Building Insurance – Automatic Run off Cover

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The Australian State of Victoria has recently adopted a suite of revolutionary building regulatory reforms which have directly caused building approval turnaround times to drop from an average of 4-6 weeks to 5-7 days – a reduction of over 80%. This is a truly stunning outcome, and one of its key components has been the introduction of a system of automatic public indemnity run off insurance cover for building practitioners.

The author of this article is aware of only two jurisdictions anywhere in the world that have been able successfully to provide automatic run off cover for building defects – France and Victoria. This article outlines the liability and insurance system in Victoria, and provides insights to the set of complementary criteria required to make this rare and utilitarian system operational.

What is 'Automatic Run off Cover'?

Within the context of building matters, 'run off cover' is an insurance policy that continues to provide profesional indemnity cover to a building practitioner for liabilities incurred by her or him under the building regulatory legislation after the practitioner ceases to operate as a building practitioner. 'Automatic run off cover' provides this on-going coverage without any further input from the building practitioner.

Responsibility for Building Control in Australia

Australia operates under a federal system of government, with a Constitution which in basic terms outlines the respective areas of responsibility of the Federal Government and the State Governments. Building Control matters come within the jurisdiction of the States, each of which has its own Parliament with its own act of Parliament covering these matters. Victoria is one of the six States in Australia. Two Territories have also been given responsibility for Building Control matters by the Federal Government.

The Federal, State and Territory Governments have established a body known as the Australian Building Codes Board (ABCB) by way of inter-government agreement. The ABCB is jointly funded by the Governments, includes members from the funding Governments and the relevant industry and Local Government sectors, and has responsibility for advising the governments on Building Control matters.

Victoria's New Building Act

In 1994, Victoria proclaimed a revolutionary new Building Act, introducing a host of ground breaking reforms. These include:

- the abolition of joint liability;
- the introduction of a 10 year liability cap for building law suits;
- a fully privatised building approval system;
- the mandatory provision of automatic run off cover; and
- the registration of building practitioners.

Each reform element was profound in its own right, yet all of them were critical components of the overall regulatory reform package, which was based on a National Model Building Act. This legislative model was the culmination of a reform initiative carried out under the auspices of the ABCB's predecessor. The author of this article was the project director of the reform consultancy which culminated in the model.

To date, a range of the reforms contained in the model have been proclaimed in three out of the eight Australian jurisdictions. Two other jurisdictions are expected to follow suit within two years. However, Victoria is the only jurisdiction which has been able successfully to introduce automatic run off cover.

What was the Traditional Insurance Coverage?

Conventional professional indeminity cover has been carried by many Australian building practitioners for a number of years. Such cover provided for the indemnification of building practitioners for negligence in such areas as building design, inspection, quality control monitoring, and costing. Under this cover, the practitioner is insured as long as she or he maintains the insurance policy by way of a paid up premium. If the payment lapses the practitioner is uninsured, and will assume personal liability for past negligent acts and omissions.

The New Automatic Run Off Cover

In Victoria, much of the work of building practitioners is now automatically insured for a set period of ten years – regardless of whether or not the practitioner ceases to practice. This cover is funded through the continuing contributions of those who maintain their insurance cover in accordance with a Ministerial Order issued under the Building Act.

Run Off Cover is Required by Law in Victoria

Section 135 of Victoria's Building Act makes it compulsory for building practitioners to carry professional indemnity automatic run off cover. Building practitioners are defined in Section 3 of the Act to include building surveyors, engineers, draftspersons, commercial and industrial builders, and quantity surveyors. Builder's run off cover is limited to structural defects. All of these practitioners are required to register with a Building Practitioners Board, and unless they carry the run off cover it is illegal for them to practice or even hold themselves out as being practitioners.

Why Did the Victorian Government Prescribe Run Off Cover as a Legal Requirement for Practice?

The reasons for prescribing automatic run off cover were multifarious, but primarily related to:

- the establishment of a private sector system for issuing building approvals;
- a perception of a need for improved consumer protection; and
- the need to provide for practitioner indemnification upon retirement, death, bankruptcy, or inability to meet a major liability.

In Victoria, a private building surveyor, like a Local Government building surveyor, can issue building permits, carry out inspections and issue occupancy permits as soon as the building work is completed and is fit for occupation. In other words, a private building surveyor 'steps into the shoes' of the Local Government building surveyor. In this context, it was seen as necessary to ensure that a private building surveyor could provide the public with the same form of indemnification as the Local Government building surveyor with respect to torts and contractual neglect.

Local Government can effectively indemnify the public in perpetuity on account of its ratepayer funded solvency. Traditional professional indemnity cover provides no such comfort. If mere conventional indemnity cover was prescribed there would be serious exposures to the public in the event that a private building surveyor retired and discontinued payment of annual premium. Automatic run off cover goes a long way to mirroring the type of protection that a council can afford to the public.

The Run Off Cover Menu of Prerequisites

While this paper's author had carriage of negotiations prior to

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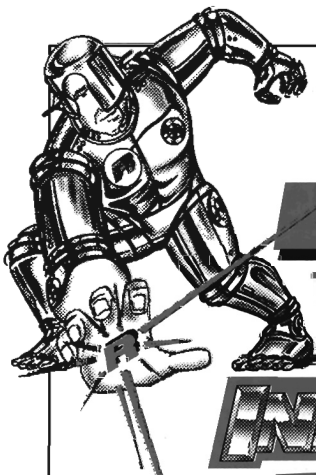

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proclamation of the mandatory insurance conditions, he was informed by key insurers that they would only embrace the future risks implicit within run off cover if a number of legislative characteristics were created. It is worth noting that it took four years of protracted, and at times debilitating negotiations with the insurance industry before commitment was forthcoming. Sedgwick Insurance Brokers in particular helped pioneer the breakthrough.

The following items were the keys to our success:

1. Clarity with respect to Liability Capping

Insurers and practitioners alike wanted legislative provision of a clear and non contentious commencement date for liability limitation periods. This was not achievable in jurisdictions which operated under the traditionally standard six year limitation periods which were extant throughout Australia.

The primary problem in this regard relates to the considerable uncertainty as to the trigger date for limitation of law suits. In other words, when does the six year period commence – for example, does it commence at the time the negligence occurs, the time the consequences of the negligence are detected, or the time the consequences of the negligence could reasonably be detected? Insurers are of the view that where the traditional approach is taken there is sufficient doubt to believe that the insurable risks are potentially infinite – a risk they were reasonably extremely unwilling to take.

This view was reinforced in a recent High Court case in Australia, Bryan vs Maloney, where a builder was held liable to the plaintiff for defective building work that he had constructed in the 1970s, notwithstanding that the plaintiff was the third successor in title. This case has bearing in jurisdictions which are not the subject of clearly legislated liability capping.

Bearing this problem in mind, in conjunction with clear evidence that the major number of claims regarding building defects relate to work less than ten years old, it was determined that the new legislation required a ten year liability cap, to be triggered by a non-contentious and clearly identifiable factor. Hence, Victoria's Building Act provides that the ten year liability period begins to run upon the date that a building occupancy permit is issued. The occupancy permit is issued when a building surveyor considers that the building work is fit for occupation.

2. Removal of Joint Liability

Under the doctrine of joint and several liability each defendant is jointly liable for the liabilities of co-defendants, assuming that all defendants bear some responsibility for a defect. Joint liability provided that the solvent parties assumed the financial liabilities of the insolvent. This doctrine greatly concerned both the insurance industry and the Local Government sector because solvent defendants frequently were at risk of becoming quasi-underwriters for impecunious co-defendants.

This has had an adverse effect upon insurance risk assessment as insurers and the Local Government sector have always been at risk of assuming the liabilities of others. In New Zealand, where the same situation is extant, a report by the New Zealand Law Commission found that "a feature of the number of building cases involving local government defendants has been the absence or irrelevance of the builder as a party to litigation, often because of the insolvency of the builder – leaving the local body as the only worthwhile defendant".

Under the new Building Act, nobody is liable for the acts or omissions of another. It is incumbent on the Courts to apportion liability on a just and equitable basis. The result of the legislated introduction of this doctrine of proportionate liability is a significant risk reduction, as no party is exposed to the assumption of risks of others.

3. Building Practitioners Board

The Building Act established a Building Practitioners Board, which sets the qualification criteria and essentially controls the entry and exit criteria for building practitioners. It has the power to fine practitioners, and/or suspend and cancel practitioners' certificates. This disciplinary body gave insurers comfort that the insured fraternity would be susceptible to professional and ethical standards.

In South Australia, one of the other jurisdictions to attempt to introduce this reform, the path of compulsory practitioners registration was not followed – with the result that while run off cover was made compulsory, no insurance company would provide it. However, it is worth noting that there are reports that the insurance industry has this situation under review, and its attitude may change in the future.

4. Qualification Criteria for Registration

Building practitioners are required to possess recognised tertiary qualifications in addition to several years' experience in their chosen field. Insurers were insistent upon a qualification benchmark to ensure that there was in place a demonstrable level of skill as a prerequisite to practice. It was considered that higher skills would translate into a lower claims occurrence environment.

5. The Legislative Compulsion for Insurance Cover

As one could imagine, the requirement by law for building practitioners to be insured has created a massive insurance premium pool for the insurance industry. At last count there were over 5,000 registered building practitioners and there is a potential pool of up to 10,000. The size of the pool has given insurers the financial fortitude to finance a future risk.

The Building Act has been operational in Victoria for 12 months. By the time the first claim emerges there will be a considerable reservoir of funds. It is noted that run off cover is not available in the Northern Territory (the third jurisdiction which proclaimed Model Building Act reforms). With a population of some 120,000 (compared to Victoria's population of around 3.5 million), and only a nominal number of registered building practitioners, the Northern Territory was unable to produce a sufficiently large insurance pool to generate the required reserves.

Summary

The reform process which culminated in the new legislation commenced in 1990. It was four years before Victoria's Building Act was proclaimed. The process was long and tortuous, and required a considerable reservoir of stamina and fortitude on the part of those who had carriage of the reforms, and considerable political commitment and boldness on the part of those responsible for their passage. This realisation needs to be stressed, because if a jurisdiction is intent on introducing the same suite of reforms then those with carriage must gird their loins and prepare for a massive challenge.