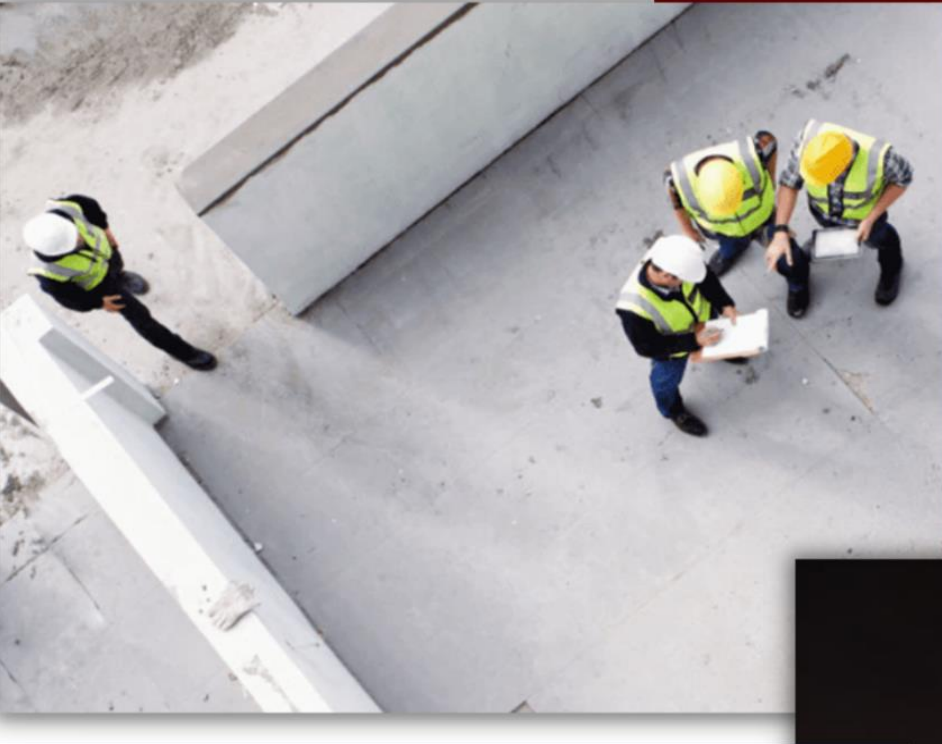


# “The Owners Corporation’s Inherent Defects Insurance Policy”



## Newsletter

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**CRISP**  
**LAW**

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## **“The Owners Corporation’s Inherent Defects Insurance Policy”**

### **1. Introduction**

An interesting development is the emerging market for “defects” insurance. In summary, it is claimed to be an insurance product (and taken from the Product Disclosure Statement) which provides “cover” for physical damage due to an Inherent Defect arising within 10 years of Completion of the Works.

Given that a number of our newsletters during 2022 have been looking at the Design and Building Practitioners Act 2020 (DBP Act) and Residential Apartment Buildings (Compliance and Enforcement Powers) Act 2020 (RAB Act), it is timely for us to assess this new insurance “product” against the promises made.

The media is almost hyperbolic for this supposed genuine alternative to the infamous “developer bond scheme”. (The “2 %” bond the Developer must make available to the Owners Corporation for so called “rectification of defective building work identified in the final report”).<sup>1</sup> It was stated in the AFR on 9 October 2022 that: “The new product, which will cover defects such as waterproofing and structural faults for the first ten years after completion is an alternative to the “strata bond” and “They now have insurance protection for 10 years after they take possession that the building will be structurally sound”.<sup>2</sup>

In this Newsletter we look at the claims made about the supposed new insurance product against the policy wording. You will see that despite the claims made, the policy covers are very deficient.

To explain the views expressed in this Newsletter it is necessary to ‘recap’ on the entitlements and liabilities under the existing Acts and we do so below.

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<sup>1</sup> Strata Scheme Management Act 2015 ss 207(3), 210(1). Under s190 “Defective Building Work” means building work that is done in such a way that it would constitute a breach of a statutory warranty under the HB Act, or such a breach if the building work were residential building work.

<sup>2</sup> “Insurers come back to NSW apartment construction” 9 October 2022 - by Michael Bleby.

## 2. The Insurance Cover for “Inherent Defects”

As to the policy cover and how structured, the Contractor needs to have obtained a “Technical Inspection Certificate” (Interestingly the building experts are retained by the Insurer) and a Certificate of Practical Completion. The cover is for an “Inherent defect”.<sup>3</sup>

The ‘cover’ is for the cost of the physical damage to the premises directly affected to relieve the effects of the Inherent Defect. An Inherent Defect is defined as “defect in the Structural Works or the Envelope... due to a defect in design plan specification workmanship or materials...” Structural Works are defined as all internal and external load bearing structures and the Envelope as the external walls and roof but not external cladding.

It would appear that the essential difficulty with the policy is the test of an “Inherent Defect” causing the required “physical damage” or threat of imminent collapse. Under the Home Building Act 1989 (HB Act) and RAB Act the relevant test(s) (said cumulatively) are a failure to comply with the BCA or defects in a building product or building element preventing proper use (ie occupation) or the use of a building product in breach of the Building Products (Safety) Act 2017. It is the failure to meet the statutory obligation that enables the cause of action without the additional step of the breach having caused “physical damage” or the threat of imminent collapse. There is no “wriggle room” for misinterpretation of cover under the policy given that cover is expressly limited to: “to relieve the effects of the Inherent Defect directly causing the said physical damage”.

An exclusion from cover is the impact of water from defective waterproofing. The “PDS” says that an Endorsement is available for “Ingress of water” but then cover is limited to post “after 12 months” and does not cover a “basement”. Further, even if the Endorsement is obtained, again there must have occurred property damage to “trigger” the “cover”.

Relevant to our assessment and this newsletter is that “Additional Benefits” include consultants fees incurred but not the “preparation of claims including any estimation of costs”. Noting this is a significant risk for the Owners Corporation given they then have this item as a cost transferred to them.

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<sup>3</sup> In summary any defect in the Structural Works and/ or in the Envelope. There is no cover for “Waterproofing” (We return to this item below). The cover is for the Owners Corporation or Strata Scheme.

### 3. “Building Elements” under the Design and Building Practitioners Act 2020

Our starting point of the entitlements and liabilities under the existing Acts is the “building elements” under the DBP Act.

Section 6 defines building elements as including:

- The fire safety systems for a building within the meaning of the *Building Code of Australia (BCA)*;
- Waterproofing;
- An internal or external load-bearing component of a building; and
- Those aspects of the mechanical, plumbing and electrical services for a building that are required to achieve compliance with the *BCA*.

The full definition of “building element” under s6 is at Schedule 1 to the Newsletter.

As we all are familiar, a design practitioner must prepare a design compliance declaration for any building element it designs which states whether the regulated design prepared for the building work complies with the requirements of the *BCA*.<sup>4</sup> A building practitioner must issue a compliance declaration stating that the final building, including any variation, complies with the *BCA*.<sup>5</sup>

When compared to the requirements of the DBP Act, the cover is well short given it is not for all building elements. As well, it fails to respond to a breach of the *BCA* requiring rectification work.

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<sup>4</sup> Ibid; Design and Building Practitioners Act 2020 s12.

<sup>5</sup> Legislative Assembly Hansard – 23 October 2019 “Design and Building Practitioners Bill 2019” page 5.

#### **4. Home Building Act 1989**

Limiting the present review of the RAB Act to “water proofing” the definition of “major element” includes “waterproofing”. This does not, however, mean that any, or all, defects involving an imperfection in the system of waterproofing of a building is a “major defect”.<sup>6</sup> The extent to which a defect in the waterproofing system of a residence impacts on habitability or the integrity of the building needs to be proved by the proponent of a “major defect”. In *Dodd v Balmain Project Group Pty Ltd*<sup>7</sup> the Tribunal stated that the roofing system is a major element of a building within the definition of s18E(4) by being part of the waterproofing.

Section 18E(4) of the DBP Act is at Schedule 2 to the Newsletter.

When compared to the requirements of the HB Act, the policy cover is deficient particularly as to waterproofing systems of any building.

#### **5. “Serious defect” under the Residential Apartment Buildings (Compliance and Enforcement Powers) Act 2020**

The Second Reading Speech<sup>8</sup> states that Part 1, Clause 3 of the RAB Bill defines a serious defect as “a defect in a building element that is attributable to a failure to comply with the performance requirements of the BCA, the relevant Australian Standards or the relevant approved plans”.<sup>9</sup>

The definition of “serious defect” under s3 is at Schedule 3 to the Newsletter.

Whilst, the insurance policy covers the resultant physical damage, the RAB Act does not need any physical damage to be proven, just the breach of the BCA. Additionally, under a “s28 Undertaking” the Developer or Builder has the obligation to complete rectification works as determined by an independent party. All costs of the processes and the costs of rectification are “guaranteed” by the security monies provided.

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<sup>6</sup> *Stevenson v Ashton* [2019] NSWCATAP 67, 69.

<sup>7</sup> [2021] NSWCATCD 82 [at 48].

<sup>8</sup> The Hon. Damien Tudehope (Minister for Finance and Small Business), Second Reading Speech, Thursday, 4 June 2020, page 2376.

<sup>9</sup> *Ibid.*

## 6. Conclusion

As an initial comment and given cover is limited to “physical damage”, relying upon the policy amounts to a huge compromise against the entitlements provided by the current Acts which compel rectification upon identification of a breach of the BCA. As such the media support for defects insurance is unjustified. It is hard to see why the cover is better for a Strata Scheme given that the Owners don’t have access to a fund to meet the costs of investigative reports identifying the breaches of statutory warranties and also reports which detail the rectification works required. Also, given that waterproofing is such a large percentage of all complaints the policy cover is improbably limited and hence incomplete.

Perhaps most troubling is that the policy cover fails or indeed ignores the comprehensive list of “building elements” the subject of warranties under the DBP Act, RAB Act and HB Act.

Given the real and significant gaps in cover, any Owners Corporation is well advised to either continue to prosecute its claims or if possible, to obtain the benefit of a s28 Undertaking (under the RAB Act) rather than relying upon defect insurance.

Equally from a Contractors’ viewpoint, it is required to fund the premium for the insurance but given the “Complainants” options and for the reasons explained above, the Contractors will be sued for its defective building works. (This is unless the Developers bond is sufficient, or the Developer is bound by a s28 Undertaking). It then must be asked, why then pay the premium?

There is another alternative source of insurance which has been the subject of a Ministerial Advisory Panel, the so called “Decennial liability insurance”. The Panel’s report as to a decennial liability insurance scheme will be explored in a forthcoming newsletter.

**“Schedules to the Newsletter “**

**Schedule 1: Excerpt from the “Design and Building Practitioners Act 2020 (NSW)”**

**Section 6 - Building elements**

- (1) For the purposes of this Act, *building element* means any of the following—
- (a) the fire safety systems for a building within the meaning of the BCA,
  - (b) waterproofing,
  - (c) an internal or external load-bearing component of a building that is essential to the stability of the building, or a part of it (including but not limited to in-ground and other foundations and footings, floors, walls, roofs, columns and beams),
  - (d) a component of a building that is part of the building enclosure,
  - (e) those aspects of the mechanical, plumbing and electrical services for a building that are required to achieve compliance with the BCA,
  - (f) other things prescribed by the regulations for the purposes of this section.
- (2) The regulations may exclude things from being building elements for the purposes of this Act.
- (3) In this section—
- above grade wall* means a wall above the level of the ground surrounding a building.
- below grade wall* means a wall below the level of the ground surrounding a building.
- building enclosure* means the part of the building that physically separates the interior environment of the building from the exterior environment, including roof systems, above grade and below grade walls (including windows and doors).



## Schedule 2: Excerpt from the Home Building Act 1989

### Section 18E(4)

*major defect* means—

- (a) a defect in a major element of a building that is attributable to defective design, defective or faulty workmanship, defective materials, or a failure to comply with the structural performance requirements of the National Construction Code (or any combination of these), and that causes, or is likely to cause—
  - (i) the inability to inhabit or use the building (or part of the building) for its intended purpose, or
  - (ii) the destruction of the building or any part of the building, or
  - (iii) a threat of collapse of the building or any part of the building, or
- (b) a defect of a kind that is prescribed by the regulations as a major defect, or
- (c) the use of a building product (within the meaning of the *Building Products (Safety) Act 2017*) in contravention of that Act.

### Note—

The definition of *major defect* also applies for the purposes of section 103B (Period of cover).

*major element* of a building means—

- (a) an internal or external load-bearing component of a building that is essential to the stability of the building, or any part of it (including but not limited to foundations and footings, floors, walls, roofs, columns and beams), or
- (b) a fire safety system, or
- (c) waterproofing, or
- (d) any other element that is prescribed by the regulations as a major element of a building.



### **Schedule 3: Excerpt from the Residential Apartment Buildings (Compliance and Enforcement Powers) Act 2020**

#### **Section 3 - Definitions**

- (1) In this Act—
- approved plans*, in relation to building work, means the following—
- (a) approved plans and specifications issued with respect to a construction certificate or complying development certificate for the building work under the *Environmental Planning and Assessment Act 1979*, together with any variations to those plans and specifications for the purposes of those certificates effected or approved in accordance with that Act,
  - (b) regulated designs under the *Design and Building Practitioners Act 2020*,
  - (c) any other plans prescribed by the regulations for the purposes of this definition.

*Building Code of Australia* has the same meaning as in the *Environmental Planning and Assessment Act 1979*.

*Building Commissioner* means the Building Commissioner referred to in section 61.

*building element* has the same meaning as in the *Design and Building Practitioners Act 2020*, and includes any element of a building that is prescribed by the regulations for the purposes of this definition.

*building product* means any product, material or other thing that is, or could be, used in a building.

*building work*—see section 5.

*building work rectification order*—see section 33.

*class of building* means a building of that class as recognised by the *Building Code of Australia*.

*completion*, in relation to building work, means the date that the occupation certificate for the building or part of a building to which the building work relates was issued.

*Department* means the Department of Customer Service.

*developer*—see section 4.

*expected completion amendment notice*—see section 8.

*expected completion notice*—see section 7.

*expected date*—see section 7(2).

*function* includes a power, authority or duty, and *exercise* a function includes perform a duty.

*occupation certificate* means an occupation certificate issued under the *Environmental Planning and Assessment Act 1979*.

*owners corporation* for a strata scheme means the owners corporation for the strata scheme constituted under the *Strata Schemes Management Act 2015*.

*prohibition order*—see section 9.

*rectification bond*—see section 28.

*residential apartment building* means a class 2 building within the meaning of the *Building Code of Australia*, and includes any building containing a part that is classified as a class 2 component, but does not include any building or part of a building excluded from this definition by the regulations.

*Secretary* means the Secretary of the Department.

*serious defect*, in relation to a building, means—

- (a) a defect in a building element that is attributable to a failure to comply with the performance requirements of the *Building Code of Australia*, the relevant Australian Standards or the relevant approved plans, or
- (b) a defect in a building product or building element that—
  - (i) is attributable to defective design, defective or faulty workmanship or defective materials, and
  - (ii) causes or is likely to cause—
    - (A) the inability to inhabit or use the building (or part of the building) for its intended purpose, or
    - (B) the destruction of the building or any part of the building, or
    - (C) a threat of collapse of the building or any part of the building, or
- (c) a defect of a kind that is prescribed by the regulations as a serious defect, or
- (d) the use of a building product (within the meaning of the *Building Products (Safety) Act 2017*) in contravention of that Act.

*stop work order*—see section 29.

*strata building* means a building containing a lot or part of a lot that is the subject of a strata scheme.

*strata plan* has the same meaning as in the *Strata Schemes Development Act 2015*.

*strata scheme* has the same meaning as in the *Strata Schemes Development Act 2015*.

**Note—**

The *Interpretation Act 1987* contains definitions and other provisions that affect the interpretation and application of this Act.

(2) Notes included in this Act do not form part of this Act.