BANNERMANS LAWYERS

SUBMISSION ON THE HOME BUILDING ACT ISSUES PAPER

TO: NSW Fair Trading Policy Division
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INTRODUCTION

This is a submission from Bannermans Lawyers addressing the questions posed throughout the issues paper using the numbering of those questions for convenience.

It is understood that the Government is seeking to kick-start the economy in relation to residential building works. However, it is not the *Home Building Act* (**HBA**) holding back new projects. It is widely accepted that the problems are:

a) Delays in the planning and approval under the *Environmental Planning and Assessment Act*;

b) Lack of capital and financing opportunities;

c) Lack of consumer confidence;

The HBA can seek to address consumer confidence by maintaining a suitable safety net for consumer so that consumers can confidently purchase new construction in NSW.

Notwithstanding the above, the government should be commended for seeking to identify reforms to simplify home building disputes thereby saving many millions of dollars in legal fees from within the sector that could be better spent elsewhere. However, it seems from many of the 2011 amendments and the issues paper that there is a substantial (and with respect misplaced) focus on attempting to achieve that by reducing consumer rights.

Reducing consumer rights will minimise the number of disputes and many consumers will be left with no rights to exercise. However, that is clearly not a fair approach. Nor will it do anything to assist consumer confidence or the quality of construction in NSW. If anything, it is having and will have the opposite effect. It will only encourage 'cowboy' behaviour and increase shonky construction further increasing the already prevalent dialogue within the consumer sector along the lines of never buy a new unit, only buy a unit that has stood the test of time.

Bannermans submits that there are a number of fair reforms available that can simplify home building disputes. They would dramatically reduce the number of disputes and avoid many millions of dollars in legal and expert fees for the various stakeholder groups within the industry. Those reforms are suggested in this submission. Simplifying key areas of the HBA to reduce disputes by reducing uncertainty is fair as everyone will know where they stand. There will be fewer disputes and fewer issues to argue about, which would result in very substantial decreases in the time and cost of residential building defect disputes in NSW

We are happy to meet with you to discuss any of the issues in our submission or generally.

ANSWERS TO QUESTIONS

1. **What aspects of the regulation of home building contracts could be improved and why**?

1.1. Subject to the comments below, the regulation of building contract terms is appropriate.

2. **Should the threshold for large home building jobs be increased from $5,000 to $20,000 to match the current home warranty insurance threshold?**

2.1. This reform is aimed at reducing the number of disclosures required in contracts to reduce compliance costs and 'red tape'. However, the compliance costs and inconvenience involved are nominal. The relevant disclosures should be, and generally are already made, in standard form contracts. Even where a contractor uses it own non-standard form contract document, the costs involved are negligible considering that the terms, once drafted, are able to be re-used in future contracts.

2.2. The proposed changes will inevitably reduce the consumer's awareness of their rights under the HBA, where the contract sum is below $20,000. That may have a flow-on effect of fewer disputes but only due to some consumers not being aware of their rights which is not an appropriate path to such an outcome.

2.3. The main annoyance from a convenience perspective is the provision of the consumer guide for every contract and the extra paperwork involved. That is not just an annoyance for contractors but also for managing agents and executive committees of strata plans who are generally managing the contracts for strata plans from the consumer end. It would be appropriate to have a standard clause referring to the consumer guide and advising how it can be easily obtained rather than requiring its provision for each contract. Such a clause should in fact be required for all contracts, not just those over $5,000. The other disclosure provisions have no real compliance cost and do not generate extra paperwork. They should be maintained for all contracts above $5,000 as there is no real compliance or convenience cost in maintaining them and their presence assists in keeping consumers informed.

3. **Will further regulation of progress payments provide greater clarity and certainty in home building contracts?**

3.1. 'Frontloading'

a) It is a common practice for builders to 'frontload' their contracts when dealing with consumers who are unfamiliar with the construction process. The approach obtains a high level of payment for the work early in a project, and disproportionate to the work carried out at that stage. Unless the consumer has significant construction industry experience, the consumer will usually not be in a position to know if a progress payment schedule is 'frontloaded'. In such circumstances, the contractor's incentive to complete the job (after the

initial stages) is reduced, as the profit in the latter stages of the project is insignificant.

b) In reality, policing 'frontloading' effectively may not be feasible. Any proposal to prohibit 'frontloading' needs to include a way of assessing and determining it. Without a clear system, home building would only become even more complex, and the change will simply present further issues to litigate. That will in turn increase the number, cost and complexity of disputes.

c) SICORP, the government agency that is now the sole provider of home warranty insurance, requires a copy of a signed building contract prior to issuing insurance, possibly for reasons not relevant to policing 'frontloading'. However, the practice gives SICORP the opportunity to have a policing role without further complicating the HBA. SICORP would presumably have personnel with the ability to spot obvious frontloading when reviewing contracts, prior to issuing insurance. It should (and perhaps it already does) refuse to issue insurance where the contract does not have a meaningful progress payment schedule or where the schedule is obviously frontloaded.

d) If SICORP considers the issue at the underwriting stage, which it may already do, it should pick up 'frontloading' in a way that will not result in a dispute for projects of less than 4 storeys. Even if the unfair multi-storey home warranty insurance exemption is not removed (we suggest it should be now that the government is the insurer), developers for projects of more than 3 storeys should be well placed to protect themselves from 'frontloading'. This issue does not affect successors in title.

e) To implement a practice of SICORP policing 'frontloading', the only change that may be needed would perhaps be to SICORP's underwriting guidelines.

3.2. To ensure that policing frontloading does not result in an unwarranted increase in costs plus contracts and to protect consumers from the risks of costs plus contracts, cost-plus contracts should be limited to circumstances where:

a) costs cannot be determined without first undertaking significant tasks to reasonably determine the scope of works; or

b) the contract price exceeds $500,000; or

c) The contract contains a cap on total cost thus making the contract a costs plus up to a total maximum cost of [agreed amount] contract.

4. **What terms, if any, should be included in a termination clause?**

4.1. It is not appropriate for the HBA to regulate termination provisions. If an attempt to do that is made, there ought be separate provisions for the different categories such as:

a) single dwelling house;

b) group title repair and maintenance agreements; or

c) contracts to undertake a residential strata development, which may have commercial and residential components combined.

4.2. Australian Standard contracts are comprehensive, sophisticated agreements. However, many who use such contracts modify the termination provisions to deal with the issues for each particular project such as:

a) the nature of the works;

b) issues concerning enforcement issues under the *Building & Construction Security of Payments Act 1999*;

c) timing issues and pressures;

d) external administration; and

e) deeds of company arrangement.

5. **If cost-plus contracts are to be regulated, in what situations should they be allowed and what controls should apply?**

5.1. Cost-plus contracts should be limited to circumstances where:

(a) costs cannot be determined without first undertaking significant tasks to reasonably determine the scope of works; or

(b) the contract price exceeds $500,000; or

(c) The contract contains a cap on total cost thus making the contract a costs plus up to a total maximum cost of [agreed amount] contract.

6. **Should the definition of "completion" include a specific definition for subsequent purchasers?**

6.1. Bannermans commends the government for seeking to provide a clear definition for completion. A clear definition of completion will avoid any real time limitation arguments. Everyone will know where they stand. Such a result would be fair as no party would be caught by surprise. It would reduce litigation as claims will either be clearly within time or clearly out of time and thus not commenced. That certainty will reduce the amount of disputes and greatly simplify matters that do need to be disputed. It would save millions of dollars in legal fees for each of the various interest groups in the sector.

6.2. The definition of 'completion', introduced in the 2011 amendments, has, despite its intention of providing a clear definition, made the issue more complex than ever, and not just for subsequent purchasers. The new definition is causing and will continue to cause many millions of dollars to

be spent on legal costs resulting from that uncertainty.

6.3. Parties in a defect matter, even if they were the original contracting parties, will generally not agree on whether or not a contract provides a meaning of when the works are 'complete' in the relevant sense, or on how the contract should be interpreted even if it does provide a meaning of when the works are complete. That is already two issues to litigate that could be avoided by a clear definition.

6.4. Without a clear outcome from the primary definition under the terms of the contract, parties then also have deal with multiple other potential 'completion' date scenarios raised by the current definition (**default definitions**). That leaves parties incurring significant fees on legal argument and obtaining evidence on a number of the different possibly applicable default definitions. In addition to inviting conflicting evidence on a number of different tests, the door for potential issues to dispute has been even further opened by the 2011 amendments for a contractor to put on evidence showing the completion date is earlier than any of the default definitions.

6.5. The time limit uncertainty causes many owners corporations to commence proceedings earlier than they would have to if the position was clear. For example, strata lawyers cannot advise owners corporations that they have a particular period of time to negotiate an agreement with a builder or developer before commencing proceedings. Instead, the advice currently needs to be to the effect that the date of completion is not known, cannot be reliably identified, can run out at any time if it has not already run out and you should commence proceedings immediately against at least the builder and developer to avoid losing all of your rights against all parties including the insurer (if there is one).

6.6. Under the current definition, successors in title, particularly owners corporations, cannot take the risk of waiting to commence proceedings. Those circumstances caused by an uncertain definition that can result in completion eventually being much earlier than expected has forced and is forcing many owners corporations to commence proceedings to preserve their position and subsequently try and negotiate an outcome. A clear definition would instead avoid the litigation of many matters by allowing parties to work together to agree an outcome, knowing how long they have to negotiate before proceedings have to be commenced.

6.7. It is crucial that a new definition be introduced that leaves no room for argument over whether or not a particular test applies or how it should be interpreted or what outcome the various conflicting evidence from different witnesses or documents may or may not support under each possibly applicable test and interpretation.

6.8. It should also be noted that the uncertainty in the current definition is such that the limitation date can only be earlier than expected. It is only consumers that can be caught out by the uncertainty in the new definition. The uncertainty in the current definition is only ever unfair to consumers and only ever hampers the settlement negotiation position of consumers. Bannermans query whether the government understood that when agreeing to the new definition.

6.9. Bannermans respectfully submits that the current definition for completion introduced in 2011, if maintained, would be the cause of the largest 'lawyers picnic' ever seen for residential building litigation in NSW. The only reason any stakeholder could have in supporting a definition that leaves uncertainty would be if that stakeholder sees a tactical advantage in consumers not

reliably knowing that they have commenced within time so that there are more issues to dispute before the resolution of a matter.

6.10. Bannermans has been and will continue to be openly critical of the current definition in favour of an alternative definition that would leave no room for debate and provide fairness through certainty thereby avoiding a 'lawyers picnic' and substantially reducing legal fees (against Bannermans' own business interest). Ironically, that criticism has been dismissed as 'ambulance chasing'. Bannermans would welcome a debate on the merits of the current definition against what it proposes below.

6.11. The answer for a clear definition is simple. If the subject building work is within a strata plan, the completion date of the work should be the date of the strata plan registration. That would leave no room for any argument on when the completion date was. That would substantially reduce the number and complexity of residential building disputes involving strata plans and save millions of dollars in legal fees for each of the various stakeholder groups in the sector. It is also unquestionably fair as all parties will know where they stand. Any party supporting the retention of the current definition from the 2011 amendments or anything similar is supporting uncertainty creating a 'lawyers picnic'

6.12. Bannermans submits that for all new construction work not within a strata plan, the date of completion should be the first date that an occupation certificate was issued for the dwelling or dwellings in the subject building. That date is almost always readily ascertainable and leaves no room for any argument and is unquestionably fair. In tandem with using the strata plan registration date for work within strata plans, it would provide certainty for all parties in respect of the construction of virtually all new dwellings, including certainty for both contracting owners and successors in title.

6.13. The enormous uncertainty caused by the current definition of completion is not addressed by requiring the provision of the building contract at the time of sale. As noted above, parties in a defect matter generally do not agree on whether or not a contract provides a meaning of when the works are 'complete' in the relevant sense or on how the contract should be interpreted. That leaves the door open for the 'lawyers picnic' described above. Further, there have been instances where contracts are entered into but then not proceeded with or contractors, when dealing with successors in title, deny that the contract was proceeded with. Thus, the successor in title is also exposed to not knowing the building contract provided during the conveyance was the building contract under which the works, or part of the works, were built.

6.14. Similarly, the provision of the building contract at the first general meeting of an owners corporation would not assist. Even where it is provided, the door remains open for numerous issues. There may also be owners corporations, under the current definition of completion, where the 2 year limitation period for non-structural defects will have expired prior to the first general meeting of the owners corporation.

6.15. It is also common that when defects arise, documents that should have been provided at the first meeting are needed, and there is dispute about what documents were or were not provided at the first general meeting. That confusion or dispute is usually several years after the provision, or non-provision, of the documents which does not assist.

7. **Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the home owner?**

7.1. It is not necessary to clarify that the principal contractor is liable for any failures of sub-contractors.

7.2. The issues paper notes the intent of the statutory warranties scheme is to ensure that a homeowner is protected against any defective or incomplete building work and to provide that the homeowner only need pursue the licensee (person or entity) with whom the homeowner had a direct contractual relationship.

7.3. The statutory warranties scheme does not provide that protection for owners in strata plans for the following reasons:

(a) Buildings of more than three storeys now have no home warranty insurance safety net. Many builders and developers avoid their liability to the owners by using $2 companies leaving the owners with no protection from a licencee or home warranty insurance. When faced with defects, they either have no protection or have to sue any viable target they can. Due to there being no home warranty insurance, they are forced to consider recovery against any subcontractors responsible for the defects;

(b) Where owners corporations do not have home warranty insurance, the insurance requirements in the HBA require not only that they sue the builder and developer (if more than 4 dwellings in the development) but that they also 'diligently pursue' those rights or lose their entitlement to any insurance cover. The effect of that is the HBA is now forcing owners corporations to proceed to litigation without tolerating any delay and to not just pursue the builder;

(c) The insurance provisions also arguably require that the owners sue the relevant subcontractors under the warranties;

(d) The HBA's home warranty insurance provisions include cover for the reasonable cost of pursuing the builder. However, despite requiring owners to also diligently pursue the developer (and arguably the relevant subcontractors) or lose all of their insurance rights, the insurance does not cover the reasonable cost of the owners suing the developer as required by the insurance. Thus, owners corporations now have to incur very substantial costs suing developers for the benefit of the home warranty insurer despite having no insurance cover for the reasonable cost of pursuing the developer.

(e) If the multi-storey exemption (which was only brought in for private insurers who no longer provide insurance) is withdrawn and owners were only required to diligently pursue the builder, then owners corporations would only be required to pursue the builder and would be adequately protected as there would be a home warranty insurance safety net if a builder is unable to meet its responsibilities;

(f) However, the current statutory warranties scheme does not provide the intended protection for owners corporations and actually requires all owners in developments of more than four dwellings to sue the developer (and arguably the relevant subcontractors) in addition to the

builder. The intent of the statutory warranties scheme noted in the issues paper is clearly not being met for owners in strata schemes.

7.4. The issues paper argues that responsibility to owners for carrying out the work properly is with the principal contractor and subcontractors at fault are still held accountable due to cross claims against them by principal contractors. That analysis overlooks that allowing principal contractors to be $2 companies means that they will not meet their responsibilities to owners and subcontractors at fault will escape responsibility as no $2 company will cross claim against any culprit subcontractors.

7.5. In such circumstances, subcontractors at fault should be accountable to owners for their defective work. The unfortunate reality is legislating to leave subcontractors without responsibility to owners under the warranties will encourage poor quality construction and leave even more owners with insufficient protection while those responsible for defects (usually due to 'cutting corners') will not be responsible for their conduct.

7.6. The interests of developers deemed to be developers who did the work would also be fairly protected by maintaining subcontractor's responsibilities under the warranties so that they can cross-claim against any culprit subcontractors. Developers particularly need that protection where the principal contractor is of limited financial means.

7.7. If subcontractors are not to be liable to owners as a trade-off for removing the multi-storey exemption, the government may wish to consider providing SICORP with a statutory right of recovery against a subcontractor when it pays out due to defects in a subcontractor's work.

8. **Do you think maintenance schedules should be required for strata schemes and why?**

8.1. Builders in defect disputes regularly argue that building defects are maintenance issues. The Office of Fair Trading has developed the Guide to Standards and Tolerances, the latest being a 2007 version.

8.2. To address the concerns raised, this document could be expanded to cover other items not currently addressed.

8.3. The *Strata Schemes Management Act* expressly deals with repair and maintenance, imposing strict obligations on owners corporations and community associations. No further legislative requirements are needed in this regard.

8.4. The reality is that the prevalence of maintenance issues in defect claims has been greatly over-exaggerated by some stakeholders in the debate on reforming the HBA. It is common for the Court or Tribunal to find that issues defended on a 'maintenance issue' basis are in fact defects. However, it is unusual for findings that claimed defect issues are maintenance issues. That is because genuine maintenance issues are generally filtered through the Office of Fair Trading Guide and discussions between the parties' experts. While there are exceptions to every rule, it is rare for an owner to pursue an issue that is not worth much after receiving advice that it is probably a maintenance issue.

9. **Should home owners' obligations relating to maintenance be further clarified in the legislation? Why?**

9.1. See 8 above.

10. **Should "structural defects" and other terms be further defined in the Act? If so, which ones and what would be the definition?**

10.1. If the structural and non-structural distinctions are to be maintained, a better definition of 'structural defect' is needed. The distinction between structural and non-structural is currently very uncertain and adding to the number, complexity and cost of disputes. The government should at least aim for a model where there is little room for argument over what is structural or non-structural, while allowing consumers a realistic chance to pursue substantial issues.

10.2. The issues paper includes one suggested definition that focuses on whether an issue is supporting part of the structure. Such an approach is literally a 'structural' defect approach and would leave only a 2 year period for other critical problems such as most water penetration issues and safety issues including fire safety. Water penetration issues and fire safety issues are the key aspects of most defect disputes. They are important issues and are usually not identified within the first 2 years after construction. A system that allows only 2 years to commence proceedings over such issues would be obviously unjust and encouraging an increase in poor quality construction.

10.3. Bannermans does not support any distinction between different types of defects as it causes the uncertainty thereby increasing the number, complexity and cost of disputes. Without such a distinction (ie: one reasonable period of all defects), there would be less to dispute and many millions of dollars saved in legal fees. The uncertainty in the legal positions resulting from the structural and non-structural distinction is a pressure point in the current system adding to the number, complexity and cost of defect disputes.

10.4. If a distinction is maintained, Bannermans submits that more appropriate terminology for a distinction would be to the effect of substantial or minor defect. The Queensland terminology favoured by the Home Building Advisory Council is probably the best approach to achieving that as the 'Category 1' or 'Category 2' terminology is less emotive.

10.5. If a distinction is to be maintained, Bannermans would support clearer defect categories with the category 1 defects clearly including:

a) All internal or external water penetration issues.

b) All health and safety including all fire safety measures.

c) All structural adequacy issues.

11. **In what ways could the statutory warranties be improved (if at all)?**

Bannermans submits that:

11.1. The previous 7 year warranty period did not need to be 'aligned' with the last resort insurance policies (2 and 6 years). Given it is the consumer's responsibility at its risk (and cost) for protecting the subrogation rights of home warranty insurance, it is appropriate that the statutory warranty period be longer than the insurance period. Otherwise insurers will not diligently assess claims and issue insurance decisions while consumers are forced to incur very substantial costs protecting the insurer's subrogation rights. If it would assist, Bannermans can give many examples of that happening since the introduction of clause 58A of the HBR.

11.2. The table below is a comparison of the statutory warranty periods across Australia as at October 2010[1]. The previous 7 year period is about the average position. At first glance, the current 6 years structural defects and 2 years for non-structural defects has been a move to the about average consumer warranty position to the equal worst position with the ACT.

	ACT	NSW	NT	QLD	SA	VIC	TAS	WA
Statutory warranty period	Structural 6 years Non-structural 2 years	7 years	No statutory warranties	6 years and 6 months	5 years	10 years	6 years	6 years

11.3. However, the true position is that NSW would have the worst consumer warranty position in Australia (excluding NT) for the following reasons:

a) The time limit uncertainty due to the definition of completion;

b) A separate and only very short period to commence proceedings for non-structural defects which is unrealistic for a number of common defects and for owners corporations generally;

c) The uncertainty in which time limit applies to which defect due to the 'structural defect' definition;

d) The fact that there will be a 'generation' of owners corporations in the near future who will not even know if they have a 7 year period for all defects or 2 and 6 periods for different defects (on top of not knowing when any of the periods commence or having clarity as to which defects are considered structural or non-structural). This is discussed further below;

[1] It was not practical to update this analysis in the time available to prepare these submissions and we are not aware of any changes to the periods since October 2010.

e) As well as the new warranty periods leaving consumers without a realistic remedy against developers or contractors in relation to many defects, insurers may reduce their liability due to beneficiaries not pursuing statutory warranty rights within 2 years. It is extremely rare for an owners corporation to be ready to commence proceedings for any issue within 2 years of completion.

f) In addition to proving an unrealistic warranty period for many defects, insurers can now deny claims if rights under the warranties are not 'diligently pursued'.

11.4. A requirement for an owners corporation to undertake full inspections of the building and become aware of non-structural defects inside 2 years, obtain legal advice and resolve to commence those proceedings is completely impractical for reasons including:

a) the scheme is usually in the control of the developer at the first annual general meeting and for some considerable time after that;

b) the scheme is not allowed to consider a motion to deal with building defects at the first annual general meeting, given the prescribed matters allowed for consideration;

c) many of the defects become manifest after two years, such as, cracks, delaminated tiles, mechanical defects and waterproofing issues;

d) the usual response from builders or developers is to return with a silicon gun and paint brush in the initial stages which will cause schemes to be walked past the 2 year limit to commence proceedings;

e) the Office of Fair Trading complaint process which is required to be undertaken before commencing proceedings, unless the Chairperson's exemption applies, often takes many months and schemes could be walked past their time limitations during that process;

f) schemes seeking to comply with the pre-litigation requirements under the Uniform Civil Procedure Rules, could be further delayed and walked past their time limitation;

g) scheme committee members are often not professionals and are usually not trained on how to manage these situations; and

h) historically, it is very rare for a scheme to be free from influence of the developer and all of the above circumstances to enable itself to investigate, obtain legal advice and commence proceedings within this period of time and the practical upshot is that builders and developers will be aware of this, with the result that the quality of non-structural construction is likely to drop even further than the current poor position as recognised by recent independent studies.

11.5. Due to the complexity of fire measures for multi-level buildings, poor certification practices, education of subcontractors and inadequate supervision, the majority of multi-level buildings' fire measures are defective. The contractors providing certificates for annual fire safety defects are not reporting on the existence of defects and are also often unlicensed and unregulated.

Consequently most multi-level buildings have significant fire safety defects that are not identified until a change in fire safety services contractor or alternatively after following advice to retain an eminent expert to investigate the existence of fire safety defects.

11.6. Most multi-level buildings have significant fire safety defects, which generally fall outside of the current structural defects category and would therefore not be insured. This is unacceptable from a consumer or even plain public safety point of view.

11.7. It is clearly unsatisfactory in such circumstances, for a builder or developer not to be liable for such defects, unless the scheme commences proceedings within 2 years.

11.8. The new 6 and 2 year warranty periods are very difficult for strata schemes to comply with and forces all owners, but particularly strata schemes, to try to commence proceedings in relation to as many issues as possible within 2 years. Such an outcome is not in anyone's interest. It fuels litigation and legal fees rather than providing a fair and simple system that encourage parties to only litigate as a last resort.

11.9. The trend of developers to hold onto or control the site after completion of the works will make it easier for developers to walk away from the 6 and 2 year warranty periods.

11.10. In the interests of consumer protection, a single period for breach of statutory warranty in relation to all defects should be provided. If that is to be 6 years, instead of the previous 7 years, it would align with the 6 year period that contracting owners have to sue builders under a contract without relying upon the statutory warranties implied into the contract.

11.11. The reasons for that include:

a) Building and certification practices have not been improving. Thus, there is no justification for the very substantial reduction consumer protection.

b) The statutory warranty scheme should be modified to reduce uncertainty, complexity and cost.

11.12. The pressure points typically creating uncertainty, complexity and cost, thereby causing and prolonging disputes include:

a) Time limit issues due to uncertainty on when completion was and which time limit applies;

b) What has to happen within the time limit?

c) Seemingly ever-ending contests between experts retained by separate parties on what items are defective, the required scope and reasonable cost to rectify?

11.13. The 2011 amendments have created a further pressure point that will further complicate defect claims for all new owners corporations for a number of years. Due to the transitional provisions in the 2011 amendments, whether or not an owners corporation has a 7 year period for all

defects or 2 and 6 years period for different types of defects that are not clearly defined depends upon the date that the original building contract was entered into on or after 1 February 2012. That is absurd as most owners corporations never see the building contract. There are many defect disputes where the builder and developer cannot even provide the building contract. Even where the building contract is available, the date noted on a building contract, assuming the contract is actually dated, is often not the date the contract that the contract was entered into. There is also the risk that the contract provided may not have been the contract under which the work, or all of it, was ultimately done, or the contractor or developer may later deny that.

11.14. This absurdity can be easily remedied now before it becomes a serious problem in the next few years. The simple solution would be to provide a certain definition that leaves no room for debate as to when the works were 'complete' and to apply the new period to works completed by a certain date such as say 1 January 2014.

11.15. In addition to the issues raised above, getting to the right answers on the issues of which items are defects, the required scope of works and the reasonable cost to rectify by agreement or by Tribunal or Court determination is usually the focus of most of the cost and time taken in building defect claims. Many defect disputes, particularly strata plan disputes with a large amount of defect issues, get caught up in years of rounds upon rounds of seemingly endless and very expensive debates between experts on these issues.

11.16. This should be addressed by the Tribunal or Court requiring the appointment of experts jointly retained by the parties to be the only experts giving evidence on particular issues at a relatively early stage. Indeed, the joint appointment of experts to assess a list of defect allegations without the need for owners to incur the cost and time of compiling litigation compliant expert reports or defending parties then countering those with reports from their own experts, should be encouraged by the Tribunal or Court.

11.17. One factor inhibiting this sensible approach to progressing the key issues of defects, scope and repair cost in Tribunal defect claims is that it does not have the same independent expert powers that the Court has in relation to appointing 'Court Appointed Experts' or requiring the appointment of 'Parties' Single Experts'. The Tribunal should be given those powers and encouraged to use them as regularly and as early as possible.

11.18. Bannermans submits that the following changes would, if made collectively, be a fair approach to changing the statutory warranty scheme to avoid or minimise the key pressure points causing litigation that have been referred to above. Adopting this approach would fairly and dramatically reduce the uncertainty, complexity, cost and duration of residential building defect disputes in NSW:

a) A clear definition of completion that leave no room for argument – strata plan registration date where applicable or otherwise date of an occupation certificate for a building and for the extremely small proportion of new construction that is not subject to a strata plan or occupation certificate and remedial projects – the date that the owner commences occupation or takes control of the new work or perhaps the last invoice issued for the work.

These last 'catch-alls' would be open to factual and limited legal interpretation debate. However, they would only apply to a very low proportion of projects (remedial projects, which are generally subject to a reasonably good level of documentation, and we speculate no more than 1% of other projects) and may be the best that can be done for reducing uncertainty in the completion definition for those projects.

b) One six year warranty period for all defects (subject to the usual extension for defects that arise in the last 6 months of the warranty period);

c) Remove uncertainty on whether the 7 year warranty period or new warranty period applies (see paragraphs 11.13 and 11.14 above);

d) Restoring the home warranty insurance safety net for multi-storey buildings;

e) No additions being allowed to the defects items in the warranty claim after the 6 year warranty period and requiring systemic defect allegations to be made during the 6 year warranty period;

f) No negligence rights for defects in 'residential building work' that arise prior to the last six months of the warranty period;

g) Providing the CTTT with the Court Appointed Expert and Parties' Single expert powers provided under the Court's Rules with an expectation that they be used by the Court and Tribunal as early as possible in the circumstances of each matter – not after exhausting the possibility of the different experts for all the different parties reaching agreement; and

h) Extending the Tribunal's jurisdiction so that if it has jurisdiction in a statutory warranty dispute, it can deal with all causes of action against all parties arising out of the subject defects (ie: including claims against certifiers, designers, product suppliers and manufacturers)[2].

i) The full terms of each type of home warranty insurance policy being schedules to the HBA to avoid the current need to cross-reference understand the interaction of many provisions across the HBA and the *Home Building Regulation* to understand how the insurance is required to operate. This approach would also avoid legal dispute "pressure points" on whether a particular term in a policy wording is valid under the legislation.

12. **Are the statutory warranty defences currently contained in the legislation adequate?**

12.1. The defence under section 18F is adequate and the builder can cross claim against other parties if warranted.

[2] For completeness, this would also involve amending Commonwealth legislation so that the Tribunal is treated as a 'Court' under the relevant legislation so that it has jurisdiction on all possible causes of action.

13. **Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**

13.1. Statutory time limitations are a critical issue in building defect matters and compliance is essential, with no ability to extend the timeframes. Despite that, they are often difficult or impossible to determine, especially by successors in title.

13.2. From 1 February 2012, the statutory time limitation timeframes were dramatically reduced. It is common practice for builders to address defects with a silicon gun and paintbrush approach at first instance so that the real significance of the defects only subsequently become obvious. It is common for this approach to be used to cause consumers to miss their warranty periods, leaving them without any recourse. The risk of this occurring is why it is not always appropriate for owners to risk having the builder back on site without first taking the step of commencing legal action to preserve their rights. Otherwise, there is a real risk they will not be able to rely on home warranty insurance, or recover from the builder or developer. Executive committees or other professionals managing a scheme also potentially face actions against them for the rectification costs, if the time limitations are missed.

13.3. Another obstacle is that the relationship between the parties in defect disputes has often deteriorated due to:

a) the quality of earlier rectification attempts being sub-standard;

b) the consumer having lost confidence in the contractor's ability after many undertakings not being met and repeated repair attempts failing or timing commitments not being kept;

c) the builder not wanting to return to rectify while being accountable for the adequacy of its repair work;

d) other parties potentially being liable, including the developer; or

e) the builder wanting a cash settlement to avoid any ongoing liability for the adequacy of the repairs, which is often the case.

13.4. Where all rights have been preserved by commencing proceedings, it may be appropriate to require access to rectify, but only where:

a) scopes of work have been agreed or determined by the Tribunal or a Court;

b) all appropriate insurances are in place;

c) the builder is deemed the principal contractor for the purposes of work, health and safety legislation;

d) depending on the complexities, an independent expert inspects the quality of the work at the relevant critical stage inspections and on completion with the builder liable for those professional costs;

e) the warranty period starting again for the rectification work only (so that the builder is accountable for the quality of its repair work) with completion of the rectification work being sign off by the independent expert;

f) the home warranty insurance cover being extended to the rectification work providing a new warranty period for the rectification work only; and

g) agreed or determined time frames with the independent expert to tender out works not carried out within a reasonable time and the contractor liable for any repairs that have to be tendered out.

14. **Are Complaint Inspection Advices useful in the dispute resolution process?**

14.1. The Home Building Dispute Resolution Services statistics do not differentiate between:

a) Single dwelling disputes; and

b) Strata disputes.

14.2. The service is not appropriate for resolving disputes in strata schemes and the success rate for strata defect disputes would be very low and the statistics do not take account of matters that did not go through the Home Building Dispute Resolution Service due to estimated repair costs of over $500,000.

14.3. Rectification orders or complaint advices are not helpful in strata disputes as:

a) the process takes too much time, especially now with a 2 year warranty for non-structural defects;

b) the scope to rectify the defects is often not provided or inadequate and rarely complied with;

c) the defects involve numerous disciplines beyond the skill sets of one person, and often experts from a number of disciplines are required, for example, general, engineering, fire or structural;

d) there is no power to award damages for out of pocket expenses to the owner;

e) where a builder returns to perform rectification works, not all items are always properly addressed or dealt with satisfactorily. In such cases, additional time and cost is incurred,

including the need to obtain further expert reports to check and comment on the sub-standard works undertaken; and

f) the Office of Fair Trading often does not enforce non-compliance with orders.

14.4. The process generally adds about 3 months to a dispute, puts all parties to additional cost, cannot resolve all issues and does not assist in the final resolution of the dispute. The Office of Fair Trading is simply not adequately resourced to deal with the issues or enforce the orders in the majority of strata disputes.

14.5. While such problems as the above-mentioned exist, it is not reasonable to require owners to provide access to rectify.

15. **Should a penalty notice offence be created for non-compliance with a Rectification Order?**

15.1. Bannermans can see no benefit in simply adding a penalty regime, in order to seek compliance with what is, in our view, an inadequate process.

15.2. It is difficult to see how adding penalty regime to the current system would benefit consumers.

15.3. Building defect matters almost always involve significant sums, complex technical issues and require expert evidence and destructive investigation to properly determine the scope of works needed to rectify the problems. What might appear to be a simple solution is unlikely to be an effective one. Aside from being unlikely to benefit the consumer, penalties may potentially be unfair, and difficult to impose, as the issues are not clear and cannot be determined simply or cheaply.

16. **Which option, if any, do you support for disputes over $500,000 and why? Do you have any other suggestions?**

16.1. The changes to the current model suggested by Bannermans are set out at paragraph 11.18 above.

16.2. In relation to the three options raised in the issues paper:

<u>Option 1: “Strengthen the promotion of dispute resolution processes</u>

16.3. This is not supported as the service, notwithstanding its many attributes, is not suited to resolving substantial (typically strata) disputes.

<u>Option 2: “Provide an expert referral service for parties to a dispute”:</u>

16.4. The suggested option would only have merit if it is limited to "technical" issues. There would be many parties that would not want to take this route at the outset for many reasons. However, some parties would.

16.5. If a model of this kind is to be pursued, a draft model should be published for comment. It is not practicable to comment in advance on all the issues for all the possible permutations in an expert referral service model. Once the industry is advised of the specific objectives of any such service and at least the basic model contemplated, the industry could comment properly on the detail.

Option 3: "Establish a Building Disputes Adjudicator":

16.6. Bannermans submits that such a service could not deal appropriately deal with the complexities of strata defect disputes. Those complexities are not only "technical" issues. The disputes should be case managed and where needed determined by Tribunal Members or Judges. However, the early use of single expert powers by the Tribunal and the Courts would see the benefits of an adjudicator approach being realised without needing to establish a new jurisdiction within an already complex area simply to exercise powers which should really only be exercised by a Tribunal Member or Judge as notwithstanding a number of common themes, all defect disputes have different circumstances and dynamics.

16.7. Another substantial difficulty is framing a dispute resolution system solely around a builder returning to rectify is well short of the mark. There are many stakeholders who should be a party to any dispute resolution process being pursued (to avoid multiple processes over the same issues) including:

a) home warranty insurers;

b) developers;

c) designers;

d) certifiers; and

e) engineers.

16.8. Any process that excludes potential parties from involvement will be resisted by many participants and abandoned in many cases so that all claims based on the same facts can be resolved through the one dispute resolution process.

16.9. The appropriate objectives for a dispute resolution process is to:

a) Not allow time-limits to commence proceedings being missed while the process is taking place;

b) Prioritise have the appropriate list of defects and scope of works identified;

c) Facilitate and encourage fair arrangements by agreement for contractors to return to rectify while giving owners the usual protections in relation to the adequacy of the rectification work;

d) Allow fair compensation to owners for their out of pocket expenses resulting from the defects such expert costs, temporary repair costs, loss of rent etc.

e) Appreciate and respect its own limitations leaving real factual or legal issue disputes to a Tribunal Member or Judge.

17. **What are your thoughts about alternative dispute resolution?**

17.1. Please refer to the comments above.

18. **Can the current dispute resolution processes be improved? How?**

18.1. There are many dispute resolution processes on offer and they operate effectively when applied.

18.2. An adjudication process or expert determination process which cannot fairly and competently resolve all issues needs to be avoided unless its ambit to restricted to "technical issues". Otherwise the dispute process will simply be another jurisdiction within the current system introducing a new layer of complexity and costs to resolving residential building disputes

19-26 No comment.

27. **Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done, bearing in mind NSW Fair Trading's jurisdiction?**

27.1. The construction industry is a high risk industry which utilises all forms of risk management measures available. Legal advisors to the construction industry have been widely recommending 'single purpose vehicles' for many years and the removal of the multi-story exemption has encouraged and increased phoenix company behaviour.

27.2. Builders and developers no longer need to satisfy a home warranty insurer's underwriting criteria prior to constructing a multi-storey building – the very type of construction where the history, skills and financial means of builders are the most important. Not having an insurer requiring appropriate security from those seeking the profit of a large development encourages the use of $2 companies to evade responsibility for defects and ensures that those $2 companies will ignore their responsibilities. That lack of accountability encourages poor construction practices which only results in more defects. That is already affecting consumer confidence in purchasing new units.

27.3. Ironically the construction that should be most regulated is the least regulated. The consumers who purchase are the ones who suffer. It should also be noted that many consumers buying into large buildings are within the most financially vulnerable proportion of home owners and are most in need of proper protection.

27.4. Numerous contractors have for many years been allowed to drop building licences and take out new licences (sometimes within a week) as soon as the earlier licence is in jeopardy (typically due to a defects dispute or misconduct). This has been exploited by a small minority in the industry so that they present to consumers with 'clean' licences. It is conducive to phoenix company behaviour.

27.5. Bannermans submits that the Office of Fair Trading should only ever issue one Home Building licence number to individuals and no licence numbers to companies. Each licence number should travel with individuals for their careers whether as contractors in their own right or as nominated supervisors for any companies or both at different times. This will make it easier for consumers to identify the disreputable minority (assisting the reputable majority) and better equip the Office of Fair Trading to identify and prevent phoenix behaviour. It would also better allow consumers to identify if a contractor really does have a 'clean' license.

27.6. Each individual's single licence number should be limited at any particular time to a contractor or nominated supervisor licence and no-one should be allowed to be a nominated supervisor for more than once company at a time. This will assist in minimising and moderating phoenix behaviour and hopefully have some positive effect on the currently widespread practice of inadequate supervision of construction.

27.7. An emerging trend not widely recognised is the use of:

a) deeds of company arrangements to sever debts and allow companies to continue after paying a paltry percentage (if anything) to unsecured creditors; and

b) registered charges to related companies and individuals as a vehicle to take priority over unsecured creditors such as legitimate claimants in building defect claims.

27.8. The ongoing trend of phoenix type arrangements is likely to continue and measures to deter phoenix arrangements linked to licensing will be worked around. It is not likely to have any substantial impact on the activity or no effect on the items mentioned in paragraphs 27.7 (a) and (b) above.

27.9. Government control cannot always adequately protect consumers and laws will always be worked around. An adequate home warranty insurance regime is needed as the security demanded by prudent underwriting guidelines has traditionally been the only dynamic forcing some builders and developers to meet their defect liabilities to owners.

28. **Should NSW Fair Trading building inspectors be able to issue Penalty Infringement Notices for non-compliance with a Rectification Order? Do you think that this will improve compliance with the legislation and Rectification Orders?**

28.1. Please refer to comments at paragraph 15.

29. **Do you think that qualified supervisors should be limited in the number of projects that they can oversee? If so, how many projects would be appropriate?**

29.1. Bannermans submits that measures should be taken to minimise qualified supervisors not being in a position to properly supervise the construction that they are responsible for. The difficult issue is identifying what the limitation measure should be.

29.2. The number of separate projects is probably not the appropriate measure as supervising one substantial project could be more onerous than supervising a dozen small projects.

29.3. A limit on the value of construction being supervised at any one time is attractive at first glance. However, to be workable for supervisors of substantial construction projects, there may be need to be a sub-category limited to one or two projects at any one time but with the value of the projects unlimited.

29.4. Another conceptual approach would be adopting categories of construction types each with a points loading and capping the total points loading for construction being supervised at any particular time.

30. **Do you think that the current disciplinary provisions provide an effective deterrent from errant conduct?**

30.1. The provisions on their own are not an effective deterrent because they are not routinely enforced.

31. **How does the NSW home warranty insurance scheme compare with other jurisdictions? What model do you think would work best and why?**

31.1 See comments at paragraph 11 above.

32. **Should new rectification work of a significant value be covered by a further certificate of insurance? Why?**

32.1. Bannermans submits that repair work with a value exceeding $20,000 should be subject to home warranty insurance cover even if the repairer is the original builder who is not charging $20,000 or more to rectify the defects (in its own work).

32.2. Repair work is just as important as the other types of residential building work. Repair work should not be treated as a lesser species of residential building work just because the original builder is carrying it out for less than commercial value. Owners are just as vulnerable to shonky repair work as they are to other types of shonky building work. In fact, repair work is generally more difficult than original construction work and there are issues with the adequacy of repair work much more often that there are issues with original construction work. Thus, owners are in reality more vulnerable in relation to repair work than they are in relation to other types of building work.

32.3. If rectification work with a value of more than $20,000 is needed, it is not minor work. If any contractor other than the original builder carried out the work, it would be under a contract with the contractor being responsible for the work under the warranties and the owner having a home warranty insurance safety net.

32.4. A system that disadvantages an owner for letting an original builder back to repair is an unfair system with a tendency to encourage owners to not agree to an original builder (who has already shown a lack of competence or willingness to 'cut corners') returning to rectify their home.

32.5. Repair work is not work arising out of the original contract as asserted by the issues paper unless it is repairs being carried out under a defects liability period under the contract. Such repairs are not the issue here. The proposition that the repair work is part of the original contract is even more flawed in respect of strata schemes that were not parties to the original building contract.

32.6. The repair work in issue is typically being discussed at the end of or after the expiry of the warranty period. Without the repair work being subject to warranties for the repair work (not the warranties about to expire or already expired in the original works carried out years earlier), original builders do not take responsibility for their repair work and owners have no protection in relation to the higher risk repair work and no home warranty insurance safety net. Such an outcome is the opposite to the stated intent of the statutory warranties scheme by leaving owners with no protection when it is most needed.

32.7. Experience indicates that builders carrying out repair work knowing that they are responsible for the repair work generally do their best to adequately rectify. While the priorities of a builder carrying out repair work without any responsibility for the adequacy repair work often lie elsewhere. Repair work done on a no responsibility basis is often shonky. The government should not impose that on owners. Just as it should not penalise owners for allowing the original builder to rectify by refusing a home warranty insurance safety net when it is needed more than ever.

32.8. Making builders accountable for the adequacy of their repair work and not disadvantaging owners for allowing the original owner back is also highly desirable from the perspective of encouraging owners to agree to early resolutions by allowing the original builder back to rectify, despite their natural and reasonable reservations due to the original builder having already failed once. Providing the usual protections to owners where builders are returning to rectify can only reduce the number, complexity and cost of residential building disputes in NSW.

33. **Is there a need for a searchable public register of home warranty insurance policies?**

33.1. There have been owners who have sought to make insurance claims only to discover the certificate of insurance was fraudulent and they have no safety net. The best approach may be to have a register that allows a search for a nominal fee that does not display the certificate but rather the details of the cover in place without disclosing any information compromising privacy compliance.

33.2. A more prevalent problem is where the certificate is valid but the works were not carried out by the contractor named in the certificate and were illegally carried out by another contractor without insurance in place or the contractor denies that it carried out the works. Both compromise an owner's protection under the warranties and under the insurance. Indeed there are numerous defect disputes where the only real issue is whether the builder who took out insurance was the contractor who actually did the work. A sceptic would say it is a defence used against successors in title, particularly strata plans, where there is no defence.

33.3. Both of these issues would be addressed by adding a requirement at the conclusion of a project for a statutory declaration witnessed by a solicitor sighting photographic identification, from the contractor confirming that the contractor did the work. The requirement to submit such a document to obtain an occupation certificate ought to prevent work being carried out illegally without insurance and also prevent the litigation of matters that should be straightforward purely due to an uncertainty as to who was the responsible contractor.

34. **Does the current 20 percent cap for incomplete work provide enough consumer protection? Should the cap be increased to 40 percent? Why?**

34.1. The cap should be 40%. It is widely accepted and understood that there is a very substantial premium involved in having a contractor take over and complete another contractor's project. Experience has shown that 20% does not provide sufficient cover which is why SICORP has recently been allowing up to 40% in a number of matters.

35. **Do you think the scheme should be renamed? Do you have any suggestions for such a name?**

35.1. Notwithstanding that home warranty insurance is a different type of insurance to other lines of insurance such as professional indemnity insurance, it is insurance and it is incorrect to suggest that it is not really insurance.

35.2. Consumers are just as likely to assume a greater level of protection than the reality from the use of the words 'Safety Net" than they are from the use of the word "insurance". Bannermans has no particular difficulty with a name change but queries the real need for or utility of it.

36. **Should the current exemption from home warranty insurance requirements for the construction of multi-storey buildings be retained? Why?**

36.1. The multi-storey home warranty insurance exemption was adopted based on the following rationale:

"The rationale for excluding multi-storey developments is that they are undertaken by developers and therefore it isn't a homeowner that goes into contract with the licensee but rather it is a large commercial undertaking. These building projects are also subject to greater involvement by industry professional. As such, there should be less need for a last resort homeowner safety net for this segment of the housing market."

36.2. The current exemption for multi-storey buildings should be abolished for reasons including:

a) The number of storeys is not and cannot be a determining factor on whether a large commercial undertaking is involved. There are many 3 or 4 lot strata schemes with more than 4 storeys which have no insurance protection. There are also many instances where an extra terrace room was created on lower rise developments, to take advantage of the exemption.

b) There are a number of small owners corporations with defects in the range of $100,000 to $250,000 per lot which have no insurance, no solvent builder or developer and are faced with great problems.

c) Consumer protection for all is required, not just those in lower rise developments.

d) If the Government wants to promote consumer confidence in strata units it cannot genuinely do so without providing appropriate protection for those consumers.

e) As the Government is now the underwriter to the policy, it should extend the protection to all.

f) Many years of substantial defect claims for large buildings have demonstrated that the notion that they will not have defects as there is more professional involvement during construction is a nonsense. The construction of a large building is much more complex than a single dwelling and much more likely to experience serious defect issues.

g) The rationale suggesting that large buildings would have less defect problems due to more professional involvement completely 'flies in the face of' of why insurers sought the multi storey exemption. The insurers did not want to continue insuring large buildings as they saw them as a bad risk and were also therefore charging high premiums to take on that high risk. It is hard to understand how the conclusion noted in the rationale could have been reached in the context of considering how to deal with the crisis stemming from large buildings having unacceptable defect risks.

h) Despite large buildings needing a higher level of regulation due to being complex construction, the exemption means that a contractor that would not be acceptable to an insurer's underwriting criteria for building a single dwelling may instead build a large building.

i) Without an insurer ensuring appropriate securities are in place, large buildings are generally now developed and constructed by $2 companies with no incentive to meet their responsibilities to consumers for shoddy construction while the same consumers, many of whom have bought into large buildings due to limited finances, are left with no 'safety net'.

j) Bannermans respectfully submit that the statutory warranty scheme cannot be fairly presented as providing reasonable protection to owners while the exemption remains in place. Retaining the exemption would be retaining no protection for a large and ever increasing proportion of NSW home owners. Bannermans do not understand how that could

be justified particularly now that the government is the sole provider of insurance and while there is a pressing need to increase consumer confidence in new construction of strata units.

37. **Does the high rise exemption require further clarification? If so, what would you clarify?**

37.1. The exemption must be abolished. There is no sensible or just reason for it to remain. In addition to it not being sensible or just, it a poorly drafted.

37.2. There has been a lot of confusion in interpreting its meaning and application by certifiers, solicitors and the Office of Fair Trading, particularly where:

a) It is a renovation, refurbishment or maintenance work; and

b) Where there is a car-space on the same level as a dwelling in the building.

37.3. The provision needs to be abolished, not clarified or amended.

38. **Is the current definition of "storey" in the Act sufficiently clear? Should any changes be made?**

38.1. See paragraph 37 above.

39. **Do you think that section 92B should be repealed? Why?**

39.1. See comments at paragraph 33 above. The suggested measures, if effected properly, would remove the need for section 92B.

39.2. The issues paper queries whether there is evidence of issues with insurance being taken out in the name of a contractor and the work then being done by another entity (or perhaps more prevalent the responsible contractor denying that it was the responsible contractor). It happens regularly. At the time of the drafting, Bannermans is acting for 6 owners corporations facing such issues and can provide further detail privately if requested.

40. **What are your thoughts on the current eligibility criteria? Can the processes be made easier, keeping in mind the level of risk taken on by the insurer and the possible ramifications on the cost of premiums?**

40.1. No comment.

41. **Does the definition of "disappeared" for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**

41.1. The definition of "disappeared" should be amended and should provide that disappeared means that the licensee or the owner builder cannot be found in Australia.

42. **What are your thoughts around home owners being able to purchase top-up cover? Is this necessary?**

42.1. If viable, it would be an improvement in the scheme. The desire to utilise it would probably be limited to a small proportion of consumers.

David Bannerman and Banjo Stanton

21 August 2012.