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22 April 2010

The Secretary
The Owners – Strata Plan No. 50785
C/- Strata Title Management
PO Box 2727
TAREN POINT NSW 2229

By Email: MPrice@stratatitle.com.au

Dear Sir

RE: DISPUTE CONCERNING PENTHOUSE BALCONY TILING

We refer to Michael Price's emails dated 31 March and 12 April 2010.

1. Our Brief

You have instructed us to advise the owners corporation in relation to its dispute with Mosaic Design Company Pty Limited ("Mosaic") regarding the defective waterproofing and tiling works carried out to the balcony of apartment C77 in 2007. You have specifically asked us to advise on whether the owners corporation is able to recover compensation from Mosaic, its director, Barry Bulmer, and certain former executive committee members.

2. Your Instructions

In 2006 it became apparent that the tiles and waterproofing membrane laid on the balcony floor of apartment C77 were defective and needed to be replaced. Two former members of the executive committee, Denis Solari and Geoff Bursill, engaged Mosaic to remove and replace the tiles and waterproof membrane on the balcony on behalf of the owners corporation ("tiling works"). The tiling works were carried out between about January 2007 and April 2007.

The tiling works are defective in a number of respects. About 75% of the tiles are drummy. Water oozes from beneath the tiles when pressure is applied to them. There is no formal termination of the waterproof membrane which is likely to cause water penetration problems. The tiling works do not comply with the applicable Australian Standard (AS 3958.1). Your building consultant has prepared a report which identifies these defects and recommends that the tiles and waterproofing membrane be removed and replaced ("remedial works").

Liability limited by a scheme approved under Professional Standards Legislation

The tiling works cost about $73,000.00 and you believe the remedial works will cost a similar amount. Mosaic has refused to acknowledge that there is a problem with the tiling works and it is therefore not prepared to fix the problem.

You recently discovered that: the tiling works were carried out without a written contract, Mosaic was not licensed to carry out the tiling works, Mosaic did not hold home warranty insurance in relation to the tiling works and Mosaic is being deregistered by the Australian Securities and Investments Commission.

You have asked us to advise on the owners corporation's rights to recover compensation, presumably for the cost of the remedial works, from Mosaic, its director, Barry Bulmer, and the former executive committee members who engaged Mosaic to carry out the tiling works.

3. Executive Summary

3.1 Claim Against Mosaic

The owners corporation is able to claim compensation from Mosaic because Mosaic carried out the tiling works in a negligent manner and in breach of contract. The owners corporation's case against Mosaic is strong. However, the owners corporation is unlikely to recover compensation from Mosaic because the company appears to have limited financial means meaning there is probably little point suing Mosaic.

3.2 Claim Against Barry Bulmer

The owners corporation may be able to sue the director of Mosaic, Barry Bulmer, to recover compensation from him on the grounds that:

- Mr Bulmer contracted to do the tiling works rather than Mosaic, and Mr Bulmer carried out the tiling works in breach of contract and in a negligent manner.

- Alternatively, if Mosaic contracted to do the tilings works, then Mosaic is a sham or acts as Mr Bulmer's agent as a result of which Mr Bulmer should be made personally liable for the wrongs committed by Mosaic.

- Mr Bulmer engaged in misleading and deceptive conduct.

We do not have enough information to enable us to definitively advise on the prospects for success of any claim against Mr Bulmer, nor do we know anything about Mr Bulmer's financial circumstances to advise on his ability to pay any compensation to the owners corporation. Based on the limited information we have, any claim against Mr Bulmer would have no better than a 35%-50% chance of success.

3.3 Claim Against Former Executive Committee Members

The former executive committee members owed the owners corporation a duty to exercise reasonable care and skill when engaging Mosaic and authorising payment of Mosaic's bills. They probably breached that duty, and were negligent, when they:

- gave Mosaic the job when it was unlicensed and did not have home warranty insurance.

- authorised payment of Mosaic's bills when the owners corporation had no legal obligation to pay those bills because Mosaic was uninsured.

The owners corporation can sue the former executive committee members in negligence to recover compensation. The chances of winning any claim against the former executive committee members are about 50-65%.

If the owners corporation claims against the former committee members it is likely they will refer the claim to your office bearers' liability insurer. Therefore, any claim against the former committee members will affect the owners corporation's insurance premium. And if the claim is successful, the owners corporation will need to pay an excess. You will need to consider these matters to gauge whether a claim against the former committee members is financially viable.

3.4 Claim Against the Sub-contractor

The owners corporation may be able to claim compensation from the sub-contractor who performed the tiling works owing to the sub-contractor's negligence. We have limited information about the sub-contractor's involvement in the tiling works but based on that information, the chances of winning any claim against the sub-contractor are no greater than 50%.

This is only a summary of our advice. You should read the legal analysis which follows to understand how we have arrived at these conclusions.

4. Recommendation

You should now send letters of demand to Mr Bulmer, the former executive committee members and the sub-contractor. The letters to the former committee members should request that they refer your claim to your office bearers' liability insurer. We can prepare these letters if need be. You should also decide quickly whether you want to sue Mosaic because it is about to be deregistered. Once Mosaic is deregistered it will cease to exist and you will not be able to sue it.

5. Legal Analysis

5.1 Claim against Mosaic

Mosaic was a building professional. Building professionals have obligations to their clients. These obligations arise in three ways: under the contract between the building professional and client; under statute; and in tort under the law of negligence. When a building professional breaches any of these obligations they may be liable to compensate their client for any financial losses suffered.

5.1.1 Liability under Contract

Whilst there was no written contract between the owners corporation and Mosaic, there is likely to have been an oral or implied contract between the parties. This contract was probably made by or came into existence because of the conduct of the former executive committee members, Denis Solari and Geoff Bursill, and Mosaic's representative, Barry Bulmer.

The contract governs, in part, the rights, obligations and liabilities of the parties in relation to the tiling works. The contract, being a contract for building works, contains several terms and conditions including:

- An implied term that Mosaic would exercise reasonable care and skill in carrying out the tiling works: see *DE Pasquale Bros Pty Ltd v. Cavanagh Biggs Partners Pty Ltd* (1999) Aust Torts Reports 81-251.

- An implied term that the tiling works would be performed in a proper and workmanlike manner: see *Cassidy v. Engwirda Construction Co. (No. 2)* [1968] Qd R 159.

- An implied term that the products supplied would be fit for their intended purpose: see *Doug Rea Enterprises Pty Ltd v. Hymix Australia Pty Ltd* (1988) 4 BCL 67.

- An implied term that Mosaic would be legally entitled to perform the work (i.e. that Mosaic was appropriately licensed): see *Byers v. Dorotea* (1986) 69 ALR 715.

Further, the tiling works were a type of residential building work. The performance of residential building work in NSW is governed by the *Home Building Act 1989* ("the HBA"). Section 18B of the HBA implies into every contract to do residential building work a number of warranties including:

- A warranty that the work will be performed in a proper and workmanlike manner.

- A warranty that all materials supplied by the builder will be good and suitable for the purpose for which they are used.

- A warranty that the work will be done in accordance with and will comply with the HBA and any other law.

- A warranty that the work will result, to the extent of the work conducted, in a dwelling that is reasonably fit for occupation as a dwelling.

- A warranty that the work and any materials used in doing the work will be reasonably fit for the specified purpose or result that was made known to the builder by the person for whom the work was done (i.e. that the tiling works would result in a weatherproof balcony, with stable, fixed tiles, which would not leak water into other units in the building).

The inspection report prepared by Strathclyde Building Services concludes that the tiling works are defective for a number of reasons which we outlined in the introduction to this letter. Therefore provided the opinions of your building consultant are correct, Mosaic breached the terms and warranties which were implied into the contract for the tiling works because, for example, the tiling works were not done in a proper and workmanlike manner; Mosaic did not exercise reasonable care and skill in performing those works; and the works are not reasonably fit for their intended purpose. Therefore Mosaic is in breach of its contract with the owners corporation.

Where a builder is in breach of contract, the law entitles the builder's client to recover damages (i.e. a court awarded sum of money) against the builder. An award of damages in contract aims to place the injured party in the same position as if the contract had been performed: see *Gates v. City*

Mutual Life Assurance Society Ltd (1986) 160 CLR 1. In the context of building cases, where a builder contracts to construct a building and the building contains defects, the normal measure of damages is the cost of rectifying the defects (in excess of any amount of the contract price that is unpaid) so that the client has what he or she contracted to get provided rectification is a reasonable course to adopt: see *Bellgrove v. Eldridge* (1954) 90 CLR 613. The client may also recover consequential losses by reason of the breach of contract.

So, to take a simple example, if the contract price is $80,000.00, $50,000.00 of which has been paid to the builder, and it will cost $70,000.00 to rectify the defects, the injured party will be entitled to recover approximately $40,000.00 in damages.

Therefore the owners corporation would be able to sue Mosaic for breach of contract to try and recover the cost of the remedial works and any consequential losses it suffered because of Mosaic's breach of contract. The owners corporation's case is strong based on the conclusions reached in the report of Strathclyde Building Services. Any claim for breach of contract would need to be made within six years of the breach: see section 14 *Limitation Act 1969*. Any claim for a breach of the statutory warranties would need to be made within seven years after completion of the tiling works: see section 18E HBA.

5.1.2 Liability under Statute

The HBA governs the performance of residential building work in NSW. The HBA contains a number of provisions including a provision which:

- Prohibits a person from contracting to do any residential building work unless that person is the holder of a contractor licence authorising its holder to contract to do that work: section 4.

- Requires contracts for residential building work to be in writing and contain certain information including a sufficient description of the work to which the contract relates: section 7.

- Prevents a person who contracts to do residential building work from recovering payments for work done under the contract where they are not licensed to do the work or the contract is not in writing or does not have a sufficient description of the work to which it relates: section 10.

- Requires a builder who contracts to do residential building work costing more than $12,000.00 to have in place a policy of home warranty insurance for the work: section 92.

- Prevents a person who does work without a contract of insurance from demanding or receiving a payment under the contract or in any other manner for the work where there is no home warranty insurance in place in relation to the work: sections 92 and 94.

- Requires that home warranty insurance must insure the person for whom the work is done and their successors in title against (among other things) the risk of being unable to recover compensation from the builder for defective work because of the builder's insolvency, death or disappearance for a period of six years after completion of the work (where the loss arises from a structural defect) and for a period of two years after completion of the work (where the loss arises from a non-structural defect): sections 99 and 103B.

Mosaic contravened the HBA when it contracted with the owners corporation to do the tiling works whilst being unlicensed and by not having in place a policy of home warranty insurance for those works.

This has two main consequences.

Firstly, the owners corporation could have refused to pay Mosaic's bills under the contract: see section 94. Although Mosaic would have had a right to sue the owners corporation to recover reasonable compensation for the work it did under the law of restitution, it would only have been able to recover an amount that a court or tribunal considered just and equitable. In circumstances where the tiling works were defective, and needed to be completely replaced, Mosaic may not have recovered anything for the work it did.

Second, Mosaic and Mr Bulmer are liable to be fined up to $110,000.00 and $22,000.00 respectively for each contravention of the HBA committed by them: see sections 134 and 137 HBA which make Mr Bulmer liable for certain contraventions of the HBA committed by Mosaic in his capacity as a director of Mosaic. Proceedings for contravening the HBA are normally dealt with in the Local Court and must be commenced within three years after the relevant contravention. The proceedings are normally taken by the Director General of the Office of Fair Trading but could be taken by the owners corporation. Unfortunately, the court cannot order Mosaic or Mr Bulmer to pay the owners corporation damages under these penalty provisions. The court can only impose a fine on Mosaic and Mr Bulmer and the fine is not payable to the owners corporation. Therefore, prosecuting Mosaic and Mr Bulmer for their breaches of the HBA are not likely to be attractive to the owners corporation because it will not be able to recover any compensation by doing so.

The owners corporation could normally lodge a complaint with the Home Building Service of the Office of Fair Trading regarding Mosaic's faulty workmanship. However, it appears that the HBA does not allow the Office of Fair Trading to investigate complaints against unlicensed builders: see section 48C.

Therefore, apart from giving the owners corporation a right to sue Mosaic for breaches of the statutory warranties found in section 18B, the HBA does not offer the owners corporation any way of recovering compensation from Mosaic.

5.1.3 Liability in Negligence

A building professional will be liable to a party in negligence if: the building professional owed the party a duty of care; the building professional breaches the duty of care; the party suffered loss or damage; and the loss or damage was caused by the building professional's breach of duty.

A building professional owes a duty of care to the builder's client under the common law. This is a duty to exercise reasonable care and skill in the course of carrying out work for the client: *Voli v. Inglewood Shire Council* (1963) 110 CLR 74. The building professional is required to exercise the care and skill of an ordinary skilled person within that profession not an extraordinary degree of skill or the highest professional attainment. But the builder must "bring to the task he undertakes the competence and skill that is usual among [builders] practising their profession."

Based on the report of Strathclyde Building Services it is apparent that Mosaic did not meet the standard of care and skill expected of a contractor carrying out tiling works and it was therefore

negligent. Where a builder is negligent and their client suffers financial loss, the client is able to sue the builder to recover damages owing to the builder's negligence. The aim of an award of damages by a court is to restore the client to the position in which it would have been placed if the wrongful act (i.e. the builder's negligence) had not been committed: *Todorovic v Waller* (1981) 150 CLR 402. Normally a court will award the client, as damages, the diminution in value of the damaged building or the cost to rectify the defective work.

Therefore the owners corporation could sue Mosaic to recover compensation from it owing to Mosaic's negligence and the owners corporation would be entitled to an award of damages which reflects the cost of the remedial works. Any claim in negligence would need to be made within six years of the owners corporation suffering damage: see section 14 *Limitation Act 1969*.

5.1.4 Mosaic's Financial Position

Mosaic is currently being deregistered by the Australian Securities and Investments Commission. Our enquiries have revealed that Mosaic is being deregistered at its request or the request of Mr Bulmer. Normally a company can only apply to be deregistered if certain preconditions are met including that the company is not carrying on business and the company's assets are worth less than $1,000.00: see section 601A of the *Corporations Act 2001*. A company cannot be voluntarily deregistered where it is a party to any legal proceedings.

Therefore it is likely that Mosaic has limited financial resources meaning that if the owners corporation were to sue Mosaic it would be unlikely to recover any money (or any significant money) even if it won the case. This assumes that Mosaic's application to be deregistered is made bona fide and it genuinely has less than $1,000.00 in assets. We have no way of knowing whether this is actually true but it certainly seems more likely than not that Mosaic has limited financial means and would not be able to pay any money to the owners corporation if a court ordered it to. There may therefore be little point in suing Mosaic.

Nonetheless, if the owners corporation wants to sue Mosaic it needs to move quickly because once Mosaic is deregistered, the company will no longer exist and the owners corporation will not be able to sue it unless it applies to the Supreme Court to have the company reinstated (which is expensive and has no guarantee of success).

5.2 Claim against Barry Bulmer

5.2.1 The Corporate Veil

A company is a separate and distinct legal entity. It enters into its own contracts and becomes liable for its breaches of those contracts or negligence. This is so even though the company is managed by persons and has no real mind of its own. This proposition was settled by the famous case of *Salomon v. Salomon & Co* (1897) AC 22 where the English Court said that a company and the individuals forming that company (even if there is only one individual) are separate legal entities however complete the control might be by one of those individuals over the company. Therefore, it is the company, and not the persons that operate it, that are liable to outsiders for the company's debts and for any legal wrongs committed by the company.

5.2.2 Piercing the Corporate Veil

In very limited circumstances the persons operating a company, such as its directors, can be held personally liable for the wrongs committed by the company. When this occurs the "corporate veil" is said to be lifted or pierced.

There is no hard and fast rule as to when the courts will occasionally pierce the corporate veil and make the directors of a company liable for any wrongs committed by the company: *Briggs v. James Hardie & Co Pty Ltd & Ors* (1989) 7 ACLC 841. Usually this will only occur where:

- The company is found to be the agent of the person who is controlling it.
- Where the company is a "mere cloak or sham" or an instrument of fraud.
- Where a statute makes the persons behind the company, such as its directors, personally liable for the company's debts: for example, sections 588G and M of the *Corporations Act 2001* which make the directors of a company personally liable for the company's debts incurred during insolvent trading.

(see the circumstances in which courts have typically lifted the corporate veil discussed in *Pioneer Concrete Services Ltd v. Yelnah Pty Ltd* (1986) 5 NSWLR 254)

The English case of *Smith, Stone & Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116, provides one of the few examples of where a company was found to be the agent of another person controlling it and hence the corporate veil was lifted. The Birmingham Corporation wanted to compulsorily acquire premises on which a waste paper business was purportedly carried on by Birmingham Waste Co Ltd ("BWC"). BWC's name appeared on stationery and on the premises but it was a wholly owned subsidiary of another company that owned the premises ("P"). The Birmingham Corporation would not have been liable to pay compensation to BWC for business disruption because its tenancy was terminable at will by P. However, P claimed that it really conducted the business and was therefore entitled to receive compensation. The court said the main question was whether BWC was carrying on the business for itself or for P. The evidence showed that BWC in truth carried on the business for P. The court lifted the corporate veil, ignored BWC and determined that P was in fact operating the business.

Gilford Motor Company v Horne [1933] Ch 935 provides an example of where the corporate veil was pierced on the basis that the company in question was a sham intended to avoid certain personal obligations of its director. Horne had promised in his contract of employment as managing director of G that he would not at any time solicit G's clients. Horne subsequently formed a company ("Z") with his wife. Z then solicited G's clients. The court held that Horne's assertion that the business was Z's rather than his, was a mere 'sham' or 'cloak'; especially since one of the reasons for Z's creation was so that Horne could evade his covenant with G. The court therefore decided to overlook the fact of Z's incorporation (or the fact that Z actually owned the business) and held Horne liable for breaching his contract with G.

Our enquiries have revealed that Barry Bulmer has at all material times held a contractor licence under the HBA for tiling whilst Mosaic has never held a contractor licence. This means that Mosaic has never been permitted to carryout tiling work. In these circumstances, it is arguable that:

- Mr Bulmer is really the builder or tiler, not Mosaic, and that Mosaic has only ever acted as his agent, intermediary or puppet, it not actually performing any tiling work or entering into any contracts for tiling work, but merely providing a letterhead and ACN to facilitate the operation of Mr Bulmer's business, and that it is, in truth, Mr Bulmer carrying on the business and who has complete control over Mosaic. If this is true, then a court might ignore Mosaic and hold Mr Bulmer personally liable for Mosaic's negligence or breach of contract.

- Mosaic is a sham, cloak or façade designed to avoid Mr Bulmer incurring any obligations under the HBA, or any contractual obligations with his clients, Mosaic holding no assets, employing no staff and having no place of business separate to that of Mr Bulmer. If this is true then a court may ignore Mosaic and hold Mr Bulmer personally liable for Mosaic's wrongs.

We do not know enough about Mosaic and Mr Bulmer's circumstances to be able to say whether a court would be willing to ignore Mosaic and hold Mr Bulmer to account for Mosaic's wrongs. However it is certainly possible that Mosaic acts as Mr Bulmer's agent or is merely a sham given that it has never held a contractor licence.

5.2.3 Did Mr Bulmer Enter into Contract Himself?

It is certainly possible that Mr Bulmer contracted with the owners corporation to do the tiling works rather than Mosaic. Whether this is so will depend on the intention of the parties, viewed objectively: *Ryledar Pty Ltd & Anor v Euphoric Pty Ltd* [2007] NSWCA 65 at [262]–[266] and cases there cited. The identification of the parties to the contract will be determined by analysing the circumstances leading up to and (possibly) after the making of the contract for the tiling works: *Dennis Pethybridge v. Stedikas Holdings Pty Ltd* [2007] NSWCA 154. Unfortunately we do not know what transpired before and after Messrs Bursill and Solari engaged Mosaic or Mr Bulmer to do the tiling works so we cannot identify with any certainty the party with whom the owners corporation contracted.

The law reports are littered with cases concerning whether a (building) contract was made with a company, or with the man who stands behind the company. A recent example is *Suncorp Metway Insurance Ltd v Owners Corporation Sp 64487* [2009] NSWCA 223. There a developer engaged a builder to construct townhouse units in Epping. After the townhouses were complete, they became the subject of a strata scheme. The building work was defective. The owners corporation sought to claim against the builder's insurer to recover the cost of repairing the defects. The builder was either Head & Sons Pty Ltd (which did not hold a contractor licence) or its directors, Clive Head and Andrew Head (each of whom held such a licence). There was no written contract for the building work. The insurer only covered Clive and Andrew Head, not Head & Sons Pty Ltd, because the Heads held the contractor licences. The insurer argued Head & Sons Pty Ltd entered into the contract for the building work with the developer, not the Heads personally, so that it was not liable to accept the insurance claim made by the owners corporation. The owners corporation contended that the Heads entered into the building contract. The NSW Court of Appeal agreed with the owners corporation. It found that the builders were the Heads and not the company. The case turned on its facts. The court analysed the documents which came into existence before and after the building contract was created, and the conduct of the parties around those times, and concluded that, even though there was no written contract for the building work, those documents and the parties' conduct showed that it was more likely than not that the Heads were the parties to the contract. The

court also said that the fact that the company carried out the building work did not prove that it was the party to the contract (although that was important).

Pethybridge v. Stedikas Holdings Pty Ltd (cited above) is another recent example of a case where the court had to decide whether a company or the man behind the company entered into a building contract.

These cases show that the question of who entered the contract is decided by a careful analysis of the parties' conduct leading up to and (possibly) after the formation of the contract. There is certainly an argument that it was Mr Bulmer who entered the contract because he held the licence to do the tilings works and, presumably, he would not allow his company to enter a contract in breach of the law (by not being licensed to do the work). However the limited information we have suggests that it was Mosaic who contracted with the owners corporation. This is because the bills for the tiling works were issued on Mosaic's letterhead and in correspondence after the conclusion of the job the parties seem to have assumed that Mosaic did (or contracted to do) the tiling works. However we have only sighted a limited selection of the paperwork. You will need to provide us with all of the material that passed between the parties around the time Mosaic or Mr Bulmer were engaged to do the tiling works in order to enable us to form a firmer view on who the contracting party was. Suffice to say, if Mr Bulmer contracted to do the tiling works, he would be personally liable for the contract breaches and negligence we reviewed earlier.

5.2.4 Misleading and Deceptive Conduct

There may be another way that Mr Bulmer could be held personally liable for any financial loss suffered by the owners corporation. The *Fair Trading Act 1987* ("the FTA") and the *Trade Practices Act 1974* ("the TPA") contain a number of laws which are designed to protect consumers, including owners corporations, against misleading and deceptive trade practices. These laws forbid a person or company from engaging in conduct, in trade or commerce, that is misleading or deceptive or which, for example, falsely represents that services are of a particular standard, quality, value or grade: sections 42 and 44 FTA (dealing with persons); sections 52 and 53 TPA (dealing with corporations). Further, section 75B of the TPA makes a person who is knowingly involved in a contravention of section 52 of the TPA, by for example, aiding, abetting or procuring the contravention, personally liable for the contravention.

A person who suffers loss or damage by reason of the conduct of another person that breaches these consumer protection laws in the FTA and TPA may recover the amount of the loss or damage from the other person involved in the contravention in a court of competent jurisdiction: section 68 FTA; section 82 TPA. The measure of damages to which the injured person is entitled is the difference between the position they are in and the position they would have been in had the other person not engaged in the conduct complained of: see *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1.

We do not know what representations were made by Mr Bulmer leading up to the appointment of Mosaic to carry out the tiling works. However, it is possible that Mr Bulmer represented that Mosaic was licensed to carry out the tiling works and/or held home warranty insurance for those works. If Mr Bulmer made representations to this effect then he would have engaged in misleading and deceptive conduct and, possibly, represented falsely that the services to be provided by Mosaic were of a certain quality (i.e. licensed contractors would be doing the job).

Even if Mr Bulmer did not make those representations, and instead remained silent about Mosaic's licensed and uninsured status, he would probably have been guilty of engaging in misleading and deceptive conduct. This is because, in the circumstances, the law would have imposed a positive obligation on Mr Bulmer to advise the owners corporation that Mosaic was not licensed to carry out the tiling works and did not have in place any home warranty insurance for those works due to the prohibitions on unlicensed and uninsured contracting for residential building work found in the Act. In the leading case of *Demagogue Pty Ltd v. Ramensky* (1992) 39 FCR 31, the Federal Court said that before a failure to speak would constitute misleading or deceptive conduct there would need to be a reasonable expectation that silence would be broken. In our view it is likely that a court would take the view that Mr Bulmer was under an obligation to inform the owners corporation that his company was not licensed to do the tiling works and, possibly, did not have home warranty insurance for those works and that by failing to divulge that information he engaged in misleading and deceptive conduct.

To be successful in any claim against Mr Bulmer for misleading and deceptive conduct the owners corporation will need to show that it suffered loss or damage "by" or "as a result of" Mr Bulmer's or Mosaic's misleading and deceptive conduct. That is, there must be a real connection between Mr Bulmer's conduct and the loss for which the owners corporation seeks to be compensated: *Anema E Core Pty Ltd v Aromas Pty Ltd* [1999] FCA 904. Unfortunately it is likely that the loss the owners corporation has suffered was not caused by Mr Bulmer's misleading and deceptive conduct. Rather, that loss was caused by defective building work.

This is confirmed by the recent case of *Campbell v CJ Cordony and Sons Pty Ltd* [2009] NSWSC 63. There, Mrs Campbell engaged a builder, CJ Cordony and Sons Pty Ltd, to renovate her house. The builder was at all times represented by Mr Cordony. The renovations were carried out but they were defective. Mrs Campbell sued the builder for compensation to recover the cost of repairs owing to the builder's breach of contract. She also sued the builder for misleading and deceptive conduct. That claim was brought on the basis that the builder represented, falsely, that it held home warranty insurance for the renovations, when it did not. The representation was contained in the building contract for the renovations which contained a statement that the builder held home warranty insurance under the HBA and oral statements made by Mr Cordony. The representations were false. Mrs Campbell invoked section 75B of the TPA to sue Mr Cordony arguing that he was knowingly involved in the builder's misleading and deceptive conduct and therefore personally liable to her.

Mrs Campbell's argument was that were it not for the builder's false representations, she would have engaged another builder to do the job, who held insurance, and would have received defect free renovations or, if there were defects, compensation from the builder's insurer. In rejecting the claim for misleading and deceptive conduct, the court said that the damage and loss suffered by Mrs Campbell was not suffered "by" the builder's misleading conduct but that her damage was actually caused by the defective work being done.

Therefore it appears unlikely that Mr Bulmer would be personally liable to the owners corporation for any misleading and deceptive conduct engaged in by Mosaic or himself concerning the insurance status of Mosaic.

5.3 Claim against Former Executive Committee Members

5.3.1 Obligations of Executive Committee Members

The rules which govern the constitution, conduct and management of your executive committee and its members are found in the *Strata Schemes Management Act 1996* ("the SSMA"). However the SSMA Act does not say that the executive committee members owe any duties to the owners corporation. This is unlike the corporations legislation which contains a number of provisions by which the directors of a company owe certain duties to the company such as a duty to act in good faith in the best interests of the company and for a proper purpose: see sections 180 – 184 of the *Corporations Act 2001*. No court has ever had to decide what, if any, duties the members of an executive committee owe an owners corporation. For that reason this area of law is uncertain.

5.3.2 The Duty of Care Owed by Executive Committee Members

However the position of executive committee members of an owners corporation is analogous to the relationship between company directors and the company or committee members and a not for profit organisation. The common law imposes a duty of care and diligence on directors. This means that directors owe their company a duty to exercise their powers and discharge their duties with a degree of care and diligence that a reasonable person would exercise if they were a director of the company and had the same responsibilities as the directors. Further, committee members of not for profit organisations owe in the same measure, the common law duties which the law has imposed on company directors: see Fletcher K, *The Law Relating to Non-Profit Associations in Australia and New Zealand*, The Law Book Co Ltd, Sydney (1986) 289; see also Sievers A, '*The Honorary Director: the Obligations of Directors and Committee Members of Non-profit Companies and Associations'* (1990) 8 *C&SLJ* 87, 89.

Drawing on company law principles the following can be said about the relationship between executive committee members and an owners corporation:

- Executive committee members owe a duty of care and skill to an owners corporation.

- Executive committee members must exercise reasonable care and skill in the exercise of their functions.

- In determining whether an executive committee member has exercised reasonable care and diligence, one must ask what an ordinary person, with the knowledge and experience of the executive committee member, might be expected to have done in the circumstances if he or she was acting on his or her own behalf.

- The standard of reasonable care is generally that of an ordinary prudent person.

- In determining whether an executive committee member has breached the standard of care and diligence a court will have regard to the owners corporation's circumstances and the committee member's position and responsibilities in the owners corporation.

- Qualifications and experience can result in a higher standard of care being expected of executive committee members: see *AWA Limited v. Daniels and Ors* (1992) 10 ACLC 933*;*

AFC v. Gallagher (1993) 11 ACLC 286 and *Circle Petroleum (QLD) v. The Greenslade* (1998) 16 ACLC 1577.

- An executive committee member can be liable in damages for common law negligence: see *AWA Limited v. Daniels and Ors* (1992) 10 ACLC 933 which confirms that a company director can be held liable in damages for negligence.

These statements are drawn from the principals of directors' liability laid down in *ASIC v. Adler (No. 3)* (2002) 20 ACLC 576.

Drawing these principles together, it can be said that the former executive committee members, Mr Solari and Mr Bursill, owed the owners corporation a duty to exercise the reasonable care and skill of an ordinary prudent person when they (a) engaged Mosaic to carry out the tiling works and (b) authorised payment of Mosaic's bills.

5.3.3 The Failure to Check Insurances and Licenses

It is fair to say that an ordinary prudent person, particularly one holding legal qualifications and experience such as Mr Solari, would have, exercising reasonable care and diligence, ensured that Mosaic was licensed to do the tiling works and, more importantly, held home warranty insurance for those works. There is therefore a strong likelihood that a court would decide that the former executive committee members were negligent when they engaged Mosaic because Mosaic was not licensed and not insured. (Of course, we do not know what, if any, investigations Messrs Bursill and Solari made at the time they engaged Mosaic. For example, if they were told by Mr Bulmer that Mosaic was licensed and insured and they were presented with evidence to confirm this (even if that evidence was fraudulent) then a court would be reluctant to hold that they acted negligently in those circumstances.)

5.3.4 The Causation Problem

However the former executive committee members will not be liable to pay damages for any negligent act or omission on their part unless their negligence caused the owners corporation to suffer financial loss. Much like a claim for damages under the FTA or TPA, any damages or losses suffered by the owners corporation must have been caused "by" the negligence of the former executive committee members, otherwise they will not be held liable for that loss. However under the law of negligence, the committee members' negligent acts or omissions need only be *a* cause of the owners corporation's financial loss not *the* cause: *Alexander v Cambridge Credit Corp Ltd* (1987) 9 NSWLR 310. A court will apply a common sense test when deciding whether the committee member's negligence did, in fact, cause or materially contribute to the owners corporation's financial loss: *March v Stramare (E & MH) Pty Ltd* (1991) 171 CLR 506.

The ultimately question to answer is whether the owners corporation's loss is the result of the former committee members' actions. In our view, it is likely that a court would conclude that the real cause of the owners corporation's loss was the faulty workmanship of Mosaic, and not the executive committee members' negligence. We are fortified in our view by the comments made in *Campbell's* case, where the court came to the same conclusion albeit in the context of Mrs Campbell's misleading and deceptive conduct claim.

5.3.5 Proportionate Liability

Even if the conclusion we have reached about the culpability of the former committee members is wrong, their liability is likely to be severely reduced under proportionate liability legislation. Part 4 of the *Civil Liability Act 2002* allows a court to limit the damages for which a person is liable in certain types of claims to an amount reflecting that proportion of the damage or loss claimed that the court considers just having regard to the extent of the person's responsibility for the damage or loss: see section 35. The proportionate liability legislation would apply to any claim made by the owners corporation against the former committee members in negligence. Clearly the extent of the former executive committee members' responsibility for the owners corporation's financial loss is limited given that the real cause of the owners corporation's loss is Mosaic's faulty workmanship. In our view, the committee members' liability is likely to be reduced to 5%-15% of the owners corporation's losses under the proportionate liability legislation (if we are wrong and they are liable for their negligence in engaging Mosaic).

5.3.6 The Fault in Authorising Payment of Mosaic's Bills

Mosaic did not have in place a policy of home warranty insurance for the tiling works. In those circumstances, section 94 of the HBA would have operated to preclude Mosaic from claiming damages or enforcing any other remedy in respect of a breach of contract committed by the owners corporation in relation to the tiling works, or recovering money in respect of the works by any other means (such as a claim in restation by way of a quantum meruit). Therefore the owners corporation could have refused to pay Mosaic with virtual impunity.

That is not to say Mosaic would have been without any remedy. Section 94(2) of the HBA says that if a court or tribunal considers it just and equitable, Mosaic, despite the absence of the required insurance, could have recovered money in respect of the tiling works on a quantum meruit basis. However because the tiling works were defective, and need to be completely removed and replaced, costing the same amount as (or more than) the tiling works themselves, a court or tribunal would have been unlikely to consider it just and equitable to allow Mosaic to recover anything.

There is therefore a strong argument that the former executive committee were negligent when they authorised payment of Mosaic's bills in circumstances where (a) the owners corporation did not have to pay those bills or (b) Mosaic could not have recovered any money from the owners corporation for the tiling works and (c) no one checked to ensure the tilings works were not defective.

The owners corporation's damage or loss by reason of the former committee members' negligence is the amount paid to Mosaic. Here there is no problem demonstrating that the committee members' negligent acts caused the owners corporation's losses because those losses are the money paid to Mosaic (which payments were directly authorised by the committee members) not the costs to carry out the remedial works. There is also no apparent prospect of the committee members' liability being reduced under the proportionate liability legislation because it appears that they were wholly at fault.

In our view there is a reasonable chance (50% - 65%) that a court would award damages against the former committee members who authorised payment of Mosaic's bills due to their negligence.

5.3.7 Insurance Considerations

If you make a claim against the former executive committee members they will probably call on the owners corporation's office bearers' liability insurance cover. This will undoubtedly cause your insurance premium to rise. Also, you may need to pay an excess if your claim is accepted. You should find out by how much your insurance premium is likely to rise and the amount of the excess if your claim is accepted to ensure it will be financially viable to claim against the former executive committee members.

5.4 Claim against the sub-contractor?

The material you provided to us indicates that the tiling works were carried out by a sub-contractor, Eugene Tesoriero, who was presumably engaged by Mosaic. If this is correct then the owners corporation may have a right to sue the sub-contractor in negligence to recover damages.

There is no general principle of law that a sub-contractor cannot owe a duty of care to a builder's client with which it has no direct contractual relationship: *Gunston v Lawley* [2008] VSC 97. Although it may well be difficult for a client to show that the sub-contractor owes a duty of care. The present law in Australia does not have a "cut and dried" answer to the existence of this duty: *Gunston*.

In a typical domestic building contract, a client's assertion that a sub-contractor owes a duty of care to it with respect to the quality of the work performed by the sub-contractor will face difficulty: *Gunston*. Each case, however, must be examined in light of the facts which are said to give rise to the duty of care including the identity and position of the parties, the relationship between them and the duties undertaken by the sub-contractor.

The feature which is of great importance in determining whether a duty of care exists is vulnerability, that is, the ability of the client to protect itself from loss in the event of the sub-contractor's negligence. In the normal case, where a duty is said to be owed by a sub-contractor to a client, this requirement may be difficult for the client to satisfy. There will usually be a contract between the client and the builder which will contain covenants protecting the client from defective work. Even if it does not, it will be difficult in the typical case for the client to persuade a court that it did not have the ability to protect itself in this way: see also *Rail Corporation of New South Wales v Fluor Australia Pty Ltd* [2008] NSWSC 1348 at 34.

We cannot say whether the owners corporation's case against the sub-contractor would be successful because we do not know anything about the relationship between the owners corporation and the sub-contractor or the terms on which the sub-contractor was engaged. All we can say is that the owners corporation may have a right to sue the sub-contractor for damages in negligence.
We suggest that you write to the sub-contractor and try and ascertain whether he did carry out the tiling works. If he did then the owners corporation may wish to make a claim against him. As we know nothing about the sub-contractor's financial circumstances we do not know if he will be able to afford paying any damages to the owners corporation if ordered to do so by a court.

6. Recommendation

You should now send letters of demand to Mr Bulmer, the former executive committee members and the sub-contractor. The letters to the former committee members should request that they refer

your claim to your office bearers liability insurer. We can prepare these letters if need be. You should also decide quickly whether you want to sue Mosaic because it is about to be deregistered. Once Mosaic is deregistered it will cease to exist.

7. Conclusion

Mosaic was negligent and breached its contract with the owners corporation in relation to the tiling works. However, Mosaic is unlikely to have enough money to pay the owners corporation any compensation if ordered to do so by a court.

Mr Bulmer might be liable to compensate the owners corporation for breach of contract, negligence and misleading and deceptive conduct although your prospects of success against him are uncertain. Based on the limited material available to us, you chances of winning against Mr Bulmer are no more than 50%.

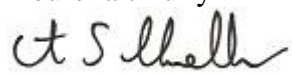
The former executive committee members might be liable to compensate the owners corporation for negligently authorising payment of Mosaic's bills. It would appear that your chances of winning should you sue the former committee members are about 50%-65%.

The sub-contractor responsible for the tiling works may be liable to compensate the owners corporation for negligence. Your chances of winning any claim against the sub-contractor are about 50% based on the limited information we have about his engagement.

Ultimately your prospects for success should you choose to sue Mr Bulmer, the former executive committee members and the sub-contractor will largely turn on the evidence which is presented to the court. We have not sighted much of that evidence. This necessarily limits the extent to which we are able to accurately advise you on your chances of winning. Nonetheless, the legal principles we have distilled in this letter should arm you with enough information to make a decision on the way forward.

We trust that our advice has clarified the owners corporation's rights against Mosaic, Mr Bulmer, the former executive committee members and the sub-contractor. We now **enclose** our Memorandum of Fees. We invite you to contact us to discuss our advice and the way forward.

Yours faithfully



J.S. MUELLER & CO
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