Second Reading

The Hon. PENNY SHARPE (Parliamentary Secretary) [9.57 p.m.], on behalf of the Hon. John Robertson: I move:

That this bill be now read a second time.

I am pleased to introduce the Home Building Amendment (Insurance) Bill 2009, which clarifies the losses that are covered by home warranty insurance contracts. A privately underwritten home warranty insurance scheme has operated in New South Wales since May 1997. This insurance scheme is established by part 6 of the Home Building Act 1989. Home warranty insurance is mandatory for residential building work with a contract value of more than $12,000. Developers and owner-builders must also have home warranty insurance if they sell a property within six years of it being completed.

The insurance scheme provides an important safety net for homeowners in the event that their builder or the developer becomes insolvent, dies or disappears. Any disruption to the home warranty insurance scheme can have a significant impact on the home building industry, potentially preventing builders and developers from starting new work. This is apparent after the events of 2001 and 2002 following the collapse of the HIH and FAI insurance group. At that time the home building industry experienced a major crisis when insurance became very difficult to obtain. In October last year a decision by the New South Wales Supreme Court had the potential to precipitate a similar crisis in the availability of home warranty insurance.

In the matter of *Strata Plan 57504 v Building Insurers' Guarantee Corporation*—decision No. 1022—the Supreme Court made a ruling that had the effect that there was no time limit on notifying an insurance claim. The Supreme Court decision drew attention to the fact that, although section 103B of the Home Building Act 1989 specifies a minimum period of insurance cover, there was no explicit statutory limit on when a claim can be made. The consequence was that as long as a loss was incurred in the period of insurance a claim could be made at any time. Contract law traditionally uses the date of handover after construction as the date of any loss that is incurred by the new owner. If this principle is applied in relation to home warranty insurance claims most, if not all, losses arising from a breach of statutory warranty would be taken to occur at the very beginning of the period of insurance when handover occurs. The period of insurance cover after handover would essentially be irrelevant. An insurer would need to consider a claim whenever it was made. I seek leave to incorporate the remainder of the second reading speech in *Hansard*.

Leave granted.

Regulatory provisions in place since the start of the private home warranty insurance scheme on 1 May 1997 prevent an insurer from denying liability or reducing an amount paid if a claim is notified to the insurer within six months of the beneficiary becoming aware of the cause of the claim.

As a consequence of this, it was clearly possible that an insurer could be found liable for losses arising from any defect caused by a breach of statutory warranty as long as the claimant notified the insurer within six months. This could potentially happen whenever the defect became apparent within the life of the building.

Previously it had been assumed that an insurance contract only provided cover where the homeowner became aware of an insured loss and notified the insurer during the period of insurance specified in the insurance contract or any minimum period prescribed by section 103B of the Home Building Act 1989.

The Supreme Court decision potentially opened the door to claims being notified after the period of insurance to all eighteen insurers who have operated in the home warranty insurance market since 1997 with no clear limit on when their liability for claims would end.

It became quite feasible that an insurer could be found liable for defects that appeared twenty or thirty years after a home was completed.

It is not possible to give precise figures on the number of insurance contracts issued since 1997 or the number of separate dwellings that have been covered by these contracts. The Office of Fair Trading has estimated, however, that there would have been more than 650,000 home building projects covered by the scheme since 1997.

Insurers faced a dramatic increase in liability which had not been taken into account when their insurance products were priced. They faced an open ended liability which could result in large scale losses.

The Supreme Court decision also affected the Crown because of indemnities provided to homeowners who are insured by contracts issued by the insolvent HIH and FAI insurance group.

Following the Supreme Court decision approved insurers began assessing whether it was commercially viable to continue providing insurance cover. Some approved insurers advised the Office of Fair Trading that they may withdraw from the home warranty insurance market.

The Insurance Council of Australia also advised the Office of Fair Trading that the capital adequacy requirements for

home warranty insurance would need to increase significantly for any insurers that did remain in the market. This would have resulted in significant increases in the cost of home warranty insurance.

It quickly became evident that the Supreme Court decision had placed the future availability of home warranty insurance in jeopardy. As a worst case scenario, all insurers would leave the market and home building activity in New South Wales would come to a virtual halt. It would not be possible for a builder to enter into new building contracts requiring insurance. Even if some insurers continued in the market, the price of home warranty insurance would increase significantly.

The Government was concerned that this Supreme Court decision had the potential to cause large scale disruption to the home building industry. Not willing to see further stress placed on this important industry this Government acted quickly to stabilise the home warranty insurance scheme.

The industry already suffering the effects of the global financial crisis and the Government not willing to see the cost of home ownership increased by higher insurance premiums, as I say, acted quickly.

The Parliament was not in session and consequently it was not possible to amend the Home Building Act to provide clarity to the cover provided by the scheme. As an interim measure clause 63A was inserted into the Home Building Regulation 2004.

The nature of the interim amendment to the Regulation was limited by the Supreme Court decision. The amendment had to be consistent with the understanding of the Act given by that decision. In essence, the Supreme Court decision was that there was no limit in the Home Building Act on when a claim could be notified or made, that is, apart from subsection 103B (3) of the Act allowing a regulatory provision which imposes a limit on when a claim can be made.

The interim amendment was also limited in that it could not retroactively address existing insurance contracts. The only effective approach available until Parliament could consider this bill was to use the regulatory power to restrict when an insurance claim can be made.

Clause 63A of the Home Building Regulation creates such a limit on when a new claim can be made. For losses arising from the non-completion of work the limit is twelve months from when work ceased or failed to commence. For other losses the limit is six months after the beneficiary becomes aware—or ought reasonably to have become aware—of the circumstance giving rise to the claim. The Regulation also places an outer limit which restricts a claim from being made more than six months after the end of period of insurance cover.

The limit on when a claim can be made is consistent with the existing clause 63 of the Home Building Regulation 2004. This clause prevents an insurer from denying or reducing liability for a claim if the claim is notified within the six or twelve month periods. An insurer can, however, potentially reduce or deny its liability if a claim is notified later than those periods.

Inserting clause 63A into the Home Building Regulation 2004 was an interim solution until the Government could bring appropriate legislation before Parliament. The Government made this clear at the time that the Regulation was amended. The real problem lies with the construction of the Home Building Act 1989 and this bill provides a more enduring solution.

The bill sets out what is widely accepted as the coverage of the home warranty insurance scheme prior to the Supreme Court decision. The bill inserts section 103BA into Home Building Act to confirm which losses are being insured. This is a more effective approach than the interim clause 63A which used administrative restrictions to limit the claims that can be made.

Some concern has been expressed that clause 63A prevented claims from being made that previously would have resulted in an insurer accepting some level of liability. Concern has also been expressed that clause 63A may have inadvertently reduced potential protection provided to insurers and to claimants by provisions in the Insurance Contracts Act 1984 of the Commonwealth.

The Government does not believe that homeowners have been disadvantaged by clause 63A but acknowledges that the true situation would not be fully confirmed until decisions by insurers were appealed and considered by the courts.

Clause 63A was always intended to be an interim solution until Parliament could consider appropriate legislation. Accordingly the bill repeals clause 63A of the Home Building Regulation 2004.

To ensure that homeowners are not disadvantaged, the transitional provisions in the bill make it clear that the period for notifying a claim in the proposed section 103BA applies in place of clause 63A. The requirement to make a claim within the six or twelve month period specified in clause 63A is removed. It is replaced with a limitation on insurance cover which has the effect that a loss needs to be notified within the period of insurance cover prescribed by section 103B.

Anybody who was prevented from making a claim by clause 63A but would have been able to notify a claim under section 103BA is given a period of grace to notify the loss to their insurer. The period of grace starts when the bill commences operation.

If an insurer has refused a claim on the basis of clause 63A, the insurer must notify the claimant of any period of grace for the loss related to the claim. In this instance, the period of grace starts when the claimant receives the insurer's notification.

The transitional provisions also make it clear that a person who has had a claim refused on the basis of clause 63A does not need to appeal that refusal. They can resubmit the claim or submit a new claim. An insurer who refused a claim on the basis of clause 63A can also simply accept and assess the claim as a claim which is now properly made.

I want to emphasise that this bill ensures that no homeowner will be disadvantaged by the operation of clause 63A of the Home Building Regulation 2004.

I will now turn to the details of the bill.

Section 103BA which is inserted into the Home Building Act 1989 makes it clear that a home warranty insurance contract does not provide open ended coverage. An insurance contract only covers a loss if the homeowner becomes aware of the loss during the period of insurance specified in the insurance contract. Minimum periods of insurance that must be included in a contract are prescribed by section 103B of the Home Building Act 1989.

Section 103BA also provides that if a loss becomes apparent during the last six months of the period of insurance, the homeowner has six months from whenever they become aware of the loss to notify the insurer. For example, a homeowner may become aware of a loss for the first time just a few weeks or days before the period of insurance ends. The homeowner has six months from that time to make the notification.

Under the last resort insurance scheme a homeowner—including a strata corporation—is principally responsible for enforcing statutory warranties. Home warranty insurance is a safety net in the event that this is not possible. A homeowner needs to actively enforce their rights. They cannot sit back and do nothing—waiting for a builder to die or go out of business before making an insurance claim.

The bill also makes it clear that an insurer can reduce their liability if a homeowner fails to enforce a statutory warranty. The bill amends the Home Building Regulation 2004 by inserting clause 58A which provides that an insurer can include provisions in an insurance contract reducing its liability or the amount payable on a claim if the beneficiary fails to enforce a statutory warranty. The amount of the reduction is limited to the extent that the beneficiary's failure has prejudiced the interests of the insurer.

The bill applies section 103BA retroactively to all home warranty insurance contracts entered into since 1 May 1997. The Government is of the view that retroactive legislation should only be made when it is unavoidably necessary and that great care should be taken to ensure that people are not disadvantaged.

Retroactive legislation is certainly necessary in this instance to confirm the previously accepted coverage of the home warranty insurance scheme and to prevent any unintended and retrospective increase in the costs of home warranty insurance.

Given the complexity of this matter and its vital importance to homeowners, it is useful to explain in some detail how the retroactive provisions are intended to apply.

The privately underwritten home warranty insurance scheme was established by the Building Services Corporation Amendment Act 1996. That amendment Act renamed the Building Services Corporation Act 1989 as the Home Building Act 1989. It made provision for the private insurance scheme at Part 6 of that Act and inserted provisions for statutory warranties at Part 2C of that Act. Supporting regulatory changes were also made to the renamed Home Building Regulation 1990.

The new provisions came into operation on 1 May 1997. From that date every contract to do residential building work is taken to include the statutory warranties which are prescribed by section 18B of the Home Building Act 1989.

Developers and owner builders are considered to be building contractors and are taken to also provide these statutory warranties. The owner of the property and successors in title are provided protection by these warranties for a period of seven years. Proceedings to enforce the statutory warranties must commence within seven years of the building work being completed.

Since 1 May 1997 contracts to do residential building work or supply a kit home must also be covered by a home warranty insurance contract when the contract is above a prescribed value. For contracts entered into between 1 May 1997 and 1 April 2002 the prescribed value was $5,000. Since then it has been $12,000. Certain exemptions to these requirements have applied from various dates, including contracts for high rise residential buildings which have been exempted from the insurance requirement since 31 December 2003.

The mandatory home warranty insurance contract must be provided by an insurer approved by the Minister for Fair Trading and the insurance contract must provide certain minimum protections prescribed by relevant provisions of the Home Building Act 1989 and the supporting regulations.

Home warranty insurance can be provided on a project by project basis—as is the current practice. It can also be provided on a professional indemnity basis where insurance cover is provided for all work undertaken by a builder or developer in a defined period.

In the first few years of the private home warranty insurance scheme some insurers provided the professional indemnity type of insurance and regulatory provisions were in place until September 2004 to support this type of insurance contract.

Home warranty insurance contracts entered into between 1 May 1997 and 30 June 2002 had to provide insurance

against the risk of loss arising from a breach of statutory warranty. This type of insurance is known as "first resort" insurance. A homeowner covered by a contract from this period may not need to take action against a builder or developer for breach of statutory warranty. Instead, they can make an insurance claim. The insurer then takes appropriate recovery action against the builder or developer.

Contracts from this period also had to provide insurance against the risk of loss arising from the non-completion of building work or the non-supply of a kit home because the builder or supplier was insolvent, dead or could not be found.

In the period of the first resort insurance scheme, section 103B of the Home Building Act 1989 provided that an insurance contract must cover losses arising from the non-completion of work for at least twelve months after work ceased or failed to commence. For all other losses, including those arising from a breach of statutory warranty, the insurance contract had to provide cover for at least seven years after the building work was completed or a kit home was supplied. The seven year period was consistent with the seven year period available for commencing action to enforce a statutory warranty.

No regulatory provisions limiting the period for making a claim were in force during this period. Clause 39A of the Home Building Regulation 1990 simply defined when work was taken to be completed or a kit home was supplied and as a consequence when the minimum period of insurance prescribed by section 1038 was taken to start. Clause 39A has continued to operate without change since 1 May 1997 and is currently in force as clause 61 of the Home Building Regulation 2004.

Regulatory provisions for professional indemnity insurance did, however, make it clear that an insurance contract could restrict coverage to claims that were made within the seven year period of insurance. Clause 39C of the Home Building Regulation 1990 (which was continued as clause 50 of the Home Building Regulation 1997) and remained in force until 30 August 2004 specifically provided that a professional indemnity insurance contract must cover claims made for a period of not less than seven years after the completion of work or the end of contract relating to the work. Any extension of the coverage beyond the seven year period was optional.

The retroactive application of the proposed section 103BA confirms that insurance contracts from the period 1 May 1997 to 30 June 2002 only provide insurance cover where a loss becomes apparent and is notified in the minimum periods specified by section 103B of the Home Building Act 1989 or any longer period that may be specified in the contract.

This means an insurance contract from the "first resort" period only provides cover for a loss arising from the non-completion of work if the loss is notified to the insurer within twelve months after work ceased or failed to commence, unless a longer period of cover is specified in the contract. A loss of any other type must be notified to the insurer within seven years after the building work was completed or a kit home was supplied, again unless a longer period of cover is specified.

The Government is aware that regulatory provisions for professional indemnity insurance contracts referred to a claim being made, rather than a claim being notified. The regulatory provisions do not specifically identify any difference between notification and making a claim and there were no regulatory provisions specifying the minimum requirements for making a claim. The Government understands that this type of insurance contract was only used for a few years early in the scheme and that it is highly unlikely that there are homes that are currently covered for new claims by these insurance contracts.

In the event there are any, compliance with the notification requirement in the proposed section 103BA should be taken to be compliance with the regulatory requirement to make a claim.

Home warranty contracts entered into since 1st July 2002 differed from previous insurance contracts by providing what is known as "last resort" insurance.

This style of insurance contract indemnifies beneficiaries for loss or damage arising from a breach of statutory warranty, being loss or damage in respect of which the beneficiary cannot recover compensation or have rectified because of the insolvency, death or disappearance of the building contractor. These contracts also continue to provide insurance against loss or damage resulting from non-completion of the work because of the insolvency, death or disappearance of the contractor.

The retroactive application of the proposed section 103BA to home warranty insurance contracts entered into since 1 July 2002 confirms that these contracts only provide insurance cover where a loss indemnified by a contract of insurance becomes apparent and is notified within the minimum periods specified by section 103B or any longer period that may be specified in the contract.

The minimum period of cover for these contracts for a structural defect is six years after the completion of work or the supply of a kit home and is two years for other losses apart from non-completion losses which is twelve months. Structural defects are defined in clause 71 of the Home Building Regulation 2004.

The retroactive application of section 103BA applies to claims made against insurance contracts entered into since 1 May 1997 and to proceedings on such a claim. This includes claims which are the subject of legal proceedings that have not been finally determined.

There is, however, no intention to reopen old claims. Section 103BA does not affect any insurance claim that has been already been paid in full or any claim where a settlement has already been agreed. It also does not affect a claim where an amount has been paid under the indemnity provided by the NSW Government to homeowners insured by the

HIH/FAI Insurance group.

Furthermore, section 103BA does not affect a decision of an insurer if the time for lodging an appeal has expired. For example, if an insurer has rejected a claim and the time for appealing that decision has expired without an appeal being lodged—section 103BA does not provide the grounds for a new appeal.

In addition to confirming the period of insurance coverage, the Government is taking this opportunity to clarify two drafting matters.

The Home Building Act 1989 was amended in November 2008 to automatically suspend a building contractor's licence if they fail to comply with an order by a court or the Consumer, Trader and Tenancy Tribunal to pay money in satisfaction of a building claim. This provision is at section 42A of the Act and commenced operation on 1 April 2009.

A provision was also inserted into section 99 of the Home Building Act 1989 enabling a beneficiary to make a home warranty insurance claim when a contractor is automatically suspended by section 42A. This change established what is known as the fourth trigger for an insurance claim.

Potential problems with the drafting of the provision for fourth insurance trigger were identified in implementation planning. A building claim which is defined in section 48A of the Home Building Act 1989 can be made for a wide range of matters, some of which are outside of the scope and coverage of the home warranty insurance scheme. Consequently, a money order made in relation to a building claim can also be for matters outside the scope of the scheme. As drafted, the provision at subsection 99 (3) of the Home Building Act 1989 potentially extends the coverage of insurance contracts to any matter included in the money order.

The bill makes the provision for the fourth insurance trigger more specific. The revised subsection 99 (3) makes it clear that the fourth trigger operates on the same basis as if the contractor was insolvent.

In particular it makes it clear that the insurer's liability is limited to losses that would have been covered in the event that the contractor was insolvent. For example, where elements of a building claim were refused by the Tribunal and were not included in the money order, the insurer would have the same capacity to refuse a subsequent insurance claim for those items as they may currently have if the contractor is insolvent.

The revised provision does, however, give some flexibility regarding the amount of a claim and the amount that is paid for a claim. This is simply to cover circumstances such as when the insurer is able to have a defect satisfactorily rectified for a sum less than the amount of the money order. It also covers potential circumstances where the amount of the money order may not enable the insurer to satisfy the relevant indemnity provided by the insurance contract.

A matter which has been determined by a court or Tribunal cannot be heard again by another court or Tribunal, except as part of an appeal process. The application of this principle in relation to a building claim for a breach of statutory warranty is made specific by section 18E (2) of the Home Building Act 1989. There is no intention with this bill to change the way that principle is applied.

There is, however, a potential that the proceedings related to the money order or the actual order itself could be seen as preventing certain actions in relation to the insurance claim associated with that order.

The bill makes it clear that the fact that a building claim order has been made should not take away from any right that a claimant has to appeal against a decision of the insurer in relation to that claim. This includes any right that the claimant may have under Part 3A of the Home Building Act.

The bill also makes it clear that the building claim order does not limit any right of recovery that the insurer may have against the building contractor in relation to the claim.

The second drafting matter addressed by the bill is the date of effect for an increase in the minimum amount of insurance coverage for a home warranty insurance contract.

Subclause 60 (4) of the Home Building Regulation 2004 provides that an insurance contract must provide that the minimum amount of cover payable is to be the amount provided from time to time by the Act or the Regulation. An equivalent provision has been in place since the commencement of the scheme in May 1997.

The Government has become aware that some insurers at various stages during the life of the scheme may have used the exact words in the Regulation rather than specifying the amount that was in effect at the time that the insurance contract was entered into. As a consequence, the minimum coverage for these contracts could potentially be seen to increase whenever the prescribed minimum amount increases.

The minimum amount of insurance was increased on 1 March 2007 from $200,000 to $300,000. The intention was to increase the minimum amount for all future contracts. There was no intention to retroactively increase the minium coverage for existing contracts which had inadvertently used an ambiguous reference to the amount of the minimum coverage.

The bill includes a provision at section 102 of the Act which confirms that the minimum coverage for an insurance contract is the minimum amount prescribed at the time that contract was entered into.

I commend the bill to the House.