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Précis Paper

Strata Law: Major Defects and Work Orders

Changing interpretations of defect and work orders in NSW building law.

Discussion Includes

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Précis Paper

Major Defects and Work Orders

1. **In this edition of BenchTV, Paul Jurdeczka, Partner Chambers Russell Lawyers, Sydney and Carlos Mobellan, Barrister, Third Floor St James Hall Chambers, Sydney discuss major defects and work orders in cases under the *Home Building Act 1989 No 147* (NSW).**

Core Idea 1

2. **Examination of the development of major defect under the *Home Building Act 1989 No. 147* (NSW).**

Core idea 2

3. **The application of work orders and money orders in NSW.**

Definition of major defect

4. **The important section is s 18E of the *Home Building Act 1989 No. 147* (NSW) which legislates and regulates home building in NSW. The definition was brought in, with retrospective effect to a certain degree, in 2015.**
5. **Section 18E(4) has two parts, the first part is:**

> **'a major defect is a defect in a major element of a building that's 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 [which replaced the Building Code of Australia recently] or any combination of these and that causes, or is likely to cause:**
>
> **[and this is usually the one that tends to come up]**
>
> **the inability to inhabit or use the building or part of the building for its intended purpose or the destruction of the building or any part of the building [which is getting pretty severe] or a threat of collapse of the building or any part of the building [which again is pretty severe but Opel tower, Mascot Towers have been in the news recently] or the use of any building product (within the meaning of the *Building Products (Safety) Act 2017*) in contravention of that Act.'**

which gets into flammable cladding which has been a hot topic over the last couple of years.

6. **The second part of this definition is it needs to be a major element:**

> **'major element of a building means 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 a fire safety system, or waterproofing, or any other element that is prescribed by the regulations of a building.'

7. **There's essentially two parts here: Is it in a major element.? And does it meet the threshold of being a major defect which means a certain threshold of being major or being significant or being serious. That's relevant because s 18E is essentially a limitation period provision and the Act says that for contracts entered into or work started where there's no contract on the 1st of February 2012 the old seven-year warranties for all defects were changed.**
8. **Contracts and works done from that point on had a different set of warranties. It was six years from completion for major defects and two years from completion for everything that wasn't a major defect and usually that's referred to as a non-major defect or a minor defect.**
9. **It's not a defined term but that tends to be used because it's not major. It can be quite significant and costly despite the fact that it's not a major defect. It's quite an artificial definition. For example, a recent matter had problems with hot water pipes in a block of over 100 units and they cost over 1 million dollars to rip out and replace. That was dealt with under the old seven-year warranties but if it had had been dealt with under the new scheme it would not have been a major defect because hot-water pipes are not a major element.**
10. **It can be quite a challenge to try and explain to clients that minor and major defects are very artificial definitions and what they think is major or minor isn't necessarily what the Act would say is major or minor. It's very important to knowing when they have to sue by because that will often force them to protect their rights by commencing proceedings.**
11. **People are coming to lawyers and asking for advice. We have to be very aware of those definitions and how they operate, and that this definition of major defect was only introduced relatively recently but it does have a historical legislative background that predates introduction.**

<u>Retrospective definition of major defect</u>

12. **It was applied retrospectively. For contracts and work starting from the 1st of February 2012 warranties given by the builder or developers or subcontractors were in these terms. But when they first did this they had a definition of structural defect which was in place for three years until 2015 and they changed that retrospectively. The case of *Ibrahim v Paragon Constructions (NSW) Pty Ltd; Paragon Constructions (NSW) Pty Ltd v Ibrahim* [2016] NSWCATCD 66 dealt with whether it went even earlier because some lawyers argued the Act wasn't clear enough but that was rejected.**
13. **Prior to 2012 there was a definition for home warranty insurance going back as far as July 2002 and there was a disparity between the statutory warranties under which consumers could sue builders, developers and subcontractors as opposed to their ability to claim under the home warranty insurance that insured it.**

14. From 2002 through to 2012 consumers could sue the builders, developers and subcontractors under the seven-year warranties for all defects but the insurance in July 2012 became what was called last resort insurance where the claim couldn't be made until the builder was dead, disappeared or insolvent or their license after a certain point had been suspended because of a building order. They had this concept of a structural defect that was in place from 2002 to 2012.
15. In 2012 warranties also took on that concept for limitation periods. In 2015 the government saw fit to retrospectively change that back to 2012 for those contracts.
16. The concept of different types of defects goes back as far as 2002. There is a long background of trying to grapple with this concept and what it means and it has changed over time and retrospectively.

<u>Court interpretation of structural defects</u>

17. Justice Stevenson got the chance to answer the question of what structural defect means
18. in 2017, 2 years after the major defect definition came in, in the case of *AAI Ltd t/as Vero Insurance v Kalnin Corporation Pty Ltd; Kalnin Corporation Pty Ltd v AAI Ltd t/as Vero Insurance* [2017] NSWSC 548.
19. That was an unusual case, it was not an owner or owners corporation suing a builder or developer. It was a recovery action run by Vero Insurance to try and recover some monies they paid by way of an indemnity under a home warranty insurance policy.
20. Justice Stevenson had to look at the definition of structural defect as it stood for that case. The two major significant differences were whether it was a structural defect - was it big and bad and mean enough - because at that time they had a threshold 'if it resulted in or likely to result in physical damage to the building, or part of the building'. That's a lower threshold than an inability to use part of the building.
21. And the structural elements, what became major elements, were different - you had the internal or external load bearing part but the only other part was any component including weatherproofing that forms part of the external walls or roof of the building. He summarised at para 93:

> ' For those reasons, my conclusion is that, on the proper construction of reg 57AC(2)(a):
>
> (1) for a "component" of a building (whether that component be foundations, floors, walls, roofs, columns, beams, or any other component) to be a "structural element" of the building for the purposes of reg 57AC(2)(a) it must be "load-bearing" such as to be "essential to the stability of the building" or any part of it;
>
> (2) building elements (such as waterproofing membranes, tiling and the like) attached to such load-bearing components will not themselves comprise a part of such component, unless they are designed or intended to, and in fact, promote the bearing of load.'

22. Justice Stevenson has taken a narrow, more black letter reading and we end up with a much narrower set of protections. And we're seeing now that the consumer protection regime isn't as good as consumers thought they had and perhaps the government thought they had provided, These are some of the issues we're having to look at - how do we widen those consumer protections? Cases like this took quite a narrow reading and now we're having to deal with limited rights in some cases that owners have to pursue these defects.
23. The amendments that took place in 2016 changing the definition of structural defects and major defect have incorporated some of these concerns about waterproofing and fire safety defects. A handful of cases since provide a little more guidance: one, in June last year is ***Stevenson v Ashton*** [2018] NSWCATCD 25, which went to appeal in ***Ashton v Stevenson; Stevenson v Ashton*** [2019] NSWCATAP 67.

<u>Testing expert examinations</u>

24. When you go into evidence about these major defects, or non-major defects if you're having an argument about which one they are, you need to get down to the nitty gritty of those definitions and meet that onus of proof from the point of view of the applicant. The danger is sometimes for some practitioners and experts things can become almost trite or unspoken - at the end of the day you have to assume the judge you go in front of will be very rigorous and say, 'where do you prove it?'.
25. Whether it meets the definition of a major defect is a mixture of both expert opinion and legal argument. The danger is sometimes clients and lawyers will look to the experts and say is it a major defect and rely completely on them. The lawyer has to be prudent and apply rigorous testing to an expert's examination. Put a series of carefully framed questions to the expert when they're being briefed and when they're being asked to provide their report and then when they give their reasoning. Have they set out their process of reasoning whereby they explain how they get to their conclusion that it is a major defect? The genesis of part of the problem may very well be in the letter of instruction to the expert themselves. Say: 'I think they're a major defect because of a, b, and c.'

<u>Fire safety defects as major defects</u>

26. ***The Owners-Strata Plan 89023 v AT Building Pty Limited and Mowbray Road Pty Limited as trustee for Mowbray Unit Trust; Jayanthi and Shikaram v AT Building Pty Limited and Mowbray Road Pty Limited as trustee for...*** [2018] NSWCATCD 33, a useful case to provide guidance, dealt with the issue of a fire safety system in the context of being a major defect.

    63. The Tribunal is satisfied that a fire safety system is made up of individual components that need to be complied with in order to provide a fire safety system,

any one of which could cause a failure of the fire safety system. The individual defects identified as involving fire safety are major defects for the purpose of the HBA as they together form the fire safety system.

27. A similar argument might be made with waterproofing – see 62.

Cases on limitation and major defects

28. *David Cameron Jones t/as Oz Style Homes v Panchal* [2018] NSWCATAP 238 wrestled with the issue of major defects/ non major defects being in or out of time.

29. Another case handed down in January this year was *Vella v Mir* [2019] NSWCATAP 28. This is useful if you're operating in the Tribunal. Section 18E is essentially a limitation provision – are you in time or not for major defects? A limitation defence will be something for defendants to raise, it's usually not something for the plaintiff to show in evidence. The Tribunal has taken the attitude they need to show they have jurisdiction – so are you in time? *Vella v Mir* was important for limitations, defences pleadings, jurisdictions, how you will frame your case as an applicant or defendant, when you're looking at s 18E and whether they're major defects or not.

30. It also wrestles with expert evidence. In paragraph 59:

> 'Expert evidence is clearly relevant to whether a claimed defect is in a major element of a building and whether it meets the definition of a major defect in s 18E(4). However, it is not determinative of the issue.'

31. The member in that case was critical that the experts had not explained their reasoning why it was a major defect. At paragraph 62:

> 'We are not satisfied that Mr Zakos' opinion alone or in conjunction with Mr Capaldi's unreasoned agreement with Mr Zakos was a sound basis on which to conclude that particular items constituted major defects. We conclude that the Tribunal fell into error by characterising s 18E as a limitation defence not properly pleaded by the Vellas.'

32. *Hanna v Kersten; Kersten v Hanna* [2019] NSWCATCD 26 went the other way and seemed to accept the evidence of experts without the scrutinising that went on in *Vella v Mir*.

33. If you want to be safe prepare your cases with these decisions in mind.

34. Three points to note: there's a statutory definition of completion - actually two - s 3B(3) and s 3C of the *Home Building Act 1989 No. 147* (NSW); limitation may be raised as a preliminary issue; and procedural fairness – if an issue is not raised by the parties but by the Tribunal member typically as a matter of procedural fairness the Tribunal should provide the parties the opportunity to make further submissions.

Work orders versus money orders

36. The context starts with *the Home Building Act*. Essentially the Act gives a statutory cause of action to homeowners and strata plans to sue both original builders and developers under the

Act basically for compensation to rectify defects in a building. The Act provides for money orders and for work orders, that is, an order that a builder does work. The important part is that under the *Home Building Act* a provision was introduced in 2014 that made work orders the preferred outcome.

Statutory warranties for homeowners

37. The Act gives homeowners the benefit of statutory warranties implied into every building contract that applies under the *Home Building Act* so those warranties apply whether that's a contract between a builder and an owner or an owner and an original builder under s 18D. They also apply in relation to claims against developers who haven't done the work but they're taken under a notional contract to have done the work under s 18C.

38. The Tribunal is mandated to deal with those building claims under $500,000.

Rectification preferred outcome

39. Two major changes in 2014 were the introduction of s 48MA and s 18BA. Section 18BA simply codified the common law position regarding mitigation. It also codified the common law position that the builder has not only the obligation to come back and rectify defects but also has the right to do those things and that a strata plan or homeowner must within six months of becoming aware of a defect invite the builder back. They can't wait until the defect has become worse. And s 48MA:

> 'Rectification of defective work is the preferred outcome in proceedings
> A court or tribunal determining a building claim involving an allegation of defective residential building work or specialist work by a party to the proceedings (the responsible party) is to have regard to the principle that rectification of the defective work by the responsible party is the preferred outcome.'

One of the key outcomes is that it is not a mandatory outcome, it's an objective test,

BIOGRAPHY

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Paul practises in commercial litigation and dispute resolution with a focus on building and construction, insurance and strata. He was admitted in 1999 and has extensive experience in home building and home warranty insurance defects matters.

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Carlos specialises in building cases with an emphasis on matters arising under the *Home Building Act 1989* (NSW), the *Building and Construction Industry Security of Payment Act 1999* (NSW) and the *Strata Schemes Management Act 2015* (NSW). Carlos was admitted as a solicitor in 1997 and was called to the Bar in 2004 where he was awarded the Bar Practice Course prize. Carlos has appeared for and against homeowners, Owners Corporations, builders, government agencies and property development companies.

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