



Proposed Reforms to Building Regulations Latest Updates and How These May Impact Contracts and Practices

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INTRODUCTION AND OVERVIEW

1. In recent years, the New Zealand building sector has demonstrated a number of failings ranging from inefficient processes and practices to bad risk management and lack of quality control. These failings have impacted the productivity of the sector, the health and safety of industry members and end users, and public confidence that structures and components meet requisite quality and compliance standards.
2. During 2018, MBIE began a comprehensive review of the sector aimed at overhauling the building regulatory system. It met with representatives from nearly 50 organizations representing sector stakeholders, who raised concerns about (among other things):
 - Quality of, and lack of information about, building products;
 - Ensuring those working in the sector have the requisite skills;
 - Ensuring those responsible for defective work are held accountable; and
 - Ensuring that risk of loss does not fall disproportionately on home owners and building consent authorities (**BCAs**).
3. In April 2019 MBIE issued a Discussion Paper for Building System Legislative Reform (**Discussion Paper**) setting out proposals for legislative and regulatory reform in relation to:
 - Building products and methods;
 - Occupational regulation;
 - Risk and liability;
 - Building levy; and
 - Offences, penalties and public information.

The objective is to achieve reforms that will deliver “safe and durable buildings, a high performing building sector and an efficient regulatory system.”

4. MBIE sought written submissions by 16 June 2019 and is in the process of refining its proposals with the intention of introducing a Bill to Parliament in the first half of 2020; this could be passed into law in mid-2020. New public notification requirements would come into effect immediately. New responsibilities relating to building products, strengthened CodeMark regulations, and a manufacturer certification scheme for modern methods of construction are proposed to be phased in over time. The regulations will potentially be finalised in 2021.

5. Concurrent with this process, MBIE is continuing its new bi-annual Building Code update programme. This commenced in 2018 with its first update in November 2018. As part of its second update in June 2019, MBIE made proposals to support higher density housing, to introduce a new light steel frame solution for low rise buildings and to update ventilation requirements for wet areas (kitchens, bathrooms, laundries) to align with proposed Healthy Home changes. The November 2019 Update consultation document proposes to extend nationally the enhanced foundation requirements for liquefaction prone areas already in place in the Canterbury region. In further support of higher density housing, MBIE also proposes adopting the National Association of Steel Framed Housing enclosure standard as an Acceptable Solution for weathertightness of Light Steel Framed buildings.
6. Collectively, the above initiatives by MBIE will result in some of the most significant changes to the building and construction legislative and regulatory framework in the last 15 years. The remainder of this paper focuses, in particular, on MBIE's Discussion Paper proposals relating to building products and methods, occupational regulation, and risk and liability.

BUILDING PRODUCTS AND METHODS

The Problem

7. Concern relating to building products and methods first rose to prominence in New Zealand during the leaky building crisis. More recently, claims that cladding products used in allegedly leaky buildings are inherently defective have been raised by the Ministry of Education in the *Carter Holt Harvey* litigation and in two actions against multinational building products company James Hardie, its parent and two related companies. The *James Hardie* claims seek \$200 million and \$250 million, respectively.
8. Following the November 2014 Lacrosse fire in Melbourne, Australian regulators have been grappling with the issue of aluminium composite panel (**ACP**) cladding, some of types of which have a highly combustible core of pure polyethylene that does not comply with applicable fire safety codes. ACP cladding was used extensively on high rise buildings in Australia (and to a lesser extent New Zealand) during the 1990s. The urgency of regulatory review was underscored in 2017 by the fatal Grenfell fire in London, where 100% polyethylene core ACP panels contributed to the fire's rapid spread.
9. The New Zealand building industry imports many of the products used in construction, so ensuring that products used in buildings meet applicable standards can be challenging. To assist in this the Codemark product certification regime, under the auspices of MBIE, was set up pursuant to the Building Act 2004.
 - (a) Sections 268-269 permit the proprietor of a building product or method to apply to an accredited certification body for certification of that product or method as complying with the building code in the certified respects.
 - (b) The certification body is required to conduct an annual audit of the building product or method to which the certification relates in order to confirm continued compliance (Building Act s 270).
10. BCAs are required to accept these certifications as proof of compliance – section 19(1)(d) of the Building Act 2004 requires the BCA to accept as establishing code compliance a current product certificate issued under s 269, if every relevant condition in that product certificate is met.

11. ACP cladding concerns have been a substantial driver of MBIE's recent review of the Codemark certification process (discussed below). However, cladding panels are not the only non-compliant product that has been widely used in the building industry in New Zealand. For example, substandard steel and electrical wiring, predominantly sourced from off shore suppliers, have also been of significant concern over recent years.
12. Specifically in relation to ACP cladding, MBIE has revoked certification for a number of ACP panel products;¹ MBIE has also revoked or suspended certifying privileges for two of its seven building products certifiers; a third certifier has withdrawn voluntarily (collectively, these certifiers issued approximately 70% of current building product certificates).² It would not be going too far to say that the Codemark certification system for building methods and products is broken.
13. The Discussion Paper identifies a number of factors that have contributed to the above problems:
 - (a) Inadequate product information – too frequently product information is simply marketing material that lacks information on the key areas of performance, code compliance, installation, and maintenance requirements.³
 - (b) Product manufacturers and suppliers are not required to supply information about their building products and in fact have disincentives to do so – while the Building Act requires that any product information provided must be accurate, it imposes no obligation to provide product information to begin with. Since liability can lie under the Building Act or the Fair Trading Act in respect of provision of inaccurate information, there is an incentive to simply provide no information at all.
 - (c) The responsibilities of manufacturers, suppliers, designers and builders for building products and methods are not clearly set out in the Building Act – this leads to unsafe practices such as the substitution of products without applying for a variation or advising the BCA – frequently product substitutions cannot be identified by BCA inspections.
 - (d) MBIE does not have the power as the product certification owner and regulator to compel the provision of information as part of an investigation into a building product or method.

MBIE's Proposed Solutions⁴

14. MBIE proposes the following solutions.

¹ See <www.scoop.co.nz/stories/PO1811/S00131/mbie-decision-on-acp-codemark-certificates.htm>.

² See <www.rnz.co.nz/news/national/394410/mbie-suspends-aust-based-building-products-certifier>; <www.rnz.co.nz/news/national/394410/mbie-suspends-aust-based-building-products-certifier>.

³ MBIE "Building System Legislative Reform: Discussion Paper: Building products and methods" (2019) at 10.

⁴ Relevant documents relating to this review include:

MBIE "Building Performance: Building Code Update: Consultation document" (August 2019) <www.mbie.govt.nz>.

MBIE "Building system legislative reform: Discussion Paper" (April 2019) <www.mbie.govt.nz>.

MBIE "Building Performance: statement of proposals for amending Acceptable Solutions and Verification Methods June 2019 update" (March 2019) <www.mbie.govt.nz>.

Tim Denne and Alexia Beer "Guarantees and Insurance Products: market and policy analysis" (Covec, Auckland, 2018) <www.mbie.govt.nz>.

Widen the purpose of the Building Act to include regulation of building products and methods with a clear definition of building product and building method

15. Under section 3 of the Building Act, the legislation's purpose is "to provide for the regulation of building work, the establishment of a licensing regime for building practitioners, and the setting of performance standards for buildings."
16. MBIE proposes that this purpose should be widened, in order to recognise the role of building products and methods in building performance. The Ministry argues that "[i]ncluding the regulation of building products and methods in the purpose of the Building Act would reflect the key role they play in building work."⁵
17. MBIE also suggests providing greater clarity as to what is meant by a building product by including the following definitions in the Building Act:
 - A "building product" is any component or system that could be reasonably expected to be incorporated into a building work. A system is a set of at least two components supplied and intended to be used together to be incorporated into building work.
 - A "building method" is a specific way of using a product or system in building work.

Require product manufacturers and suppliers to supply information about their building products. Set minimum standards for that information.

18. This would not apply to building methods, but only to building products. The required information will include:
 - (a) A description of the product (e.g., name, picture, identification code) that is sufficient to avoid its being mistaken for another product, and the date that information is produced.
 - (b) Details of importing supplier, manufacturer (if made in New Zealand) and retailing supplier, including contact details.
 - (c) The building product's scope and any limitations on use. This would address factors that may affect the performance of the product within a building system, including loading, exposure to fire / heat and weather conditions.
 - (d) Design and installation requirements.
 - (e) Maintenance requirements.
 - (f) Declaration if a product is subject to a warning or ban under section 26 of the Building Act.
19. Manufacturers and suppliers would be required to make this product information publicly accessible, either with the product or via the manufacturers' website.
20. Finally, MBIE proposes that it would be an offence to fail to provide the minimum level of information. The penalty would be a notice to fix, an instant fine (i.e. an infringement notice), or a court-ordered penalty. The provisions in the Fair Trading Act would continue to apply to the accuracy of the information provided.

⁵ MBIE, "Building Legislative Reform: Discussion Paper" at 32.

Clarify the responsibilities of manufacturers, suppliers, designers and builders for building products and methods

21. MBIE proposes to create an explicit responsibility under the Building Act on manufacturers and suppliers to ensure that a building product is fit for its intended purpose.
 - This would apply to all building products that could reasonably be expected to be incorporated into residential or commercial building work, but would not apply to building methods.
 - Building owners would be able to seek redress through the courts if building products were not fit for purpose.
22. Where a building product or method is specified in the building consent, MBIE proposes that BCAs must be told of proposed product substitutions by way of an application for a variation to the building consent and builders are not able to make such a substitution until the variation has been issued.
 - Typically, it is the building owner who has the responsibility for obtaining building consent and so for seeking any variations. It will therefore be important for the building contract to provide that any substitution of products that are specified in the building consent must be approved by the owner and is subject to the issue of a variation to the building consent by the BCA.
23. Finally, under this heading, MBIE proposes to amend the existing responsibilities for designers and builders set out in sections 14D and 14E of the Building Act to include responsibilities for building products and methods.
 - MBIE suggests that designers' responsibilities could include to "ensure that the building products and methods specified result in building work that complies with the building code (where the work is properly completed in accordance with the plans)".
 - MBIE suggests that builders' responsibilities could include to "ensure that the building products and methods used result in building work that complies with the building code and the products and methods specified in the consent".
24. The above are not intended to change existing legal responsibilities, merely to clarify them.

Give MBIE the power to compel information to support an investigation into a building product or method

25. Currently, MBIE is forced to rely on the voluntary cooperation of manufacturers and suppliers when investigating the performance of a building product or method. MBIE has no power to compel a person to provide information or documents, such as the results of product testing.
26. MBIE proposes that it should be able to require a person by written notice to provide information and / or product documents if:
 - MBIE has cause to consider issuing a warning or ban under section 26 of the Building Act; and
 - The information is necessary to make that decision, and

- The information is not readily or publicly accessible.
27. MBIE also proposes to create an offence for failing to supply information on, or hindering an investigation into, a building product or method. The proposed penalty would be an instant fine (infringement notice) or a court-ordered penalty. The quantum would align with similar offences under the Building Act.
28. Finally, MBIE proposes it should be empowered to share such information with other regulators if there is evidence that another act or regulation has been breached – e.g., with the Commerce Commission, if there is evidence of a breach of the Fair Trading Act.

Strengthen the framework for product certification for building products and methods

29. Broadly, this proposal involves reforming CodeMark so as to enable MBIE to exercise greater oversight powers.
30. MBIE considers that it presently does not have “the tools [it] need[s] to be an effective scheme owner”.⁶ The Ministry highlights several factors that play into this.
- MBIE is unable to set new rules for the product certification scheme, even though existing rules may no longer be fit for purpose;
 - MBIE is unable to set the policies, procedures and systems that a PCB (a product certification body) must have in place to adequately assure products and methods comply with the building code;
 - The current accreditation process does not fully assess whether a PCB is competent to assess products and methods across all aspects of the building code;
 - The legislative and regulatory framework lacks a clear and structured process for taking timely action to address poor performance and poor quality product certificates;
 - Product evaluations can be inconsistent and of variable quality;
 - Poor quality certificates can be registered despite containing errors, and MBIE cannot suspend a certificate simply on grounds of error or require that those errors be resolved.
31. MBIE argues that, as the owner and regulator of product certification schemes, it should be able to:
- Specify the policies, procedures and systems a PCB should have;
 - Assess whether PCBs are operating as intended under the Building Act;
 - Ensure that the quality of certificates is maintained.
32. MBIE proposes to amend the Building Act to enable it to issue regulations prescribing:
- The process and requirements for applying to MBIE for registration as a PCB;

⁶ MBIE Discussion Paper at 46.

- The requirements for maintaining registration as a PCB;
 - The process and requirements for registering a product certificate;
 - The policies, procedures, and systems that PCBs must have in place; and
 - The qualifications and competencies of those in technical roles.
33. Finally, MBIE argues that it should gain the power to:
- Make rules that govern the interactions between the PCABs (product certification accreditation bodies) and PCBs, PCBs and product certification owners, and PCBs and external contractors;
 - Suspend or revoke a PCB's registration if it no longer meets the requirements of being registered;
 - Decline registration of, suspend or revoke a product certificate that has errors (including if the certificate was issued incorrectly).
34. This would give MBIE a greater role in oversight over the product certification programme. MBIE contends this will not change the role of the PCAB in accrediting and auditing PCBs but that the proposed changes would enable MBIE to set out the criteria to which the PCAB must refer when accrediting and auditing a PCB. It is not clear however, how MBIE's powers of suspension or revocation of a PCB's registration would sit with the accrediting powers of PCABs.
35. This proposal would give stakeholders, especially building consent authorities such as city councils, greater confidence in the quality of product certificates.
36. It would enable MBIE to hold PCBs accountable if they fail to act according to their obligations under the proposal.
37. Further, MBIE would have the powers to intervene if poor quality or inappropriate product certifications were issued.

Modern Methods of Construction

38. MBIE identifies that the consenting process does not adequately address modern methods of construction and most particularly off-site manufacture ranging from individual items, such as panels, made in a factory and then assembled on site, through pods (e.g., individual bathrooms) made offsite and then integrated into a building, complete houses manufactured off-site or 3D printed on site using concrete.
39. Many of these methods of construction use processes that are precise and repeatable so that each product produced by the pertinent process can reasonably be expected to be of the same quality. Currently, however, manufacturers using such processes are still required to provide assurances of compliance of their work each time it is used.
40. MBIE proposes to resolve this amending the Building Act to provide a regulatory framework under which a manufacturer could obtain consent for repeatable manufacturing processes used to produce building work.

41. To this end, MBIE envisages a voluntary manufacturer certification scheme with a focus on assuring that manufacturers use robust processes and quality assurance for their products. The certification, which would be undertaken by accredited third parties, would mean that a building work produced by such a repeatable manufacturing process would be “deemed to comply” with applicable code requirements. The certification would be attached to the process and would be specifically intended to cover everything a manufacturer produced by that process with just one certification.
42. Where manufacturers design and manufacture entire buildings, the scheme could certify design as well as construction compliance. This would mean that BCAs would have to focus only on site-specific elements of a build that were not covered by the certification (for example) foundations.
43. These proposals are directed towards simplifying the consenting process which would certainly be an advantage. Of course, compliance costs could be challenging for some manufacturers (although these would likely be passed on to consumers). Given the recent Codemark problems, there may also be concerns as to effective auditing of the competence and certifications issued by accrediting agencies. There will need to be clarity as to accountability should accrediting agencies default.

OCCUPATIONAL REGULATION

44. Occupational regulation of who can perform certain types of skilled work assists in ensuring that such work is performed with proper care and skill thereby protecting public safety. Regulation comes at a cost, however, which can reduce the pool of available practitioners. The building sector contains a wide range of roles subject to varying degrees of licensing. Traditionally, professions are licensed to practice by independent professional bodies. More recently changes to the Building Act have introduced licensing requirements for builders who perform restricted building work, namely work on residential properties.
45. The problem is that the scope of occupational regulation is inconsistent and so not providing the protection needed.
46. MBIE identifies three areas where it believes licensing requirements need to be tightened:
 - (a) The licensed building practitioner (**LBP**) scheme.
 - (b) Engineers, and
 - (c) Plumbers, gasfitters and drainlayers.

Licensed Building Practitioners

The Problem

47. Currently, restricted building work is limited to work on residential properties and, in that sphere, to houses and small apartments. However, owners and occupiers of multi story apartment buildings, hospitals, schools and commercial properties are also vulnerable to the harmful consequences of design and construction errors and such properties tend to be of more complex design and construction than individual houses and small units and so more difficult to construct. Also because they tend to be more densely occupied than houses, the impact of construction errors has the potential to harm many more people.

48. By way of example, one area of current concern is in relation to passive fire resistance in high rise buildings. Industry professionals have recently expressed alarm at the prevalence of inadequate or non-existent fire stopping in New Zealand high rise buildings and the apparent lack of understanding among some builders as to when penetrations need to be stopped and what is or is not effective to do this. This is of particular significance given the potentially disastrous consequences of rapid fire spread in high rise buildings.
49. It really does not make sense to have a builder licensing regime that does not apply to work undertaken on these more complex and higher risk structures. In Australia, all but two jurisdictions regulate building practitioners over both the residential and commercial sectors. Several expressly link practitioner licensing to the complexity of the building work required.
50. Another problem MBIE reports is that many stakeholders believe the current entry-level LBP scheme provides too low a standard (no formal qualifications are required for entry), does not recognise different levels of competence and so does not place a value on higher competencies. Any LBP can supervise unlicensed builders regardless of whether they have any supervisory training or experience.
51. Finally, although the current LBP scheme contains technical competence requirements, it does not have ethical behavioral requirements designed to ensure, for example, that corners are not cut. Although the Building Act has provisions for a code of ethics to be prescribed by order in Council, no code has yet been adopted.

MBIE's Proposal

52. First, MBIE proposes to broaden the definition of RBW to include more complex residential and non-residential building work. It will encompass:
 - All residential buildings (including mixed use), and
 - Commercial and communal buildings, including:
 - Importance level 2 buildings with a height of 12 metres or more or capacity over 200 persons; and
 - All buildings importance level 3 and above.
53. Structural, weathertightness and fire safety systems will remain the core elements of RBW under this expanded definition.
54. Second, MBIE proposes to shift to a tiered licensing class structure, recognizing different levels of skill and so creating a path to upskill and progress through the industry. To that effect, the Ministry proposes introducing a supervision license tier for which standards of competence would be set by the Building Practitioners Board (**BPB**) at a higher level than for the standard LBP. The existing specialised license classes will remain but be simplified. A supervisory LBP would only be able to supervise within their area of competence.
55. Finally, MBIE proposes to introduce a fit and proper person requirement so as to raise the bar for entry to the LBP scheme which would be supported by a code of ethics including (among other things) requirements to follow the law, act honestly and fairly and to conduct their work with reasonable skill, care and diligence, and to take reasonable steps to safeguard health and safety.

Engineers

The Problem

56. Unlike, for example, the term “architect”, the term “engineer” is not a protected term. That is to say architects are licensed (registered) by a statutory body of professional architects appointed by the Minister of Building and Construction. By statute, no person who designs buildings, prepares plans and specifications for buildings, or supervises the construction of buildings may use the title “architect” unless he or she is a registered architect.⁷
57. Surprisingly to lay persons, that is not how it currently works for engineers. While the profession has several credentialing bodies, in New Zealand you are not required to be an accredited member of any of these in order to hold yourself out as an engineer.
58. The Chartered Professional Engineer (CPEng) credential is a statutory title that provides recognition of an engineer’s general competence. The system is administered by Engineering New Zealand with oversight from the Chartered Professional Engineers Council. A CPEng found to have been negligent can be fined and have their registration suspended or cancelled. However, because there is no statutory requirement for engineers to hold a CPEng in the first place, there is nothing to prevent an engineer whose registration has been cancelled from continuing to design buildings. Finally, because accreditation is voluntary and maintaining CPEng registration is considered to be quite onerous in terms of time and effort, many extremely competent practicing engineers choose not to obtain the CPEng credential in the first place.
59. Engineering New Zealand also maintains a self-regulatory system of which you can become a chartered member. Again, however, membership is voluntary and Engineering New Zealand can do nothing to prevent non-members from practicing as engineers.
60. Much recent concern has been raised about the powerlessness of existing accrediting bodies to act where a member gives up their credentials to avoid censure – such a person can still continue to practice as an engineer.
61. The fact that both competent and incompetent engineers can and do practice without any certification / registration means it is up to the public and BCAs to scrutinise the background of engineers to determine their competencies. While not all engineering roles are safety critical, many are – including structural, geotechnical and fire-engineering. The situation is accordingly less than ideal.

MBIE’s Proposal

62. MBIE’s proposal is threefold.
 - (a) First, the Ministry proposes to replace CPEng with a new statutory certification scheme.
 - (i) A new regulator will be established (accountable to the Minister for Building and Construction) with the power to determine competency standards and set the assessment process.

⁷ Registered Architects Act, 2006, section 7(2).

- (ii) MBIE contemplates that the existing staff of Engineering New Zealand will perform this role; independence will be achieved by virtue of their being directly accountable to the regulator / Minister and subject to MBIE oversight.
 - (iii) A new title will be established for engineers certified under the scheme and that title will have statutory protection such that only engineers so certified will be permitted to use that title.
 - (iv) That accreditation will then be a stepping stone on the path to licensing (see below).
- (b) Second, MBIE proposes amending the Building Act to create a new category of “restricted engineering work” (**REW**) This would apply to safety critical engineering disciplines (including structural, geotechnical and fire engineering) and would cover medium to high complexity work in those fields, triggered by factors such as building size, use and location. It would apply to both residential and commercial buildings.
- (c) Finally, MBIE proposes establishing a new licensing scheme to regulate who can carry out or supervise REW. This also will be administered by the new regulator, accountable to the Minister for Building and Construction and with general oversight by MBIE.
- (i) Certification under the new statutory certification scheme will be a prerequisite for licensing. Beyond that, the regulator will establish what competencies are required to perform or supervise REW.
 - (ii) Only engineers licensed under the scheme will be authorised to carry out REW and it will be an offence for someone not licensed to carry out REW or to retain an unlicensed person to undertake REW.
63. MBIE contemplates that there should be an independent decision maker for complaints and discipline with a robust series of disciplinary measures / penalties available and appeal to the District Court.

Plumbers, gasfitters and drainlayers (PGD)

The Problem

64. The Plumbers, Gasfitters and Drainlayers Act 2006 is designed to ensure that these specialised trades that can affect public health are performed by suitably qualified practitioners. To that end the PGD Board was established to set competency standards and license practitioners. The problem is that there are numerous (11) exemptions that permit unqualified people to perform restricted sanitary work, some of which seem arbitrary and unjustified.

MBIE’s Proposal

65. MBIE proposes to repeal the exemptions for householders in specified areas and for rural districts, and for PGD work done under supervision.

RISK, RESPONSIBILITY AND LIABILITY IN BUILDING PRACTICES

The Problem

66. MBIE commissioned a report from Sapere Research Group on liability outcomes in the building sector. The report, published on 13 November 2018, analysed 138 cases dealing with the apportionment of liability and costs in negligence-based building defect disputes, between 2008 and 2018.
67. The total value of the claims was \$144,972,217. The average value of claims was \$1,487,320, although this is skewed higher by a small number of extremely high-value claims. The average value of orders made was \$160,946, although, again, this is skewed by a small number of high-value orders.
68. The report found that builders had orders made against them in 69 of the 138 cases, averaging around \$670,000 per case. The value of the orders ranged from just under \$1,400 to over \$21 million, although under half of all orders against builders were between \$100,001 - \$500,000. Builders were usually jointly and severally liable for the full amount of claimant's losses.
69. The report found that developers had orders made against them in a third of cases, and these orders average around \$1 million.
 - (a) The vast majority of these orders are against individuals, which shows the courts' willingness to hold parties personally liable for their actions, even if a company structure exists to limit their liability.
 - (b) The maximum order was for almost \$21 million, while the smallest was just over \$3,000. Almost 45% of the claims against developers are between \$100,001 - \$500,000. This reflects the influence of larger claims.
 - (c) Developers are "routinely" jointly and severally liable for the full amount of damage, and are allocated 62% of costs on average.⁸
70. The report found that BCAs had orders made against them in over half of the cases.
 - (a) They are routinely held jointly and severally liable for the full amount of damage.
 - (b) Where other parties are unable to pay their share of the damage costs, BCAs may face the full amount of the damage costs.
 - (c) BCAs paid out an estimated \$1 billion in building disputes between 2008 and 2018.⁹
71. The net result is that BCAs bear a disproportionate amount of the costs of damage, builders and developers routinely face the risk of becoming insolvent, and homeowners are likely to be left 'out of pocket' in situations where there is no BCA presence and the builder or developer has become insolvent. Remedial costs – particularly in more serious cases requiring recladding, re-stopping or foundation replacements – can exceed what home-owners can readily afford.

⁸ Sapere Report at 15.

⁹ MBIE Building Legislative Reform Discussion Paper at 130.

MBIE's Proposed Solution -- Policies for Specialist Construction Insurance in New Zealand

72. One way for consumers to adequately protect themselves against builder insolvency, defective building work or post-completion defects is through insurance. MBIE describes these types of insurance generally as “guarantees and insurance products” (GIPs).
73. GIPs have been identified as having the potential to reduce the problem of apportionment of loss, provided they have the following characteristics:
- Wide availability;
 - Incentivise building quality improvement (through differential pricing to reflect risk and/or having entry standards which limit risk);
 - Do not reduce competition;
 - Certainty of redress (without the need for high transaction-cost pursuit, through the courts, of those who are at fault).
74. There are currently three types of GIPs schemes available in New Zealand (Halo, Masterbuild and Stamford), although currently only 53% of new properties built each year are built with a GIP, and only 23% of renovations have a GIP. This is a very low uptake, although that may in significant part be attributed to lack of knowledge on the part of many home-owners. A 2018 Colmar Brunton poll commissioned by MBIE found a low awareness of GIP products among home-owners and a lack of understanding that building work requires different cover to that provided by a standard home-owner’s policy.
75. MBIE has considered four options:
- (a) Do nothing;
 - (b) Provide information only;
 - (c) Create a government-provided insurance scheme; and
 - (d) Create a compulsory insurance scheme with or without opt-out.

Do nothing

76. MBIE does not favour this option which would see incremental developments in the GIPs market over time, but is not expected fundamentally to solve the underlying problems.
- It would create no appreciable incentive for improved builder or building quality.
 - It would not reduce BCAs’ liability.
 - Builders, developers and designers would continue to be liable through judicial processes for damage caused to homeowners’ properties. As a corollary to this, homeowners would still need to go through the judicial process in order to recover their losses.

Provide information only

77. Again MBIE does not favour this option, primarily because the effectiveness of such a campaign is uncertain.
78. However, it would be likely to have some impacts on both the supply aspect (improving GIP quality) and demand (encouraging purchase of GIPs) at least among risk-averse homeowners.
79. It would also be likely to have a small positive impact on creating incentives for improved builder or building quality. Again, however, it will appeal to risk-averse builders.

Create a government-provided insurance scheme

80. MBIE is not considering this as a stand-alone solution since it would crowd out the market for private GIPs, and MBIE considers the cost would not equate with the size of the risk being managed.

Compulsory insurance with an opt-out at the discretion of the home-owner

81. This is MBIE's preferred option.
82. Residential builders would be required to offer a GIP type product to homeowners. The builder would have to either join a builder's association offering such a product (e.g., Masterbuild) or be approved by an insurer or broker to offer their product. This in turn would encourage a rise in builder quality standards.
83. Homeowners would pay the premium either directly or through the builder. The home-owner would be the policy holder who could make a claim. Subject to insurer subrogation rights, this would not prevent a homeowner from pursuing negligence claims in court. Homeowners who wished to manage their own risks could opt out.
84. MBIE would like to see the scheme apply to all residential buildings, but is uncertain whether the existing market could provide such insurance or how mixed use buildings should be treated. It is accordingly continuing to explore what types of residential building should be included.
85. While MBIE considers that all new builds should be part of such a scheme, it advocates a threshold policy for renovations and alterations. The Ministry considers three options:
 - (a) Alterations valued at \geq \$30,000 (this mirrors the threshold for having a written building contract, but captures low risk work that some owners may wish to self-insure and means that fewer builders may be available to undertake renovations).
 - (b) Alterations valued at \geq \$100,000 (this captures higher risk work that fewer owners will wish to self-insure).
 - (c) Alterations that would affect the structure or weathertightness of the building (this captures high risk work, but is harder to clearly define or implement).
86. Ultimately, as MBIE notes, "[t]he social costs of building problems are the costs of fixing them; GIPs shift this cost from the homeowner to the insurance company, builder or membership organization, and ultimately via premiums, to all people who contract for building work. This has equity benefits and has wellbeing net benefits to the extent that risk-averse people

purchase GIPs that they would not otherwise, and that this benefit exceeds the sum of GIP premiums paid by the risk-neutral.”¹⁰

87. One possible problem with the proposed scheme is insurer uptake. Essentially a GIP is insuring for latent defects and the insurance market does not find this particularly attractive. First, you are insuring for a long time (usually 10 years) for an up-front premium (and so cannot be adjusted over time to respond to events). Second, the likelihood of claims being made is quite high as has been demonstrated by the leaky building crisis. Third, as this crisis has also shown, remedial damages costs can be quite high. This raises the issue of the need for reinsurance by the Insurer.
88. However, MBIE believes that GIPs options are worth assessing further. The next step will involve consultation with the construction industry.

Limiting liability for BCAs

89. MBIE considered setting a cap of 20% on liability of BCAs in line both with their supervisory role in the building process and the allocation of liability made by courts under applicable case law.
- One downside is that while such a cap ensures BCA liability is better aligned with its role and responsibility, this outcome would increase the amounts other parties (such as engineers and builders) have to contribute – in some instances out of proportion to their role.
 - This could also reduce the attractiveness to insurers of providing GIPs (since it would impact rights of subrogation) or increase the costs of GIPs to homeowners either of which could reduce uptake.
90. Although it will undertake some further investigations, assuming the other changes proposed by MBIE are adopted, the Ministry currently proposes leaving the liability settings for BCAs unchanged, that is not introducing a liability cap or a proportionate liability system.

OTHER PROPOSED CHANGES

91. For completeness, MBIE also proposes reducing the rate of the building levy, raising and standardizing the threshold for imposing it, and empowering MBIE to spend the levy for purposes relating to building sector stewardship.
92. Finally, MBIE makes proposals to:
- Increase the maximum penalties under the Building Act and set these levels higher for organizations than for individuals;
 - Extend the relevant time enforcement agencies have to lay a charge under the Building Act from six months to twelve months; and
 - Modify the definition of “publicly notify” in section 7 of the Act to enable publication in a more modern form than via the newspaper publications currently provided for by the Act.

¹⁰ MBIE Discussion Paper at 135.

COMMENTS ON HOW THESE MAY IMPACT CONTRACTS AND PRACTICES

93. The proposed changes indicate a move towards greater regulation of the industry and monitoring by MBIE. This is particularly the case in respect of product certifications and MBIE's proposals for the engineering profession and LBPs.

Engineering

94. With respect to engineering, there has been some significant pushback.
- Submissions by Engineering NZ oppose the creation of a new statutory certification scheme, arguing that self-regulation is preferable to governmental control at the general qualification level and that the existing Engineering NZ chartered membership provides a suitable starting point certification that is already recognised internationally.
 - Engineering NZ does support licensing for safety-critical engineering work – to be administered by Engineering NZ with government oversight. They view this as being limited to design, oversight and supervisory responsibility in the safety critical fields, although they comment that these are broader than structural, geotechnical and fire-safety – essentially every engineering discipline can affect safety.
 - Engineering NZ strongly recommends that membership of a professional body should be mandatory for practicing engineers. (It is difficult to see how this could be achieved other than by a statutory mandate.)
 - Overall, Engineering NZ describes its view as endorsing licensing supported by strong professional self-regulation.¹¹
95. MBIE has reported that of 104 online and 102 written submissions on the subject, the majority of respondents opposed substituting a new statutory certification for the CPEng and thought that the CPEng – or possibly a modified form of the CPEng – could adequately provide a certification of professional competence. This opposition to a new statutory certification was predominantly from engineers. Others, including Local Government New Zealand, the Insurance Council and the CTV Building Families Group supported the proposal.¹²
96. There was, however, significant industry-wide support for a statutory mark for engineers of professionalism and general competence. The issue was whether this could be provided through modifying CPEng or whether a totally new statutory certification was required. Interestingly, the majority of fire, geotechnical and structural engineers felt that the CPEng mark currently did not provide a sufficient mark of professionalism and competence.¹³
97. While there was broad support for creating a category of REW, it is clear that more work needs to be undertaken on how to define this – further options raised were to include engineering geology as well as other engineering disciplines (e.g., façade and civil) or, indeed, all engineering disciplines, including mechanical and electrical and all specific engineering

¹¹ Engineering New Zealand: *The Future of Engineers' regulation in New Zealand* (Engineering New Zealand's response to MBIE's proposed reforms), 14 June 2019; see also discussion at <<https://www.stuff.co.nz/the-press/business/114025158/engineers-oppose-new-government-body-to-regulate-their-profession>>

¹² See MBIE, Building System Legislative Reform Programme, Summary of Submissions, August 2019, at 37-38.

¹³ Id. at 38.

design. Others suggested that instead of focusing on what type of work is safety-critical as a criterion, criteria such as building size, use or ground conditions could be used to determine what work is restricted.¹⁴

98. There has also been broad support for establishing a licensing scheme. The Insurance Council believed this would give insurers greater confidence and may encourage greater acceptance of risk. A majority of respondents agreed that engineers should satisfy the requirements for certification before they could be assessed for licensing.¹⁵

LBPs

99. While fully supporting broadening the LBP scheme, some commenters have warned of the risks of exacerbating existing labour shortages by introducing the expanded requirements too quickly. This was also a concern with respect to introducing licensing for engineers. Skill shortages will remain in the market while practitioners are upskilling. Given the existing four year timeframe to receive entry level LBP qualifications, a number of submissions suggested a minimum five year transition period to the expanded scheme.¹⁶
100. We can also expect to see project costs increase, not least because upskilled workers will expect higher salaries. Builders and engineers can also be expected to pass on increased registration / licensing costs in higher fees.

Contracts

101. A number of the proposed changes will have impacts on building contracts. For example (and non-exhaustively):
- With the move towards broadening the LBP scheme, we can expect more contractual requirements relating to qualifications of personnel.
 - We can also expect to see tightening of provisions relating to product substitutions in light of tighter building product regulation.
 - The growth of off-site manufacture and the creation of a regulatory framework for this type of building work may require the development of new contractual models that combine elements of product supply agreements with traditional building contracts.

Certification for manufacturing processes

102. The creation of a certification scheme for repeatable manufacturing processes used to produce building work will remove much of the responsibility for off-site manufacture from BCAs to manufacturers and certifiers. “Deemed to comply” provisions will reduce BCA exposure to liability. However, this also carries risk, as the recent Codemark certification problems have demonstrated – since certifiers will be unlikely to have the resources of BCAs this could end up transferring risk back to the ultimate building-owner in the event of certifier default. Proper auditing and quality control of certifiers will thus be critical.

¹⁴ Id at 39-42.

¹⁵ Id at 42-43.

¹⁶ See, e.g., Property Council submission on building system legislative reform, 16 June 2019 at <<https://www.propertynz.co.nz/resources/property-council-submission-building-system-legislative-reform-programme>>.

Risk and liability

103. In terms of risk and liability, there appears to be broad support for mandatory GIPs, although opinion is divided on the opt-out option. One concern, however, must be the appetite of private insurers to provide cover beyond the relatively narrow scope of the individual house construction cover currently available.
- GIPs typically have a single premium up front as payment for insurance against damage / losses that could arise over up to ten years. There is no opportunity to adjust premiums over time to reflect subsequent events.
 - Historically, the leaky building crisis has meant most insurers are reluctant to provide GIPs type insurance in New Zealand houses. Current widely recognised problems such as use of ACP cladding, defective steel and electrical wiring, and defective passive fire protection do not contribute to the attractiveness of this market.
 - Payouts tend to be high – even in individual homes a re-cladding can cost in the multi-\$100Ks. If this is extended to high-rise apartment and multi-use buildings, costs can rocket into the tens of millions.
104. In light of these factors, insurers may well find the risk unattractive or be willing to offer such insurance only at higher premiums or with exclusions that substantially eat up cover for the more likely significant losses. It should be noted that following the Grenfell fire, submissions from the insurance sector strongly argued that the insurance industry should not be viewed as the principal mechanism by which to address defective construction.
105. Of course, to the extent that RBW is extended and REW is introduced in conjunction with properly targeted licensing systems to ensure that such work is only undertaken by properly qualified practitioners, it may be that the insurance industry will perceive the risks of GIP to be more acceptable than perhaps is presently the case.
106. Nonetheless, responses to MBIE's proposals confirmed concerns as to whether the current GIP market was available and willing to support the proposals, including submissions from the insurance industry members. Lloyds in particular noted that "caution should be exercised about making any assumptions that there will be sufficient capacity, both now and in the future, to cover the entire residential building market for the mandatory offering of guarantee and insurance products."¹⁷
107. This is unquestionably an area where MBIE will need to consult closely with the insurance industry.

Conclusions

108. Although sharply focused on safety and competency issues, the legislative and regulatory changes MBIE is proposing are extensive and will impact the whole construction sector. MBIE is only part way through its review and consultation process and is currently working through the issues that have been raised with industry stakeholders, including the engineering and insurance sectors. Legislation is aimed to be drafted and presented next year.
- WATCH THIS SPACE.**

¹⁷ See MBIE, Building System Legislative Reform Programme, Summary of Submissions, August 2019, at 52.