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THE HIGH COURT

2009 242 SS

IN THE MATTER OF THE ARBITRATION ACTS 1954 TO 1998 AND

IN THE MATTER OF SECTION 35 (1) OF THE ARBITRATION ACT 1954

AND IN THE MATTER OF ORDER 62 OF

THE RULES OF THE SUPERIOR COURTS, 1986

AND IN THE MATTER OF A SPECIAL CASE STATED BY AN ARBITRATOR IN THE COURSE OF A REFERENCE TO ARBITRATION

BETWEEN

BOWEN CONSTRUCTION LIMITED

PLAINTIFF

AND

KELCAR DEVELOPMENTS LIMITED

RESPONDENT

JUDGMENT of Mr. Justice Ryan delivered on the 16th day of October, 2009

1. Blarney Golf Resort, Co Cork consists of a golf course, a clubhouse, a hotel and 56 cottages. The course is owned by Kelcar Lands Ltd. and the clubhouse and hotel by a group of private investors. Eighteen of the cottages have been sold while the remaining 38 continue to be held by Frank and Derek McCarthy, the shareholders in Kelcar Developments Ltd., party to these proceedings. The resort is operated by BGR Limited, a wholly owned subsidiary of Kelcar.

2. The construction work for the development was carried out pursuant to a building contract between Kelcar Developments Ltd. [Kelcar] as employer and Bowen Construction Ltd. [Bowen] as contractor. Kelcar transferred the ownership of the buildings to others, including associated persons and companies, on foot of development agreements. Under one of the terms of the building contract, Bowen agreed to execute collateral warranties to give the transferees of the buildings similar rights to sue for defects as were contained in that agreement. The development agreements also contained warranties by Kelcar as to the quality of the buildings.

3. Pursuant to the undertaking in the building contract Bowen executed collateral warranties under seal in favour of the private investors, who own the clubhouse and the hotel, which conferred on them the right to pursue the contractor for defects. However, in the case of the cottage owners, although Kelcar and Bowen agreed that such warranties would be given, they have not, in fact, been executed. Bowen submitted that it is willing do to so but has not been called upon to execute any such warranty. Kelcar does not contest this proposition.

4. The arbitrator in a dispute under the building contract for the development has sought directions from the court in respect of issues that have arisen in the course of the hearing. Under s. 35 of the Arbitration Act 1954, he has stated questions of law in the form of a special case for the decision of the court. The legal issue raised is whether the employer who is party to the building contract can counterclaim and set off in the arbitration the costs of remedying defects, and anticipated consequential losses arising therefrom, in circumstances where those losses have been or will be sustained by other persons or companies who were not parties to the building contracts. The question has not been the subject of a written decision by a court in this jurisdiction but the English Courts have done so and the House of Lords considered the question as recently as 2001. In this reference, Bowen Construction Limited [Bowen] is the contractor and Kelcar Developments Limited [Kelcar] the employer in the building contract.

5. Kelcar does not have any legal interest in the buildings that have the alleged defects; neither does it operate the resort. The buildings are owned by different but (for the most part) associated persons or companies and the resort is operated by a wholly owned subsidiary company, BGR Ltd. When these issues came to light during the proceedings, the arbitrator gave leave for Kelcar to amend its points of defence and counterclaim, but he rejected an application to join BGR as a party in the arbitration. The amended pleading set up the cost of remedying the defects in the buildings, plus projected consequential losses ascribed to BGR, by way of counterclaim and set off, in reduction of the claim for extra payment under the contract. An amended answer by Bowen denied the legal validity of these claims on the grounds that Kelcar was not entitled to make them because it had not and would not sustain any losses itself and that the parties that had done so or would do so were not parties to the building contract.

6. It is claimed that there were serious defects in the buildings, particularly in the construction of the roofs, giving rise to a substantial claim for compensation in respect of repair costs and consequential loss. The claim for loss includes that of BGR which, it is said, will have to close the resort for the duration of the repair work and will suffer disruption of business. Bowen does not admit that any of these losses has arisen or will arise. It is however accepted that, for the purpose of answering the questions posed by the arbitrator, it is to be assumed that there were defective roofs and that they will give rise to the alleged losses, or some of them.

7. The contractor relies on the doctrine of privity of contract. Only a party to a contract can sue for breach. And a claimant can only recover losses that he has sustained or will sustain. Kelcar counters this argument on two grounds, which, to say the least, are not wholly consistent. In written submissions, it contends that the facts of the case come within an exception to the privity rule that has been recognised in a series of English cases, which reflect the

development of the Common Law and ought to be followed. In oral argument on the reference, Counsel for Kelcar adopted these written submissions but also made the case that the provisions of the building contract itself enabled the third party losses claims to be maintained. If this latter submission is correct, it means that it is unnecessary to rely on the privity exception and it would also seem that the amendments sought by Kelcar in the arbitration would not have been needed, because the claims could simply have been advanced under the building contract. I consider the second of these arguments before turning to the privity issue.

8. This contention is that clauses 21(A) and 21(B) apply to losses sustained by third parties and authorise the employer to make a claim in respect of such losses under the terms of the contract. Section 21(B) deals with insurance against damage to persons and property and it is contended that this has relevance because it requires a building contractor to arrange for insurance against the liability that is described in s. 21(A) but it does not appear to have any other significance. Clause 21(A) at para. (i) imposes liability on the contractor and an obligation to indemnify the employer in respect of any loss, damage or injury to personal property that "arises out of or in the course of or by reason of the execution of the works" if that is due to negligence or fault on the part of the contractor or a sub-contractor or their servants or agents. Paragraph (iii) excludes the building works themselves from the above liability up to the date of practical completion or earlier if the contractor's function is terminated. It is suggested that these provisions introduce a liability for loss or damage suffered by third parties after the date of practical completion or determination of the contractor's employment.

9. I cannot accept this interpretation. These contractual provisions in my view are intended to apply to entirely different situations from the one proposed. They deal *inter alia* with personal injury and damage to personal property that arise out of or in the course of the works, due to the negligence of the contractor or a sub-contractor or a servant or agent of either. For obvious reasons, the contract imposes or recognises that liability on the part of the contractor and provides for an indemnity for the employer and this liability comes to an end when the building work is practically completed. A reading of s. 21(B) which relates to insurance, confirms this meaning. It is simply a misreading to think that Clause 21(A) extends the contractor's liability to parties claiming losses by reason of defective execution of the building work, when para (iii) expressly excludes the works themselves. The time period specified is a limitation of liability not a commencement date.

10. Turning to the other argument made by Kelcar in its written submissions, this is that the case comes within the exceptions to the privity rule that have been recognised by the English Courts in order to avoid injustice. Kelcar says that Bowen's argument would result in a situation where the building contractor would be "entitled to escape all liability for its wrongdoing", i.e. on the agreed assumption for the purpose of this case that there are defects resulting from breach of contractual obligations.

11. The rule that a claimant cannot recover more than the amount required to compensate him for his own and not another's loss can result in injustice, as the 30th edition of 'Chitty on *Contracts'* remarks:-

> "because it can give rise to what has been called a 'legal black hole', that is, to a situation in which the promisor has committed a plain breach which has caused loss to the third party whom the contracting parties intended to benefit, but none to the promisee, and in which no other remedy (than damages for the third party's loss) is available against the promisor". (Para. 18-051)

12. The loss suffered by the aggrieved person who is not a party to the contract can fall into this legal black hole where the person does not have a remedy. In order to avoid this unjust situation, there are exceptions to the general rule.

13. The area of exception that is relevant to this case begins with *Linden Gardens Trust v. Lenesta Sludge Disposals Limited* [1994] 1 A.C. 85. The employer in that case under a building contract succeeded against the contractor, notwithstanding the fact that the site of the building work had been transferred to a third party. The contractor's argument that no loss had been suffered by the employer as he was no longer owner of the land when the alleged breaches occurred, and was therefore entitled to no more than nominal damages, was rejected in the House of Lords on two distinct grounds.

14. The so-called broader ground, which was proposed by Lord Griffiths, was that the employer was entitled to have the contract he had entered into performed by the other party so as to give the employer "the benefit of the bargain which the defendant had promised but failed to deliver". He said that the court would have to be satisfied that the repairs had been or were likely to be carried out, but subject to that, the disappointed party was entitled to have the contractual obligation fulfilled in accordance with what had been agreed.

15. The other members of the House of Lords in the *Linden Gardens* case based their decision on what is known as the narrower ground. They applied the exception that was recognised in the *Albazero* case [*Albacruz (Cargo Owners) v Albazero (Owners) (The Albazero)* [1977] A.C. 774], the rationale being that the contractor could foresee that parts of the new development were going to be occupied and possibly purchased by third parties, so that it could be foreseen that damage caused by a breach would cause loss to a later owner. The contractor could also foresee that a later owner would not have acquired rights under the building contract against the contractor since that contract expressly prohibited assignment by the employer without the contractor's written consent, which had not been sought. At para. 18-053, Chitty summarises the Linden Gardens case as follows:-

> "The effect of the Linden Gardens case was thus to extend the scope of the *Albazero* exception from contracts for the carriage of goods by sea to contracts generally, but it was consistent with two factors which had restricted the scope of that exception: namely, that (a) the loss or damage was caused to property which had been transferred by one of the contracting parties to the third party; and (b) the third party had not acquired any rights under the building contract and it was foreseeable (by reason of the prohibition against assignment) that he would not do so."

16. In *Darlington BC v. Wiltshire Northern Limited* [1995] 1 W.L.R. 68, the Court of Appeal effected an extension of the *Linden Gardens* decision to a situation in which there was no transfer of the property to the third party and this extension was subsequently approved by the House of Lords. This removed limb (a) of the restriction in the *Linden Gardens* decision

but it left limb (b) in place.

17. The latest case is a decision of the House of Lords, *Alfred McAlpine Construction Limited v. Panatown Limited* [2001] A.C. 518. The building contract was made, not between the building contractor and the company that owned the site but, for tax avoidance reasons, between the contractor and another company that was associated with the owner of the site and which was the employer under the building contract. A separate contract was made between the owner of the site and the contractor which imposed obligations on the contractor that were broadly similar but not precisely the same as those in the building contract and one of the differences was that it did not include an arbitration clause. In a subsequent arbitration, the employer claimed damages from the contractor who resisted the claim on the basis that the employer could recover no more than nominal damages since it was not the owner of the property. The House of Lords, by a majority, upheld the contractor's argument and so rejected the employer's claim for substantial damages in respect of the owner's loss.

18. The House considered whether the *Linden Gardens* grounds, either the broader or the narrow ground, supported the employer's claim. Chitty comments that the *Linden Gardens* exception did not apply:-

> "because the duty of care deed gave the owner an independent contractual right against the contractor."

19. The *Linden Gardens* exception was not needed because there was no risk of a legal black hole when the third party had its own contractual rights against the party in breach.

20. The majority in the House of Lords in the *Panatown* case also held that the rights enjoyed by the sustainer of the loss, pursuant to its separate contract, also precluded the employer from recovering damages under the broader ground advanced by Lord Griffiths in the *Linden Gardens* case. Chitty supports this aspect of the judgment, for two further reasons:-

> "First, the creation of extension of exceptions to the general rule that a party can recover damages only in respect of its own loss is, and should be, driven and limited by necessity: that is, by the need to guard against the risk of 'legal black holes' of the kind described above; and in the *Panatown* case, there was no such risk. Secondly, the decision gives effect to the 'contractual scheme' created by the parties; and this point, so far from being undermined by the fact that the contractor's obligations to the owner under the duty of care deed were not precisely conterminous with his obligations to the employer under the building contract, is reinforced by this fact." (Para. 18-056)

21. It follows from all this that there is no support in English authority for abandoning the general rule of privity of contract so as to enable a party to an arbitration to claim losses sustained, or allegedly sustained, by other parties in circumstances where those other parties enjoy their own legal rights to claim in respect of losses that they may have sustained.

22. Kelcar's Written Submission seeks to distinguish this case from *McAlpine v. Panatown* [2001] 1 A.C. 518 by relying on the separate development agreements that Kelcar made with the original owners of the 56 golf lodges (who still own 38 of them) and the owners of the clubhouse and hotel. The similarity with that case, however, is that the latter group can recover damages for defective construction from the builder under the warranty agreement. As to the lodge owners, the builder is bound by agreement to provide a similar warranty but that has not been executed to date.

23. Kelcar then relies on what is called the "broader ground" of liability in the building cases. This was the basis of the reasoning of Lord Griffiths in his speech in *Lindon Gardens Trust v. Lenesta Sludge Disposals Limited* [1994] 1 A.C. 85. It is that the employer in a building contract has a right to have the contract performed according to its terms and is therefore entitled to sue for substantial and not merely nominal damages in the event of breach, despite not being the owner of the building at the time of the claim, provided it is clear that he actually intends to carry out the repairs. *Lindon Gardens Trust* was a case where the claim was allowed as "a remedy where no other would be available to a person sustaining loss which under a rational legal system ought to be compensated by the person who has caused it." – speech of Lord Browne-Wilkinson at pp. 114 to 115.

24. In respect of the anticipated loss by BGR, Kelcar argues that there could be a legal black hole whereby BGR would suffer loss attributable to the breach of the building contract, but nevertheless be deprived of any remedy. The remedy proposed is for Kelcar to be entitled to make the claim. Kelcar submits in the alternative that it is entitled to abatement of the amount found due to Bowen in the cost of repairs to the buildings.

25. Bowen submits that the doctrine of privity of contract is well established in Irish law and casts doubt on whether the English authorities cited above ought to be followed, in so far as they afford any basis for Kelcar's argument. I do not think that *Burke (A Minor) v Dublin Corporation* [1991] 1 I.R. 341, which is relied on, has any application to the issue here. I am satisfied that the consensus of the English cases represents the development and application of existing principles of the Common Law to new situations, for the purpose of avoiding injustice, and that it ought to be followed.

26. Subject to the above reservation, the contractor relies on the *McAlpine v Panatown* [2001] 1 A.C. 518, citing the speech of Lord Browne-Wilkinson at p. 531 of the report at 531H et seq:-

> "If the contractual arrangements between the parties in fact provide the third party with a direct remedy against the wrongdoer the whole rationale of the rule disappears."

27. It seems to me that the cases cited, insofar as they are relevant to the issues in the case, yield to the following propositions:-

- Privity of contract together with the general prohibition on claiming for loss or damage sustained by third parties are subject to exceptions in order to avoid injustice.

• In building contract cases, the exception applies to cases where there would be a "legal black hole", meaning that the person who sustains the loss would be without any remedy in law, the person entitled to sue would not be able to prove substantial loss and the party in breach of contract would go scot-free.

• Where the party suffering the loss has a right of action against the person in breach of contract, the exception does not apply – *Alfred McAlpine Construction Limited v. Panatown Limited* [2001] 1 A.C. 518.

• On the "broader ground" that Lord Griffiths applied in *Lindon Gardens Trust*, the contracting party has a right to sue for failure to provide what was contracted for, if it is shown that he intends to do the remedial work but that basis of claim has not been adopted in other cases. If it were to be adopted in a case where it was not necessary in order to avoid injustice because there was no other remedy available, it would give rise to a problem as to the status of any damages that might be awarded to the employer in respect of repairs or consequential losses sustained by other parties.

28. In this case, the owners of the clubhouse and hotel have their own remedy against the building contractor. The lodge owners are entitled to a similar remedy but it has not been provided to date. Counsel for the builder has acknowledged its willingness to do so for the lodge owners. It follows in my mind that there is no legal black hole in this case. If the builder reneged on the undertaking to furnish the lodge owners with the agreed protection, there would be a black hole and Kelcar could sue for specific performance of the agreement to provide the warranty, which would I think be the most appropriate relief and, in the alternative for the cost of repairing the lodges.

29. The issue to be decided in the reference is whether the facts bring the case within the exceptions to the rule of privity of contract. Can Kelcar as the employer party to the building contract claim in the arbitration for the alleged defects in the work and for anticipated consequential losses by other associated persons or companies? In my view the case does not constitute a recognised exception or an exception that ought to be recognised. No legal black hole exists. In the absence of any refusal by the builder to furnish the collateral warranties to the cottage owners, I cannot see how the employer is entitled to pursue the claims of third parties.

30. It seems to me that there are substantial practical objections to permitting the employer to put forward in the arbitration the claims of the third parties. If Kelcar claims in respect of the defects and projected losses, does that operate as a bar to any claims by the private investors who own the hotel and clubhouse, the people who own the 18 cottages that have been sold, the owners of the remaining 38 cottages and BGR Ltd., the operator of the whole resort? None of those is a party in the building arbitration between Kelcar and Bowen, so how can their claims be heard and determined? There would be nothing to prevent any of them from bringing a claim against Bowen in respect of alleged defective workmanship and/or consequential loss. It would be no answer for Bowen to say that it had already paid out the money on foot of a proceeding to which the claimants were not parties. Neither is it reasonable to suggest as Counsel did that, since the parties and companies are interconnected, their separate identities can be ignored, since that represents the "reality of the situation".

31. A party is best left to make its own case for loss or damage and can be disadvantaged by having another make that case on its behalf. The whole point in this case of seeking to set up these claims for repairs and anticipated consequential loss is to wipe out Kelcar's liability to Bowen under the arbitration *pro tanto*. In my view, that is the potential black hole because any compensation that was due to other parties could disappear into the reduction of Kelcar's contractual liability.

32. My conclusion is that this is not a case that is within the exceptions to the privity rule. This is consistent with the consensus of the authorities that were cited and it accords with logic. To hold otherwise would be to introduce a new ground of exception and would itself produce legal difficulties and potential injustice, including the risk of double liability on the part of the contractor.

33. As to the particular issue of BGR's anticipated consequential loss, it seems to me that, if it is claimable under the building contract, it is similarly claimable under the rights that have been conferred on the clubhouse and hotel owners and on the rights to which the lodge owners are entitled. BGR's position therefore is unaffected.

34. I answer the questions posed in the case stated as follows:-

3.2.1 In the light of the fact that Kelcar is not the owner of any of the buildings in respect of which remedial work will be required, can Kelcar claim in its own right the costs of those remedial works?

Answer: No.

3.2.2 Not applicable because of answer to 3.2.1

3.2.3.1 Not applicable because of answer to 3.2.3.2

3.2.3.2 If BGR is, as a matter of law, entitled to recover damages from Bowen, can those damages be claimed by Kelcar in these proceedings?

Answer: No.

3.2.4. Not applicable because of answer to 3.2.3.2