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DEFECTS IN PROPERTY CAUSING PURE ECONOMIC LOSS

Management Corp Strata Title Plan No 1272 v *Ocean Front Pte Ltd (Ssangyong Engineering & Construction Co Ltd & Ors, third parties)*[1]

I. INTRODUCTION

THE first question to be dealt with in a negligence case is: is a duty of care owed by the defendant to the plaintiff? If there is none, the negligence action will fail. If the answer is in the affirmative, the other elements of the tort will then be considered: the defendant must have breached this duty and this breach must have caused the damage for which compensation is sought.

Although the requirements of duty, breach and damage are distinct elements, the nature of each affects the other to an extent. For example, the nature of a defendant's misconduct (omission or an act) alleged to constitute the "breach" of duty is relevant when considering whether there is a duty of care owed in the first place.[2] Similarly, the determination of the duty of care is affected by the type of damage that is alleged to have been caused. *Management Corp Strata Title Plan No 1272* v *Ocean Front Pte Ltd (Ssangyong Engineering & Construction Co Ltd & Ors, third parties)*, hereafter referred to as *Ocean Front*, is a case where the type of damage for which the plaintiff claimed – pure economic loss – has an effect on whether there is a duty of care.

II. FACTS AND DECISION

In *Ocean Front*, the plaintiffs, the management corporation of Bayshore Park condominium, sued the defendants, Ocean Front Pte Ltd, the developers of the condominium, for alleged faulty construction of certain

1 [1995] 1 SLR 751.

2 For example, where the alleged misconduct is the defendant's failure to prevent the plaintiff's damage from occurring, a duty of care is owed only in limited circumstances. For an illustration, see *P Perl (Exporters) Ltd* v *Camden London Borough Council* [1984] QB 342.

areas of the common property. The defendants raised two preliminary issues. First, whether the management corporation were competent to sue in their own name for the alleged defects. Second, whether they could recover the cost of remedying the defects since such expenses were in the form of purely economic losses. Warren Khoo J held that the management corporation could sue in their own name and that they could recover for their pure economic losses since they were owed a duty of care by reason of their very proximate relationship with the defendants. This note focuses only on the decision made with respect to the recovery for pure economic loss in the tort of negligence.

Warren Khoo J accepted that the loss suffered in this case was pure economic loss and noted that the cases of *Murphy* v *Brentwood District Council*[3] (hereafter referred to as *Murphy*) and *D & F Estates Ltd and others* v *Church Commissioners of England and others*[4] (hereafter called *D & F Estates*) have held that such pure economic losses were not recoverable in tort. He observed that Lord Bridge in *Murphy* proceeded on the basis that the House in *D & F Estates* had held that:

> a builder in the absence of any contractual duty or of a special relationship of proximity introducing the *Hedley Byrne*... principle of reliance, owed no duty of care in tort in respect of the quality of his work. To hold that the builder owed such a duty... would be 'to impose on him the obligation of an indefinitely transmissible warranty of quality'.[5]

Notwithstanding these holdings, Warren Khoo J decided that the pure economic losses in the present case could be recovered. He thought that on the present facts, there was a sufficient relationship of proximity. He drew support from *dicta* of Lord Bridge in *Murphy* who had said that:

> There may, of course be situations where, even in the absence of contract, there is a special relation of proximity between builder and building owner which is sufficiently akin to contract to introduce the element of reliance so that the scope of the duty of care owed by the builder to the owner is wide enough to embrace purely economic loss.[6]

Support was also found in the Australian High Court decision in *Sutherland Shire Council* v *Heyman*[7] (hereafter called *Heyman*) wherein Mason

3 [1990] 2 All ER 908.
4 [1988] 2 All ER 992.
5 *Supra*, note 1, at 765A-C.
6 *Supra*, note 1, at 765D-E.
7 (1985) 60 ALR 1.

J remarked that the general proposition that pure economic loss is not recoverable is not an absolute or inflexible rule but simply a "reflection of the law's concern about endless indeterminate liability."[8]

The learned judge was of the view that these pronouncements applied to the present case because "the test of proximity is more than amply satisfied in the instant case."[9] He held that the relationship between the management corporation and the developers was as akin to contract as any relationship could be, since a developer of a condominium knows from the time of conceiving a plan to develop that the management corporation will come into existence. He was confident that to hold such a developer liable to the management corporation would not "open a floodgate to unlimited claims by an unlimited class of persons."[10]

III. Analysis and Comments

A. *The Type of Damage*

Although the "damage" suffered by the plaintiff in *Ocean Front* was defective property, the court correctly classified the damage as pure economic loss.

In the case of *Anns and Others* v *Merton London Borough Council*[11] (hereafter referred to as *Anns*), the plaintiffs claimed that there had been structural movements in the block of flats in which they were lessees, because it had been erected on inadequate foundations. The plaintiffs alleged that the defendant Council had been negligent in approving the foundations and/or failing to inspect them. The House of Lords, in considering whether a local authority owed a duty of care to such plaintiffs, proceeded on the basis that the damage was physical damage. Hence the court did not consider the special nature of the damage but was only concerned with how the fact that the defendants were a public body, whose powers and duties were definable in public not private law, would affect the duty of care owed by them in tort. This characterization of damage as physical damage instead of pure economic loss has been pointed out to be incorrect in *Murphy*.

In *Murphy*, the plaintiff purchased a semi-detached house which had been built on a concrete raft foundation. Serious cracks appeared in his house and it was discovered that the raft foundation was defective. The necessary repairs would have cost £45,000. The plaintiff sold the house subject to the defects for £35,000 less than its market value in sound

8 *Ibid*, at 32.
9 *Supra*, note 1, at 765I.
10 *Ibid*, at 766C.
11 [1978] AC 728.

condition. He brought an action against the Council for their engineer's negligence in recommending approval of the plans and alleged that he had suffered an imminent risk to health and safety. The House of Lords held that the damage suffered was pure economic loss in the form of the expenses incurred in rectifying the defects or in the loss sustained in selling the house for less than its market value without the defects. The defective foundation did not cause any property to be damaged; the foundation and the walls of the house on which cracks appeared were one structure. In other words, there was no physical damage to property other than the house itself; the very property which was purchased by the plaintiff was defective as a whole and was therefore worth less than expected. This loss to the plaintiff is pure economic loss.

It is easy to understand why the damage in *Anns* was characterized by the court as physical damage. The building, which is physical property, was in a defective state. It is unlike cases where money or profits are lost due to a negligent act. In cases of money losses, the damage is clearly economic; no physical property is involved. In cases of defective property, some physical property is in a defective condition. Nevertheless, after the decision in *Murphy*, it is clear today that such "damage" suffered by a plaintiff is not physical damage but a defect in quality. The loss suffered by the plaintiff in *Ocean Front* is similarly also pure economic loss.

It is submitted that although *Ocean Front* correctly applied *Murphy* in the characterization of the damage, it failed to apply *Murphy*'s decision on whether a duty of care was owed in such cases of pure economic loss. Once the damage suffered in these circumstances is characterized as pure economic loss, the inevitable result is that there is no recovery in tort.[12] There are only a few limited exceptions to this, none of which applies to *Ocean Front*'s case. Consequently, the defendant developers should not have been found to owe a duty of care in tort to the plaintiffs in constructing the defective common property.

B. *Duty of Care in Cases of Pure Economic Boss*

Warren Khoo J did not "intend to enter into a philosophical discourse on the general question whether a pure economic loss is recoverable in tort" but preferred instead to take "the pragmatic route by simply asking ... whether

[12] This is the effect of applying *Murphy*'s decision. It is however, noted that Saville LJ in the Court of Appeal decision in *Marc Rich & Co* v *Bishop Rock Marine Co* [1994] 3 All ER 686, 693 had said that in determining duty, "the law draws no fundamental difference between such cases (of pure financial loss or expense) and those where there is damage to person or property". Whether this represents the law of England on this point will depend on the outcome of the appeal of the same case in the House of Lords.

the management corporation in this case should be allowed to recover the cost of putting right the alleged defects in the common property."[13] Unfortunately, the case involves the complex area of duty of care and it is necessary to make some study into the question of whether, on present law, a pure economic loss is recoverable in tort.

The starting point in understanding the test of the duty of care today is found in *Caparo Industries plc* v *Dickman*[14] (hereafter referred to as *Caparo*). Much earlier on, the landmark case of *Donoghue* v *Stevenson,*[15] which is probably best remembered for Lord Atkin's "Neighbour Principle", had introduced one of the first tests of the duty of care in tort. Subsequently, the two-stage test of duty[16] formulated by Lord Wilberforce in *Anns* made a great impact in this area of the law.[17] *Anns*' test has now been superseded by the test in *Caparo*, which established three requirements in order to found a duty of care:

> in addition to the foreseeability of damage, necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the party to whom it is owed a relationship characterized by the law as one of 'proximity' or 'neighbourhood' and that the situation should be one in which the court considers it fair, just and reasonable that the law should impose a duty of a given scope on the one party for the benefit of the other.[18]

What then, do "foreseeability", "proximity" and "fairness, justice, and reasonableness" mean? Lord Bridge explains that:

> the concepts of proximity and fairness embodied in these additional ingredients are not susceptible of any such precise definition as would be necessary to give them utility as practical tests, but amount in effect

[13] *Supra*, note 1, at 764F.

[14] [1990] 1 All ER 568.

[15] [1932] AC 562.

[16] "First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter – in which case a *prima facie* duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise..." *Supra*, note 9, at 751-752.

[17] For a more detailed study of the tests of duty in negligence prior to the House of Lords decision in *Caparo*, see Tan Keng Feng, "The Three Part Test – Yet Another Test of Duty in Negligence" (1989) 31 Mal LR 223.

[18] *Supra*, note 14, at 573j-574a.

> to little more than convenient labels to attach to the features of different specific situations which, on a detailed examination of all the circumstances, the law recognises pragmatically as giving rise to a duty of care of a given scope.[19]

In similar vein, Lord Roskill explains that these phrases:

> are not precise definitions. At best they are but labels or phrases descriptive of the very different factual situations which exist in particular cases and which must be carefully examined in each case before it can be pragmatically determined whether a duty of care exists and, if so, what is the scope and extent of that duty.[20]

From these explanations of the three-part test of duty of care, it can be deduced that the test is not a universal, practical test based upon any measurable principle or yardstick; rather, it is an endorsement of an *approach* in finding duty of care in negligence cases. *Caparo*'s statement of the test effectively returns the law to the early days when liability was found by considering whether the facts in question were the same as, or analogous to, a category of facts which have previously been found to give rise to liability. Lord Bridge adopted the view of Brennan J in *Heyman* that:

> the law should develop novel categories of negligence incrementally and by analogy with established cases, rather than by a massive extension of a *prima facie* duty of care restrained only by indefinable 'considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed'.[21]

This approach may conveniently be referred to as the "incremental approach".

The approach in determining duty in *Ocean Front* should therefore have been to examine whether there had been any established cases with facts similar or analogous to those of the present case. If there are no such cases which have given rise to a duty of care, there will similarly be no duty on *Ocean Front*'s facts. Conversely, if there had been similar cases which have given rise to liability, it will be likely that *Ocean Front* is a case which satisfies the requirements of foreseeability, proximity, justice and

[19] *Supra*, note 14, at 574b.
[20] *Supra*, note 14, at 582a.
[21] *Supra*, note 14, at 574Bc-d.

reasonableness and hence a case where there is a duty of care owed by the defendant to the plaintiff.

The learned judge in *Ocean Front* recognized that the damage suffered was pure economic loss, and noted that in similar cases (*Murphy* and *D & F Estates*) involving pure economic loss, recovery had been denied. Despite these observations, he decided that on the facts, there was a duty of care owed because there was a relationship of proximity akin to contract. With respect, the decision reached by Warren Khoo J cannot be supported.

First, his Honour did not apply the incremental approach in *Caparo's* test of duty. He appeared to have applied the test of duty as if it were a universal test; an approach which has been rejected by the House of Lords in *Caparo*. He relied on the concept of proximity as a formula or principle and concluded that there was sufficient proximity on the facts. He reached this conclusion because he thought that the relationship between the management corporation and the developers was as akin to contract as any relationship could be. By this his Honour was effectively attaching a definition to the label "proximity" and applying it as if it was a universal test. He failed to explain how the present facts were at least analogous to some previous cases where duty had been found to exist. The "learned pronouncements" relied on were taken from the cases of *Murphy* and *Heyman*, both of whose facts did not give rise to a duty of care.

Even if it could be said that Khoo J had been applying the incremental approach, the result reached is still, it is submitted, wrong. His Honour may have implicitly relied on the case of *Junior Books Ltd* v *Veitchi Co Ltd*[22] (*Junior Books*) as an established category permitting recovery when he recited Lord Bridge's statement in *Murphy* that there may be recovery in a case involving a special relationship of proximity akin to contract. The context in which Lord Bridge made the statement in *Murphy* may support this reading. His Lordship's statement preceded his remark in the same paragraph that the "decision in *Junior Books*... can... only be understood on this basis."[23] Thus the statement appears to be an explanation of the decision in *Junior Books*. However, the case of *Junior Books*, although not explicitly overruled, has been confined to its own unique facts as a legal footnote. In *D & F Estates*, Lord Bridge said:

> The consensus of judicial opinion, with which I concur, seems to be that the decision of the majority (in *Junior Books*) is so far dependent on the unique, non-contractual, relationship between the pursuer and the defender in that case and the unique scope of the duty of care owed by the defender to the pursuer arising from that relationship that

[22] [1982] 3 All ER 201.
[23] *Supra*, note 3, at 932e-f.

> the decision cannot be regarded as laying down any principle of general application in the law of tort or delict.[24]

In fact, *Junior Books* has been consistently distinguished in subsequent cases. An example is *Tate and Lyle Industries Ltd* v *Greater London Council*[25] where *Junior Books* was treated as a case involving physical damage. The effect of such subsequent treatment of *Junior Books* is that its result can never be repeated in future cases. It does not represent authority establishing duty of care for a class of fact situations.

The factually-similar cases involving defective property causing pure economic loss such as in *Murphy* have clearly decided that no duty of care is owed under such circumstances. To permit recovery would:

> open on an exceedingly wide field of claims, involving the introduction of something in the nature of a transmissible warranty of quality.[26]

Murphy is a case which demonstrates how the requirement of duty of care in negligence cases functions as a device which controls the scope of liability.

C. *Where Recovery is Possible*

In order to achieve a more complete view of the position on recovery for damage suffered due to defective property, a brief discussion of situations where such damage may be recoverable in tort is pertinent. Three "exceptions" to recovery are briefly described below. Of the three situations, two are claims for physical damage; in this respect, they do not represent true "exceptions" to the general rule of no recovery for pure economic loss. Nevertheless, they are set out below because they are damage caused by defective property. The last "exception" is a true qualification to the rule that pure economic loss arising from property defects is not recoverable.

1. *Dangerous defects causing physical damage*

Where damage suffered is not pure economic loss but physical damage to other property or injury to persons caused by latent defects in the property, recovery is possible. Lord Keith clarified in *Murphy* that:

[24] *Supra*, note 4, at 1003b-c.

[25] [1983] 2 AC 509. See also *Muirhead* v *Industrial Tank Specialties Ltd* [1985] 3 All ER 705 and *Simaan General Contracting Co* v *Pilkington Glass (No 2)* [1988] 1 All ER 791.

[26] *Supra*, note 3, at 921b.

> In the case of a building, it is right to accept that a careless builder is liable, on the principle of *Donoghue* v *Stevenson*, where a latent defect results in physical injury to anyone, whether owner, occupier, visitor or passer-by, or to the property of any such person.[27]

Thus, if the defects in the common property in *Ocean Front* had been latent defects which caused actual physical damage, the developers would be liable in tort for the damage caused. Such facts would fall within the *Donoghue* category of cases.

However, the same cannot be said of a situation where the defect is discovered before it causes any other physical damage. In *Ocean Front* and *Murphy*, the defects in the properties were discovered before any physical damage could be caused. Lord Bridge explained that in such cases,

> because the defect is now known and the chattel cannot be safely used unless the defect is repaired, the defect becomes merely a defect in quality. The chattel is either capable of repair at economic cost or it is worthless and must be scrapped. In either case the loss sustained... is purely economic.[28]

Thus where a dangerous defect which has not been discovered results in physical damage to a plaintiff, the plaintiff can obtain compensation for the physical damage suffered. However, if the defect is discovered before any damage is caused, a plaintiff who is aware of the danger may have problems recovering his loss in tort because the defences of contributory negligence and consent may reduce or wipe out his claim.

2. *Complex structure theory*

Another "exception" is that recovery is possible where one part of a complex structure which may be defective causes physical damage to another part. This theory was mooted by Lord Bridge in *D & F Estates* and explained further in *Murphy*. Lord Bridge in *Murphy*[29] gave the example of a defective heating boiler exploding and damaging the house in which it is installed as a possible case where the negligent manufacturer of the boiler may be liable in tort for damage caused to other property. Lord Jauncey of Tullichettle explained that this theory is limited in application since:

[27] *Supra*, note 3, at 917h.
[28] *Supra*, note 3, at 925h-j.
[29] *Supra*, note 3, at 928e.

> the only context for the complex structure theory in the case of a building would be where one integral component of the structure was built by a separate contractor and where defect in such a component had caused damage to other parts of the structure, *eg,* a steel frame erected by a specialist contractor which failed to give adequate support to floors or walls.[30]

Lord Jauncey was of the opinion that defects in ancillary equipment such as heating boilers would be subject to the normal *Donoghue* principles if such defects gave rise to damage to other parts of the building. This observation reveals the analysis behind the theory: the loss in such cases is classified as physical damage since it involves one distinct part of a structure physically damaging another part and is therefore recoverable as physical damage under *Donoghue* principles.

The complex structure theory, like the first situation of dangerous defects causing physical damage, is therefore not a true exception to the general rule that there can be no recovery in negligence for pure economic losses. It merely provides a way of characterizing the type of damage such that the plaintiff's claim is not barred by the rule.

3. *Endangering neighbouring land or public highways*

Lord Bridge made one exception to the general rule that pure economic losses arising from defects in property are not recoverable. He said:

> if a building stands so close to the boundary of the building owner's land that after discovery of the dangerous defect it remains a potential source of injury to persons or property on neighbouring land or on the highway, the building owner ought, in principle, to be entitled to recover in tort from the negligent builder the cost of obviating the danger, whether by repair or by demolition, so far as that cost is necessarily incurred in order to protect himself from potential liability to third parties.[31]

Thus the cost of remedying defects which pose danger to neighbouring property or users of public highways, although in the nature of pure economic losses, are recoverable as an exception. Lord Bridge does not explain the justification for the exception but one can postulate that the reason is probably to remove the disincentive to rectify dangerous defects at the plaintiff's own expense in cases where there is danger to

[30] *Supra*, note 3, at 942b-c.
[31] *Supra*, note 3, at 926b-c.

third parties. It remains to be seen whether this exception will be applied in future cases, being merely *obiter dicta* of only one judge, who had provided no legal explanation or basis for the qualification.

It is noted that none of the "exceptions" *1, 2* and *3* apply to the facts of *Ocean Front.*

IV. The Plaintiff's Options and Solutions

A. *Contract*

Since pure economic losses caused by defects in property are not recoverable in tort, plaintiffs who suffer such losses must seek their remedy in contract. In *Ocean Front*, a contract action would involve *all* the subsidiary proprietors (owners of individual lots) of Bayshore Park bringing an action against the developers for the defects in the common property, since the common property is owned by all the subsidiary proprietors, who have sale and purchase contracts with the developers. According to Warren Khoo J in *Ocean Front*, the management corporation cannot take a representative action on behalf of all the subsidiary proprietors under section 116 of the Land Titles (Strata) Act[32] in a situation where the defects only affect the general body of owners in their enjoyment of the common facilities but where no particular lots are affected by the defects in the common property.[33] To require each and every subsidiary proprietor to sue is highly impractical and practically, almost unworkable.[34] This is probably one of the reasons why the Land Titles (Strata) Act[35] gives the management corporation the capacity to sue and be sued in matters affecting the common property. On the facts of *Ocean Front*, where the management corporation is suing in its own capacity for defects in the common property, it cannot sue in contract since there are no sale and purchase agreements between them and the developers. Its cause of action lies in tort. Unfortunately, because the damage suffered is in the form of pure economic losses, there is no recovery.

B. *Legislation*

In England, a builder may be liable under section 1 of the Defective Premises Act 1972[36] which provides that:

[32] Cap 158, 1988 ed.
[33] *Supra*, note 1, at 761B-762G.
[34] See the remarks of Warren Khoo J on this point in *Ocean Front*, *supra*, note 1, at 759G-760E.
[35] *Supra*, note 32, s 33.
[36] 1972, c 35.

> a person taking on work for or in connection with the provision of a dwelling... owes a duty... to see that the work he takes on is done in a workmanlike or... professional manner, with proper materials and so that as regards that work the dwelling will be fit for habitation when completed.

The duty is owed to the person who orders the work and every person who subsequently acquires an interest in the dwelling.[37] Thus where a builder has breached his duty by constructing defective property, the owner can recover the resulting losses even if such losses are in the nature of pure economic loss.

There is no equivalent provision under the law in Singapore. Thus while there is statutory redress for owners of defective properties in England, there is none in Singapore. *Ocean Front* demonstrates a legal gap in the law. Perhaps it is time that Singapore considers providing for such a remedy in cases of losses occasioned by defective property. On present tort law, it might be arguable that no such remedy is available.

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[37] See notes in *Halsbury's Statutes of England* (1994), Vol 31 at page 246.

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