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14 March 2008

Consumer Policy Framework Inquiry  
Productivity Commission  
GPO Box 1428  
CANBERRA CITY ACT 2601

And By Email to: consumer@pc.gov.au  
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Dear Commissioners

Your Inquiry has only just come to my attention and I apologise for the lateness of my brief submission. Nevertheless, I congratulate you on the production of your draft document highlighting the deficiencies in the product known as "builders warranty insurance" and its inability to protect consumers in the way in which it was originally conceived.

I am a lawyer who has been providing legal services to builders and owners for more than a decade. I am also a member of the Victorian Building Appeals Board which is the ultimate tribunal in relation to matters arising under the *Building Act* 1993.

I believe I have the experience to contribute to your Inquiry in a helpful manner by outlining some of the salient deficiencies with the current scheme as I see them.

In the early nineties, the Victorian Government wound down the Housing Guarantee Fund (and liquidated its considerable funds) to allow the private sector to provide insurance in its stead. The initial private insurance allowed by the legislature for owners (as consumers) was for them to be beneficiaries of a product that provided an indemnity for both a builder's workmanship and/or a project's increased cost due to non-completion arising from insolvency. In addition, the applicable Ministerial Order also allowed for builders to be named as an insured so that the policies were in effect a form of professional indemnity insurance. As the Commissioners will well know, this is so important to so many professional industries where the consequences of loss occasioned by accident or mishap are too grave for such loss to be borne completely by the individual otherwise liable.

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In my opinion, the relevant insurers then successfully petitioned the Victorian Government to cause the Ministerial Order to be amended so that builders were not included in the definition of being an insured. This occurred so that a insurer had a right to subsequently sue a builder for its payments made pursuant to the indemnity; rather than be barred under the *Insurance Contracts Act 1984* (Cth) which prohibits an insurer claiming recovery against a party also named as an insured. Despite this, it was not observed by me that there was any adjustment in premiums despite the significant reduction of an insurer's commercial risk.

By the Ministerial Order amendments in 2003, the insurance scheme was again radically altered so that it became (as the Commissioners will be well aware) an insurance scheme which only indemnified the owner for capped amounts for loss occasioned by disappearance, death or insolvency. Thus it became commonly known as an "insurance of last resort".

The most troubling aspect for me with the current insurance scheme in Victoria, is that while it is perhaps acceptable that builders be required by law to obtain this form of insurance, the private market is forcing the individuals behind the building company, including their spouses, to give personal guarantees. In the case of the average residential builder this means "putting up" their family home and/or life savings.

To my mind this transaction is quite unpalatable in the context of the notion of insurance; which involves the "right" or privilege to collect a premium, in return for an obligation to pay or indemnify a party for its loss. This is why the law has always treated contracts of insurance special obligations on insurers and being, what lawyers call, "uberrimae fidei" (of the fullest confidence). The current scheme in my opinion effectively allows builders to be made to re-insure the insurance companies in as much as the insurer's practice of obtaining these guarantees. This means that those insurance companies are currently enjoying an extraordinary benefit of collecting premiums in return for little or no risk, which is unfortunate in the following respects.

Firstly, this increased risk to the average residential registered builder, means that I am witnessing that many very good competent builders declining to practice in the domestic sphere. Indeed, it is fundamental to the notion of promoting enterprise that individuals be allowed to trade through corporations which have limited liability. If that position is eroded, it is inevitable that many individuals involved will not engage or chance in that enterprise (which in turn employs and engages many other small businesses who provide labour and materials as subcontractors). It is these small businesses that also rely on the enterprise of those who are prepared to engage in the high-risk profession of residential builder.

Secondly, the increased risk is priced accordingly, which has the consequence of being passed on to the home owner.

The consequences of these two points above mean that Victoria is, in my opinion, currently experiencing a shortage of domestic builders which, due to that lack of competition and increased risk has greatly inflated the price of domestic construction for consumers.

Thirdly, I am concerned that residential builders are often unsophisticated people with small businesses and are also deserving of protection. So many builders are being forced to sign documents which can be said to be unconscionable in the sense that spouses and others are required to guarantee the obligations of the insurance company with the equity in their homes or their life savings. I am as a lawyer quite weary and saddened by the devastation caused to individuals and their families by an insurer calling up such guarantees.

As the building industry is the biggest engine of the Victorian economy (and of that activity approximately 60% of all building activity is residential) it is absolutely vital, in my opinion, that the current form of "builders warranty insurance" be dismantled.

It is respectfully submitted that creating a scheme whereby both builder and owner can be indemnified by the insurance policy is the most appropriate. Alternatively, one is implemented without any individual being forced to bear all the loss of accidental mishap. This would result in insurers again returning to the normal model of being allowed to collect a premium in return for indemnifying a peril.

In my opinion, the consequences of the present scheme are contributing significantly to the shortage of builders and the alarming increase in the inaffordability of housing.

I thank you for the opportunity to commend these views of mine to the Productivity Commission.

Yours faithfully  
**BEST HOOPER**



**David Fairweather**  
Partner

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