Submission No 70

INQUIRY INTO REGULATION OF BUILDING STANDARDS, BUILDING QUALITY AND BUILDING DISPUTES

Organisation: Stanton Legal

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STANTON LEGAL

SPECIALISING IN RESOLVING CONSTRUCTION, INSURANCE AND STRATA DISPUTES

28 July 2019

Mr David Shoebridge MLC
Chair
Public Accountability Committee

Dear Chair, Deputy Chair and Committee

INQUIRY INTO REGULATION OF BUILDING STANDARDS, BUILDING QUALITY AND BUILDING DISPUTES

I am a Law Society of NSW Accredited Specialist in Commercial Litigation who specialises in resolving construction, insurance and strata disputes. I estimate that approximately 80% of my practice over the last 13 years has consisted or working on building defect claims under the *Home Building Act 1989 (NSW)* (**HBA**) statutory warranties and/or home warranty insurance. For that reason, the focus of my submission below is on matters arising under paragraph 1(b) of your terms of reference.

1. The most significant systemic factor behind the steep increase in residential unit block defects is that the persons profiting most from the construction (the builder and developer for each project) control the quality of the construction and are generally well aware that there will be no consequence for them if the work is done defectively. That is due to loopholes in the law and the ability since late 2003 to build and develop residential buildings higher than 3 storeys (**multi-storey buildings**) via $2 companies.

2. Under the current regime which has been acknowledged as essentially *"self regulation"*, the builder and developer of a multi-storey building control the construction process. When using $2 companies, the persons behind the builder and developer of a multi-storey building know that even if their $2 companies can still be held liable by the time defects become known to the future owners corporation, they can simply walk away from dealing with the defect issues without any consequence to them (ie: the persons behind the companies).

3. Without any accountability or consequence for 'cutting corners', the temptation to increase profit by 'cutting corners' has left a trail of destruction for many thousands of new unit purchasers . That has caused the now overwhelming crisis in consumer confidence that is threatening the viability of the state's economy.

4. This crisis is not new. It has simply grown greater as the causes have become more entrenched. My submission[1] to the government on 21 August 2012 in respect of the Home Building Act Issues Paper included the following comment on the approach then being pursued of seeking to reduce building defect litigation by reducing consumer rights:

[1] On behalf of Bannermans Lawyers where I then worked.

[It] *"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' behavior 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."*

5. The submission below suggests 10 reforms to assist in preventing residential strata building defects and providing better protections for owners against construction contractors, designers and developers. The numbering of each reform is for convenience. It is not intended to suggest an order of priority amongst the reforms. Reform needed 1 below addresses closing the legal loopholes causing issues for residential apartment owners pursuing construction contractors, designers and developers. Reforms needed 3, 4, 5 and 6 are directed at $2 company issues.

6. This submission then makes some comments in relation to the protection provided by the current home warranty insurance scheme (where it does apply) and the 'building bond' scheme (where it will apply).

Reform needed 1 - The legal loopholes

7. The legal loopholes are known and easily addressed by simple amendments to the HBA and implementing a strong statutory duty of care that is not 'watered down' during a consultation process.

8. The HBA loopholes for consumer protection are noted in the Owners Corporation Network's (**OCN's**) recent submission to the NSW government inspect of the 'Building Stronger Foundations' Discussion paper. Annexure 'A' to that OCN submission details the required amendments to the HBA.

9. **Annexure 'A'** to this submission is a copy of the existing relevant HBA provisions marked up with track changes that adopt the OCN proposed revisions.

10. Currently the person/company on whose behalf the work is done can completely avoid the HBA warranties if the development is structured so that another person/company is the owner of the land at the time that the work is done. Despite the intention noted in the existing note under section 3A(1A), the current provisions do not prevent that. A recent example of this is Ecove, the 'developer' for Opal Tower not having any responsibility for defects under the HBA warranties as it was not the owner of the land during the development. Another is *The Owners – Strata Plan No 74602 v Brookfield Australia Investments Ltd* [2015] NSWSC 1916 (16 December 2015).

11. The revised section 3A proposed by OCN, together with the revision of the successor in title requirement in the OCN proposed section 18C, closes that loophole so that the section actually operates as per the existing note under section 3A(1A). The wording of section 3A would also be significantly simplified.

12. The OCN proposed amendments would also confirm that subcontractors are responsible to owners under the HBA warranties for defects in their work. That is done via the proposed minor revisions to sections 18B(2), 18C and 18D(1A).

13. The section 18F defences should only ever be available to a builder and also only to a builder that is not related to the developer. The OCN proposed revision to section 18F is directed at stopping developers from 'gaming' the current wording of section 18F.

14. The OCN proposed revision to section 18G would add to the Court's ability to stop parties to a development avoiding responsibility under the HBA warranties via contract structure approaches.

15. The addition to the definition of *"owner"* in annexure 'A' is consistent with the OCN's noted submissions comments on closing the loophole that recently arose in *The Owners – Strata Plan No 91322 v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* [2019] NSWCA 89. If that loophole is not closed, then no leasehold strata scheme will have any rights under the HBA against any party for defects.

16. Annexure 'B' to the OCN's noted submission provides the drafting for an appropriate duty of care provision.

17. Closing the HBA loopholes and providing a statutory duty of care should be done retrospectively. The statutory duty of care is simply about making people accountable for their own incompetence/recklessness. Victims of professional incompetence/recklessness should not be left with no redress simply because the relevant wrongdoers thought that they would not be held responsible for their incompetence/recklessness at the time of their incompetence/recklessness.

Reform needed 2 – a single warranty period under the HBA

18. Returning to a single warranty period for all defect issues is another clearly desirable reform that can be immediately implemented. The warranty periods that currently apply are not just unfair to consumers. They also make the resolution of building disputes much more complex than they need to be. As well as distracting from an aim of getting defects fixed, that unnecessary complexity adds to the time and cost of progressing building defect disputes.

19. The HBA warranty period was reduced in October 2011 from 7 years for all defects to 2 years for some defects and 6 years for others. Where a defect first becomes known or reasonably discoverable by an owner in the last 6 months of the relevant warranty period, the warranty period for that defect is extended by 6 months. Thus, consumers seeking redress for defects now need to understand and litigate 4 warranty periods as follows:

    (a) 2 years for non-*"major defects"* that first become known or reasonably discoverable by an owner in the first 1.5 years after completion;

    (b) 2.5 years for non-*"major defects"* that first become known or reasonably discoverable by an owner in the first 1.5 years to 2 years after completion;

    (c) 6 years for *"major defects"* that first become known or reasonably discoverable by an owner in the first 5.5 years after completion; and

(d) 6.5 years for *"major defects"* that first become known or reasonably discoverable by an owner in the first 5.5 years to 6 years after completion.

20. Consumer rights were further reduced in 2015 by definition changes that reduced the types of defects issues that would have a 6 year warranty period.

21. The aim should be to have an efficient dispute resolution system focused on getting repairs done. Such an objective is undermined by needing to assess how a complex and convoluted definition of *"major defect"* applies to every separate defect issue. Nor should there ever be a need for evidence and arguments on when an owner should have seen the first sign of trouble for a certain (or every) defect issue with competing expert reports debating what the first symptoms of a defect issue probably looked like at particular points in time and at what time there was probably something visible that an owner should have noticed and should have been alarmed by.

22. The 4 separate warranty periods and the issues that they turn upon are a recipe for a 'lawyers' picnic'. They often makes disputes about what the builder and developer can 'get out of' instead of being about what repairs should be done.

23. If the warranty periods stay as they are, it will take 10-20 years of test cases to get to the point where lawyers can confidently advise upon which defects are and are not *"major defects"*. For each one of those test cases, there will be a party who pays a very very expensive price for the privilege of developing the law and reducing the current uncertainties in how it applies. Even then, there would still be a number defects, and sometimes entire disputes, turning upon evidence of when an owner should have seen the first sign of trouble in respect of a certain issue with competing expert reports debating what the first symptoms of a defect issue probably looked like at particular points in time and at what time there was something visible that an owner should have noticed and have been alarmed by.

24. Reducing the complexity and cost of litigation for consumers, builders and developers while also truly aiming to make the focus of defect disputes about fixing the defects demands that there be only one warranty period for all defect issues under the HBA with no extensions to that period to apply in any circumstances. That will also assist the state's resourcing of NCAT and the Courts and their workloads.

25. Having one warranty period under the HBA is a 'no-brainer'. The only real discussion should concern how long such a warranty period should be.

Reform needed 3 – $2 building companies and regulating building licences for multi-storey buildings

26. The urgently needed reform proposed below for $2 building companies and regulating building licences for multi-storey buildings can be immediately implemented. It does not need to wait upon the consideration and finetuning of other reforms. That first stage will be a good start towards addressing builders (but not developers) building multi-storey buildings through $2 companies.

27. There has been no attempt to regulate which builders should be allowed to build multi-storey buildings. Until late 2003, the effect of that lack of regulation was

controlled by the underwriting requirements of private home warranty insurers. If no insurer could be persuaded that a particular builder was experienced or competent or solvent enough to build a development, the developer would have to find another builder. Where the issue was solvency, and particularly where the builder and/or developer were small or $2 companies, the insurers would generally deal with that by requiring a bank guarantee or directors' indemnity against any insurance payouts for defects. That provided a strong commercial incentive for those builders and developers to work towards providing a defect free building. It tempered their incentive to increase profit by 'cutting corners'.

28. That private 'policing' of this regulatory failure was removed for residential strata construction of more than 3 storeys in late 2003 when such construction was exempted from the need for home warranty insurance. Due to that, the absurd position is that the building licence regime in NSW works like this:

Builders without a licence	Restricted to work worth less than $5,000
Builders with a licence but not authorised by the government home warranty insurer to contract with a consumer for work worth $20,000 or more	These building licence holders can: (a) Contract with consumers to do work worth less than $20,000; **and** (b) Contract with anyone to build a high rise or anything else of any value that is over 3 storeys high; **and** (c) Subcontract (without the need for anything in writing) to build anything that the head contractor is licenced to do.
Builders with a licence that are authorised by the government home warranty insurer to insure for work worth $20,000 or more	These building licence holders can: (a) Contract with consumers to do work worth less than $20,000; **and** (b) Contract with consumers to build anything under 4 storeys that the government home warranty insurer will insure them for; **and** (c) Contract with anyone to build a high rise or anything else of any value that is over 3 storeys high; **and** (d) Subcontract (without the need for anything in writing) to build anything that the head contractor is licenced to do.

29. Under the current regime, the construction of multi-storey buildings, which is the most complicated and risky construction, is the least regulated construction. If a builder meets the requirements to be licenced to contract with a consumer to do work worth $5,000 to $19,999, the builder does not need to satisfy any other licence

requirements to build a high-rise. Nor is there a home warranty insurer involved to say no if the builder is unsuitable for such work. As one would expect under such a regime, the large majority of people who build multi-storey buildings now do so via $2 companies.

30. As there is no home warranty insurer to satisfy any solvency risk issues or requiring any bank guarantees or director indemnities from builders or developers when considered needed, developers now carry out the large majority of residential developments via $2 companies without any threat of losing a bank guarantee or directors being liable for any defect issues. Thus, all a $2 company developer needs to achieve commercially is a building that is presentable for several months after completion. By that time, the developer has typically completed the sales for all units and the profits from the sales will have left the $2 company. Any defects that are discovered after that are of no consequence to the people behind the developer as liability for those defects is left with the $2 company which has no more assets or income to lose.

31. Such a system creates a commercial incentive for developers to proceed with reckless design decisions to reduce costs. It also creates a commercial incentive for developers to retain the building contractor that provides the cheapest quotation even if the building contractor is clearly insufficiently experienced for the work and/or has had to allow for 'cutting corners' in its contract price to win the work.

32. A number of commentators have referred to these dynamics as a 'race to the bottom' as without any consequence for defects, the cheaper the construction, the greater the profit.

33. I propose that the government introduce additional building licence requirements for a builder to be permitted to construct multi-storey buildings.

34. There is already a government agency that is the home warranty insurer for residential work up to 3 storeys. That government agency already has underwriting criteria for, and 9 years of practice in, assessing whether a builder is experienced, competent and solvent enough to be trusted enough to insure to build a strata development of up to 3 storeys (**3 storey insurance eligibility**). Even if the government does not immediately restore the requirement for insurance for building more than 3 storeys buildings, the government can immediately, amend its licencing of builders to restrict builders from building above 3 storeys if they do not have at least 3 storey insurance eligibility.

35. That would see builders that the government insurer does not consider an acceptable risk for building a 3 storey unit block not being able to simply build a high-rise instead.

36. That one change will go a long way towards stopping 'cowboy' builders and $2 building companies building multi-storey buildings. It does not address 'cowboy' $2 company developers. However, it should stop 'cowboy' developers being able to use obviously 'cowboy' builders. It should also stop obviously 'cowboy' and $2 company builders from undercutting reputable builders competing for multi-storey building construction contracts. It will hopefully also result in contractor pushback against dubious design decisions.

37. With time, the licencing requirements for building above 3 storeys can evolve so that there are appropriately tiered levels of eligibility requirements for building above 3 stories. For example, there could eventually be a set of licence eligibility requirements for building 4-6 levels, an increased set of licence eligibility requirements for building 7-12 levels and so on.

Reform needed 4 –$2 company developers

38. Addressing $2 companies for multi-storey buildings, and in particular, $2 company developers, is to restore the home warranty insurance safety net for multi-storey buildings.

39. As both the building licence regulator and home warranty insurance underwriter, the government can do this while controlling the insurance risk that it takes on. The government just needs the political willpower to impose appropriately strict underwriting criteria and realistic premiums. That would restore consumer confidence for the purchasing of new units.

40. Complaints by developers concerning cashflow and the payment of premiums could be addressed by not requiring the payment of the home warranty insurance premium until immediately before the registration of a strata plan. That would see developers only having to fund the premium payments for the short period from then until the completion of unit sales. It is also reasonable to expect that the higher sale prices that the market will pay when consumer confidence is restored in this way will be more than the insurance premiums payable. That would see developers actually making a profit from restoring home warranty insurance notwithstanding the need to pay realistic premiums.

Reform needed 5 – further building licencing changes in practice needed

41. I propose that the government only issue residential building licences to individuals and that each person only be allowed one licence number for life. The eligibility of a licence holder from time to time, or at the same time, to contract to do work personally, or to be the licenced nominated supervisor for a company, and to be licenced at different times to do different categories of work, can all be easily administered via one licence number issued to the individual.

42. That approach will make a builder's track record much more transparent for consumers and also for the government insurer at the underwriting stage. The 'bad apples' will also not be able to hide behind the apparently clean record of a new licence number after abandoning a previous licence.

43. There should also be a presumption for residential building licencing that each (individual) licencee may only carry out residential building work through one company. It is difficult to justify why one person would need to have a number of different companies for that person to do residential building work through. However, it is common in my experience of being involved in at least several hundred residential building defect disputes for the licenced nominated supervisor of a company to be the licenced nominated supervisor for two or more companies. They are often similarly named. For example (Two Dollar Construction Pty Ltd and Two Dollar Construction (NSW) Pty Ltd and/or TD Construction Pty Ltd). The current

licencing practice of allowing builders to have multiple licenced companies facilities phoenix company approaches to construction.

44. Similarly, there should be a presumption against allowing an individual licencee to build through a company when that licencee has previously been building through another company that been put into administration or liquidation or deregistered. Again, that is common to see when one is acting for owners corporations with defect issues and carries out searches on the persons behind the company that built the strata plan. Again, the new companies often have very similar names to the companies that have folded. Incredibly, it is not rare to see a licence given for someone's new company to build shortly after the old similarly named company folds.

45. Again, that licencing practice is facilitating phoenix company behavior. The fact that an owner has not thrown a lot of 'good money after bad' pursuing a $2 company to a judgment despite knowing that nothing will be recovered from the $2 company (which is needed to trigger the HBA's current provisions supposedly stopping phoenix company practices) does not mean that the builder is not engaging in phoenix type behavior.

46. The same factors support individual licence holders only being allowed to build through companies that they are a director of. A building company should be under the control of the person that is able and required to supervise its building work

Reform needed 6 – the government insurer properly screening corporate applicants for insurance

47. The government insurer's underwriting requirements for companies has at least historically been horrendously lax at great expense NSW taxpayers with those losses then used as an excuse to further reduce insurance protection for consumers. That is highlighted by the following extract from the OCN's submission dated 29 February 2016 on the HBCF Discussion Paper and the examples noted within that submission of extremely poor underwriting and issuing of licences (copy provided at **annexure 'B'** to this submission):

> *"The 'elephant in the room' is the minority of builders who use companies to avoid responsibility for their shoddy work. Only 18% of home building contractor licence holders in NSW are companies. However, insolvencies within that 18% of the licenced contractor population somehow accounts for 85.6% of all accepted insurance claims[2].*
>
> *There cannot be an innocent explanation for such an extremely disproportionate statistic over the 12 year period to June 2014. The extremely disproportionate amount of accepted claims relating to company insolvencies shows that the government's regulation of the sector is tolerating phoenix company behaviour. That leaves it to taxpayers to pick up the tab via the HBCF for the minority of shoddy builders who work through companies to avoid responsibility for their defects.*

[2] Page 33 of the Discussion Paper.

It is obvious that the government should be focussing on the causes of the noted statistic. That is the key to not just achieving substantial savings for the HBCF but also substantially reducing the prevalence of residential construction defects in NSW. That is the only good government solution. The discussion paper should have confronted that rather than focussing on seeking to justify further reductions to consumer protection."

48. The history of the 18% of licence holders that are companies (as opposed to sole traders) accounting for 85.6% of the government insurer's payouts clearly shows the government home warranty insurer's losses have been mainly due to lax underwriting controls for companies.

49. Hopefully, progress has been made in addressing those historical underwriting failures highlighted by the annexure 'B' 2016 OCN submission. However, that should be independently reviewed and any recommendations for changes to underwriting criteria for companies or how those criteria are followed must be properly implemented. That will also become of wider public importance if a licence category for multi-storey buildings relying upon 3 storey insurance eligibility is now introduced as proposed above.

50. Another appropriate measure would be if the government insurer has had to pay out in relation to work carried out by a company, any other company that a former director of the failed insured company is involved with should be ineligible for insurance unless the amount paid out by the insurer has first been reimbursed to the insurer (NB: That would not restrict former directors from continuing to operate by contracting in their own name thereby taking personal responsibility for their ongoing work as per 82% of current contractor licence holders).

Reform needed 7 – more site supervision/inspections

51. Many stakeholders have recently commented upon the clear need for more independent inspections of work during construction.

52. Requiring the return of the 'clerk of works' role has been a suggested reform. If that can be achieved, it would be a very positive step. However, due to there generally not being a clerk of works for any residential projects In NSW over the last few decades, it may be difficult in the short to medium term to find enough sufficiently experienced and willing building practitioners to resource, or at least capably resource, a mandatory clerk of works requirement.

53. A viable alternative that would involve less cost would be to:

    (a) Require designers to nominate hold points in their declared designs which are to form part of the approved construction consent plans; and

    (b) For all those hold points to be inspected by independent government employed and specially trained hold point inspectors.

54. Such a system would allow for independent inspections of critical stages in the construction process (where the adequacy of work carried out can be visually

checked before proceeding further makes that no longer possible) without having to resource a further full time presence on site.

55. That cost to government could be paid for or subsidised by charging inspection fees. There would also be scope for structuring those fees to reward good construction by charging less when the construction being inspected is passed.

Reform needed 8 - private certifiers

56. As it currently stands, at least for the foreseeable future, the NSW construction industry, and therefore the NSW economy, needs private certifiers to stay in business. However, the viability of the already small number of private certifiers continuing to operate is already under severe threat due to insurance premiums and now insurance exclusions.

57. There has been valid criticism of private certifiers being selected and retained by developers. That independence issue is an issue with the system. There have also been examples of particular private certifiers acting inappropriately. However, generally where there are defects, the private certifier has not been the main, or even a significant, culprit. The provider/s of the inadequate design and/or construction are the main culprits. However, certifiers are often conveniently blamed for the wide prevalence of defects.

58. A further issue for private certifiers is the use of the word *"certifier"* to describe them. That does not accurately reflect their legislative role. However, it typically leads purchasers of units to the impression that a 'certifier' has checked and certified that all aspects of the building has been properly constructed. It would be impossible for anyone to do that for a strata building without having had a full time role on site, assistance from various specialist contractors and reasonable payment for such a role. None of those are provided to private certifiers.

59. My proposal in relation to private certifiers is that:

    (a) They now be referred to in a way that accurately represents what they do and does not create a false consumer perception. One possibility would be a 'private consent authority';

    (b) They be allowed the same protections from liability as a Local Council under the *Local Government Act* but only for the work that they carry out in the capacity of being a private consent authority;

    (c) The valid independence criticism of the current private certifier system be addressed along the lines of Local Councils having a list of approved private certifiers for their area who are allocated by random or rotation basis for any party seeking the appointment of a private certifying authority to progress a development (that would go a long way to addressing the independence issue while keeping the current practitioners in work. It would also allow the practitioners to provide all the other services that their skillsets allow them to provide to the construction industry on a normal consultation retainer basis subject to appropriate conflict of interest controls).

Reform needed 9 – Declarations of plans and registration schemes

60. The government's proposed declaration of plans registration scheme reforms are positive steps that will add to a 'wholistic' solution to the current issues. However, their effect on reducing the prevalence of defects in NSW will not be as strong as any of the Reforms Needed numbered 1-7 above. Care also needs to be taken so that the end result does not create a disproportionate amount of 'red tape'.

61. An important aspect of these reforms will be mandatory wordings to use for the declaration of plans and construction so that disclosure of any issues cannot be avoided by carefully worded 'certificates'.

62. Another important aspect will be ensuring that an owners corporation has full access to all the documents submitted on the relevant portal for its own building. It seems trite to say that an owners corporation should be provided access to the documents for its own building. However, the current systems in place resist that. Developers generally do not provide the documents they are supposed to provide owners corporations prior to their first AGM. Also, the government has to date, despite requests made on behalf of the OCN, refused to allow owners corporations to access the equivalent portals for their own buildings that are being created for the purposes of the defects bond scheme.

Reform needed 10 – subcontracts to be in writing

63. A regulatory hole in NSW not commented upon by recent studies is that in NSW it is not mandatory for any subcontracts in relation to the carrying out of residential building works to be in writing (see section 7(8) and section 7AAA(3) of the HBA).

64. I have always found it incredible that any residential construction work done under a subcontract in NSW, irrespective of how much of the work (which could be the entirety of the work and/or to a value of tens of millions) or its importance, can be done on a 'handshake' basis and without a record of who was contracted to do what.

65. I see this as a regulatory gap that should be closed to promote the objectives of good and accountability based construction. I suspect that the ATO would also support such a step.

Comments on the adequacy of home warranty insurance coverage for apartment owners (where there is insurance)

66. My view is already detailed above on the need to remove the multi-storey building exemption from the requirement for home warranty insurance. Before commenting upon the adequacy of home warranty insurance cover for the minority of owners corporations who do have insurance cover, I wish to observe one aspect relevant to the financial viability of restoring home warranty insurance for multi-storey buildings that seems to have been 'under the radar'.

67. Home warranty insurance policies issued prior to 1 July 2002 were 'first resort' policies. Policies issued since 1 July 2002 have been 'last resort' policies upon which an owner can only claim if the contractor has died, disappeared, become insolvent or

not complied with a Court or NCAT order to pay money in respect of a HBA warranties claim.

68. Commentary concerning home warranty insurance cover for multi-storey buildings generally presumes that providing such insurance again, on a 'last resort' basis, would be very uneconomic. However, the data that I consider most relevant for examining that has never, to the best of my knowledge, been analysed.

69. The only 'last resort' insurance ever issued for multi-storey buildings in NSW was issued by private insurers during the period 1 July 2002 to 30 December 2003. I have never seen any data identifying the premium received versus claim costs for the policies issued by private insurers for multi-storey buildings during that 18 month period. Even if the data for that period is for policies issued for all strata construction, as opposed to four plus level strata construction, the data would still be informative. It would show the extent of the loss, if any, suffered by private insurers from the issue of 'last resort' home warranty insurance. That data would probably also include details of the average premium charged per strata dwelling during that period. That would also be very helpful for an analysis of how expensive premiums for multi-storey building insurance would need to be to contain the potential losses of responsibly underwritten 'last resort' home warranty insurance for multi-storey buildings..

70. Where home warranty insurance is in place, the adequacy of the cover for the defects at hand usually come down to one or more of the following:

    (a) Whether the financial loss flowing from the defects is within the policy limit;

    (b) Time limit issues;

    (c) The design exclusion.

71. The *"diligently pursued"* requirement for a *"delayed claim"* is also an issue that could cause perverse outcomes for consumers (see section 103BB(6) of the HBA and clause 46B of the *Home Building Regulation 2014 (NSW)*). It is possible that it already has in matters that I am not aware of.

72. The policy limit is usually sufficient in a strata defects claim although there are sometimes exceptions to that. However, the policy limit would fall well short for any catastrophic demolish and rebuild strata insurance claim.

73. The unnecessarily complex 4 warranty periods and the unfair *"major defect"* definition commented upon above for Reform Needed 2 (for warranty claims against builders and developers) also apply for the period of insurance. The difference is that instead of 6 month extensions to the 2 and 6 year periods in certain circumstances, there can be extensions of up to 6 months for those periods in certain circumstances.

74. For the same reasons as referred to above, there should just be one single period of insurance. The only debate should be what would be the duration of a fair (single) period of insurance.

75. An owners corporation can lose its insurance rights completely through no fault of its own under the section 103BC 10 year 'long-stop' limit on insurance claims. Section 103BC should be repealed.

76. Home warranty insurance includes cover for defects caused by a builder's faulty design but excludes cover for *"a defect due to a faulty design provided by a beneficiary or a previous owner."* I understand that the rationale behind that has always been that an owner should be able to recover such loss from the party that provided the relevant design and that such a party would be insured. That rationale no longer applies for owners corporations. On the current state of the law, a designer or other consultant who provided a faulty design on behalf of a developer would not owe a duty of care to the owners corporation.

77. If the government's planned reforms results in such parties owing a proper statutory duty of care to owners corporation while also ensuring that the parties that provide design are insured and can be readily identified by an owners corporation, the design exclusion could remain in place without leaving a significant consumer protection hole.

78. The *"diligently pursue"* requirement for a *"delayed claim"* can also see an owners corporation unfairly lose all of its insurance rights. The insurer can seek a 'windfall' complete defence to an insurance claim under this provision based on matters that turn on subjective assessment and irrespective of whether the insurer has suffered any prejudice due to what it says was a *"diligently pursue"* failure[3]. The extent that an insurer can rely upon the *"diligently pursue"* requirement should be limited to any prejudice caused to the insurer.

79. Another unfair aspect of the current *"diligently pursue"* requirement for owners corporation is that it requires owners corporation to incur significant costs pursuing developers under the HBA warranties. However, the insurance cover only includes cover for the reasonable costs of pursuing the *"contractor"*, not a developer. Thus, an owners corporation can be unfairly forced to incur very substantial costs to protect the insurer's subrogation position against the developer without the ability to recoup its reasonable costs incurred doing that under the insurance.

The Defects Bond Scheme

80. The defects bond is not a substitute for proper regulation of strata construction or home warranty insurance. Further, the *'devil in the detail'* for how the scheme has evolved has severely compromised the ability of the defects bond scheme to assist consumers. The significant issues include:

    (a) The developer selecting and retaining the inspector. This compromises the independence of the inspector and has parallels with the widely criticised private certifier regime;

    (b) The ability for an owners corporation to litigate the developer's choice of inspector is 'cold comfort'. The original point of the scheme was to reduce litigation - not to

[3] NB: Pursuant to section 9(2) *Insurance Contracts Act 1984 (Cth),* that Act does not apply to *"State insurance"*. It is unclear whether insurance issued by SICorp is *"State insurance"*.

create extra issues to litigate over. The independence issue and this extra litigation issue would be avoided by a government agency selecting and retaining inspectors (at the cost of developers). That was the model initially conceived by stakeholders;

(c) The building inspector not including a scope of works or any hold points for independent inspections during repair works in the initial report. This aspect of the scheme sees the owners effectively being forced to provide access to builders to do whatever repairs the builder chooses without any independent oversight. That does not promote the carrying out of proper repairs and provides 'rogue' builders with an opportunity to cover up their defects. A 'band-aid' repair can then see an owners corporation lose the opportunity of a remedy under the defects bond. It will probably also often cause an owners corporation to not realise that a defect has not been properly repaired until after the expiry of the (in many cases 2 year) time limit for the owners corporation to commence proceedings against the builder and developer for the defect;

(d) The building inspector not providing an estimated repair cost in the final report. The cost to rectify any defect in the final report is meant to be paid out of the bond. The building inspector should be required to include an estimated repair cost in the final report. That amount should then simply be paid out of the bond. Instead, an owners corporation has to brief its own cost estimation consultant and try to agree upon the amount to paid out of the bond with the developer and if agreement cannot be reached, that must then be litigated. The owners corporation cannot recover any of its costs of those unnecessary processes that it must go through in order to obtain a payout under the bond. That will make pursuing a payment from the bond unviable for many owners corporations. Again, this detail now applied to the scheme defeats the original point of the scheme which was to reduce litigation. Instead, it will create extra litigation and cost.

I hope that the above is of assistance and would be happy to assist further in any way that I can

Banjo Stanton
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