



Précis Paper

Residential Construction Defects

A discussion of the *Home Building Act 1989* (NSW) and its application to construction contracts, residential rectification works and liability periods.

Discussion Includes

- The difference between defects liability period and statutory warranty
- Completion and practical completion
- To pay or to rectify
- Claims by owners
- The *Home Building Act* and its application to rectification works
- The fit for purpose warranty
- Contract for rectification works
- How does the position in NSW differ from other jurisdictions?

Précis Paper

Residential Construction Defects

1. In this edition of BenchTV, Garth Campbell (Barrister – 5 Wentworth Chambers, Sydney) and Christine Jones (Partner – Holding Redlich, Sydney) discuss the *Home Building Act 1989* (NSW) and its application to construction contracts, residential rectification works and liability periods.

The difference between defects liability period and statutory warranty

2. The *Home Building Act 1989* (NSW) has a particular impact on residential construction work however its impact on rectification works is not very clear.
3. Both the defects liability period and the statutory warranty period contained in the *Home Building Act* are considerations for the builder making the decision to pay for or to rectify a defect.
4. The contract provides for the defect liability period which provides a contractual mechanism to force the builder to come back and fix their work.
5. However, in the larger scheme of things and in regard to legal proceedings there is the limitation period under the *Home Building Act* which has been the topic of a lot of amendment over the years.
6. In the past the statutory limitation was 7 years from completion in which owners could bring proceedings for claims of defects.
7. However, the term 'completion' was not defined until 2011 and before this, what completion actually meant was left to the discretion of the courts.

Completion and practical completion

8. In 2011 the *Home Building Act* was amended to define completion.
9. The first limb of that definition in section 3B of the *Home Building Act* states 'completion under the contract' if the contract provides a definition.
10. When a building is complete is something that is very hard to establish as there is consistently a little defect or a problem coming up.
11. The question of completion when you have a scope of work requires a perfect building, whereas in reality this is never the case.
12. Businesses have dealt with this issue by developing the term 'practical completion' which roughly equates to when one can move into the building for its intended purpose.
13. Some Contracts require a Certificate of Completion which may constitute completion under the *Home Building Act* as well.

14. Nevertheless, as most contracts do not have a definition of completion contained therein, it falls on the second and third limbs under the *Home Building Act* to determine when the limitation period actually starts.
15. If there is no contractual definition or time under which completion will occur as a contractual mechanism, it is up to the *Home Building Act* itself to determine when completion of the project occurs
16. From that date there is a 2 or 6 year limitation period depending on whether the defects are major or not.
17. The definition of major defects is defined in a multi-stage definition which can be quite difficult to meet, however generally if a defect is something that effects the structure of the building, generally speaking it will be held to be a major defect as opposed to a minor one.

To pay or to rectify

18. If a builder pays an owner out, instead of rectifying a defect, there is no issue of restarting or extending any warranty period by performing any more residential building work.
19. If the owners receive money from the original builders then they might seek the work of another builder who will then start a new limitation period from when they complete the rectification works.
20. If the builder does the work themselves, the question is whether they have extended the completion date and therefore extended the warranty period or whether the new works come with a separate warranty period which starts at the completion of that work.
21. That is, is there a statutory warranty implied into a contract under which the rectification works are done and if so, is that a new date of completion or does the old date of completion remain?
22. Builders often prefer to pay for the defect rather than take on the additional risk of extended limitation periods.
23. However, if a builder pays they are essentially giving the owners money to get someone else, who is unfamiliar with the project to do the work.
24. The new builders are generally going to be reluctant to take on the risk of an unfamiliar project and the owners are going to have to pay more to get the new builders in. As a result the original builder may have to pay significant premium to the owners to 'pay away' the problem.
25. If two separate builders have been engaged in the works, it can often be a difficult task when a defect arises down the track to determine whether the defect was the result of the original builder's work or the new builder's work.
26. For owners who want to protect themselves, it is important to get regular and detailed reports during the progress of the construction works by independent consultants.
27. This is often done through monthly reports from the consultant attesting that the builder has performed the work in accordance with the design

28. Owners then have a record to go back to later to potentially work out where the issues have stemmed from.

Claims by owners

29. There are essentially 4 ways an owner can frame their claim:
- i. They can make a claim under the statutory warranties which are implied into every contract
 - ii. A claim in negligence
 - iii. A claim in Contract
 - iv. A claim in misleading and deceptive conduct
30. As evidenced in the case of *Owners Corporation Strata Plan 72535 v Brookfield [2012] NSWSC 712*, a claim in negligence may be problematic because the fact that there are statutory warranties means that Owners Corporations are not vulnerable to the presence of defects and that they are able to protect themselves.
31. In *Brookfield Multiplex Ltd v Owners Corporation Strata Plan 61288 [2014] HCA 36* it was noted that having the statutory warranties makes it difficult for owners to make claims in negligence.
32. A claim in contract may also be difficult as contractual arrangements under which projects are generally constructed usually means that the owners do not have a direct contract with the builder, therefore suing a builder in contract without the assistance of the *Home Building Act* may be difficult.
33. This is particularly the case for Owner's Corporations as Owners Corporations generally only come into existence after the project is complete.
34. In regard to a claim in misleading and deceptive conduct, an owner may argue that the builder made a representation in some way that the building was complete and built in accordance with the designs when in fact it might not have been.
35. However, this can be difficult as often there is not a direct representation from the builder to the owner especially in the case where owners, such as the Owners Corporation only came into existence on completion of the project.
36. Therefore, the statutory claim under the *Home Building Act* is the most likely avenue for a successful claim against a builder for defective work.
37. If the owner brought a claim in negligence or contract, there would be a 6 year limitation period on such a claim.
38. However, under the *Home Building Act* it is possible that there is only a 2 year limitation period for something that is considered to not be a major defect.

39. For Owner's Corporations the 2 year limitation period is a pressing one and there are requirements on Owners Corporations to consider the limitation periods in the General Meetings.

The Home Building Act and its application to rectification works

40. The *Home Building Act* has a definition of residential building work which is,
"Any work involved in, or involved in coordinating or supervising any work involved in
a) the construction of a dwelling or
b) the making of alterations or additions to a dwelling or
c) the repairing, renovation, decoration or protective treatment of a dwelling
41. In a case in the Consumer Trader and Tenancy Tribunal, it was found that the works carried out by the builder after the issue of the Occupation Certificate was in the nature of rectification and maintenance rather than residential building works as defined in the *Home Building Act*.
42. Therefore there is authority to say that defect rectification work is actually not residential building work under the Act.
43. Section 92 of the *Home Building Act* requires that a person who does residential building work must have an insurance contract in place, and that the insurance contract must comply with the *Home Building Act* and extend to any residential building work done by way of rectification of the original work.
44. Whilst work cannot be done without an insurance contract, the insurance contract can be the original contract that also covers the rectification works.
45. Whether a new building contract needs to be entered into depends upon the terms of the building contract itself.
46. If the original building contract contemplates a scope of work that is rectification works, then it could be argued that the rectification work is work under the original contract and the date of completion under the original contract as determined by the contract or by the *Home Building Act* is the commencement date for the limitation period for a claim of breach for warranty.
47. If the defect is in the nature of a design defect or an issue with the scope of the works then the work may not be covered in the original contract in the sense that it is not in the scope
48. For example, there may need to be a whole entire new design developed to rectify the defect and in that instance it may be difficult for an owner or a builder to say that the rectification work is covered by the original contract and a new contract will need to be entered into for the original builder to perform the rectification work.
49. This particularly the case if there is a new Development Application as it would be difficult to argue that those works were covered under the original contract.
50. Further, in the case of an Owner's Corporation it is arguable that a new contract will need to be entered into as it will be the Owners Corporation engaging the builder to perform the

works, not the original developer. That is, different parties to the contract for the work that needs to be done.

51. It is likely that any rectification work will be residential building work under the *Home Building Act* and because there is a new contract for new building work, there will be implied into that contract statutory warranties which will start a new limitation period.
52. If there is a new scope of work because of a deficiency in the original scope of work, the builder will have a good argument that they should be paid something rather than it being purely rectification work.
53. This payment of money to the builder will put it beyond doubt that this is a new contract.
54. In circumstances where there are external designers who have put together a design and a scope and a builder has come in to do a construct only project, it is likely the builder will point to a designer and claim the defects were the fault of the designers and as such the builder should not be penalised by not receiving any more money.
55. In circumstances where it is a design and build construction contract, it will be more difficult for the builder to argue such a case.

The fit for purpose warranty

56. Under Section 18B(1)(f) of the *Home Building Act 1989*, the fit for purpose warranty is one that can catch a builder where they have been engaged to design and construct a building to a certain requirement for the owners that is set out in writing.
57. If the building fails to meet that requirement, they can be liable for that failure regardless of how much money it costs to redesign and rebuild.
58. There may also be a circumstance where a builder is liable for rectification works even if the problem is one which enlarges their scope of works significantly and had it been designed in the beginning, they would have received a significant increase in payment.
59. The fit for purpose statutory warranty is a heavy burden for a builder to carry especially if there is no fit for purpose obligation in the contract because the warranty automatically gets implied.

Contract for rectification works

60. A contract's scope of works can change as a result of finding a defect and if there is a scope change it is going to be very difficult to argue that there was no contract to begin with.
61. If it is purely rectification of work under the original scope and performance of that work properly there are a few considerations which apply.
62. Firstly, the terms of the original contract.
63. There is usually a defects liability period provided for in the contract in under which works can be done under the original contract and rectification of these works will not restart the limitation period if that date has been held to be the date of practical completion.

64. The date of practical completion will be the date as determined by the *Home Building Act* and its definition of practical completion, even if it conflicts with a contract.
65. Sometimes defect liability periods, which are usually 12 months under a contract, are extended.
66. If a 12 month defect liability period is extended for another 12 months by operation of the contract, at the end the 2 year limitation period under the *Home Building Act* will have expired.
67. The question which arises is if after a period of 3-4 years after practical completion, in which the defect liability period is well and truly over, a defect arises, is it covered by the original contract or not?
68. Section 18B(a) of the *Home Building Act* requires that an owner must not unreasonably refuse a builder access to rectify their defective work.
69. Further, Section 48MA says that a court or tribunal determining a building claim is to have regard to the principle that rectification by the responsible party is the preferred outcome.
70. An issue for owners is when the end of the 6 year limitation period nears and the builder wishes to come in and rectify works under the original contract.
71. This is because once that 6 year period hits, the time for making a claim expires if there is no extension of the limitation period.
72. If a builder comes in, rectifies a significant defect and the rectification work itself fails, if it is under the original contract, the limitation period expires and the owner has no other recourse against that builder.
73. Often there is an agreement between the builder and the owners which is born out of the threat of litigation, resulting in the owners forcing the builder into a settlement agreement to come in and rectify the defects.
74. Arguably this will be a new contract for residential building work and a new limitation period would apply from the completion of that work.
75. There have been decisions on appeal to the Appeal panel with owners who are unhappy with the application of Section 48MA of the *Home Building Act* and also by builders who are unhappy to have been ordered back to rectify works.
76. It is a common complaint from owners that a tribunal has ordered a builder to go back and rectify defects they have caused in the first place.
77. If the rectification order has been unsatisfied there is an option to go back to the tribunal to seek a conversion to money order.
78. A builder does not need to have more insurance for the rectification work if it is within the original scope however if there is a contract to do residential building work then you have something that the statutory warranties are implied into and new time.
79. Another issue in regard to a settlement agreement between a builder and owner which involves doing some more works would likely not tick all the requirements of section 7 of the *Home Building Act* as to what a contract for residential building work is.
80. From the builder's side, on a liability perspective, they may be best served by having no additional contract.

81. Under the *Home Building Act*, there is no definition of what a building contract is.
82. This can be contrasted to the *Security of Payment Act 1999* (NSW) which provides that a construction contract is a contract or other arrangement under which one party undertakes to carry out construction work or supply related goods and services to another party.
83. The case *The Owners - Strata Plan No 76674 v Di Blasio Constructions Pty Ltd [2014] NSWSC 1067* upheld the builder's right to claim that they made rectifications pursuant to their obligation to do so to avoid liability.
84. Builders can make a claim that there is no new contract and that they are simply performing their obligations under the original contract or under the liability that arises from the original contract.

How does the position in NSW differ from other jurisdictions?

85. Residential building contracts are regulated on a state by state basis
86. In Victoria, the *Domestic Building Contracts Act 1995* (Vic) has an almost identical set of warranties to the warranties that get implied into NSW contracts.
87. The situation in Victoria is different due to the Victorian Court of Appeal's decision in *Brirek Industries Pty Ltd v McKenzie Group Consulting (VIC) Pty Ltd [2014] VSCA 165*.
88. The Court found that the limitation period of 10 years provided in section 134 of the *Building Act 1993* (Vic) was an extension of the limitation period.
89. Therefore, no matter what, the limitation period will be 10 years in Victoria from the date of issue of an occupation certificate or a certificate of completion of the works.
90. In Victoria, the date from which the limitation period starts is the issuance of certificates and not some concept of completion or practical completion.
91. In other jurisdictions the position is not as clear as they have not had the extent of the litigation that NSW has.

BIOGRAPHY

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Garth was called to the NSW Bar in 2017 and has practiced as a solicitor since 2004. With over 15 years of technical knowledge and experience, he has extensive expertise in building and construction, general commercial litigation and defamation. Garth has worked in both private practice and in house, advising and acting for a number of large construction firms, international banks and major corporate and private entities.

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Christine was admitted as a lawyer in 1998. She is currently a disputes partner in the Construction and Infrastructure Group. Christine acts in disputes across residential, commercial and infrastructure asset classes. She is the editor of Holding Redlich's fortnightly newsletter for professionals in the residential building sector in NSW and the NSW Government Bulletin.

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Legislation

Home Building Act 1989 (NSW)
Security of Payment Act 1999 (NSW)
Building Act 1993 (Vic)
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