INSURANCE COUNCIL OF AUSTRALIA

Home Building Act Review
Fair Trading Policy
PO Box 972
PARRAMATTA NSW 2150

By email: policy@services.nsw.gov.au

17 August 2012

Dear Commissioner

NSW HOME BUILDING ACT 1989 REVIEW

The Insurance Council of Australia (ICA) and our members are pleased to contribute to the Home Building Act Review. Please find attached our detailed responses to the *Reform of the Home Building Act 1989 Issues Paper* (Issues Paper) released by Fair Trading in July 2012. Our submission is divided into two parts, being:

- Part 1 – A response to the issues raised in the Issues Paper dated July 2012, and;
- Part 2 -– Our comments in relation to additional issues not identified in the Issues Paper but which ICA submits should be addressed as part of the review.

If you have any questions or comments in relation to the above please do not hesitate to contact Vicki Mullen General Manager Policy, Consumer Directorate on (02) 9253 5120 or vmullen@insurancecouncil.com.au .

Yours sincerely

Robert Whelan
Executive Director & CEO

Review of the NSW Home Building Act 1989

Submission by Insurance Council of Australia

Insurance Council of Australia Limited
ABN: 50 005 617 318
Level 4, 56 Pitt Street
SYDNEY NSW 2000
Phone: +612 9253 5100
Fax: +612 9253 5111

17 August 2012

Contents

Introduction

The Insurance Council of Australia (ICA) welcomes the review of the *Home Building Act 1989* (Act) in New South Wales and seeks to make a positive contribution to that review on behalf of our insurer members. Some of our members operate in the NSW home warranty scheme as agents on behalf of NSW Self Insurance Corporation (SICorp) trading as NSW Home Warranty Insurance Fund and others as run off insurers.

The ICA submission will concentrate on issues and points of discussion directly relevant to our members' experience where we believe we can make a worthwhile contribution to the debate.

We note the extent of the review and refer to the *Reform of the Home Building Act 1989 Issues Paper* (Issues Paper) released by Fair Trading in July 2012. Our submission is divided into two parts, being:

- Part 1 – A response to the issues raised in the Issues Paper dated July 2012, and;
- Part 2 -– Our comments in relation to additional issues not identified in the Issues Paper but which ICA submits should be addressed as part of the reform.

In making this submission, the ICA has assumed that, unless expressly stated, retroactive amendments will not be made to the Act or the *Home Building Regulation 2004* (Regulation) so as to affect existing building contracts, policies of Home Warranty Insurance, works carried out under those contracts and claims made under those policies. If that assumption is incorrect and amendments are intended to be made that affect or potentially affect the ongoing liability of ICA members under polices of Home Warranty Insurance already issued, the ICA would wish to be heard and have the opportunity to make further submissions in response to any such proposed amendments.

Part 1 – Response to the Issues Paper

Key Issue 2: Statutory Warranties

Issue 1 - Subsequent Purchasers
The Issues Paper suggests that a separate definition or regime for determining the date of completion of work for subsequent purchasers may be considered[1].

ICA submits that having a separate definition of completion for subsequent purchasers is not practicable for the following reasons.

- A separate completion date for subsequent purchasers would in turn provide for two different periods of liability/risk for both the liabilities of contractors and developers under Part 2C of the Act, and for the liabilities of insurers under Part 6 of the Act.
- Before a property is sold the builder/developer and/or insurer may be "off risk" for a claim under Part 2C or Part 6A of the Act, only to find that, following the sale of the property, the completion date (and hence the period of risk) has shifted forward, resulting in the builder/developer and/or insurer suddenly being back on risk.
- Contractors and Developers are entitled to know with certainty the point at which their liability for breaches of the statutory warranties is at an end.
- Similarly, insurers under Part 6 of the Act are entitled to know with certainty whether they are still on risk under a Part 6 policy of insurance or not.
- By having a system whereby the period of that liability / risk can be extended or reduced simply by the property being sold, contactors/ developers and insurers would be forced to assume that, even though a property may not have been yet sold, the period of risk / liability must be the greater of the two periods for original owners and successors in title. This will undoubtedly lead to more difficulties arising with contractors / developers seeking the return of securities from insurers which should be avoided.

Issue 2 - Sub-contractors responsible for statutory warranties
ICA submits that any sub-contractor engaged by a contractor should be responsible for their work complying with the statutory warranties set out in Section 18B of the Act and that those warranties should be owed to and enforceable by the homeowner and any successor in title.

In our members' experience, it is not uncommon for contractors to subcontract substantial parts of or sometimes all of the relevant work. In those situations, it is appropriate that homeowners be entitled to look to the subcontractor directly in respect of any defects in their work (which will only usually ever occur in practice where the head contractor is insolvent or disappeared).

The issue is, however, how this is to be done.

Are the warranties to be implied into the sub-contract (which is often not written), and owed to the contractor who then passes the benefit of them onto the client/owner (and any successors in title)?

Alternatively are the statutory warranties to be owed directly to the client/owner the contractor is doing the work for, and their successors in title? If so, it will also be necessary to make clear how such a situation is covered where the contractor is the owner of the land where the work is being done (that is, a "builder-developer").

[1] *Reform of the Home Building Act 1989 Issues Paper* (Issues Paper), p18

Key Issue 4: Owner Builders

In relation to Owner Builder work we would like to raise the issue of the liability of co-owners in these circumstances.

The ICA believes that there are a number of conflicting superior court authorities on the question of whether, in circumstances where land is owned by multiple persons and yet only one of those persons obtains an owner builder permit, all of the owners who do the work owe the statutory warranties to subsequent purchasers.[2] We submit that the confusion that has been caused by these decisions should be resolved in the legislation.

We submit that, in circumstances where Owner Builder work is done on land, all of the owners of that land at the time the work is done should be regarded as Owner Builders irrespective of who took out the Owner Builder permit and irrespective of who did the actual work. Otherwise, successors in title may be left to speculate as to who did the work, and who is liable for the statutory warranties. We believe that this could be achieved by deeming owners of the land upon which owner builder work is done to be Owner Builders in the same way as Developers have been deemed Developers under section 3A(1A) of the Act.

Key Issue 6: Home Warranty Insurance

Issue 3 – Improvements to current NSW scheme – clarification of insurance coverage for rectification work

The ICA submits that as well as looking at whether rectification work requires further insurance or not, the matter of how the statutory warranties in section18B apply to rectification work should also be considered.

In our members' experience, many issues arise when a contractor returns to site to undertake repairs. These issues are complex, interrelated and we believe require careful consideration. Some of those issues include the following.

- Does a contractor rectifying his/her own defective works constitute an agreement to do residential building work, with all the provisions that relate to same (including the need to have a written contract complying with the Act, a new set of statutory warranties and the potential need for further home warranty insurance)?
- If the homeowner is not the original person on whose behalf the work was done, does there need to be a fresh contract to do the work for the new owner?
- If the repairs are said to be done under the original contract and the statutory warranties under that contract, how does the new work in the form of the repairs affect the date of completion for the work for the purposes of the statutory warranty period and any home warranty insurance policy? Does the new work extend the warranty period and insurance for the entire work, or just the repairs done? Do the warranties still expire 7 years after the original completion, thus reducing the protection of the statutory warranties for the repairs (e.g. if they were done 6.5 years after original completion)?

[2] See *Gunn & Anor v Steain & Ors* [2003] NSWSC 1076, Sorbello and *Donnelly v Whan* [2007] NSWSC 951 (29 August 2007) and *Atkinson v Crowley* [2011] NSWCA 194).

- If the rectification work attracts a fresh set of statutory warranties, are those warranties for 7 years in line with the original contract or are the warranties given under the new regime of 2 / 6 year warranties for non structural / structural defects respectively?
- Is there is a need for home warranty insurance for the repairs, and if so are the repairs covered under the home warranty insurance policy for the original work? If so, how are insurers to be on risk for work they may not know about, and might not consent to?
- All these issues need to be considered, and detailed submissions sought from insurers given the significant importance of the issues to being on risk for policies already issued (and also for insurance issued in the future by SICorp).

We submit that retrospective changes would be preferred, however we acknowledge that this may also cause problems where persons have dealt with such issues in good faith and then find themselves in breach of such retrospective provisions.

We note that the Issues Paper recommends that rectification work undertaken by the original licence holder be considered as work arising out of the original contract so that the contractor does not enter into a new contract with the homeowner for an additional contract sum.[3] We submit that there is likely to be several complexities which arise from this view.

We believe that while rectification work might "arise" out of the original contract in the sense of it being work required to remedy a defect caused by a breach of a warranty in that contract, it is not necessarily the case that rectification work is work done **under that contract**.

We submit that a decision of the Consumer, Trader & Tenancy Tribunal (CTTT) supports our view. Member Durie at paragraph (i) of the judgement states:

> "*I then look to see when actual completion was achieved. In this case, the evidence leads to the conclusion that 31 October 2000 was the correct date. It was then that the works required under the contract had been completed.* ***There were some matters later attended to by the Builder pursuant to its obligations under the statutory warranty provisions contained in the Act, but that is not work done under the contract.*** *The matters attended to in order to obtain the certificate of occupancy did not require building work, but rather the provision of certification for works carried out*" (emphasis added).[4]

We submit that a statutory warranty, when breached, usually gives rise to an entitlement to damages for loss. It does not, of itself, give rise to an obligation on the contractor to rectify the breach by fixing the defects, nor does it oblige the homeowner to accept as a remedy, the contractor returning to rectify the breach.

As a result, when a statutory warranty is breached and the contractor returns to rectify the defects caused by the breach, arguably this is not work done under the original building contract. Rather, it is work done under an agreement between the homeowner and the contractor that the contractor shall be allowed to rectify the defects in consideration for the homeowner not exercising their right to sue the contractor for damages for the breach. If that

[3] Issues Paper, p45.

[4] Owners Corporation SP66090 v Sydney Commercial Builders Pty Ltd & Anderson (Home Building) [2008] NSWCTTT 1096 (30 June 2008)

is the case, the ICA submits that the agreement between the homeowner and contractor may be seen as a new contract under which the rectification work is done.

In other situations the contractor may be ordered to rectify the defects pursuant to a rectification order by the CTTT. In such cases, there may not be any contractual arrangement between the homeowner and builder - but rather, the rectification work is done as a result of the Tribunal's order.

Section 92 of the Act is usually the basis for the position that such work requires insurance. That section deals with work under a contract. Although Section 96 of the Act refers to work other than pursuant to a contract, we believe that this is aimed at situations involving owner-builders or builder-developers - rather than repairs done by a contractor for an owner or successor in title.

Section 92(3) provides section 92 does not apply where the contract price does not exceed $12,000 or, where the contract price is not known, where the reasonable market cost of the labour and materials involved does not exceed $12,000. Where repairs are involved, and the contractor is not charging any monies for doing the repairs, we submit that this exclusion does not necessarily apply. Firstly, there is no contract price, and arguably it cannot be said that the contract price is not known, as there is no contract price at all. It is known to be nil. However, this provision seems intended to deal with cost plus contracts rather than repairs.

As noted above, an issue arises as to whether any repairs create a new set of statutory warranties, or entail a new contract. As the insurance only covers the original contract and statutory warranties, to the extent the repairs are under a new contract or the new warranties, the ICA submits that the insurer is not on risk for the repairs.

Again, if the repairs are undertaken under a new contract or agreement, then arguably Section 7 of the Act applies and the contract must be in writing. The industry practice is not to do so, and any such agreements are often verbal.

In our members' experience, an issue often arises where the contractor no longer has a licence when defects are complained of, and therefore the contractor cannot undertake the work. Often the contractor will arrange and pay for another contractor to do the repairs.

We believe that the provisions of the Act are not clear in these circumstances, particularly when there is a new contractor with a different licence to that used for the original work. This new contractor has no direct contractual relationship with the owner and may be undertaking repairs without a written contract and without insurance. The question arises as to how the owners are said to have the benefit of the statutory warranties when they have no contract with that new contractor. In fact, they may not even know the identity or licence number of the new contractor if the original builder has arranged for them to do the work, and has not advised the owners of those details.

It is also worth noting that in some claims our members have dealt with, the claimant has maintained that any repair work requires a fresh Development Approval (DA), as it would not be covered by the original DA. As such the repair work would not fall within the relevant exemptions under the planning legislation.

As such, ICA submits that an exemption should be granted to repairs to be done by a contractor, so that no fresh DA is required, subject to the work complying with the previous DA conditions. However, in circumstances where the repair work will be substantial and disrupt neighbours, we submit that the Council be notified that work is to be done under the

original DA with a requirement that compliance be monitored by either the Council or Principal Certifying Authority.

The ICA submits that the issues raised above require clarification under the legislation as to how such repairs are to be dealt with.

Issue 8 – Definition of "disappeared" for the purposes of lodging a claim
We submit that the legislation should also be amended to contain a clearer definition of 'disappeared'. In 2011 the District Court of NSW held that a builder who had left the state of NSW would be regarded as having disappeared for the purposes of the Act and Regulations.[5] The ICA strongly submits that this is an unworkable interpretation of the term 'disappeared'. Under this decision a builder who retires and moves to Canberra or Queensland, will be regarded as having disappeared.

The ICA believes that this decision is not consistent with the 'second -last resort'[6] nature of the scheme. In the situation where the builder has absconded but is located within the Commonwealth of Australia, we believe that the homeowner is still able to obtain a remedy against the builder relatively easily.

However, in the situation where the builder has absconded overseas, it is considerably more difficult for the homeowner to obtain a remedy against that builder due to the jurisdictional and practical difficulties associated with effecting service of court process outside the Commonwealth of Australia. In those situations, we submit that a deeming provision would be appropriate.

[5] *Wesfarmers General Insurance Limited trading as Lumley Insurance v John Nestel* [2011] NSWDC 224
[6] Issues Paper, p 40.

Part 2 – Other issues not considered by the Issues Paper

Statutory Warranties – Hierarchy

In its current form, there is no order of precedence or hierarchy as between each of the statutory warranties. In our members' experience, this can lead to disputes in circumstances where, in order to comply with one of the warranties a contractor must breach another.

For example, where contractual plans require the building to be constructed in a manner that renders the building non compliant with the relevant DA conditions, a conflict will arise between the warranty in section18B (a) and (c). In those circumstances, whilst a prudent contractor might place its concerns in writing and therefore avail itself of the statutory defence in section18F of the Act, contractors in such situations should be able to know with certainty, irrespective of section18F, which warranty they are required to comply with in the event of such a conflict.

It is therefore submitted that consideration should be given to providing some form of hierarchy or order of precedence within the warranties in section 18B of the Act.

Monetary Amounts

The ICA believes that the structure of the Act and Regulations is adversely affected because, unlike the Income Tax Assessment Act, the Act itself or the Regulations nominates specific monetary amounts.

Examples include the excess [section102(6)], the minimum value of building work requiring home warranty insurance [regulation 69 (2) (b)] and the minimum cover provided under the policy, etc.

As these amounts are subject to variation (e.g. indexing or legislative change) it is suggested that the use of Schedules or Gazette Notices to the Regulations be adopted to which the Act and Regulations refer. This would allow for ease of amendment and facilitate reference to both the Act and the Regulations. This is already the case for Penalty Points.

Double References

We also submit that confusion can be avoided (especially for consumers) where similar or related matters are dealt with together. For example, sections 62A and 64 deal with the same matter (Deeming), although they have different meanings depending on the relevant date.

Confusion can also be alleviated by avoiding reference to or dealing with the same matters in both the Act and Regulations. An example of this can be seen at section 102 (3) and regulation 60 (1) concerning Minimum Insurance Cover.

Terms

The ICA believes that the Act and Regulation rewrite should define the terms assigned to the persons or parties referred to in it in a clear and unambiguous way. We submit that consistency would be improved if particular terms had the same definition throughout the legislation rather than separate definition sections at the beginning of each part of the Act and Regulations.

In particular, we submit that regulations 52 and 55 should amend the definition of 'beneficiary' to clarify that they are 'the owner of the land upon which the work is to be done' or the Owners Corporation in the event of work to an existing strata scheme's common property.

The Act, we believe should also make it clear that the builder and/or developer is not a beneficiary of the insurance. There is judicial debate on the meaning to be ascribed to the terms 'beneficiary' and 'insured'[7] which could be resolved with appropriate amendment of the Act.

Definition of Residential Building Work

We believe that the current definition of 'residential building work' in the Act and Regulations is ambiguous and is therefore open to varying inconsistent interpretations. We submit that the Act be amended to clarify this issue.

In particular the ICA submits that the Act should make it clear as to whether demolition and excavation work in preparation for construction (including under a separate contract or by a separate contractor) should be regarded as residential building work - thereby requiring insurance under the Act.

This 'middle man' is regularly being excluded by the courts from residential building work[8]. We believe that it should be included, to allow the Department of Fair Trading to regulate and enforce the work, including the need for insurance. Otherwise, we submit that a clear definition of when and how such work is excluded is required.

We believe that the Government will have to consider carefully how to word the definition. If worded incorrectly, this could exclude any work that a contractor did outside the scope of his licence or certificate. This could mean it was not residential building work, and thus that the contractor was not liable under the statutory warranties for it, and it would not be covered by the relevant home warranty insurance policy (both of which only cover residential building work done by the relevant contractor).

Supervision of Residential Building Work

Clause 9(1)(g) of the Regulation excludes from the definition of residential building work under Section 3 of the Act 'the supervision of residential building work by any other person, if all the residential building work is being done or supervised by the holder of a contractor licence authorising its holder to contract to do that work.'

[7] (see The Owners Strata Plan 56587 v TMG Developments Pty Limited [2007] NSWSC 1364.)
[8] *Collings Homes v Head* [2002] NSWSC 1219

The ICA submits that this exclusion is ambiguous. It appears to intend that any person working only as a supervisor is not doing residential building work if the contractor who contracted to do the work is another person. However, the wording is such that it arguably might be taken to mean that a contractor, who undertakes only supervision of sub-contractors and does not undertake any work himself or herself apart from supervision, was not undertaking residential building work.

As such, we believe that this clause should be clarified to ensure that the person who contracts to undertake residential building work, where in doing so they are only supervising the work they have contracted to undertake, is undertaking residential building work in the form of that supervision, notwithstanding Clause 9(1)(g) of the Regulation.

Building Claims in the CTTT

Section 48A(2) of the Act, and Regulation 65, should, we submit, explicitly state that only a beneficiary under the relevant Part 6 contract of insurance (and not the builder or any other person) can lodge an 'appeal' with the Tribunal.

We believe that the term 'Collateral Contract' under Section 48K should be narrowed or at least clearly defined. A claim in relation to a Part 6 contract of insurance (except as a building claim already defined, being an appeal against the decision of an insurer) should also be explicitly excluded.

Section 48L(2) should be altered such that 'defendant' is replaced with 'person' on whose behalf the work is done or person in receipt of the goods and services, to avoid such a person originally choosing to commence proceedings in another court and then have a builder or insurer transfer the proceedings to the CTTT against their choice.

Calculation of limitation period under s18C of the Act

Section 18C of the Act creates a liability on developers for breaches of the statutory warranties as though the developer itself had done the work under a contract with the successor in title.

In 2011 the NSW Court of Appeal held that section 18C of the Act creates a separate right of action in respect of each contract that the developer enters into to have the building work carried out. Therefore, if the developer has contracted with more than one builder to do the work, there is a separate limitation date running for the commencement of proceedings against the developer under section18C for the work done by each builder.[9]

For example, if a developer contracts with 10 separate builders to do various stages of the work, either simultaneously or consecutively, the statutory warranties given by the developer under section18C will have a different expiry date for each builder's work. As a result, an owners' corporation that wishes to bring proceedings against that developer under section18C must identify the builder who carried out the work which resulted in the particular defect complained of, identify when that builder's work was completed and then commence proceedings against the developer within the limitation period for that particular work. This of course requires an analysis of the contractual arrangement between the developer and the

[9] *Owners Corporation Strata Plan 64757 v MJA Group Pty Ltd* (MJA) [2011] NSWCA 236 (16 August 2011)

relevant builder. We believe that this same exercise would need to be done for each defect complained of.

We submit that this creates significant evidentiary issues for owners' corporations who may not know how many contractors the developer engaged, or the developer's particular contractual arrangements with each of those builders. In the MJA case, the fact that there was a second builder contracted by the developer after the first builder left the site was not known or ascertainable until the proceedings had been commenced against the Developer and evidence was being given by the builder. We believe that it may be extremely difficult for owners' corporations to ascertain this information before commencing proceedings.

In these circumstances we believe that the Act should be amended to make it clear that the time limit for suing a developer under section18C of the Act commences to run from the completion of all of the work done on behalf of the developer.

Section 18E(2) of the Act & *Honeywood v Munnings* (Honeywood)[10]

The ICA submits that an important issue was not addressed in Honeywood, or in any of the subsequent amendments made to section 18E of the Act, that the abuse of process principles in Anshun's case should be applied.[11]

We also not that there is no definition of 'enforced' in section 18E(2). We believe that such a definition should include any settlement, release or bar granted.

Developers or builders (or related persons or entities) as owners of lots

Where a developer, builder or related entity continues to own lots within a strata scheme, it has been argued that the home warranty insurance will still cover the entire common area, despite the fact that the developer, builder and/or related entity own those lots and a proportionate share of the common area, with the result that the developer, builder or related entity would directly benefit from the insurance being called upon to rectify defects to the common area. The ICA submits that the scheme should not allow developers, builders or related entities to benefit from the insurance in respect of their own defective work.

The problem is highlighted where, for example, the developer and builder construct a 100 unit strata scheme covered by home warranty insurance but do so with significant defects. The developer and builder sell a small fraction of (say 10) of the lots and retain the other 90. The Strata Plan is registered and the owners' corporation then claims upon the insurer seeking (say $20m) to repair the defects to the common area on the basis that the claim is made by the owners' corporation, not the developer or builder. Assuming the lots all had equal unit entitlement, the developer and builder would, if the insurance responds, enjoy the indirect benefit of $18m in insurance cover through their ownership of 90% of the lots.

We strongly submit that this is an unintended consequence of the Act which should be clarified through amendment.

[10] [2006] NSWCA 215 (2 August 2006)
[11] *Port of Melbourne Authority v Anshun Pty Ltd* [1981] HCA 45; (1981) 147 CLR 589

Mixed Commercial/Residential buildings

Where a building contains a mix of say 50% commercial and 50% residential lots, we believe that the same problem arises. If the home warranty insurance is taken out to cover the residential lots it could be called upon by the owners' corporation to repair all defects in the entire common area, regardless of the fact that the repair of those defects will directly benefit the commercial lot owners proportionate to their share in the common property.

The ICA submits that the Act and Regulation should be amended to clarify that where developers or builders or related persons own lots in a strata plan or the scheme contains non-residential lots, the insurance does not extend to cover either those lots, or those lots' proportionate share of the common area.

In these circumstances we believe that the insurer should be entitled to reduce liability for the indemnity to be paid in relation to the common area based upon the unit entitlement of the relevant (builder owned/developer owned / commercial lots) within the strata scheme as a proportion of the total unit entitlement for the scheme.

For example:

- Assume a 100 lot strata scheme with a unit entitlement of 10 units per lot, giving a total of 1000 units (100 x 10). The builder owns 5 units, with a combined unit entitlement of 50. The developer owns 5 units with a combined unit entitlement of 50 and there are 5 commercial lots with a combined unit entitlement of 50.
- A claim is then made in relation to the common area against the home warranty insurer issued for the building and assessed at a rectification cost of $800,000.
- The combined unit entitlement of the builder owned, developer owned and commercial lots (15 lots in total) is 150 out of a total 1000 issued for the building, i.e. 15%.
- Accordingly, the insurer's liability in relation to the common area defects is reduced by $120,000. ($800,000 x 150/1000 = $680,000)
- The remaining $120,000 of rectification costs would need to be raised by the builder, developer and commercial lot owners to cover their respective contributions to the cost of rectifying the common property. A law should be introduced in that regard to avoid a special levy being raised against all lots.

We strongly submit that this amendment be made retrospectively to provide certainty for those already engaged on this point.

Recovery Rights

ICA submits that the amendment of the Act and Regulations to properly provide for recovery rights of insurers and the Building Insurers Guarantee Corporation is a significant issue to be addressed by the current review. The lack of any provisions in either the Act or Regulation that specifically deal with or give rights to insurers in recovering indemnities paid from builders and developers is a significant issue for insurers.

The basis of the problem is that, at common law, only when an indemnity is paid can an insurer subrogate to the rights of beneficiaries to pursue any right of recovery the beneficiary may have had against the builder or developer. Given that the period for commencing such recovery proceedings typically expires at the same time as the period of insurance cover expires, where claims are made close to the expiry of the insurance period, insurers are left

with very little time to assess the claim, pay the claim and commence any recovery proceedings.

Take the following example:

- A homeowner holds a first resort policy of insurance with a 7 year period of cover for defects.
- The homeowner discovers defects 1 month before the expiration of the 7 year period and lodges a claim with the insurer.
- If the insurer indemnifies the homeowner for the defects, the insurer is subrogated to the rights of the homeowner against the builder and can bring proceedings against the builder in the homeowner's name for breach of the statutory warranties.
- However, the action against the builder must be commenced within 7 years from completion of the work, which expires in just 1 month
- As a result, the insurer has just 1 month to assess the claim, indemnify the homeowner and then commence recovery proceedings against the builder (and/or developer as the case may be).

In circumstances where the homeowner is an owners' corporation and the claim involves a strata building with several hundred defects worth millions of dollars, resolving the claim and commencing any recovery actions within the 1 month period is extremely problematic.

Under the scheme in place between 1997 and 2002 we believe that, despite its operation as a first resort scheme, builders could delay the claims until the 7 year statutory warranty expired so that the home owner claimed directly against the insurer. In our members' experience, while the home owner was able to claim under the home warranty insurance, the insurer was statute barred from seeking any recovery from the builder.

Our members have experienced similar difficulties under the scheme from 2002 to 2010 with last resort policies where, although the builder may be insolvent, the developer escapes liability due to the claim being made close to the 7 year statutory warranty period for defects that were notified to the insurer within the 2 or 6 year period of insurance cover for structural or non structural defects.

Ultimately we believe that it is the homeowner who often pays the price for this problem. Where a homeowner makes a claim close to the 7 year period expiring but fails to take action to preserve their rights against the builder, the insurer can be entitled to reduce its liability to the homeowner under clause 58A of the Regulations for failing to take action against the relevant builder.

It is submitted therefore that this situation will continue to erode homeowners' rights and will continue to allow builders and developers to avoid responsibility for building defects that have arisen during the 7 year statutory warranty period.

The ICA strongly submits that the Act be amended to provide insurers with rights similar to those provided to the Fair Trading Administration Corporation (FTAC) under the Building Services Corporation Legislation, and those provided to the Building Insurers' Guarantee Fund under Section 103N of the Act - which creates a statutory debt obligation by the builder to the insurer in the event the insurer pays a valid claim.

This would be likely to have the following effects:

- It would make builders and developers more accountable for breaches of the statutory warranties;
- It would remove the risk of home owners who make claims at the very end of the statutory period having their claims denied due to their failure to preserve recovery rights;

Both builders and developers (as opposed to other liable parties such as engineers or architects) should, we believe, be subjected to a statutory debt liability due to their direct statutory liability to homeowners under sections 18B and 18C of the Act.

As per the rights given to FTAC and the rights given to Building Insurers' Guarantee Corporation under section 103N of the Act, upon payment of an indemnity the insurer should be granted a statutory right to a claim in debt for the relevant indemnity and any associated reasonable costs.

For such a right to be of any useful effect however, we submit that it would need to be retrospective in operation so as to apply to claims already paid in circumstances where the defects can be shown to have arisen during the 7 year statutory warranty period.

However, as matters presently stand, there is a problem with Section 103N(3), which provides as follows:

> *The Guarantee Corporation may only give a direction under subsection (1) or (2) to the extent that an insolvent insurer (if it was not insolvent) would be able to require that work or supply, or require a payment to the insurer by the builder, under the relevant insolvent insurer's policy"*

We believe that under the Act or Regulations the insurers do not have the power to 'require' the builder and/or developer to pay or do work in answer to a claim on the insurance. Accordingly, the ICA submits that either this pre-requisite to the operation of Section 103N should be removed, or alternatively, the insurers should be given the power to 'require' builders and/or developers to do the work or make payment.

Whilst the addition of rights similar to those provided in Section 103N should be given to insurers as against builders and developers, we submit that the addition of such rights should expressly co-exist with the insurer's subrogated rights (of beneficiaries) against any other person in relation to the subject matter of the claim. Whilst we believe these rights already exist, there have been challenges to these rights in the courts.[12]

The ICA submits that this is required for two reasons.

- Firstly, the insurer's rights to recover the indemnity paid to the beneficiary from parties other than the builder or developer (such as architects, engineers, etc) should be preserved.
- Secondly, the ability to rely upon subrogation rights against the builder should also be preserved as not all claims will trigger or benefit from the use of section 103N style direct

[12] *The Owners Strata Plan 56587 v TMG Developments Pty Limited [2007] NSWSC 1364.*

recovery rights. The insurers should retain the option of using either subrogated recovery rights or, alternatively, direct recovery rights under section 103N.

The Government sought to give itself such a power for the Building Insurers' Guarantee Corporation, under Section 103N (although that section has the issues noted above and so the same wording could not be used). As such, ICA submits it would be appropriate to provide insurers with the same right, and the Government may wish to provide itself with such a cause of action for the Government underwritten scheme which commenced in 2010.

The builder could still defend an unreasonable claim by the insurer by proving the claim should not have been paid. However, the onus would be upon the builder to do so.

There would also have to be provisions dealing with claims by owners themselves, including for any uninsured loss, to avoid double recovery, and also to avoid situations where the owners might sue for a full loss without disclosing an indemnity had been paid (or at least requiring accounting for monies recovered to the insurer).

Consequential Losses

Clause 58 of the Regulation includes at clause 58(1)(k)(ix) a permitted exclusion for loss or damage resulting from 'consequential loss, including, without limitation, loss of rent or other income, loss of enjoyment, loss of business opportunity, inconvenience or distress'.

In the decision of McDougall J of the Supreme Court of NSW in the matter of *Waterbrook and Yowie Bay Pty Limited v Allianz*[13], His Honour considered whether the following clause in an insurer's policy was void by reason of non-compliance and/or inconsistency with the Act and Regulation at the time the policy was issued in 1999:

> *"The insurer shall not be liable for any claim for loss or damage or loss of use and/or consequential loss of any other kind arising directly or indirectly out of any event listed in the building owners indemnity except as provided in sub-clause 5".*

As the relevant policy was issued in 1999, Regulation 58(1)(k)(ix) did not exist at that time and as a result, the exclusion of consequential loss was not included.

After having considered the Regulation applicable at the time, McDougall J concluded that the Act and Regulations did not permit exclusion for consequential loss in the manner that the insurer's policy attempted to. As a result, His Honour found the relevant clause void.

However, the ICA is of the view that His Honour's decision places a significant burden on insurers. We submit that the exclusion of consequential losses in all Home Warranty Policies is reasonable and necessary for the proper operation of the scheme for the following reasons.

- The intent and spirit of the scheme is to provide cover to homeowners for the actual cost of rectifying or completing the physical building works, together with other express heads of cover such as alternative accommodation and storage costs. To allow consequential

[13] [2008] NSWSC 1407

losses to be covered (or not excluded) would be to effectively add an additional head of cover to the scheme in circumstances where the legislation clearly intends the cover to be limited.

- By expressly providing for particular types of other losses such as alternative accommodation, the intent of the scheme is not to provide limitless categories of loss or damage that might be conceivably claimable. The exclusion of consequential losses by insurers should not therefore be seen as being contrary to the spirit and intent of the scheme.
- To prevent the exclusion of consequential losses for all policies issued since 1997 (which is the effect of McDougall J's judgement) would risk opening the way to further claims for losses and damages that have nothing at all do with the rectification of building defects and the completion of building work. For example, claims for distress, disappointment and inconvenience, loss of opportunity, claims for lost income, claims for personal injury arising out of defective building work, claims for legal costs incurred in seeking advice, could all be made.

Further, whilst the exclusion of consequential losses is now permitted by the Regulations, we believe the manner in which the permitted exclusion is provided needs further clarity, as it is prone to challenge.

In that regard, clause 58 (1)(k) of the Regulation only allows exclusion of 'consequential loss, including, without limitation, loss of rent or other income, loss of enjoyment, loss of business opportunity, inconvenience or distress' where the exclusion of those losses 'is a standard policy provision of the insurer'. Does this require the insurer to prove that other policies issued by it that are unrelated to home warranty insurance also exclude 'consequential loss, including, without limitation, loss of rent or other income, loss of enjoyment, loss of business opportunity, inconvenience or distress'. Does such an exclusion have to be identically worded in other policies issued by the insurer for it to be a 'standard policy provision'? What if the wording of such exclusions is different in other policies? What if only some of the insurer's other polices contain such an exclusion whereas others do not? Would this mean the exclusion in the Home Warranty policy is not permitted?

We submit that the phrasing of clause 58(1)(k) is therefore unnecessarily restrictive and confusing, and leaves the application of the exclusion open to debate as between homeowners and insurers.

For these reasons, it is ICA's submission that the Act and Regulation should be amended to specifically exclude cover for consequential losses under all home warranty insurance policies issued since 1997. To simply allow the exclusion of consequential losses is insufficient in our view. The legislation should specifically exclude such losses from cover retrospectively so as to prevent an increase in claims as noted above.

Preventing home warranty insurance claims by 'related' parties

The ICA submits that the definition of related party (taken from the *Corporations Act 2001 (Cth)*) is too limited to be of appropriate assistance to insurers.

We believe that the meaning of 'close associate' and 'prescribed relationship' provided under Section 3AA of the Act should be utilised to widen the exclusions for builders and developers under the Part 6 Insurance certificates. This would cover the situations proposed by the Government, without having to add yet another definition to the Act for only this purpose.

That is, Regulation 55(2)(d) of the Act should be widened from 'related companies' as defined therein, to cover related persons similarly to Section 3AA of the Act.

Insolvency and Home Warranty Insurance

We believe that some consideration should also be given to the situation where a builder or contractor becomes insolvent and enters into administration (without a Deed of Arrangement) - but then ceases to be so and again trades profitably.

This situation can give rise to a claim but, where the builder has ended its insolvency with no adverse effects upon the beneficiary's rights, it remains contestable as to whether the policy has been triggered. Some clarification would provide certainty in these circumstances.

Insolvency of Partnerships

The ICA submits that a beneficiary should not be able to make a claim under the insurance when only one member of a partnership has become insolvent.

Under the scheme from 2002 to 2010 it provided a safety net for home owners when the relevant contractor was no longer available to rectify the defects or compensate the owner for the cost of repairing them. As the members of a partnership are jointly and severally liable for the actions of their partners, while the remaining partner(s) are solvent they are still able to be sued for compensation even if they are unwilling or unable to rectify defects themselves.

To allow an owner to claim under the insurance while the partner(s) is still solvent in our view defeats the purpose of the last resort insurance, as the owner has not exhausted their avenues for seeking compensation.

The fact that the relevant work was undertaken by a partnership should not allow an owner to claim earlier than they would be entitled to had the contractor been an individual or a company.

The Deposit & other Losses

The ICA submits that the Regulations, in particular, clauses 52(2) and 56, should be amended to state that where a deposit has been paid but physical work has not commenced and a non-completion claim is then made, the beneficiary is restricted to a loss of deposit claim. Otherwise beneficiaries can claim for a loss of chance or opportunity if they cannot secure another builder to do the project for the same price. Regulation 57 would also have to reflect this.

Regulation 56(3)(e) should also indicate, we believe that the costs themselves should be reasonable as to quantum, and reasonably incurred, which is not currently clearly indicated. The costs should be indicated as being costs of proceedings, not costs otherwise incurred and should be restricted to party/party costs, not solicitor/client costs. We submit that the costs should be indicated as being on a scale (to be determined).

We believe that regulation 56 should be amended to clarify whether the insuring provisions in 56(3)(c), (d) and (e) are stand-alone insuring provisions or are simply extensions of the non-completion head of cover. This is important as it is not clear whether claims under these

heads are regarded as non-completion claims for the purposes of regulation 58(1)(j) and are therefore subject to the 20% capping on non-completion claims.

Whilst it is accepted that certain costs will be incurred in these circumstances, the experience of our members has been that because these costs are not scaled (as they are in other statutory schemes) there is an incentive for the head of cover to be leveraged. All of this adds to the ultimate cost to consumers.

The ICA submits that the costs provided for under the policy are scaled costs as in, say, Workers Compensation. This would provide some protection for costs for consumers.

Regulation 58(1)(a) should also be amended to define what 'damages for delay' means.[14]

As noted above, Regulation 58(1)(k) requires further clarity on what constitutes a standard policy provision of an insurer and whether this means home warranty policies or general insurance policies. We believe that the Regulation should be amended to simply allow such exclusion to be included if the insurer wishes - but only if it is not inconsistent with the Regulations, as stated in Regulation 58 (2).

Negligence

The ICA notes the decision of McDougall J in *Owners Corporation Strata Plan 72535 v Brookfield* (Brookfield)[15] where His Honour found that a builder and developer of a residential unit development owed no duty of care to the owners corporation in respect of the defective construction of the building and as a result, had no liability in the tort of negligence for that defective construction.

The basis for His Honour's finding (that no duty of care was owed) was essentially that where the legislature, through the Act, has imposed a statutory liability on builders and developers (through the Part 2C Statutory Warranties), 'the courts should be slow to substitute their own judgment for that of the legislature'.

The consequence of this decision for homeowners and insurers is likely to be significant. In our members' experience, it is regularly the case that homeowners who discover defects close to the expiration of the statutory warranties have insufficient time to commence legal proceedings against their builder or developer. This also occurs with owners corporations who are successors in title and therefore often have no direct knowledge or information as to the identity of the builder or builders or the date of completion of the work. This may leave them with little to no time to carry out those enquiries and if necessary, pass the relevant resolutions necessary to instruct solicitors to commence proceedings. Quite often the only remedy these consumers have is to pursue the builder and/or developer through the tort of negligence in order to obtain a remedy. That remedy is now no longer available.

Similarly, we submit that insurers who receive claims close to the expiration of the statutory warranties have insufficient time to assess the claim and indemnify the homeowner so as to be able to then subrogate to the homeowners' rights and commence proceedings against the builder and/or developer.

[14] (see Royal & Sun Alliance Insurance Ltd and Ors v Buttigieg and Ors [2001] VSC 475 (14 December 2001)

[15] [2012] NSWSC 712 (Unreported 29 June 2012)

In view of His Honour's decision that a duty of care should not be imposed on builders and developers where there is a statutory warranty regime in place, it is submitted that the review of the Act should include a review of the timeframe required for proceedings to be commenced against builders and developers for breach of the statutory warranties. Whilst the duration of the warranties themselves may remain unchanged, the time limitation for commencing proceedings for a breach of same should be urgently reviewed.

The only alternative to extending the time for proceedings to be commenced would be to address the Brookfield decision by an amendment to the Act which expressly recognises the existence of a duty of care or expressly preserves any such common law duty - notwithstanding the existence of the statutory warranty regime.

Specific Regulations

Regulation 58(1)(k)(viii) regarding pest issues might arguably limit the exclusions under (c) or (f). It should be made clear that (viii) does nothing to limit or read down (c) or (f), or (viii) should simply be deleted given it is duplicating these Regulations. Alternatively, (viii) could be indicated as being part of what is excluded under (c) and (f).

We believe that regulation 62 clashes with section 28 of the *Insurance Contracts Act 1984* (Cth). The Regulation should state it does not include fraudulent misrepresentation or non-disclosure, in which circumstances Section 28 of the *Insurance Contracts Act 1984* prevails to the extent applicable.