

**CONTRACT ADMINISTRATOR'S LIABILITY
FOR PURE ECONOMIC LOSS**

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ABSTRACT

Employers engage contract administrators to assist them in administering their construction works. Contract administrators are those that claimed to have knowledge regarding construction works. The contract of engagements and the construction contracts set out the duties and roles of contract administrators. The duties may differ according to the type of standard form of contract used; such as PAM 2006, PWD 203 or 203A (Rev 1/2010), AIA, FIDIC, AS 2124, etc. In the performance of their duties, contract administrators may be held liable in negligence if they fail to carry out their duties with reasonable skill and care. Thus, the objective of this research is to determine the liability of contract administrators against claim from contractors for pure economic loss. This research firstly establishes the essential duties and liabilities of contract administrators under contract. Secondly, it discusses the concepts of pure economic loss under the law of contract and tort. It is settled that the contract administrators' standard of duty is to perform their duties with reasonable skill. The damage that the injured party intends to be compensated for must not be too remote and is foreseeable. It is also settled that claims under tort of negligent requires injury or damage to property. In the absence of injury or damage, recovery for claim that is purely economic may not be successful. Pure economic loss in tort arises when the claim is either for diminutive value of building, loss of profit or cost of repairing. There appears to be some confusion in claim for economic loss under law of contract and law of tort. Regarding contractors' claims on pure economic loss against the contract administrators, the courts seem to favour that the claims are made under contract rather than under tort. The only exception where the court may allow for recovery of pure economic loss under tort is when the principle fall under the principle as established in *Hedley Byrne v Heller* or fulfilled *Caparo* test of proximity, foreseeability and it is just, reasonable and fair to do so.

ABSTRAK

Pemilik projek melantik pegawai kontrak untuk membantu di dalam kerja-kerja pentadbiran projek. Pegawai kontrak ialah seseorang yang dikira mempunyai ilmu yang mencukupi di dalam bidang permbinaan. Skop tugas pegawai kontrak adalah seperti yang dinyatakan di dalam perjanjian pelantikan dan kontrak pembinaan. Skop kerja pegawai kontrak adalah berbeza bergantung kepada jenis borang kontrak yang digunakan; seperti PAM 2006, PWD 203 atau 203A (Rev1/2010), AIA, FIDIC dan AS 2124. Di dalam pelaksanaan tugas, pegawai kontrak boleh dituduh bersalah bagi kecuaiian jika mereka gagal dalam melaksanakan tugas mengikut piawaian yang sepatutnya. Oleh itu, kajian ini dijalankan bagi mengenal pasti liabiliti pegawai kontrak terhadap kontraktor bagi tuntutan kerugian tulen. Pertama, tugas-tugas dan tanggungjawab pegawai kontrak dikenal pasti. Kedua, konsep kerugian ekonomi tulen diterangkan. Ia adalah dipersetujui bahawa kemahiran yang munasabah adalah seperti yang telah dikenal pasti sebagai yang munasabah bagi seorang manusia. Kerugian yang ingin dituntut mestilah kerugian yang boleh dijangkakan. Di dalam membuat tuntutan di atas kecuaiian, penuntut mestilah mengalami kecederaan atau kerosakan pada bangunan. Apabila tuntutan hanya melibatkan wang, tuntutan mungkin tidak berjaya. Contohnya, susut nilai bangunan, kerugian dan kos penambahbaikan. Terdapat kekeliruan dalam tuntutan kerugian ekonomi tulen di bawah kontrak dan tort. Bagi tuntutan kerugian ekonomi tulen di antara kontraktor dan pegawai kontrak, mahkamah lebih gemar jika tuntutan di buat di bawah kontrak. Pengecualian hanya diberikan oleh mahkamah bagi tuntutan ekonomi tulen apabila prinsip kes jatuh di dalam prinsip seperti yang telah ditetapkan di dalam kes Hedley Byrne v Heller atau telah memenuhi ujian Caparo yang melibatkan tahap kedekatan, boleh dijangkakan dan ianya adalah adil, berbaloi dan saksama untuk tuntutan dibenarkan.

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CHAPTER 1

INTRODUCTION

1.1 Background of Study

Every party under the construction contract has their respective roles to be played in order to ensure the success of the project. Due to the complex nature of construction contract, appointment of a contract administrator is essential to administer the contract on behalf of the employer.

Contract administrator concerns the effective execution of construction contract (Cunningham T., 2016). The primary objectives of the appointed contract administrator is to administer the building contract so as to ensure the project will be delivered safely, in required quality standard, on time and within budgetary constraint of the employer¹.

In meeting the objectives, the contract administrator is bound by the duties as stipulated in the contract; where, the duties are usually as specified in the standard form of contract as preferred by the parties to govern their contract. It is also bound

¹ Cunningham T. (2016) The Role of the Contract Administrator under the Principal Irish Standard

by general duties of professionals, which includes advising the owner about the site conditions², duty to prepare plans, drawings and specifications,³ and to supervise the work up until completion.

All standard form of contract however demands one thing in common. The contract administrator is required to act fairly and impartially between the employer and the contractor (Elliot T., 2006). For instance, the contract administrator is expected to act impartially during the issuance of certificate.

In *Michael Sallis & C Ltd v Calil and William F Newman & Associates*⁴ the liability of an architect towards the contractor was considered by the court. It was held that a duty to act fairly was owed to the contractor, similar to the duty owed to the employer. The architect must not act unfairly for instance during the issuance of certificates and granting of extension of time. If the architect had acted unfairly when he is required to be fair, the contractor may recover the damages from him to the extent where he could establish his damages due to such unfairness.

In the performance of its duty, the contract administrator owes duty of care equivalent to both the employer and the contractor. The duty had resulted in the arise of concurrent liability under contract and tort (Xavier Grace, 2000). It must perform their duties well under the contract and also must not be negligence in the performance of their general duties.

If claiming under contract, the claimant must ensure that the privity of contract is established between them. The liability under contract and tort could co-exist, but remedies under tort could not be sought with the intention to exempt the

² *Pullen & Anor v Gutteridge, Haskins & Davey Ptd Ltd* [1992] APCLR 91

³ *Vermont Construction Inc v Beatson*, 67 DLR (3d) 95

⁴ [1987] 13 ConLR 68

limitations imposed under contract between the parties.⁵ Furthermore, negligence must be able to be established without reference to the contract⁶. The contractual duty and tortious duty must be slightly different or non-coextensive for the concurrent liability to be established.

In *Pacific Associates Inc and Another v Baxter and Others*⁷, the defendant was an engineering partnership. The contract was formed between the employer and the contractor. The defendant was under obligation to supervise the work. It was held that the defendant was the employer's agent and he did not owe duty of care for the acts where under contract the employer could be held liable. Therefore, it can be seen that when the contract provides adequate remedies, the courts are slow in imposing tortious liability of the wrongdoer.

However, it was decided differently in *Voli v Inglewood Shire Council*⁸ where the judge had said that in his judgment;

“Neither the terms of the architect’s engagement, nor the terms of the building contract, can release the architect from duty of care to persons who is not a party to the contract. Nor they can directly determine what he must do to satisfy his duty to such persons. That duty is cast by him by law, not because he made a contract, but because he entered upon the work.”

In this case, the stage in Council Hall was collapse. The stage was collapse due to the joists supporting the span of the floor was not strong enough to carry the load. The judge of High Court of Australia had held that an architect that undertakes

⁵ Neo, Monica (2005). *Construction Defects: Your Rights and Remedies*, Singapore. Thomas Sweet & Maxwell Asia, p.4

⁶ *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; *Eso Petroleum Co Ltd v Mardon*, Ibid 4

⁷ [1990] 1 QB 993

⁸ [1963] 110 CLR 74

professional duties had accepted the ordinary liabilities of a professional man, as recognised by his profession.

He is not expected to act extraordinarily but he must exercise due care, skill and diligence, with competence and skill similar to other practicing architect. The only exception to the liability of an architect against the action for negligence is that he had used his reasonable care, skill and diligence during the performance of the work.⁹

It is supported by a New Zealand case of *Bowen v Paramount Builders*¹⁰. The Court of Appeal had held that the architects, engineers and contractors were expected to use reasonable care to prevent damage or injury to anyone that is foreseeable to be affected by the work.

The duty owes by the contract administrator is the standard duty of an ordinary competent contract administrator. If the professional body agreed of such conduct and other contract administrator would have acted the same, he is said to have done sufficiently.

This is as per the established principle of *Bolam test*, where, if a doctor had acted in accordance to the principle as accepted by his profession, the doctor is hence not guilty of negligence¹¹. However, he is not subject to mere accusation of negligence just because others would have acted differently.¹²

⁹ Ibid, pg 85

¹⁰ [1977] 1 NZLR 394

¹¹ *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582

¹² Ibid and *Nye Saunders and Partners v Alan Bristow* [1987] 37 Build. LR 92

Malaysian courts were not reluctant to recognize liability under negligence when personal injury or death, and/or damage to property could be established. However, the legal position in regard to claim for economic loss is a little unclear.

It was described by *Lord Steyn*¹³ that the liability for claim in negligent for damages that is purely economic is an area of controversial. In short, he stated that, “it is one of the most complex and confusing areas in law of tort”.¹⁴

The claim for pure economic loss arises when there is no damage to property or injury or death of a person could be established. It arises purely financial, either from the diminution of value of building, loss of earnings, or cost of repairing or remedial works.¹⁵ In short, pure economic loss can be defined as financial or pecuniary loss, which not caused by any physical damage to the property or a person.¹⁶

In the case of *Lok Kok Beng & 49 Ors v Loh Chiak Eong & Anor*¹⁷, the judge stated that in recovering for pure economic loss against negligence cases, the judgment was to be given by proper consideration of the fact of each and individual cases. Some measure of public policy must be taken into consideration even though it is not the sole determinant of liability.¹⁸

The principle of establishing the duty of care that cause pure economic loss is as per stated in the famous case of *Hedley Bryne v Heller*¹⁹ where the requirements are;

¹³ *Caparo Industries plc v Dickman* [1990] 2 AC 605

¹⁴ (1998) Bernstein, *Economic Loss* 2nd ed.

¹⁵ Ter, Kah Leng, “*Builder’s Tort Liability for Pure Economic Loss Arising from Defective Buildings*.” *Malayan Law Journal* Article[2989] 2 MLJ p.1.

¹⁶ *UDA Holding Bhd v Koperasi Pasaraya Malaysia Bhd & Other Appeals* [2009] 1 CLJ 329
¹⁷ [2015] 5 AMR 185

¹⁸ *Ibid*, para 64. Pg 45

¹⁹ *Ibid* 6

“(1) there must be duty of care based on special relationship between the plaintiff and the defendant, (2) the statement must be untrue, inaccurate or misleading, (3) the defendant must have acted negligently in formulating the misstatement, (4) the plaintiff must have relied in a reasonable on the statement, and, (5) the reliance must had caused damages unfavorable to the plaintiff.”

The economic loss doctrine had suffered variation in application. States are split about whether the economic loss doctrine prevent third party claim against professionals in construction contract. If the economic loss arises as a result of physical injury or property damage due to the negligence of the defendant, the court is not reluctant to allow for its recovery.

The historical development that marks the willingness of the English court in entertaining claim for pure economic loss was in the case of *Anns v London Borough of Merton*²⁰. The judge had suggested that once the neighbouring principle was fulfilled, there is a duty of care owed. The duty can be denied on the policy ground.

In the case of *D & F Estates & Ors v Church Commissioners for England & Ors*²¹, the House of Lords held that the action in tort could not be successfully because the cost of repairing defects in a chattel constituted to pure economic loss. The House of Lord held the contractor owed a duty to the home owner. The duty owed in regard of quality of the construction should be as accordance to the contract. Therefore, any claim should be raised for breach of contract terms rather than in tort.

However, the decision was not followed in the later case of *Murphy v Brentwood District Council*²². The judge held that pure economic loss is itself

²⁰ [1978] AC 728

²¹ [1988] 2 All ER 992

²² [1991] AC 398

irrecoverable; unless the plaintiff could establish that the relationship between him and the defendant falls within the Hedley Byrne principle.²³.

There had been series of important development took place in English Common law and other jurisdictions. These were part of the effort in establishing principles on how claim in regard to pure economic loss should be treated. This research intends to identify what circumstances allows the contractor to claim for pure economic loss against the contract administrator.

1.2 Problem Statement

In ascertaining the principle question in economic losses cases, it is essential to establish the rationalization and appreciation of duty of care. The duty of care owes are subject to terms implied under common law. For instance, the architect's duty may be extended up to or even beyond the completion period of a project. A duty may arise reactively either when asked to do so or in the event where further advice is needed. In the case of *London Borough of Merton v Love*²⁴, the Court of Appeal held that the architect has a continuous duty. It subjects to the consequent detection of defect.

In *RSP Architects & Engineers v Ocean Front Pte Ltd*²⁵ case, the plaintiff was the management corporation for a condominium. It commenced a claim against the developer for damages that the management corporation claimed to be arises due to the negligent act of the developer. It also claimed for damages for the defective construction of some common property. The claimed was initiated after the recovery

²³ Ibid 16

²⁴ [1988] 18 Con LR1

²⁵ [1996] 1 SLR 113

of spalling concrete in the car parks ceiling of several blocks and water ponding at several lift. The developer in turn joined the architect; RSP Architect & Engineer in the claim. The developer requested for the determination of preliminary issue from the High Court. The issue to be determined was on whether the claim for pure economic loss by the management corporation, for the cost of repairing works of the defects, was barred under the law.

The Court of Appeal had used the two-stage test to establish duty. The judge had also applied *Junior Books v Veitchi*²⁶. Further, the House of Lords had allowed for the recovery of pure economic loss. This was because the loss caused by a defective chattel was in near contractual circumstances. This court had based its judgment on the basis of proximity. It also signified that there were no standard rules to be applied, in the identification of whether duty of care could exist in certain situation.

Where, in *Junior Books*, the recovery of economic loss could be made possible in any circumstances where the defendant could foresee the loss.

Veitchi was nominated as a specialist sub contractor for the project. He was in contract with the main contractor. He was appointed to lay concrete floor. During the laying of the composition, Veitchi used mixture that was too wet. He had applied a very thin top coat and failed to cure the composition properly. Consequently, cracks began to develop and the floor began to break. Junior Book brought action against Veitchi in negligence. The floor needed to be replaced. Junior Book contended that while the floor is being replaced, they had lost business and encounter loss of overhead. Therefore, they demand to recoup the cost of restructuring of the floor and consequential cost arises therewith.

²⁶ [1982] 3 All ER 201

Veitchi in contention argued that the claim could not be preceded. This was because the parties had no direct contractual relationship. As the floor did not caused danger to anyone or to any property, hence, there is no cause of action that can established. The House of Lords held not in favour of the subcontractors. The court agreed that there was physical damage to floor and agreed that there was consequential loss encountered by Junior Book due to the damage. The subcontractors were appointed for the skills, hence, he must well aware that the employer relied on their skill. Hence, damage was a foreseeable in the event of negligence. Therefore, as the reliance on the subcontractors by the employer is clearly expected, economic loss claim could be allowed.

Hence, in reference to the case, in the presence of sufficient proximity, the pure economic loss could be recovered.

The court in Georgia have disposed claim for negligent on construction managers based on the economic loss rule (Parkman W.H.,2008). In *J. Kinson Cook of Georgia, Inc v Heery/Mitchell*²⁷, the contractor alleged that the construction manager had breach his duty by failing to make precise and appropriate decision, make decision that clearly change the scope of work of the contractor, failed to process the approve variation order and fails to pay diligently. The Court of Appeal held the construction manager, owed no duty other then duty as stipulated in the contract. Hence, the claim was declined due to privity requirement was not fulfilled.

Economic losses constitute no physical damage at all. They did not contribute to social losses but merely a transfer of wealth. The claim for economic loss exposes liability to the defendant for an indeterminate amount, time and class of person.²⁸ In pure economic loss claim, there is no damage to property or injury to person that accrues together. . It is not a fair transaction as fair as it could be if the party made their claim under contract.

²⁷ 284 Ga.App. 552, 644 S.E2d 440 (2007)

²⁸ Ultraman Corporation v Touche [1931] 255 NY 170

It is not easy to apply the economic loss rule. The difficulty is even obvious for its application in the construction industry.²⁹ The economic loss doctrine had been wrestled in between the clash of contract law and tort law. Some court even tried to stop the increase in number of negligence claim that had overruled the contractual duties. In the case of it was stated that “if the court allowed the development of tort claim for economic losses to progress too far, then the contract law would be drown in the sea of tort”.

Carl J Circo³⁰ criticizes the rule of not allowing the economic loss claim under construction litigation, when proper consideration of the commercial context on why they arise, was not made. He states that,

“a typical construction project inherently creates an environment of economic interdependence that should impose a duty of care on some participants to avoid causing economic loss to others.”

The case of *Anns v London Borough of Merton*³¹ had marks the highest turning point of the English court’s, on readiness to entertain claim for pure economic loss, in negligence. The principle was then extended to cover situation where it is foreseeable by the defendant that another person might suffer economic loss. This is as decided in the case of *Junior Books Ltd v Veitchi Co Ltd*.³² This case manifest that when the degree of proximity between the parties is sufficiently close, the recovery of pure economic loss could be possible. Lord Roskill held that,

“The appellants must be have known that if they did the work negligently (as it must be assumed that they did) the resulting defects would at some time require

²⁹ *Presnell Consturction Managers, Inc. v EH construction, LLC*, 134 S.W.3d 575 n. 12 (Ky 2004)

³⁰ *Placing the commercial and Economic Loss Problem in the Construction Industry Context*.

³¹ *Ibid* 17

³² [1982] 3 All ER 201

remedying by the respondents expending money upon the remedial measures, as a consequence of which, the respondents would suffer financial or economic loss.”

The case of *Dr Abdul Hamid Abdul Rashid & Anor v Jurusan Malaysia Consultants*³³ have turned the tables on the time-old adage that pure economic loss is irrecoverable, due to the need to avoid the liability for an indeterminate amount, time and class of a person. In another case of *Majlis Perbandaran Ampang Jaya v Steven Phao Cheng Loon*³⁴, the judge stated the claim for pure economic loss could be awarded in the event of negligence. However, in court of appeal in *LimTeck Kong v Dr Adul Hamid*³⁵, the Court of Appeal had held that the engineer’s liability to Dr Abdul Hamid was not pure economic loss but was contractual in nature.

The tortious action can be carried out by any third party arising from negligence between parties where the principle of privity of contract is not established. The enlightening of professional duties and liabilities are essential so as to ensure errors and negligence could be avoided from endangering human lives. It must be considered with great caution as it have grave consequences. Further, the major question to be considered is the recoverability of pure economic loss which resulted from such negligence.

1.3 Objective

The objective of the research is to determine the liability of contract administrator for pure economic loss under the law of tort.

³³ Ibid 22

³⁴ [2006] 2 MLJ 389

³⁵ [2006] 1 CLJ 391

1.4 Scope and Limitations of Study

The scopes of this study are:

1. The study emphasis on liability of contract administrator for pure economic loss towards contractors in the construction industry.
2. The study is made by analysing law cases derived from Lexis Malaysia, including the Malay Law Journal (MLJ) including Malay Law Journal unreported (MLJu) and international cases. The study will consider journal and articles from seminar papers and research conducted previously.

1.5 Importance of Study

The doctrine of economic loss had continuously set limit to liability in tort for construction contract. Hence, the purpose of this research is to review the limit and extend of different application of economic loss rules in the construction industry context, with a specific focus on claims against contract administrator. It will critically describe the basis of judgment of the court in analysing claim in negligence for pure economic loss.

1.6 Research Methodology

Provided this research is a legal research, the appropriate approach in carrying out this research is to analyse the law cases. In order to identify the liability of the contract administrator for pure economic loss, sample of cases will be selected. The cases will act as representatives in determining the judgments on liability and the reasons behind such judgments.

The first two (2) chapters of the research will consist of literature review. The review of the literature is vital in order to support the research, and to provide sufficient information in enhancing the study. The literature review will be made thoroughly from books, journals, articles and other appropriate documents that is necessary in the effort of providing sufficient information in relation to the research.

1.6.1 Case law analysis

The research is a qualitative research. All law cases were derived from the Lexis Nexis, from all jurisdictions. The analysis of the case law will provide better understanding on the judicial interpretation on the stand on whether the contract administrator will be liable for pure economic loss in the particular situation. Total of seven (7) cases will be discussed and analysed. The cases analysed cases are cases from 1989 to 2016 from various jurisdictions including United State of America (US), United Kingdom (UK), Australia and Singapore. This is essential in order to ensure comprehensive study is made; across 27 years of development of jurisdictions and stand on different countries in regard to the issue could be determined.

The identification of the cases law is made using keywords. The utmost important keyword is the pure economic loss. Total of 181 cases retrieved from the keyword.

Further keyword used to reduce the result search such as construction industry reduced it to only 28 cases. Other related keywords include architect, contract administrator, caparo test and negligence.

1.6.2 Research Phases

In achieving the objective of the study, there are four (4) major phases that need to be followed, which are:

Phase 1 – Development of proposal

This phase is the first phase before a deeper research can be done. Under this phase, the research issue and objective are identified. In formulating the issue and objective, initial literature review is made to find the latest issue and to ensure that there are enough resources available to support the research. Once the objective had been determined, the scope and the title of the research can be determined.

Phase 2 – Data and Information Collection

Once the objective is clear, thorough literature review will be made considering all the facts that are related in achieving the objectives. Data collected will be recorded accordingly. All the data will be derived mainly from Lexis Malaysia which include Malayan Law Journal, Malayan Law Journal unreported and international cases. More data will be obtained from books, article reports, journal and seminar paper. Important and relevant cases will be collected for analysis at the later phase.

Phase 3 – Data Analysis

All the documents obtained will be analysed and the analysis will be documented accordingly. The focus will lie on the issue of the research and in answering the objective.

Phase 4 – Conclusion and Recommendation

This is the last phase of the research. The discussion will then lead to the conclusion and hence could provide answers to the problems and issues put forward under this research. Recommendations on further research will be made for upcoming researchers.

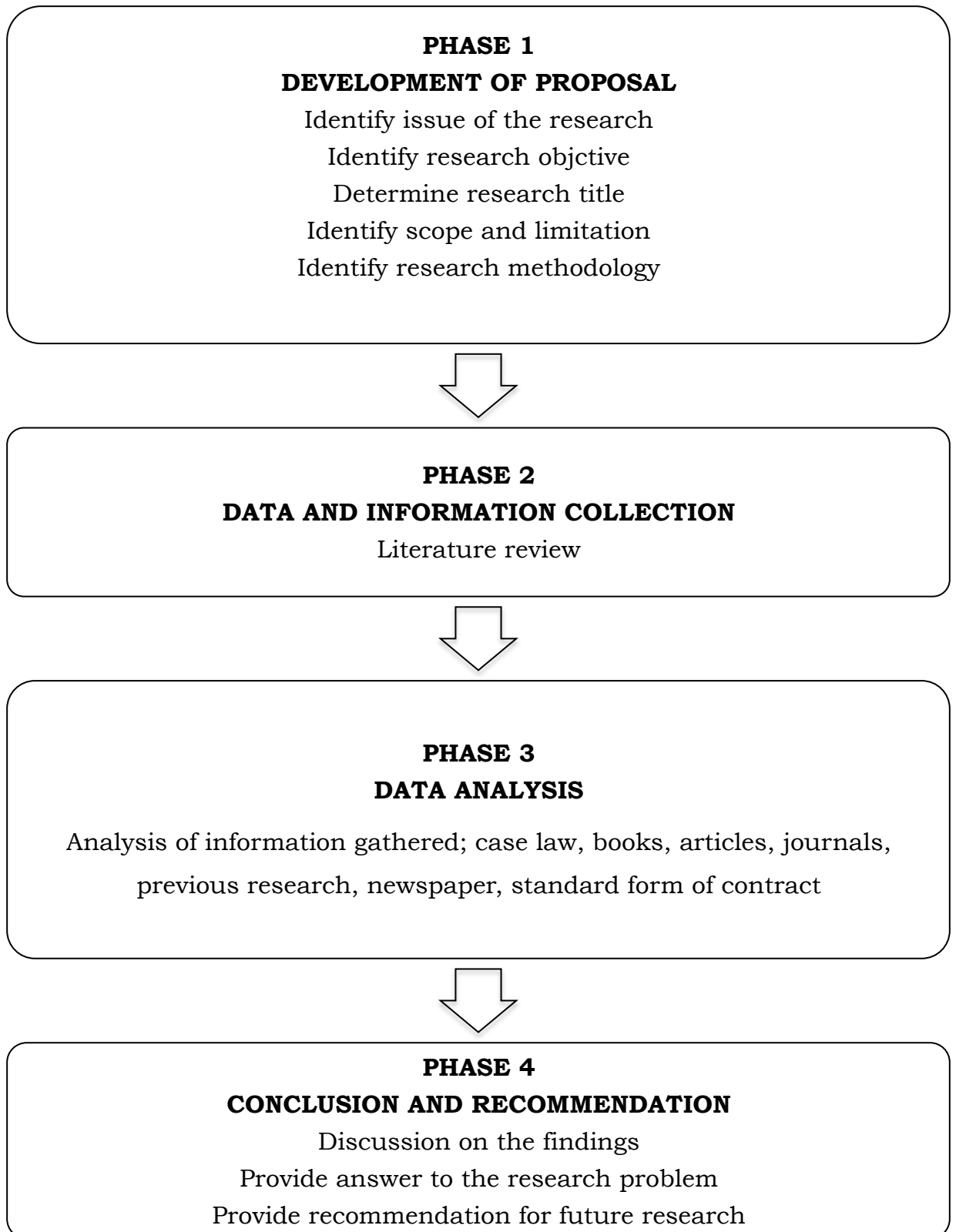


Figure 1: Research Methodology

7.0 ORGANISATION OF STUDY

The research will consist of five (5) chapter in which will be organised as follows:

Chapter 1 - Introduction

The first chapter will cover on the introduction which will emphasize on the issues in regard to professional liability and pure economic loss, the topic, aim and objectives of this research, issue, problems statement, scope of study, research methodology and brief description on chapter organisations.

Chapter 2 – Duties and Liability of Contract Administrator

The second chapter will explain on the duties of contract administrator, various definitions of liability and the differences in liability of contract administrator under contract and tort.

Chapter 3 – Pure economic loss

This chapter will elaborate on the definition of negligence, the elements of negligence claim. It will also highlight on the definition of pure economic loss, the development of pure economic loss the in construction industry.

Chapter 4 – Liability of contract administrator for pure economic loss

This chapter will recognise the grounds that allows the recoverability of pure economic loss and the exception set by the court, and clarify the liability of contract administrator for pure economic loss.

Chapter 5 – Conclusion and Recommendations

The last chapter will conclude on the findings and recommendation for future research will be made.

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