the 87 shower screens, in accordance with Mr Ash's evidence, which was not challenged on this point, is the difference between $105,879.00, which the frameless shower screens would have cost, and $22,359.00, which I consider CFA is entitled to recover from Management, it being Management's obligation to ensure that the Contract provided for that finish or, alternatively, to advise CFA to seek a reduction in price."

104 Apartments submitted on appeal that the referee was in error in not taking into account shower/bath screens as well as shower screens and in not taking into account the costs of replacement as well as the cost of the screens. As to the former, it said that while Ex Y referred to shower screens it was a generic reference and extended to those units which were to have baths and accompanying shower/bath screens. It said that it so submitted to the judge, but that again his Honour did not specifically deal with the matter.

105 The submission to the judge was in three paragraphs of the written submissions. They began with the assertion that the referee had not approached the matter "*according to law*", and relevantly said only -

"*259. The prospectuses and REA valuation referred to frameless glazing and the architect's drawing at Bundle 235v1 shows that screen to be common for showers and baths. The Referee does not give any reasons in his report for the exclusion of bath screens from the defective item for which CFAL is entitled to compensation.*"

106 This did not clearly take issue with failure to include the costs of replacement, and certainly did not present an argument for error in that respect. The submission was incorrect in asserting lack of reasons: the referee plainly stated that he did not take shower/bath screens into account because they were not specified in Ex Y. The schedule of finishes part of Ex Y refers to "Shower screen fixed frameless glazing". We were not referred to the architect's drawing. Its import for what was specified in Ex Y is not self-evident, and without the drawing can not be assessed.

107 The submission to his Honour appears again to have been within the "complaints" to which he referred at [201] set out in [98] above. Management's written submissions on appeal relevantly contended that the referee was "entitled to make findings of fact as to the original scope of works envisaged and the 'changed' scope of works that Constructions was ultimately engaged to perform", and that "it was open for the Referee to find as he did". However, the question is rather whether material error on the part of the judge has been shown.

108 There were 87 units, and the referee allowed for 87 shower screens. Mr Ash's costing included 51 shower/bath screens in addition to 87 shower screens. The bill of quantities of December 1999 priced 136 "shower screens". It is likely that as at December 1999 the units were to contain 136 screens, whether shower or shower/bath. The comparison between the total number of screens and the 87 screens in the referee's assessment, rather than their being shower or shower/bath screens, suggests error in the referee's conclusion.

109 But this was not brought out for the judge's consideration, and so far as can be seen without knowledge of the import of the architect's drawing the submission to his Honour did not recognise and address the referee's stated reason that shower/bath screens were not specified in Ex Y. Error in the exercise of a discretion calls for regard to, amongst other things, the submissions made as to why it should be exercised in a particular way. Again, notwithstanding that McDougall J dealt rather summarily with Apartments' submission, I do not think that miscarriage in the exercise of his discretion has been shown.

Orders

110 Management's appeal has failed, and it must pay costs. Apartments' appeal has succeeded as against Constructions, in part, and has failed as against Management, but since Constructions and Management were jointly represented a global order is appropriate; Constructions should pay costs, but discounted.

111 I propose the orders -

In proceedings 40715/05, appeal dismissed with costs.

In proceedings 40789/05 -

1. Appeal allowed in part.
2. Set aside order 1 made on 2 September 2005 so far as the adoption of the interim reports adopted the referee's conclusions that damages should not be awarded with respect to the car park shutter, internal doors, security system and access control, mechanical deficiencies, falls to showers, materials pipes, defects identified by Tyrrells and defects identified by purchasers.
3. Set aside the judgment against the second defendant in order 3 made on 2 September 2005.
4. Remit the proceedings to McDougall J for further consideration of adoption of the interim reports in accordance with these reasons.
5. Second respondent to pay eighty per cent of the appellant's costs of the appeal and to have a certificate under the Suitors Fund Act if qualified.

112 **McCOLL JA**: I agree with Giles JA.

113 **CAMPBELL JA**: I agree with Giles JA.

D E Grieve QC & F J Hicks – Appellant instructed by
F Corsaro SC – Respondent instructed by Hicksons Lawyers