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A new duty of care changes the liability landscape – the impact of the *Design and Building Practitioners Bill 2020*

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The NSW Government has introduced sweeping legislative changes that are intended to regain public confidence in the construction industry. This is Part 1 of Wotton + Kearney's coverage of these landmark legislative changes and the implications for insurers.

AT A GLANCE

The ***Design and Building Practitioners Bill 2020*** **(DBP Bill)** passed through NSW Parliament on 3 June 2020. The DBP Bill is awaiting Royal Assent and will become law by 19 June 2020, if not sooner. The three key issues for insurers are the introduction of:

1. mandatory declarations by construction professionals that their work complies with the Building Code of Australia
2. mandatory insurance requirements for "any liability" to which the construction professional may become subject, and
3. most importantly – a new statutory duty of care that operates retrospectively.

Who does it apply to?

The DBP Bill is intended to apply to all parties in NSW involved in the construction of residential or mixed-use developments. Specifically, it includes any person or entity that undertakes building or design work, supplies or manufactures building products or supervises building work.

Questions to be answered

This legislation will have significant effect on the liability of construction professionals and how they are insured. Some questions that arise, which we will address in our series of papers on these sweeping legislative changes, include:

- How will the process of mandatory compliance declarations be enforced?
- Can limitations be imposed on the scope of the declarations and how will the declarations work regarding interdependent work?
- How will the retrospective operation of the statutory duty apply in practice? Will current proceedings be amended to plead this statutory duty of care? Will more defendants be added to litigation? Will the operation of, and contracting out of, the proportionate liability regime be impacted?
- How do construction professionals comply with the mandatory requirement to be adequately insured against "any liability" in the face of non-conforming product exclusions and other exclusions?
- With renewals looming, how will underwriters price this fundamental shift in the liability profile of construction professionals?

BACKGROUND

The evacuation of Sydney Olympic Park's Opal Tower in December 2018 made national headlines. It was the most dramatic example of what the media called "the building compliance crisis". The general consensus among industry commentators was that, since the privatisation of the building certifying role in the 1990s, building defects in high rise residential developments had become commonplace. The pressure on state governments (responsible for building standards) increased rapidly in 2019. The DBP Bill is part of the NSW Government's response to the crisis.

The NSW Government's response is based on recommendations set out in the *Building Confidence Report*.[1] The report found that the accountabilities of different construction professionals were unclear, and that there were insufficient controls on the accuracy of design and construction documentation. The DBP Bill is intended to strengthen the regulation of designers and builders and ensure their compliance with the Building Code of Australia (BCA). It requires registration of construction professionals under a new scheme, and mandatory declarations to be made by designers and builders, confirming compliance with the BCA. The DBP Bill also makes it clear that those who make mandatory declarations must be "adequately insured".

However, the most significant development is the introduction of a new statutory duty of care that applies retrospectively to building contracts commenced before the inception of the new law, and to buildings less than 10 years old. The practical effect of the new duty for insurers is that the exposure of insureds for defective design work, or supply of defective building products, has now significantly increased. This is likely to have an immediate impact on professional indemnity and general liability insurers operating in this space.

DESIGN AND BUILDING COMPLIANCE DECLARATIONS

The DBP Bill introduces new mandatory obligations on design and construction professionals to declare that:

- building designs comply with the BCA, and
- building works comply with the BCA and have been performed under a "regulated design" before an occupation certificate can be issued.

This strict new documentation regime is intended to ensure that each step of the design and construction process is documented, and that construction professionals declare that their work complies with the BCA.

Building and design declarations are also required for any variation of the building work. Often claims for defective building work arise where a design has been varied through amended drawings or 'on the job' performance solutions. The DBP Bill requires any variations to be documented by both the designer and the builder to declare compliance with the BCA.

The upshot of this is that any declaration that is non-compliant with the BCA, and causes damage to the building owner, can form the basis of a viable claim under the new regime. The new declaration system will mean that responsibility for non-compliance with the BCA can be precisely identified.

This is intended to provide a framework to better identify the roles, responsibilities and liabilities of design and construction professionals. In other words, it will bring more certainty to liability issues.

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[1] In August 2017 the Building Ministers Forum commissioned Peter Shergold and Bronwyn Weir to assess the effectiveness of compliance and enforcement systems in the building industry. Shergold and Weir produced the *Building Confidence Report* in February 2018.

COMPULSORY INSURANCE REQUIREMENTS

Section 14 of the DBP Bill makes it clear that those who make mandatory declarations must be "adequately insured". Precisely what "adequately insured" means is unclear. The DBP Bill states that:

> "(2) *For the purposes of this section, a registered principal design practitioner is* ***adequately insured*** *with respect to a declaration and work if the practitioner —*
>
> *(a) is indemnified by insurance that complies with the regulations against any liability to which the practitioner may become subject as a result of making the declaration or carrying out the work, or*
>
> (b) ..." [emphasis added]

It is unclear how construction professionals will comply with this mandatory requirement. This is because construction professional indemnity policies contain exclusions for exposures such as non-compliant building products (i.e. cladding). These polices reflect the high risk status of the construction industry. They do not cover "… *any liability to which the practitioner may become subject…"*

The details of the required insurances will be set out in the regulations. Until this is clarified, section 14 of the DBP Bill may bring an unwelcome conundrum for insurance brokers placing cover in a hardening market.

HOW DOES THE NEW DUTY CHANGE THE LIABILITY LANDSCAPE FOR BUILDING PROFESSIONALS?

The state government has introduced this new duty to address gaps in the pre-existing legal framework that have disadvantaged building owners and subsequent purchasers. Those gaps included:

- warranties under the *Home Building Act (NSW) 1989* (HBA) expire after six years
- Home Building Compensation Cover (HBC) is only compulsory for buildings over three storeys
- there is no basis for contract claims or claims under the Australian Consumer Law (ACL) by subsequent purchasers, and
- importantly, there was little to no scope for a duty of care claim by subsequent purchasers.

It is this last point that the new duty is intended to remedy – it eradicates any uncertainty that existed in the common law surrounding the duty owed to the end user for defective building work. The DBP Bill makes it clear that a beneficiary of the duty will be entitled to seek damages for the breach of the duty as though the duty was established by the common law.

The new duty effectively reverses the High Court's decisions in *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288* (2014) and *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515. Those cases are authority for the proposition that subsequent purchasers of buildings cannot sue construction professionals for pure economic loss arising from latent defects that are discovered after purchase.

The general proposition is that construction professionals do not owe a duty of care to subsequent purchasers unless "salient features" exist (reliance, assumption of responsibility and vulnerability of the subsequent purchaser). The common law in Australia is in a similar position to the UK. Accordingly, the new duty is a move away from the traditional approach by Australian and UK courts, which limit tortious liability for pure economic loss in building claims.

The common law of negligence for defective building is supplemented by the HBA. The HBA provides statutory warranties included in all contracts between owners and builders/tradespersons for "residential building work". The primary redress for breaches of the HBA statutory warranties is to have the work rectified by the builder/developer or seek financial compensation for the cost of rectification.

The HBA statutory warranties do not provide an avenue for building owners to make claims directly against design professionals or manufacturers/suppliers of building products. The new duty of care broadens the classes of construction professionals who will have direct liability to building owners, while also increasing the categories of building owners that they will be liable to. In other words, the pool of potential claimants for defective building work has increased and direct claims against construction professionals has been opened up – regardless of the contractual framework in place.

THE NEW DUTY EXPLAINED

Under the DBP Bill, construction professionals that carry out "construction work" have a duty to exercise reasonable care to avoid economic loss to owners caused by building defects. The definition of "construction work" is wide. It includes residential building work under the HBA, design, manufacture, supply and supervision or management of building work. The new duty of care is owed by those who:

- undertake building and/or design work
- supply or manufacture building products, and/or
- supervise others performing building work.

The new duty of care is owed to current, and subsequent owners of land, whether or not they were a party to the construction contract. Accordingly, under the new law, owners of land and subsequent purchasers (including Owners' Corporations) will be entitled to claim damages for breach of the new duty directly from the construction professionals who did the work.

THE ELEMENTS OF THE NEW DUTY

The new duty of care is subject to the existing framework set out in the *Civil Liability Act 2002* (CLA). Essentially, the new duty simply clarifies that a duty is owed.

All claims will be assessed through the causation and remoteness principles set out in the CLA. This means that while a duty of care will be owed to a class of potential claimants, any person who proceeds with litigation will be required to meet the other tests for negligence established under the common law and the CLA. This includes determining that a breach of the duty occurred and establishing that damage was suffered by the owner as a result of that breach. The hurdle of establishing that a duty is owed, however, will no longer be required, saving court time and expense.

The new duty of care is in addition to existing common law and statutory obligations on construction professionals. The new law prohibits contracting out of, or delegating, the new duty. The new duty is subject to the same time limitation as a claim in negligence – i.e. six years from the date of damage. That is broader than the limitations placed on HBA statutory warranty claims, which run from the date the work is completed.

The regulations, expected to be introduced later this year, will determine the classes of buildings that the new duty will apply to. It is envisaged that the new duty will apply to buildings classed 1, 2, 3 and 10 under the BCA - this includes residential and mixed used commercial/residential apartment buildings. It does not include commercial buildings.

THE NEW DUTY APPLIES RETROSPECTIVELY

The new duty applies to all new buildings and buildings less than 10 years old. It extends to construction work carried out before the commencement of the DBP Bill. This means that:

- claims can be made for breach of the new duty for defective buildings up to 10 years old, and
- currently litigated claims can be amended to include a new claim for breach of the new duty.

This is a significant change in the legal landscape that will have immediate effect – insurers could see claims for breach of the new duty soon after the DBP Bill is assented to – this could be within the next few months or weeks.

IMPLICATIONS FOR PROFESSIONAL INDEMNITY AND GENERAL LIABILITY INSURERS

The new duty of care means that design professionals (architects, engineers etc) insured under professional indemnity policies will soon be subject to direct claims from subsequent owners. This is not an insignificant risk – many industry commentators advise against the purchase of apartments in new high-rise developments – well over 100,000 of these high-rise apartments have been built in Sydney alone over the last five years.

The inclusion of manufacturers and suppliers of building products in the definition of "construction work" will also likely see an increase in claims under general liability policies.

The risk profiles for construction professionals has increased. This will prompt many insurers to reassess their underwriting guidelines. The obvious question is how that will play out in the insurance market. Any increased risk will need to be priced.

It is hoped that the economic consequences of this increased liability have been calibrated by the state government. The theory is that this increased liability, coupled with mandatory insurance requirements, will expand the insurance pool and spread liability across the entire construction industry. In other words, the insurance problem will be dealt with by spreading the risk across a larger pool of insureds with increased premiums collected by insurers to accommodate increased claims.

The risk is that claims experience may not spread evenly across a larger pool of insureds – claims may coalesce in some areas of the industry. Some building professionals could be priced out of the insurance market, and that may result in sections of the industry seizing up.

This is a particularly sensitive time for the construction industry given that a significant contraction has occurred, and the general economy is moving into recession. How the insurance market reacts to the state government's reform package will be a significant factor in the success of government's response to the crisis.

Commentary to come

Wotton + Kearney's continuing coverage of the NSW Government's reform package will include how the new duty is likely to play out, the challenges that the compulsory insurance requirements will bring, the Building Commissioner's increasing jurisdiction and role, and the *Residential Apartment Buildings (Compliance and Enforcement Powers) Bill 2020*.

NEED TO KNOW MORE?

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