KERIN BENSON LAWYERS

24 July 2019

Building Stronger Foundations Consultation
Regulatory Policy
Better Regulation Division
Department of Finance, Services and Innovation
2 – 24 Rawson Place
HAYMARKET, NSW, 2000

BY EMAIL: BCR@finance.nsw.gov.au

Dear Sir / Madam

RE: BUILDING STRONGER FOUNDATIONS CONSULTATION

Thank you for the opportunity to make submissions to the above consultation.

I have advised, and acted for, owners corporations and apartment owners in NSW for over 10 years. In that time, I have advised over 50 small and large owners corporations in relation to building defects and combustible cladding matters.

Submissions

1. Risk Management

An understanding of risk and how to manage risk in the NSW building and construction industry does not appear to be a driver in the approach to ensure an appropriate level of building quality in NSW residential buildings.

Although the NSW state government and other respective state and territory governments have recently taken a positive step by committing to ongoing cooperation to implement building reform throughout Australia, this must be done with a full appreciation of the risks that are involved and the parties that a best positioned to manage those risks now and in the future.

It is clear that building defects in the residential building sector in NSW are endemic (see the City Futures Research Centre Report – Governing the Compact City, May 2012).

The proposed response of government to this is has been more and more regulation. For example, the *Home Building Act 1989* and related *Home Building Regulations* have been amended well over 100 times over the last 20 years to try to manage the issue of building defects.

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Unfortunately, regulation tends to have a self-generating property. That is, the more regulation you have, the more you seem to need. Indeed, notwithstanding the ever increasing level of building regulation which has been introduced, the quality of building work seems to have become worse not better.

While one or two elements of the currently proposed amendments are welcome (in particular the proposed duty of care of building practitioners), the remainder will simply add a further layer of compliance which will be welcomed by lawyers but be unlikely to change behaviours in the construction industry.

What is missed in the proposed approach is the fact that behaviours are not changed through more regulation. Builders, while vaguely aware of the legislation that governs them, do not and will not change their behaviours due to the ever increasing complexity of the laws that govern them.

What would change the behaviour of builders, developers and designers is the clear knowledge that they will bear the entire risk of any building defects. When builders, developers and designers know that they will be held responsible for defects (no matter what asset protection measures are put in place), then builders, developers and designers will work as if the building being worked upon is their own.

In this regard, commercial buildings do not suffer from the same level of building defect issues as residential buildings. The reason for this is that the developer of a commercial building is the ultimate owner of the building and ensures that the work completed by the builder and designers is of the required level. Given residential developers are not the ultimate owners of the buildings they develop, the incentive to ensure the building is built to the correct standard is simply not present.

The question is, how is risk being managed in the residential apartment sector at present?

Recognised risk management principles generally hold that a party should bear a risk where[1]:

- the risk is within the party's control;
- the party can transfer the risk, eg through insurance, and it is most economically beneficial to deal with the risk in this fashion;
- the preponderant economic benefit of controlling the risk lies with the party in question;
- to place the risk upon the party in question is in the interests of efficiency, including planning, incentive and innovation; and
- if the risk eventuates, the loss falls on that party in the first instance and it is not practicable, or there is no reason under the above principles to cause expense and uncertainty by attempting to transfer the loss to another.

In short, the risk associated with building defects in the residential building sector in NSW has over the last thirty years been transferred from the NSW Government (where it resided with the Building Services Corporation who provided unrestricted insurance for all

[1] National Public Works Conference (NPWC)/National Building and Construction Council (NBCC), No Dispute – Strategies for Improvement in the Australian Building and Construction Industry (1990) p 6.

residential buildings in relation to building defects) to the private insurance sector in 1995 (when government began outsourcing functions that were thought to be not core to government) and then finally to lot owners (following the collapse of HIH in 2001 and the home owners warranty insurance reforms that followed).

Unfortunately the transfer of this risk was not in accordance with the above recognised risk management principles. Lot owners have no real way of managing the risk of building defects as:

- negotiating warranties in sale of land contracts, while legally possible, is usually commercially impossible; and
- the usefulness of statutory warranty coverage is dependent upon a defendant who has assets to pay any judgement amount. In this regard, the common use of special purpose vehicles or having multiple entities controlled by one or two directors or shareholders (any one of which can be deregistered cheaply within a short period of time) as well as the practice of phoenixing means that aside from tier one builders and developers, there is always a high risk that years of litigation will result in a pyrrhic victory.

The parties who have the real ability to manage the risk associated with building defects (builders, developers, consultants, insurers and government) are no longer the bearers of that risk (ie the risk has been passed onto lot owners).

The way in which risk can be firmly placed back on the builder and developer is via decennial liability and decennial liability insurance.

Indeed, given most building industry stakeholders believe that “they are doing a good job”, there should not be any real objection to such a step.

2. Decennial Liability and Decennial Liability Insurance

Decennial Liability

Decennial liability originates from the French Civil Code of 1804. The French Civil Code and its updated versions have had a considerable influence on civil law jurisdictions worldwide.

Decennial liability is a statutory mechanism currently in force in at least thirty-nine (39) countries, including:

- Algeria
- Angola
- Argentina
- Bahrain
- Belgium
- Bolivia
- Brazil
- Cameroon
- Canada
- Chile
- Colombia
- Egypt
- Finland
- France
- Gabon
- Indonesia
- Italy
- Iraq
- Jordan
- Kuwait
- Louisiana (USA)
- Lebanon
- Mali
- Malta
- Morocco
- Netherlands
- Oman
- Paraguay
- Peru
- Philippines
- Republic of Congo
- Romania
- Saudi Arabia
- Senegal
- Spain
- Sweden
- Syria
- Tunisia
- United Arab Emirates

Broadly speaking, under the principles of decennial liability, the builder and designer are jointly liable for:

a) a total or partial collapse; and/or

b) any defect that threatens the structural integrity and safety of the building.

Naturally, the precise extent of liability varies from jurisdiction to jurisdiction.

The builders and designers remain liable for the buildings they built and designed for a period of at least ten (10) years following project completion.

A critical factor with decennial liability is the imposition of a three (3) year limitation period for bringing claims against the builder and/or designer which commences from the date of the collapse or discovery of the defect. Therefore, the maximum period that an owner or owners corporation can bring a claim is thirteen (13) years from the completion of the building.

As decennial liability is a form of strict liability, there is no need to prove error or fault on the part of the builder or architect/engineer. That is, all builders and designers involved in a building's construction are automatically responsible or liable for damages which compromise or have the potential to compromise the structural integrity of the building or render it not fit for its intended use and occupation.

Any compensation for decennial liability is in respect of the actual loss suffered and may include loss of profit/loss of use. Furthermore, the law expressly prohibits any attempt to contract out of or to limit such liability.

Decennial Insurance

Given decennial liability falls outside the scope of the standard cover provided by contractor's all risk and professional indemnity insurance, the implementation of the decennial liability scheme in NSW law would require the implementation of a scheme of decennial liability insurance for the builder and developer in relation each individual building project.

Many countries, including the following, have some form of mandatory latent defects or decennial insurance:

- Algeria
- Belgium
- Cameroon
- Denmark
- Egypt
- Finland
- France
- Hungary
- Mali
- Republic of Congo
- Senegal
- Spain
- Tunisia

Decennial insurance differs from professional indemnity insurance, where the policy that is current at the time the claim is made responds to the claim. Therefore the building owner has the absolute assurance that there is a policy in place that will respond, rather than having to rely upon a consultant renewing its professional indemnity insurance policy for the next 10 years.

The existence of mandatory decennial liability insurance would be critical in the success of a decennial liability scheme in NSW. It would provide builders and designers with a

form of indemnity coverage that would protect them from significant claims under decennial liability.

The co-existence of decennial liability and decennial liability insurance would also provide far greater protection to owners and owner corporations than the current protections available under NSW law.

It is therefore my submission that a decennial liability scheme be implemented together with mandatory decennial liability insurance for each builder and designer for each separate building project.

3. Implied Warranties in Sale of Land Contracts

A common thought arises in the mind of a lot owner when building defects are discovered in apartment buildings – 'sell before the word gets out'.

In this regard, NSW should look to adopt a similar regime of implied warranties as may be found in the Australian Capital Territory in the *Civil Law (Property) Act 2006* (see Division 2.9.3).

In short, the seller of a unit warrants to the buyer that there are no unfunded patent or latent defects in the unit or common property other than those arising through fair wear and tear or defects disclosed in the sale of land contract.

This will assist lot owners to focus on the repair of the defects rather than simply passing the problem onto others.

4. Rectification Agreements

In 2018 the Victorian State Government introduced the *Building Amendment (Registration of Building Trades and Other Matters) Act 2018* which established a regime of rectification agreements (**Rectification Agreements**).

Rectification Agreements are a three-way voluntary agreement between an owner or owners corporation, lender and local council to fund particular rectification works.

Rectification Agreements function by way of a lender who loans money to an owner or owners corporation and the loan repayments are made over time through the council rates system. The council will act as guarantor and provide the repayments received through the council rates system to the lender.

The purpose of Rectification Agreements is to provide necessary funding to specific rectification works by providing the required rectification funds on very minimal or no interest terms.

Rectification Agreements may pose a significant benefit to NSW as they provide benefit to owners without further restriction or overregulation of the building industry.

Such a mechanism could be used to provide the necessary funds for the rectification of building defects or the replacement of combustible cladding.

It is my submission that the NSW Government should follow the path of the Victorian Government and implement a Rectification Agreements Scheme to address the building defects and combustible cladding crisis in NSW.

5. Industry Awards

Legislation should be enacted not allowing a building to be given any industry award until four years has passed since its completion and any defects which manifest during that period be taken into account when considering that building for an award. This would enable a more realistic assessment of the quality of design and construction of a building.

6. Public Register

The establishment of a public register of residential buildings which have been the subject of a rectification order by the Office of Fair Trading together with the names of the builder, developer and any directors of the building and development companies involved with such residential buildings.

Quality issues in relation to cars, refrigerators, washing machines, credit cards, heath insurance policies, etc are constantly analysed by consumer organisations like Choice. There is no reason that this cannot be done for residential buildings.

Thank you for considering my submissions.

I look forward to hearing from the Department of Finance, Services and Innovation in due course.

Please do not hesitate to contact me should you require anything further.

Yours faithfully

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