LEAKY VENDOR WARRANTIES

- Gareth Lewis

Gareth Lewis considers recent case law on the interpretation of vendor warranties in relation to building work under the REINZ/ADLS agreement for sale and purchase.

A property owner arranges for a building to be constructed on his or her property. The owner then sells. The issue of who as between vendor and purchaser bears the risk of the building being defective is of fundamental importance to the parties.

The vendor warranties in the REINZ/ADLS agreement are drafted in such a way that purchasers of leaky homes have been able to argue that some or all of this risk lies with the vendor. However, the correct interpretation of these warranties has been a matter of significant debate and the outcome of the vendor warranty claims is difficult to predict. With so much at stake, the way in which the Courts interpret these warranties is worthy of examination.

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REINZ/ADLS agreement

In New Zealand the principle of *caveat emptor* applies to contracts for the sale and purchase of land. This principle is subject to the terms of the agreement between the parties.

The seventh edition (2) July 1999 of the REINZ/ADLS agreement includes the following warranty:

"6.2 The vendor warrants and undertakes that at the giving and taking of possession:

(5) Where the vendor has done or caused or permitted to be done on the property any works for which a permit or building consent was required by law:

(a) the required permit or consent was obtained; and

(b) the works were completed in compliance with that permit or consent; and

(c) where appropriate, a code compliance certificate was issued for those works; and

(d) all obligations imposed under the Building Act 1991 were fully complied with.

In New Zealand the principle of caveat emptor applies to contracts for the sale and purchase of land. This principle is subject to the terms of the agreement between the parties.

In the seventh edition (3) July 1999 clause 6.2(5)(d) was amended to read: "all obligations imposed under the Building Act 1991 and/or the building Act 2004 (together the "Building Act") were fully discharged." Otherwise, clause 6.2(5) remained the same.

The eighth edition 2006 states at clause 6.2(5):

"(5) Where the vendor has done or caused or permitted to be done on the property any works:

(a) Any permit, resource consent, or building consent required by law was obtained; and

(b) The works were completed in compliance with those permits or consents; and

(c) Where appropriate, a code compliance certificate was issued for those works.

In the ninth edition 2012 clause 6.2(5)(b) was amended to read: "to the vendor's knowledge, the works were completed in compliance with those permits or consents." Otherwise the clause remained the same as the eighth edition.

Work requiring building consent

An issue which can arise in vendor warranty claims is whether work requires a consent. In *Newton & Ors v Stewart & Ors* [2013] NZHC 970 the Court considered whether work fell within an exemption in schedule 3 of the Building Act for the lawful repair of a component or assembly that has not failed the durability requirements of the building code. Justice Williams decided:

- the work was a "repair" as it was an attempt to prevent water pooling on window moulds.
- in order to be "lawful" the repair had to meet the performance requirements of the building code, including clause E2 (external moisture), and the repair did meet code requirements.
- The moulds had not failed the durability requirements of the code (clause B2). They continued to serve their decorative purpose with or without the repair

Accordingly, the work did not require building consent and the vendor warranties did not apply.

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Interestingly, in *Ford v Ryan* (2007) 8 NZCPR 945 (HC) Justice Mackenzie decided that the warranty in clause 6.2(5)(d) (seventh edition) applied to building work which did not require building consent (a retaining wall) as it was part of a wider project for which a building consent was required.

Compliance with building consent

The issue of whether building work complies with the consent has proved to be a difficult issue.

In *Aldridge & Ors v Boe & Ors* (HC AK CIV-2010-404-7805 [10 January 2012]) Justice Potter considered an appeal from the Weathertight Homes Tribunal regarding an agreement which contained clauses 6.2 (5)(a) and (b) from the seventh edition (but not (c) and (d)). There was also a clause which excluded liability "in respect of the condition of the property" including the "condition or structural soundness of the buildings".

Justice Potter decided:

- it followed from the provisions of the Act that a warranty that building works were completed in compliance with a building consent includes a warranty that the works comply with the building code because the consent has been issued on this basis.
- the intention of the parties was not such that the clause should be read down.

However, the work was covered by the exclusion clause so the vendor warranty did not apply.

Justice Woodhouse considered the meaning of clause 6.2(5)(b) in another appeal from the Weathertight Homes Tribunal, *Keven Investments Ltd v Montgomery & Ors* [2012] NZHC 1596. The agreement was the eighth edition of the REINZ/ADLS agreement (which does not include clause (d)). At issue was whether clause (b) required compliance with the building code, in addition to the building consent plans. Justice Woodhouse held:

- the house only had to be built in accordance with the consented plans. Although the consent stated the work was to be undertaken in accordance with the plans and specifications "so as to comply with the provisions of the building code", this was merely an objective and not a directive.
- it is possible for a building to be constructed in accordance with the consented plans but not meet the building code so it would be unfair to require the vendor to comply with both.

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- if the parties intended to warrant compliance with the building code or more broadly all obligations imposed under the Building Act, they would have inserted an express provision to that effect.

In *Brebner & Ors v Collie* [2013] NZHC 63 Justice Peters considered an appeal from the Weathertight Homes Tribunal relating to a vendor warranty in the eighth edition of the REINZ/ADLS agreement. She agreed with Justice Woodhouse that compliance with the building consent did not require compliance with the building code. The consent means the consent itself, the consent conditions and the plans and specifications. Justice Peters decided that clauses in the specification regarding the standard of work, including conformity with good trade practice, did not form part of the consent as they were matters of concern to the contracting parties only.

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Justice Asher addressed the issue of what forms part of the building consent in another appeal from the Weathertight Homes Tribunal, *Saffioti v Ward & Ors* [2013] NZHC 2831. The consent stated that "all endorsements on plans form part of the building consent and must be adhered to". The plans included "Architectural Notes", one of which required compliance with the building code. Justice Asher decided the architectural note was not part of the consent as it did "not have the flavour of a condition or endorsement, and was no more than a general observation as to the standard to be observed by the builder". An "endorsement" in this context meant an endorsement imposed by Auckland City or where relevant the private certifier.

All obligations imposed by Building Act

The vendor warranty at clause 6.2(5)(d) of the seventh edition is drafted in very wide terms. The ADLS subcommittee which removed clause (d) in the eighth edition of the agreement stated:

> "The subcommittee considered, particularly in light of the litigation arising out of the "leaky home" crisis, that it is inappropriate for a vendor to give a blanket warranty that all

obligations under the Building Act have been fully discharged, especially as the obligations...are not limited to those imposed on the vendor...".

The first High Court decision on a vendor warranty which included clause (d) was *Ford v Ryan*. The purchaser in that case was unaware that a code compliance certificate had not been issued but was aware of significant building defects. Justice Mackenzie held there was a breach of clause (c) only. In his discussion of whether the defective exterior cladding system constituted a breach of clause (d) he stated that where a consent is required for the building works clause (d) only concerns building code matters to the extent that it prevents the issue of a code compliance certificate.

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Justice Ronald Young reached a different conclusion in *Hooft v Woodley & Ors* [2012] NZHC 2685, another appeal from the Weathertight Homes Tribunal. He stated there was no reason to read down clause (d) so that it only related to the vendor's obligations regarding building consents and code compliance certificates. The narrow approach would render clause (d) superfluous. Irrespective of whether there was compliance with clauses (a)-(c) the vendor warranted compliance with the Act, and therefore through section 7 of the Act, compliance with the building code.

Justice Ronald Young expressed concerns that vendors may be liable for a leaky home which shows defects the vendor has no knowledge of many years after construction. He stated there was an inherent restriction in clause (d) in that the vendor only warrants the work meets the building code as judged by the knowledge of construction work at the time. He decided the work in that case met that standard and there was no breach of warranty.

In *Saffioti v Ward* Justice Asher also considered the issue of whether clause (d) includes a warranty by the vendor that the work complies with the building code. He decided:

- clause (d) only refers to the obligations specifically placed on owners under the Building Act.

- section 7 of the Act, which states all building work is required to comply with the code, sets out a general purpose and principle and does not place any obligation on the owner to ensure compliance with the building code. Clause (d) cannot not create such a duty. In addition, the code is a schedule to the Act and not part of the Act.
- If the parties intended a radical departure from the *caveat emptor* principle they would have inserted an express warranty requiring compliance with the code.

Comment

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Under the 1991 and 2004 Building Acts the way in which the building is to achieve compliance with the building code is determined at the consent stage. Thereafter the focus is on compliance with the consent. Under both Acts the Council "inspection" means checking compliance with the consent. Under the 2004 Act Councils issue code compliance certificates based on compliance with the consent, not the code.

Accordingly, it will not be surprising if the final word on this topic is that a building consent does not automatically incorporate the requirements of the building code.

The approach of the Courts by which they decide parts of the plans or specifications do not form part of the consent, either because they only appear relevant to the contract between the parties or because they do not have the "flavour" of a consent condition, is likely to be problematic. It requires that judges and adjudicators engage in an arbitrary exercise which is likely to create significant uncertainty.

The consent is granted on the basis of the plans and specifications so the full content of both should be regarded as part of the consent. If the specification contains contractual provisions the Council does not wish to be included in the consent, it is free to require that these be removed before consent is issued. To the extent that the content of the consent may be internally inconsistent, the Court is able interpret the consent as a whole as it often does in the case of contracts with inconsistent provisions. As for onerous requirements in the plans/specifications, the vendor has the ability to check for these and delete clause 6.2(5)(b) if necessary.

It remains to be seen which reading of clause 6.2(5)(d) in the seventh edition will prevail. If Justice Ronald Young is correct that the clause requires compliance with the building code, it is submitted that the building work should be judged by the performance requirements of the building code not the "knowledge of construction work" at the time. Contrary to popular belief, the building code requirements relating to external moisture (E2) have not changed in any significant way since 1992.

There are a number of discussion points arising from Justice Asher's interpretation of clause (d) in *Saffioti*:

- In stating that clause (d) only applies to the "vendor's" obligations the Court did not follow the ordinary meaning of the clause. There does not appear to be anything in clause 6.2(5) as a whole or the reported facts of the case to warrant the clause being read down in that way.
- It is true that section 7 of the Building Act 1991 is within the "purposes and principles" in the Act and does not place a specific obligation on any party. However, "all obligations" under the Act relating to the building work need to be taken into account. If the Council complies with its obligations in issuing consent and the code compliance certificate and the owner and builder comply with their obligations to build in accordance with the consent one would ordinarily expect the building to comply with the building code.

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- The Court effectively said the obligations of the vendor in statute and the common law suggested an intention by the parties that was contrary to the wording of the clause. This appears to run counter to the freedom of the parties to reach their own agreement as to the allocation of risk between them.

If an appropriate case comes before the Court of Appeal many of these issues may be resolved. Claims which originate in the Weathertight Homes Tribunal cannot be appealed beyond the District or High Court, so it will require a High Court claim which is appealed to resolve these areas of contention. As time passes, further rulings on clause 6.2(5)(d) become less likely because of the removal of clause (d) in the eighth edition of the REINZ/ADLS form and the 6 year limitation period. The change to clause 6.2(5)(b) in the ninth edition will significantly restrict the ability of purchasers to claim. In the meantime, leaky building claims will continue to generate debate as to how the vendor warranties should be interpreted.

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