

Run-off cover has resulted in peace of mind for building practitioners

HISTORICALLY one of the banes of the building industry was the man of straw, or the impecunious defendant. Some plaintiffs, after spending large amounts of money on lawyers, were left destitute because they couldn't enforce a judgment.

Why? Because the defendant couldn't pay for the liability.

Hiding behind the corporate veil of the company was a common method used to frustrate financial responsibility. When a judgement was made against a company for defective building work, the directors simply wound the company up. This is no longer possible because building practitioners have to be insured.

In the past, some practitioners carried professional indemnity cover. It provided indemnification for negligent design, inspection, monitoring, contract administration and costing. As long as the practitioner was paid up he was indemnified by the insurer and the public possessed the capacity to get effective financial redress. The problem was that if the payment lapsed, the practitioner was uninsured and had to assume personal liability for past sins and omissions.

As many defects take a number of years to emerge, by the time litigation ensued there was a good chance that the practitioner was no longer insured. This was particularly the case in the late '80s recession where the industry experienced massive practitioner casualties — people who could no longer afford to practise, let alone pay their premiums.

Since the Building Act was proclaimed in 1993 there has been an about change, courtesy of automatic run-off cover. All building practitioners are now required to carry run-off cover in order to practise. Run-off cover continues to provide professional indemnity cover to practitioners for liabilities incurred after their registration ceases. While a practitioner is registered he is required to pay an annual insurance premium. If



By **Kim Lovegrove**, building contracts lawyer.

the practitioner retires or can no longer afford to practise, provided he was registered and insured while practising, he is indemnified by the insurer for the duration of the liability period. That period is 10 years under the Building Act 1993.

This is an added benefit for practitioners. Prior to proclamation of the act the only way that a retired practitioner could avoid the spectre of personal liability for past omissions was to purchase an annual run-off policy. This was expensive because peace of mind had to be maintained for a person's natural life. (I know of one case where a retired engineer was sued in his 80s — many years after leaving the industry. He was uninsured and personally liable for the full brunt of the judgement.)

Ten-year run off cover is rare internationally. The only other jurisdictions in the world that have this cover are South Australia, where it is limited to building surveyors and France. It requires a massive premium pool.

Automatic run-off cover is funded through the continuing contributions of those who maintain their insurance in accordance with the Building Act. At last count there were more than 20,000 registered and insured practitioners in Victoria.

The beauty of run-off cover is that owners and developers have an indemnified practitioner defendant in the event of litigation. The indemnity lasts for the duration of the liability period.

Some anomalies do, however, exist. Domestic builders are only required to have a six-and-a-half-year cover. There is therefore a hiatus between the second half of year 7 and the balance of the liability expiry date, which is 10 years after the occupant permit is issued.

This means that if an occupancy permit is issued for a house and a claim for defects is issued eight years hence, a "man of straw" may surface. However, for an additional premium this gap can be covered by some insurers, such as BRIC and CE Heath. It is also noteworthy that the insurance cover for commercial and industrial builders is limited to structural defects.

Even though the Government has created a utilitarian consumer-oriented benefit, this does not give owners license to abdicate responsibility for prudence and vigilance. Owners should check the amount of cover to ensure that the risk underwritten equals the value of the building. Practitioners should shop around among insurers and read the fine print. The market is competitive so a good deal can be struck, but don't be solely driven by bottom line; rather, analyse the extent and scope of the cover. One would be foolish not to cover the gap between year 7 and 10 for residential risks. Research reveals that defects can take up to eight years to evolve from a dormant to a discernible stage.

In summary, the introduction of mandatory run-off cover has been a remarkable consumer breakthrough.

It has increased the security of the industry both financially and in terms of peace of mind. It also generates that added benefit of quality control. High-risk practitioners will feel the weight of increased premiums which will mean they will either lift their game or be priced out.