BUILDING PERFORMANCE

Risk, Liability and Insurance in the Building Sector

Policy Position Statement

June 2023

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Te Kāwanatanga o Aotearoa
New Zealand Government

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Ministry of Business, Innovation and Employment (MBIE) Hīkina Whakatutuki – Lifting to make successful

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Purpose

Risk, liability and insurance settings in New Zealand's building and construction sector have been extensively examined for more than 20 years by policymakers, legal experts, sector participants and researchers. A range of perspectives exist. For the building and construction sector, the key question has been whether to retain the current joint and several liability rule or move to proportionate liability. Successive governments have sought to address the issue of how to allocate liability among multiple defendants in building negligence claims.

In 2011 the Government referred the liability question to the Law Commission for consideration. In 2014 the Law Commission presented its final report *Liability of Multiple Defendants* to the House of Representatives. The report recommended that the joint and several liability rules remain and made a number of recommendations for further work in relation to the building and construction sector.

The Government response in 2014 to the Law Commission's report accepted the Law Commission's recommendation to retain joint and several liability across the legal system. The Government directed agencies to undertake further work, including consultation and regulatory impact analysis, on the Law Commission's recommendations to cap building consent authority liability and, if proved feasible, introduce a residential building guarantee scheme.

This Policy Position Statement sets out the last 20-plus years of risk, liability and insurance work undertaken by the Ministry of Business, Innovation and Employment (MBIE) and its predecessor. It provides clarity on the Government's position on the risk, liability and insurance settings for the building and construction industry, and in doing so covers the following matters:

- An outline of the two Law Commission reviews of joint and several liability, and the rationale behind the Government's response to each of these reviews.
- A summary of consultation on, and subsequent analysis of, the Law Commission's recommendations to cap building consent authority liability and introduce a residential building guarantee scheme.
- Recent decisions on the Law Commission recommendations.
- The case for a whole-of-system approach to risk and liability in the building and construction sector.
- An overview of whole-of-system reforms to date.
- The direction of future reforms.

This Policy Position Statement has been released to support consultation on the Building Consent System Review, which is the next stage of the Government's whole-of-system approach. Submitters to the Building Consent System Review consultation may find this document provides additional background and analysis to inform their submissions.

Introduction

Getting policy settings right on the allocation of risk in the building sector is important. The allocation of risk across the building sector, and the regulatory settings underpinning this, affects the level of productivity and innovation in the sector, supply of housing, quality of building work, consenting efficiency, sector capability and the outcomes for consumers when things go wrong.

Risk, liability and insurance in the building and construction sector came to prominence in the aftermath of the leaky homes crisis in the 1990s and early 2000s and the systemic failure of New Zealand's building regulatory system. Since then, there has been substantive and widespread reforms to the regulatory control system for building and construction. Reform in this area continues.

Risk management in the building sector is a shared responsibility

The nature, allocation and incidence of risk and liability in the building and construction sector is a product of the institutions, laws, processes, and formalities that underpin the building regulatory framework. Participants' obligations and responsibilities are also determined by common-law responsibilities and contractual arrangements. The interaction between these different elements shapes the incentives and behaviours of industry participants and the overall performance of the sector.

An important principle and theme underpinning this Policy Position Statement is the need for the building regulatory control system to clearly define the roles, responsibilities and accountabilities of all building industry participants. Therefore, all parties should recognise that building safety, quality and compliance with the Building Code are a shared responsibility and understand how individual participants contribute to that.

Getting building work right first time — A whole-of-system approach

The Government is taking a whole-of-system approach to risk and liability in the building and construction sector. This incorporates the many elements of the building control system and focuses on ways to strengthen the incentives, accountabilities and behaviours of industry participants to get building work right in the first place.

In this context, this Policy Position Statement provides an overview of the reforms implemented, underway and proposed that aim to ensure quality building standards are in place that are effectively monitored and enforced, an effective and efficient building consent system, a skilled and competent building workforce, and informed and empowered consumers. Together, these minimise the prospect of building defects and disputes where liability issues are most visible.

The current focus of the whole-of-system approach is:

- A first-principles review of the building consent system. The building consent system is the primary mechanism that governs risk allocation in the building system. The review will seek to ensure the building consent system is fit-for-purpose; including that it provides a strong assurance mechanism for building work and that the roles and responsibilities of all parties are clear.

- A review of occupational regulation of building and construction professions. Occupational regulation aims to protect the public from the risks of an occupation being carried out incompetently or recklessly. The review of building and construction occupational regulation will ensure building and construction professionals are skilled and competent so people can have confidence in them and their work, and poor performers are held to account.
- A review of consumer protection in the building and construction sector. Many building system settings have, at their heart, a public policy interest in protecting consumers. The consumer protection review will ensure consumers are able to manage their risks in the process, are empowered to make good decisions, and have mechanisms to enforce their rights.

Policy Position: risk, liability and insurance

The Government has responded to the Law Commission's recommendations in its review of how liability for damages in civil matters among two or more liable parties should be allocated, including for the building and construction industry. The following policy proposals are examined and form the basis of this Policy Position Statement.

- liability rules — joint and several vs. proportional
- capping building consent authority liability cost and/or limiting building consent authority duty of care
- a publicly-provided building defects insurance scheme.

Liability rules—joint and several vs. proportional

Liability arises when things go wrong. In New Zealand, as in many other common law jurisdictions, the liability rule where multiple parties have been found negligent and responsible for the same loss is joint and several liability. Essentially that means each of the guilty parties who are responsible for the same loss to a plaintiff are both 'jointly' liable for the loss suffered with the other defendants and 'severally' or individually liable for all of the loss. Therefore, under this rule, a plaintiff (in this context, the homeowner) is able to recover costs from any of the parties who played a part in causing the loss. If one liable party does not pay their share of the costs for any reason (such as insolvency or absence), the homeowner can recover that share from another liable party. This rule is primarily concerned with protecting the injured plaintiff (homeowner).

An alternative liability rule is 'proportionate liability'. Under proportionate liability, each liable party is allocated or apportioned a share of the total cost, based on the court's judgment of each liable party's share of responsibility or fault. This means that judgement may not be given against a defendant for a sum greater than the amount apportioned to them. If one liable party does not pay their share of the costs for any reason, the homeowner cannot recover that share from another liable party. Liable parties are protected from paying more than their proportion, which means the homeowner must bear the cost of any missing liable party or any party that cannot pay their share.[1]

[1] More detailed descriptions of different liability schemes can be found in Law Commission "Review of Joint and Several Liability" (NZLC IP32, 2012), *Issues Paper*. (NZ Law Commission: Wellington)

Some stakeholders in the building and construction sector support a move away from joint and several liability in New Zealand. The key reason for many is the perception that a change would result in fairer outcomes when things go wrong. They would prefer a slightly different application of the joint and several rule or a move to proportionate liability, and argue that joint and several liability:

- is flawed in principle as defendants are liable to the plaintiff for the whole loss, regardless of the role they play in causing it
- is unfair in practice because it can require solvent defendants (so called 'deep pocket defendants') to carry liability beyond their apportioned share when other negligent parties are absent
- may lead to risk-averse behaviour (e.g., taking excessive care), particularly by 'deep pocket defendants'.

The Law Commission note that the views of either side are often strongly entrenched, and there is no consensus on which system is fairer. Unsurprisingly, "views on which liability rule is better, fairer or more efficient tend to divide neatly according to whether a person is more likely to be a plaintiff or a defendant."[2] Put another way, who should bear the risk of an uncollectable share—the plaintiff (homeowner) or defendant? This is the heart of the issue. Where all parties are present and solvent, the concerns with joint and several liability and claims of major injustice lessen, provided all parties can make the necessary financial contribution.

The Law Commission ('the Commission') has carefully considered what the appropriate liability rule for New Zealand should be in two separate investigations. First in 1998[3], and then again in 2014[4].

Law Commission's preferred rule — 1998

The Commission's review of the rule of joint and several liability was carried out as part of a wider review of the rules of apportionment in civil liability. This review was important as it was probably the first consideration in recent times of the appropriateness of joint and several liability for New Zealand.

In its 1998 final report the Commission was of the firm view that no sufficiently compelling case was made for replacing the joint and several liability rule. The Commission thought it was undesirable that a plaintiff should be left to carry the burden of an insolvent defendant, where the plaintiff suffers loss at the hands of others through no fault of their own.

Considerable emphasis was put on the point that the whole basis of the law of civil liability is that quantification is determined not by the degree of the wrongdoer's fault but by the extent of the injury to the plaintiff. The Commission's view was that as a defendant's liability is for the whole loss caused by the defendant's wrongdoing, liability should be unaffected by the fact that the behaviour of some other party has caused the same loss.

[2] NZLC R 132, Liability of multiple defendants (June, 2014), p. iv, (NZ Law Commission: Wellington)
[3] NZLC R 47, 'Apportionment of civil liability', (May, 1998) (NZ Law Commission: Wellington)
[4] NZLC R 132, 'Liability of multiple defendants', (June, 2014) (NZ Law Commission: Wellington)

The Commission's views were also strongly influenced by the reluctance of legislators and reformers overseas to move away from joint and several liability. Central to this reluctance is the view that joint and several liability is the best means of ensuring fairness to the plaintiff.

As part of its inquiry, the Commission examined a compromise scheme somewhere between joint and several liability and proportionate liability. However, this was rejected outright as it considered this would produce a fundamental change in the law that is unjustified.

Law Commission's preferred rule — 2014

Given the large numbers of multiple defendant cases arising from the leaky homes crisis, and the strongly divergent views in the building sector, the Law Commission was again asked to investigate this issue in 2011, and to recommend a preferred liability rule. The Commission delivered its final report in 2014 and concluded that joint and several liability is clearly the preferable system, rather than adopting proportionate liability or a hybrid model, and that it should remain the general rule.

The principal reason for the Commission's recommendation is joint and several liability provides the best assurance that plaintiffs (homeowners) will be compensated for their loss. Therefore, provided there is a present and solvent liable defendant who has caused the loss, the plaintiff will receive full compensation irrespective of the proportion of the loss actually caused by that present and solvent liable defendant. A shift to proportionate liability simply moves the responsibility for the uncollected share from the liable parties, including building consent authorities, on to the blameless homeowner.

The Commission concluded that assertions of "unfairness" of joint and several liability to some defendants is, at best, overstated. Further, no defendant is called upon to meet all the plaintiff's damages unless they have first been found to have caused the plaintiff's loss in some material way and meet all other legal requirements to be held liable.

Fundamentally, the policy issue comes down to a choice between a blameless plaintiff taking on the risk of an absent defendant, or a wrongdoer co-defendant taking on that risk. On this issue, the Commission clearly comes down in favour of the innocent party. Unless there is some substantial reason of public policy that demands some adjustment, parties who have actually caused the harm are the parties who should bear the risk.

The Commission noted that its conclusion on this issue was boosted by the fact that some specific legislative steps have been taken over the past decade to help resolve the leaky home crisis, as well as more general changes and improvements to building legislation and regulations.

While the Commission clearly preferred joint and several liability as the general liability rule for New Zealand, including the building sector, they did identify adjustments that could be made "to improve fairness for both sides". It was recommended that the liability of building consent authorities held liable in tort negligence relating to building consents and all related work should be capped. Further, it was recommended that work be progressed by government officials in developing, if proved feasible, a comprehensive residential building guarantee scheme.

The Government response in 2014 to the Law Commission's report accepted the Law Commission's recommendation to retain joint and several liability across the legal system. The Government directed agencies to undertake further work, including consultation and regulatory

impact analysis, on the Law Commission's recommendations to cap building consent authority liability and, if proved feasible, introduce a residential building guarantee scheme. The outcome of this work is discussed later in this Policy Position Statement.

Liability rules and economic efficiency

The Commission also reviewed the evidence as to which liability rule is more likely to produce economic efficiency. The Commission found no sound evidence that proportionate liability can better incentivise economically efficient behaviour or outcomes:

- There is anecdotal evidence that the proportionate liability process is often longer and more complex because it requires a full assessment of relative liability. Lessons learned from Australia indicate that proportionate liability can be more costly than the joint and several liability regime for both plaintiff and defendant.
- A common perception is that limiting 'collective' liability should stimulate activity, particularly in areas where multiple parties contribute to activity. However, liability will still exist, and the incentive to avoid it is strong regardless of regime.
- Risk-averse behaviour can be exacerbated, but is not caused by, the joint and several liability rule. A range of other factors combine to cause risk aversion, some of which the Government is working to address through ongoing *Building Act 2004* reforms to strengthen accountability and provide consumer tools for risk management.

The impact of the joint and several liability rule on building consent authorities

The practical application of joint and several liability in the building sector means some parties responsible for the building work might bear more of the cost if other parties are absent. For example, if both the building consent authority and the builder are found liable but the builder is no longer in business, building consent authorities can be made to cover damages otherwise allocated to the builder. In some cases, the building consent authority may be the only solvent party in a building defect case (the so-called 'last party standing') and, under the joint and several liability rule, is liable for covering the whole loss. The question is how often does this situation arise, and how material is it?

To help answer these questions, MBIE commissioned Sapere Research Group.[5] Sapere examined the legal cases that went before the courts and found that building consent authority negligence costs are estimated at approximately $1.1 billion over a 10-year period 2008-2018, at the peak of leaky homes negligence cases. This included an estimated $332 million towards other parties' share of the costs where other defendants were absent, or 48 per cent of cases where building consent authorities were jointly and severally responsible. These costs represent a relatively small proportion of all consents issued (valued at approximately $75 billion for the same period). The Sapere study also estimated that, for the same period, homeowners were left out of pocket by $458 million, or 10 per cent of the value of total claims in the cases studied.

It is also important to note how many building consents actually result in disputes. For the 10-year period 2008-2018, Sapere estimated that around 2.5 per cent of residential building consents resulted in court action or another dispute resolution process. But only a small

[5] Sapere Research Group (2018), "Liability outcomes in the building sector: glimpses from available data", Report for MBIE (13 November 2018).

percentage of building defect disputes make it to court (around 5 per cent of disputes). Therefore, many disputes are settled out of court to avoid the cost and time of court hearings, while others are not resolved at all, at a cost to the homeowner.

Setting aside the implications of joint and several liability when there are absent defendants, precedent suggests that a building consent authority's own liability in each negligence case is assessed by reference to the nature, and value, of its role and responsibility in the building process relative to other defendants. Liability for building consent authorities has been determined by the courts to be in the region of 20 per cent.

Substantial reform has also been implemented in response to the leaky homes crisis. This has had an impact. Notably, the Sapere research indicates that the number of defective building cases involving building consent authorities has been declining since 2012. This suggests that the majority of leaky building cases may have worked their way through the system. Along with the proposed changes contained in the current legislative reform programme, the potential liability risks to building consent authorities should be lower than they were five to 10 years ago.

Policy position

The Government accepts the Law Commission's recommendation that joint and several liability remain the liability rule for allocating liability for damages in civil matters in the building and construction industry, and more generally across the legal system. It is not fair that a homeowner should be left to carry the burden of insolvent or absent defendants through no fault of their own. The innocent party should be protected. Joint and several liability provides the best assurance that the homeowner will be compensated.

Capping building consent authority liability costs and/or limiting their duty of care

Concerns have been expressed by some in the building sector that the current risk and liability settings (i.e., joint and several liability) mean a risk-averse approach is taken by building consent authorities in carrying out their consenting function and that this, in turn, impacts on the speed of consenting. Therefore, some building consent authorities perceive there to be a high risk of being the last party standing when there are absent defendants in building negligence court cases and are incentivised to over-invest in care in carrying out their consenting function. As a consequence, a cap on building consent authority liability costs and/or limiting their duty of care is often put forward as a policy solution in addressing these perverse incentives.

Moreover, in its 2014 report, the Law Commission acknowledged that local authorities remain attractive potential defendants because of their resources, especially if another major liability event emerges. The Commission therefore concluded that, on fairness grounds, some further protection from excessive liability is justified, and recommended a cap on building consent authority liability. Specifically, the Commission considered such a backstop cap on building consent authority liability apply to any excessive effect on local authorities arising from "a

future major liability event" and where local authorities are likely to constitute the "last person standing".[6]

Capping building consent authority liability costs would provide certainty for building consent authorities in terms of the maximum expected liability they might face in the case of building defects. Likewise, limiting building consent authorities' duty of care will potentially provide an element of certainty as to the scope of their liability. However, there is little evidence that either of these options would result in building consent authorities acting in a less risk-averse way or changing their approach in delivering their consenting functions, and it is questionable whether this is desirable.

Building consent authority decision-making and risk aversion—what is the evidence?

MBIE research and consultation with sector participants produces a mixed picture on the impact of risk and liability settings on building consent authority behaviour. While some building consent authorities perceive there to be a high risk of being the last party standing when there are absent defendants in building negligence court cases, MBIE has been unable to find concrete evidence as to ways in which building consent authorities were over-investing in care in carrying out their consenting function.

Other building consent authorities and industry stakeholders do not see liability as an issue and argue that it is not a primary driver of consenting behaviour. In any case, some considered additional scrutiny of building consent applications was a good thing rather than a problem. Some industry stakeholders acknowledged that, while compliance costs and overall regulatory burden may have increased following the leaky homes crisis, this was considered necessary (i.e., previously building consent authorities were too lax) and meritorious (i.e., it may serve to improve quality and effectively weed out those who are unable or unwilling to comply).

The impact of potential liability claims on building consent authority behaviour and decision-making is difficult to quantify and there is little evidence to suggest that the liability regime alone drives building consent authority behaviour. Other drivers of building consent authority decision-making that have previously been identified include their:

- views about their statutory responsibilities and duties around building code compliance and the behaviour and actions required to satisfy these responsibilities and duties (*Building Act 2004*)
- views about wider sector capability and capacity, including poor quality building consent applications
- views about their duty of care and obligations to their community to ensure a safe built environment and to perform their functions in a cost-effective way (*Local Government Act 2002*)
- difficulties in gaining adequate insurance cover and concerns about other sector participants seeking to manage risk through company structures.

Claims of excessive risk aversion by building consent authorities need to acknowledge that the role of building consent authorities has changed in recent years since the leaky homes crisis and the introduction of building consent authority accreditation. Accreditation requirements have necessarily increased the education and skill requirements for building consent authorities and

[6] NZLC R 132, Liability of multiple defendants (June, 2014) (NZ Law Commission: Wellington), p. 55.

the level of information required to carry out their function. It would be expected that these additional requirements have shaped their incentives and behaviours.

Given the many influences and drivers of building consent authorities decision-making, a cap on building consent authorities liability costs or limiting their duty of care is unlikely to change building consent authorities approach to managing risk in the building consent process and decision-making behaviour.

Consenting speed and efficiency

It could be expected that if building consent authorities were over-investing in care, then this would negatively affect consenting speed and efficiency. This does not appear to be the case. Indeed, New Zealand compares well internationally. The 2020 World Bank Doing Business report ranked New Zealand 7th out of 213 jurisdictions for ease of dealing with construction permits, ahead of Australia (11th), the United Kingdom (23rd) and the United States (24th).[7] It is relevant to note that the civil liability regimes in each of these three jurisdictions differs from New Zealand's. Both the United States and Australian states retain a proportionate liability regime, while the United Kingdom limits liability and the duty of care for the building regulator (New Zealand's equivalent of a building consent authority). New Zealand's placement ahead of these countries in ease of dealing with construction permits would seem to contradict claims that New Zealand's liability rule/duty of care settings are having a negative impact on consenting speed.

Given the current record levels of building consent applications, what impact has this on processing times? An MBIE survey covering the period March-September 2021 found it took on average across all building consent authorities 14 working days to process building consents. However, there is a significant variance in performance across building consent authorities. While the majority were managing to meet statutory requirements for processing consents during that period, some were struggling. MBIE estimated around one-quarter were falling far short of compliance with the requirement to process consents within 20 working days.[8]

Building consent authorities' workload and resourcing has a major impact on efficiency. In this regard, building alterations and additions can take up a significant amount of building consent authorities' time and resourcing. Alterations and additions are often unique and therefore likely to be more difficult to consent, attracting more requests for information and potential delays. MBIE's evaluation data shows that, in an effort to improve efficiency and cope with increasing demand and complexity in building consents, many councils are in practice taking a risk-based approach to consent processing.

The Government is therefore not persuaded that liability settings and excessive risk aversion is driving building consent authority consenting behaviour, decision-making and efficiency. This issue is much more complex and nuanced. There would therefore be little point, and indeed it would be very costly, to design a policy intervention targeting either building consent authority

[7] https://archive.doingbusiness.org/en/data/exploretopics/dealing-with-construction-permits#

[8] The actual time it takes to process a consent will largely depend on the quality of the application, and complexity of the proposed building work. It is also important to note that the total elapsed time from the receipt of application to the issuing a consent may be longer than reported processing times, as the processing time excludes time the application may be put 'on hold' while the building consent authority waits for further information from the applicant. MBIE does not currently have reliable information on the frequency of requests for information, or the total elapsed time to process building consents.

liability costs or their duty of care when many other factors are at play in the building consent process.

Risk shifting, productivity and fairness

A cap on building consent authority liability costs or limits on their duty of care can be expected to move any excessive risk aversion from building consent authorities to other parties in the building system. In particular, it would leave the blameless homeowner exposed to the risks of absent parties and uncollectable costs. Put another way, limiting building consent authority liability effectively transfers building risk from those able to manage risk and deal with loss or damage, to the homeowners who have the least ability to manage building risk and cope with losses.

There are also wider productivity impacts when transferring risk to other parties in the building system. For example, building professionals may prefer to stick to building designs, techniques and practices that they have experience in rather than adopting new innovative solutions (a long-standing problem in the New Zealand building industry). Others may choose to leave the sector altogether, as they are not willing to bear the level of risk and potential costs they face.

Out of fairness, it could be expected that other participants in the building process will equally seek a cap on their liability costs should a cap be placed on BCA's liability costs. This point was made by a number of submitters as part of the 2019 Building System Legislative Reform Programme consultation on this issue. In effect, capping multiple parties' liability would be a move to proportionate liability and would leave the homeowner even more exposed.

There is also a fairness issue relating to how and where any liability cost cap is actually set. While building consent authorities have tended to be responsible for around 20 per cent of the liability, there have also been cases where they have been responsible for more than 20 per cent of the liability. If the cap is set too low, then building consent authorities avoid the cost of damage and culpability for their negligent decision-making. Conversely, if the cap were too high then there would likely be no (potential) behaviour change at all. Such implementation issues are not straightforward.

MBIE also examined and received advice on a number of options that limited building consent authorities' duty of care. That is limiting their duty of care to:

- 'gross negligence', or provide BCAs with statutory protection from the costs of liability
- 'substantial safety and sanitary issues'
- just 'first owners', and so exclude subsequent purchasers.

While these options will likely limit liability of building consent authorities, they will potentially have different impacts on risk allocation, liability and insurance in the sector; homeowners; and consenting efficiency. These impacts can be summarised as follows:

- Less protection for homeowners as risk and liability costs shifts to homeowners, particularly where other parties are absent from dispute.
- Unlikely to increase consenting speed, as building consent authorities still have statutory obligations to their community and compliance with their accreditation requirements.
- Wider productivity impacts as other parties in the building system take on more risk and liability, influencing the incentive to innovate.
- Increased legal complexity, litigation and cost.

- Greater legal uncertainty as courts work through the interpretation of scope of building consent authorities duty of care and definitional issues.
- Possible negative impacts on professional indemnity insurance market where building consent authorities are no longer required to contribute towards the costs.
- Withdrawal or increase in the cost of insurance, as insurers have reduced ability to reclaim costs.

Consultation with building and construction sector—mixed feedback

In April 2019, as part of the Building System Legislative Reform Program consultation, and the release of a discussion document, MBIE sought feedback on a wide range of reform measures aimed at improving the performance of the building regulatory control system. This consultation included a proposal to cap liability costs for building consent authorities.

There was mixed feedback from the building and construction sector on the proposal to cap building consent authority liability costs. Building consent authorities and some other sector participants strongly supported a change to the liability settings as they consider it will better reflect the role of building consent authorities in the building process and may mitigate risk-averse behaviour. Ratepayers would not be subsidising the failures of other industry entities, and it would incentivise other sector players to lift their performance. Many of the submitters who supported a change to liability settings also advocated for proportionate liability rather than a cap.

The majority of written submissions did not support a cap on building consent authority liability costs. While many building consent authorities supported a cap on liability costs, a significant number of stakeholders saw this as unfair as liability and cost would simply be shifted to other parties in the building process, including the blameless homeowner. Some considered that this undermines the more general policy goals of reform in that joint and several liability is considered a valuable protective measure for homeowners. It also creates an incentive for good risk management. Other participants in the building process also advocated for a cap on their own liability, while others supported a fundamental move to a proportionate liability rule.

More generally, there were mixed views on whether changing liability settings would impact consenting behaviour. While most of the written submissions thought improving building products and processes would have the biggest impact on consenting efficiency, many online survey respondents thought risk and liability settings would have the biggest impact. Another common viewpoint was the need to focus on high-quality standards that are well supervised and enforced to minimise the risk of poor-quality products and workmanship.

Potential for perverse and unintended outcomes

The potential impacts of any limitation on building consent authority liability are extremely complex. The actual impacts depend on how parties (particularly building consent authorities) adjust their behaviour in response to any limitation of liability, which is difficult to predict with certainty. There is a risk that while a building consent authority liability/cost cap may change incentives, this might not translate into a significant change their behaviour. For example, despite any form of statutory protection from liability or liability costs, building consent authorities will still be obligated to meet their consenting accreditation requirements and uphold their wider obligations to the community.

More broadly, limiting building consent authority liability is not consistent with the policy expectation that people will be held liable for their negligent actions, and sends a mixed message about parties having to stand behind their work. It also gives rise to outcomes that would seem perverse. Building consent authorities that, by virtue of their superior standards, processes and conduct in undertaking their consenting function, may be less likely to be in a situation that exposes them to significant liability risks. On the other hand, building consent authorities that have lower standards, poor processes and poor conduct are afforded protection.

Policy position

The current liability settings for building consent authorities should remain. There is a weak case for implementing a cap on building consent authority liability costs or limiting their duty of care, given the potential costs, risks, and benefits. This is unlikely to result in a change in building consent authorities decision-making behaviour, nor result in faster building consenting. It would impact negatively on fairness and productivity in the building sector, and risk unintended outcomes.

Building warranty insurance

Guarantee and insurance products provide protections to homeowners who are building or renovating their home against non-completion of building work and post-completion defects. These can be a guarantee or insurance policy. In general, a guarantee provides assurance that something will be fixed if it goes wrong, whereas insurance provides compensation for loss.

- A guarantee provides a promise to ‘make right’, that the builder will complete the home in accordance with the building contract, and the home will be free of defects. A warranty is a promise by the builder to fix any defects. It is a mechanism to ensure the guarantee promises will be kept.
- An insurance product is a policy that will compensate the policy holder for a (insured) loss, and often pays for the problem to be corrected.

The coverage levels and types of protection offered by insurance and guarantee products differ significantly. If the insurance or guarantee offers ‘first resort’ cover, the homeowner can turn to the insurance company or guarantor in the first instance of a defect and have them arrange repairs for the full period of cover. The insurer acts for the homeowner in dealing with claims. However, homeowners purchasing ‘last resort’ cover must attempt to negotiate with builders to resolve building defects, or demonstrate that the builder is no longer in existence, before the insurance company or guarantor will step in. All avenues for recovery of any loss must have been exhausted.

Guarantee and insurance products are also regulated differently with insurance products subject to much more stringent regulatory oversight and requirements.

New Zealand has a limited building guarantee market. All schemes are offered by the builder or building industry association. They have acceptance criteria relating to business history that a builder must meet. The schemes also offer differing levels of protection and focus on the performance of the builder. Notably, none of these guarantees protect against design defects that the building consent authority may identify through the consenting process.

Exact figures of new build stand-alone houses in New Zealand covered by some form of guarantee are not known. A typical guarantee in New Zealand provides cover for builder insolvency during the build, and structural and other defects for certain periods post-construction (with limitations and exclusions). Guarantees are typically transferable to a new owner where ownership of the home changes during the cover period.

The absence of a building warranty insurance market in New Zealand

A viable insurance market for building defects in New Zealand has not developed. Stamford Insurance previously had an insurance product that provided protection against both design and workmanship defects. However, its underwriter, Lloyds, left the market at the end of 2019, leaving no building warranty insurance products available in the New Zealand market.

There are a number of reasons why a building defects insurance market has not developed in New Zealand, including the:

- low levels of consumer demand for, and awareness of, guarantee and insurance products
- effectiveness of the system for regulating building sector professionals
- ability of insurers to recover losses from other negligent parties (including building consent authorities)
- small size of the New Zealand market
- challenges insurers face when pricing for a the 10-year limitation period required by the *Building Act*, the so-called 'long tail risk', which makes it difficult for insurers to be able to predict their losses and therefore price insurance products
- nature of the risks in New Zealand's building and construction sector
- lack of information on the causes of risk in New Zealand's building sector (efficient pricing requires good information on the causes of risk)
- reluctance of underwriters to set up a physical presence in New Zealand (a Reserve Bank requirement for insurers).

The absence of a building warranty insurance market in New Zealand raises the policy question as to what the government's role is in developing and supporting a warranty insurance scheme. Some building sector participants would like a publicly provided warranty insurance scheme or product.

Publicly provided building warranty insurance scheme

The Government has considered the merit of a publicly provided insurance scheme for New Zealand. This was in the context of any proposal for a cap on building consent authority liability, and the subsequent impact of this on consumers, and the absence of a building warranty insurance market or offering in New Zealand.

A publicly provided building warranty insurance scheme could be a reinsurance scheme where the government insures private insurers, private insurers on-selling government insurance, or direct provision. This would be a significant intervention in the New Zealand insurance market and raise a number of risks that would need to be managed.

Potential for perverse and unintended outcomes

Transferring risk to an insurer removes important incentives on other parties in the building sector to actively reduce and manage risk, leading to higher expected losses overall. This is the so-called moral hazard problem or 'peace of mind' effect of insurance where industry participants have weak incentives to closely monitor building work and identify defects. That said, the design of an insurance product could seek to minimise moral hazard incentives through, for example, risk-based pricing, eligibility and access standards, regulation and limiting coverage.

However, controlling moral hazard risk can be problematic. The 10-year limitation period for building warranty insurance (required by the *Building Act 2004*), the policy intent to provide cover for non-chance events (e.g., negligence), and the relatively short lifespan of building companies collectively weaken the effectiveness of these controls. These are likely to be contributing factors to the lack of a building warranty insurance market in New Zealand (and would likely be an issue for any publicly provided building warranty insurance).

The existence of a 'deep pocketed' party can also exacerbate moral hazard risks and is likely to be the case if a deep pocketed public insurer replaces building consent authorities - but with the public insurer having less direct control to manage risk.

Fiscal risk for the Government

A public insurer would generate a fiscal risk to the Government that its claims exceed its revenue for any given period. Private insurers manage this risk by building up capital (e.g., retained profits accumulated over time) or purchasing reinsurance. A public insurer would likely carry a government guarantee, either explicit or implicit, meaning the Government would need to consider how it manages the fiscal risk.

Finally, any government-provided warranty insurance product would effectively move the cost of liability from the building consent authorities to central government. While this might be a fairer option for ratepayers, central government does not have any means to manage this risk, and this could be seen as unfair for taxpayers.

The Building Performance Guarantee Corporation

New Zealand has previously had a government provided insurance scheme for building defects. In 1977, the Building Performance Guarantee Corporation was set up with the aim of protecting homeowners from building defects from new builds. A key concern at the time was the cost of homeowners to pursue their legal rights.

The Building Performance Guarantee Corporation's general functions were to issue indemnities protecting and indemnifying owners of residential buildings against loss or damage from defects or deterioration of residential buildings, and make good such defects, damage or deterioration.

However, there were a number of concerns with the performance of the Building Performance Guarantee Corporation and its ability to achieve its objectives. These included:

- the high cost of claims and the availability of similar schemes in the private sector
- suggestions that the scheme was not established or operated on a sound actuarial basis and concerns about the government's potential contingent liability
- a high proportion of small claims with assessed liability of less than $500 (indicating builders leaving the finishing work and contract maintenance work uncompleted)
- builders and building companies refusing to carry out remedial work
- problems with builders and building companies refusing to co-operate in settling claims.

These concerns underline the potential moral hazard and fiscal risks discussed above. The *Building Performance Guarantee Corporation Act 1977* was repealed by the *Finance Act 1987* and the Building Performance Guarantee Corporation was disestablished.

Consultation with building and construction sector

In April 2019, as part of the Building System Legislative Reform Programme consultation, and the release of a discussion document, MBIE sought feedback from building sector stakeholders on a proposal requiring that a guarantee and insurance product for building defects be put in place for all residential new builds and significant alterations. In other words, making it a mandatory requirement, but one where homeowners could actively opt-out.

The majority of submitters supported a proposal requiring a guarantee and insurance product for residential new builds, with the most common reason that it would provide better protection for homeowners. It was not considered a solution to increasing building consenting efficiency nor improving building quality. However, there was wide-spread concern about the ability and capacity of the current insurance market to offer a viable quality product. Some described the market as 'immature' and 'underdeveloped'.

While many submitters supported the proposal for a mandatory guarantee and insurance product for residential new builds and alterations, there were significant concerns about the potential impact on the building sector, including that it may constrain the supply of builders and increase building costs. Other submitters considered there should be a greater focus on measures to lift the quality of building work to reduce the risk of defects in the first place.

Many submitters emphasised that any requirement for a guarantee and insurance product was reliant on successfully reforming the building sector first through implementing the other proposals in the 2019 discussion paper. Many considered better quality buildings and clearer roles, responsibilities and accountabilities will increase insurer confidence and enable insurers to make an informed decision about participating in the market.

Another regular comment from submitters was that a guarantee and insurance product is not the best way to respond to issues of building industry quality and performance, as it acts as the 'ambulance at the bottom of the cliff'.

Overseas experience and insights

A review of overseas residential building warranty insurance regimes highlights a wide range of different approaches, design features and levels of government involvement. For example, home building insurance schemes are mandatory in every Australian state except Tasmania.

Every Australian scheme, including schemes underwritten by government, are last resort schemes (except Queensland).

In contrast, all insurance warranty schemes in Canada are privately provided and are mandatory first resort schemes. And in five Canadian provinces, builders are required by law to provide home buyers with a third-party new home warranty. But in the rest of Canada new home warranties are voluntary. Likewise, in the United Kingdom the major providers are private sector, who mostly offer first resort warranty insurance products, and participation in warranty insurance schemes is voluntary.

Like New Zealand, most U.S. states have a set of statutory warranties that are implied in contracts. In these states, participation in warranty insurance plans is voluntary. It is up to the builder to decide whether to rely on that state's implied warranties, offer a written warranty of its own, or purchase a third-party warranty from an independent insurance company.

To the extent that the risk and liability of future building defects is transferred to an insurer (either public or private), there are strong incentives for the insurer to manage potential future liability. What can be seen from a close examination of different overseas insurance and warranty regimes are the different ways insurance providers manage risk and the prospect of pay-outs to homeowners. For example:

- tightly specified conditions where building work is deemed inadequate
- strict coverage exclusions
- maximum claim values
- conditions that exclude pay-outs for weathertightness issues
- terms of cover (from one year to 10 years).

There are also examples overseas where the insurer imposes strict conditions on building work through setting their own minimum building standards. These need to be satisfied before insurance cover is provided, and sometimes the standards exceed actual building regulatory requirements.

Obviously, the differences observed in overseas building insurance regimes reflect different jurisdictional contexts, legal frameworks, market dynamics and political economy trade-offs. For this reason, there needs to be caution when considering possible lessons in the New Zealand context.

A notable insight from Canada and Australia is that building permit approvals are not being granted any faster despite mandatory warranty legislation appearing to have removed some of the liability risk from building authorisation organisations at the local government level. Likewise, a review of mandatory building defects warranty and insurance legislation in the United Kingdom and Australian states also suggests that, on their own, mandatory policies are not a panacea for building quality problems. Consumer organisations in these jurisdictions have reported extensive complaints about the quality of new-build dwellings.

Policy position

There is a weak case for establishing a publicly provided insurance scheme for building defects after weighing up the costs, risks and potential benefits. The design of such schemes is complex, fraught with uncertainty and unintended effects, and presents a significant fiscal risk to the government that it is not best-placed to manage compared with the private market.

Risk allocation across the consenting model

Risk and liability settings differ depending on the type of building consent approval required (if any) and how this allocates responsibilities and accountabilities across industry participants. In 2021, the Government implemented reforms that improve the efficiency of consenting processes and pathways, support housing supply and improve housing affordability. At the same time, these new approval pathways also reallocate risk, responsibility and liability to other parties in the building system.

These reforms are:

New additions to the list of Schedule 1 Exemptions. The Building Act 2004 enables some types of building work to be exempt from requiring a consent. In 2021 this list was expanded to include larger buildings that are low risk. Building consent authorities do not oversee exempt work, and the risk and liability sits with the homeowner and tradespeople.

Kāinga Ora approved as an accredited building consent authority. Consentium is an independent consenting agency and is approved as an accredited building consent authority providing building consent services for residential state housing owned and retained by Kāinga Ora, excluding mixed tenure dwellings. In order to become registered, Consentium had to meet the standard adequate means test, which includes 10-year liability cover. This change will reallocate the risk and liability for consenting these types of houses from councils to Kāinga Ora, which will now perform the function of a building consent authority for its housing programme.

The introduction of the BuiltReady scheme. This provides a new certification scheme for prefab, offsite and modular components. Certification schemes provide assurance that the building product or method complies with the Building Code. This will increase consenting efficiency and limits both the consenting activities and liability on building consent authorities by shifting liability to the certification body and certified manufacturers.

Improvements to product certification (CodeMark). CodeMark is a product certification scheme that provides an assurance that the product complies with the Building Code. CodeMark places more liability on product certification bodies and product manufacturers, which reduces building consent authority liability for buildings that use products that have a CodeMark certificate. Changes to the CodeMark scheme are underway which aim to improve confidence in the scheme and increase uptake.

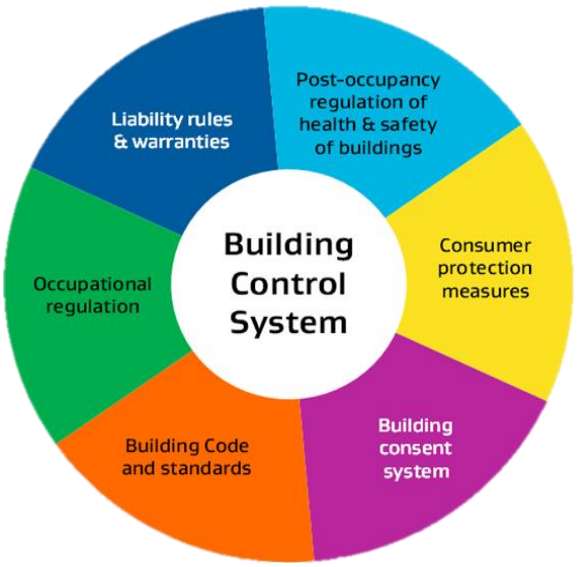
Increasing uptake of MultiProof. MultiProof is a national multiple use approval that enables building designs to be approved as compliant with the Building Code once, and then used multiple times at different sites. With MultiProof approvals, building consent authority liability is limited to the scope of their involvement - usually site-specific considerations. There is an opportunity to actively promote uptake of MultiProof, which has been relatively low to date.

Together, these reforms will deliver meaningful improvements in the performance of the building control system and the efficiency of different pathways for consenting approval, particularly in the way new, innovative, and efficient building methods are supported. At the same time, these reforms effectively reallocate risk across the system to where it is best placed to be managed, thereby reducing the chance of things going wrong during and after the building process.

Strategic direction: a whole-of-system approach to risk and liability in the building sector

A whole-of-system perspective to risk and liability in the building sector takes into account and leverages the many elements of the building control system, with the aim of getting building work right first time (figure 1). Therefore, risk management in the building system focuses on ensuring inputs into the building process are high quality, rather than focusing on liability and culpability when things go wrong. The focus is on strengthening the incentives, accountabilities and behaviours of industry participants to enable efficient consenting, quality building, improved sector capability, and positive outcomes for homeowners.

Figure 1: Building control system: key elements



There has been, and continues to be, active reform of the building regulatory control system across all these elements. This reform programme started following the weather-tightness issues that emerged in the 1990s and the systemic failure in the building industry.

Appendix 1 provides an overview of the reforms implemented, underway and proposed that strengthen the institutions, laws, processes and formalities that underpin the building regulatory control system. These reforms aim to get building work right first time. Together, they lower the potential liability risk in the sector and, importantly, mitigate the potential for systemic failure in the building industry in the future.

Key focus: building system reforms

The Building System Legislative Reform Programme commenced in 2019, with the overarching focus to lift the efficiency and quality of building work and provide fairer outcomes if things go wrong. Past reforms and progress made on the Building System Legislative Reform Programme has provided a strong base to deliver bigger and better system improvements. The Government's future whole-of-system approach will focus on the following.

Strengthening occupational regulation

The Government is making reforms to the way building and construction sector professionals are regulated. The objectives of occupational regulation reform are to ensure that:

- practitioners are providing services with reasonable care and skill
- practitioners are operating within their areas and levels of expertise
- practitioners can be held accountable for substandard work and poor behaviour
- regulation is proportionate to the risks to public safety and wellbeing.

The initiatives that sit under this piece of work include:

- a new, two-tier regulatory regime for engineers
- strengthening the licensed building practitioner regime
- improving the operation of the plumbers, gasfitters and drainlayers regime and the electrical workers regime
- a review of the occupational regulation regime that applies to registered architects.

Consumers and regulators need to be able to rely on the work of building and construction professionals. Strong and appropriate regulation of the building and construction sector's professions leads to increased trust and confidence that practitioners are competent and their work will be free of defects or, if things do go wrong, they will take responsibility for putting it right.

Strengthening consumer protection

The Government is evaluating consumer protection outcomes in the building and construction sector. The objectives of this work are to:

- improve the way consumers manage their own risks in the building process
- provide the right protections, so consumers are not bearing the risks of others
- improve access to ways to hold poor practitioners to account.

An evaluation of consumer protection was completed in 2022, and found:

- consumers can't easily access and understand information on their rights and practitioner obligations
- use of written contracts is high, but less likely to be used for renovations; contracts can be complex and weighted towards the practitioner
- seeking redress is difficult, complex and costly, which allows some practitioners to avoid accountability.

Following the evaluation, MBIE is developing a proactive information and education campaign for consumers and practitioners as well as considering potential regulatory changes to improve the existing consumer protection mechanisms in the Building Act.

It is appropriate that building professionals and regulators take most of the responsibility for good building work - they are the experts. Consumers have a role to play by making sure they choose competent people to do building work and hold to account those who perform poorly. It is important that consumers are empowered and have access to the right information, tools and processes to do these things.

Modernising the building consent system

The Government is currently undertaking a first-principles review of the building consent system. The aim of the building consent system review is to modernise the system to provide assurance to building owners and users that building work will be done right first time, thereby ensuring that buildings are well-made, healthy, durable and safe.

The review is investigating the building consent system from the commissioning of building work through to the issuing of a code compliance certificate. It will examine how the:

- regulatory regime is structured and the institutional arrangements
- regulatory requirements are implemented by various people involved in building work
- how the overall building consent system is managed.

Everyone connected with buildings and building work - such as owners, developers, product suppliers, designers, builders and regulators - relies on the building consent system to ensure buildings are safe, durable and comply with the Building Code. It is important that the building consent system meets their expectations.

Appendix 1: Reform strengthening the building control system

Building consent system

Building consent authority institutional form, governance and processes

Introduction of MultiProof approvals (2009). MultiProof is a national, multiple-use approval that enables building designs to be approved as compliant with the Building Code once and then used multiple times at different sites.

New additions to the list of Schedule 1 Exemptions (2020). The Building Act 2004 enables some types of building work to be exempt from requiring a consent. This list was recently expanded to include larger buildings that are low risk.

The Building Amendment Act 2012 introduced a risk-based consenting approach. These changes provided for a streamlined consenting process for low-risk building work and a more rigorous process for complex and commercial work. In approving these amendments to the Building Act 2004, Cabinet set a number of conditions that must be met before risk-based consenting could be implemented. Those conditions have not yet been met, and the scheme remains dormant in the Building Act 2004.

MBIE is undertaking a first-principles review of the building consent system. The aim of the building consent system review is to modernise the system to provide assurance to building owners and users that building work will be done right first time, thereby ensuring that buildings are well-made, healthy, durable and safe.

Building consent authority capability and capacity

Introduction of the Building Consent Authority Accreditation Scheme (2006), requiring building consent authorities to meet specific standards to be accredited. This aims to ensure that building consent authorities can carry out their consenting function to a high standard. Performance of their consenting function is periodically audited. Building consent authorities must have specific policies and procedures in carrying out their building control function, as well as specific education and skill requirements (2006).

Kāinga Ora approved as an accredited building consent authority. An independent agency, Consentium, was established and registered to provide building consent services to Kāinga Ora, with an initial focus is on basic consents and is restricted to residential state housing owned and retained by Kāinga Ora (excluding mixed tenure dwellings). The scope of Consentium's consenting operation is to be expanded to include complex consents (2021).

Building Code and standards

Quality building standards that are effectively monitored and enforced

The introduction of the Building Act 2004 repealed the Building Act 1991 and introduced substantive changes to the law governing building work. The changes were introduced in stages between 2005 and 2012.

The objective of the Building Act 2004 is to "design and build it right first time" through improving the control of, and encourage better practices in, building design and construction to provide greater assurance to consumers, including:

- setting clear expectations of the standards buildings should meet
- guidance on how to meet those standards
- more certainty that capable people are undertaking design, construction and inspection
- scrutiny of the building consent and inspection process
- protection for homeowners through mandatory warranties.

The Building Act 2004 has been subject to reviews and amendments since its introduction to make technical adjustments and introduce improvements in building controls for the sector.

An annual Building Code maintenance programme is undertaken to ensure effective management of the Building Code and its documents (such as the development of standards). This can include updating Building Code regulation, Acceptable Solutions, Verification Methods and published guidance information.

Building product and process certification schemes

The introduction of the BuiltReady Modular Component Manufacturer scheme, which provides a new certification scheme for prefab and modular components. Certification schemes provide assurance that the building product or method complies with the Building Code. This will also increase consenting efficiency (2022).

Introduction of CodeMark, a building product certification scheme that provides assurance that building products or method comply with the Building Code (2008).

The CodeMark scheme has been strengthened to improve confidence in the scheme and increase uptake (implemented 2022-2023).

Occupational regulation

Licensed Building Practitioners Scheme was introduced, setting out standards and skills required to carry out or supervise certain types of building work (2007).

Restricted building work regime was introduced, requiring certain residential building work can only be carried out or supervised by a Licensed Building Practitioner (2012).

The Licensed Building Practitioner Scheme is being strengthened, which will include the introduction of a code of ethics to establish clear and concise behavioural expectations and standards, amendments to licensing processes and improvements to complaints and disciplinary processes (2021-2023).

Further reforms to the Licensed Building Practitioner Scheme are being examined, with a focus on the structure of the licence classes.

Cabinet agreed to establish a new regulatory regime for engineers, including the introduction of a code of ethics, raised competency standards and strengthened administration and disciplinary functions (2022).

A statutory review of the regulatory regime for plumbers, gasfitters and drainlayers has been completed and reforms are proposed (2021).

Liability rules and warranties

Introduction of implied warranties provided for in the Building Act 2004. These are automatic, apply for 10 years from the build date (including a 12-month defect repair period) and cover almost all aspects of building work. They apply regardless of whether there is a written contract.

Government agreement to the Law Commission inquiry recommendation that joint and several liability remain the liability rule for the building and construction sector, and more generally (2014).

Consumer protection measures

Building professional information disclosure requirements

Requirements for a written disclosure of certain information from the prospective building contractor, prior to an offer of contract (2015).

Requirement for a written contract for residential building work above $30,000 in value (2015).

Requirement for building contractors to provide consumers with any critical information on product maintenance and documentation of key product warranties at the completion of building work (2015).

Disputes resolution processes and information and education

The Government is currently evaluating the consumer protection measures in the Building Act 2004 and supporting disputes procedures. This review will determine if these measures are working as intended, the extent homeowners are aware them, are fit-for-purpose and identify any necessary improvements to better achieve objectives (2022-2023).

Amendments to the Construction Contracts Act 2002 to enable parties to residential construction contracts to better use the Act to resolve building disputes (around 2015).

Post-occupancy of health and safety of buildings

Introduction of earthquake-prone building system to addresses seismic risk for the most vulnerable buildings, or parts of buildings, across Aotearoa New Zealand (Building (Earthquake Prone Building) Amendment Act 2016.). It imposes obligations on territorial authorities to identify, and building owners to then remediate, these buildings to help protect people from the life safety risk posed in a moderate earthquake.

Introduction of Residential Earthquake-Prone Building Financial Assistance Scheme in 2020. Supports residential owners of earthquake-prone buildings that are in financial hardship through.

MBIE's Seismic Work Programme aims to ensure there is a comprehensive approach to incorporating new seismic risk knowledge into the building regulatory system, and to ensure that seismic risk is managed effectively in new and existing buildings.

Residential Tenancies (Healthy Homes Standards) Regulations 2019 - The healthy homes standards introduce specific and minimum standards for heating, insulation, ventilation, moisture ingress and drainage, and draught stopping in rental properties.