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State Insurance Regulatory Authority
McKell Building
Level 6
2-24 Rawson Place
SYDNEY NSW 2000

Dear Sir/Madam

HOME BUILDING COMPENSATION SCHEME REFORMS

Strata is the fastest growing form of residential property ownership in Australia. Over half the new dwellings to be built in our metropolitan areas over the next decades will be strata titled. The growth of this sector raises increasingly important questions over property ownership and governance.

The Owners Corporation Network of Australia Limited (OCN) is the peak body representing residential strata and community title owners and occupiers. OCN is therefore the key consumer voice in this review.

OCN urges SIRA to focus its attention on the main cause of the cost of HBCF claims, being deliberate insolvencies. Doing so would most likely result in a scheme that can offer a safety net to all residential strata buildings, not just those 3-storeys or less.

This submission will therefore focus on eligibility.

The 'elephant in the room' is the minority of builders who use companies to avoid responsibility for their shoddy work. Only 18% of home building contractor license holders in NSW are companies. However, **insolvencies within that 18% of the licensed contractor population somehow accounts for 85.6% of all accepted insurance claims**[1].

There cannot be an innocent explanation for such an extremely disproportionate statistic over the 12 year period to June 2014. The extremely disproportionate amount of accepted claims relating to company insolvencies shows that the government's regulation of the sector has tolerated phoenix company behaviour.

[1] Table 5.4, Budget Statement 2015-16

SIRA needs to focus on the causes of the above statistic. That is the key to not just achieving substantial savings for the HBCF but also substantially reducing the prevalence of residential construction defects in NSW.

The cost-effective litigation minimising Queensland 'first resort' model has been given reverential status in reform discussions over the last 5 years. There is a reason why the system in Queensland works so well, with most disputes resolved by builders carrying out proper repairs without the need for an insurance payout. The reason is that in Queensland, shoddy builders are held to account and cannot avoid responsibility by hiding behind $2 companies. In Queensland, if a company does not properly deal with its defect issues, thereby causing the need for an insurance payment, the Queensland Building and Construction Commission may recover the cost of that payment from the directors of that company as a debt.

Below we provide some evidence of how in many instances the persons behind companies that became insolvent without addressing their defect issues have been allowed to simply move on to operating via other companies.

<u>The builders behind the insolvent companies – Where are they now?</u>

OCN is grateful to Stanton Legal, Bannermans Lawyers, Chambers Russell Lawyers and Makinson d'Apice Lawyers for identifying from their records the matters with which they have been recently involved where a last resort insurance claim has been lodged where the insured builder was a company, and the names of those companies.

An analysis, based mostly on searches of the Fair Trading Home Building Contractors register, with some references to ASIC searches, has been undertaken to assess whether the persons behind the collapsed companies whose work has resulted in last resort insurance claims simply continued residential construction in NSW through other companies.

The analysis sample was 43 companies. The detail of the analysis is provided at Annexure 'A' with each of the 43 building companies given a number rather than identifying them publicly. The outcome of the analysis was:

- In 27/43 or 63% of the sample of failed companies that led to last resort insurance claims, persons behind the company continued residential construction in NSW through one or more other licenced companies;

- Of those 27 examples where persons behind a company continued residential construction in NSW through one or more other licenced companies, there were 17 examples (or 40% of the total sample) where the other companies were given eligibility for insurance.

Those statistics show:

1. In the majority of cases, the persons behind the company have simply let the company go and continued building through another company;

2. A substantial proportion of instances where not only have the persons behind the failed company moved onto another company, the HBCF is taking the risk of the other companies also being allowed to collapse in the face of further defect issues at great taxpayers' expense;

3. It is too easy for builders operating through companies to walk away from any consequences for their shoddy work;

4. The regulation for granting home building licences to companies is a failure;

5. The HBCF's underwriting procedures for companies have been too lenient.

Such a state of affairs does nothing to encourage builders operating through companies to take care with their work, and does nothing to encourage them to properly deal with defect issues once they are raised by owners.

The financial cost of that to the HBCF cannot be properly measured. However, common sense suggests that it has had a large part to play in a large proportion of the 85.6% of accepted insurance claims where the insured contractors were companies.

The worst examples of lax regulation from the study undertaken are probably:

(a) Company 3: This company's licence ended in May 2014 and 5 insurance claims in relation to the company have been paid out. Two directors of the company have continued operating through a second licenced company which has been eligible for insurance since December 2013;

(b) Company 4: This company's licence ended in March 2010 and 7 insurance claims in relation to the company have been paid out. One of the directors has continued operating through a second (similarly named) licenced company which has been eligible for insurance since January 2011;

(c) Company 11: This company's licence ended in December 2007 and 6 insurance claims in relation to the company have been paid out. The directors have continued operating through a second licenced company from May 2007 which has been eligible for insurance since January 2009. They have also been operating a third licenced company (with a similar name to the second licenced company) since August 2009 which has not been eligible for insurance.

The 'bad apples' may only be a minority of the industry but they are causing enormous damage to the industry and consumers as well as causing enormous cost to taxpayers through the HBCF. It is essential SIRA addresses the regulation inadequacies that have allowed this to occur.

Options for 'weeding out' the 'bad apples', or at least making it harder for them to continue their phoenix behaviour, include:

1. Following Queensland's lead by creating a system where defects are generally addressed by builders without the need for an insurance payment by making directors of companies personally liable for any amount that the HBCF pays out. It is reasonable to assume that companies will then deal with defect issues instead of folding, and the personal accountability for shoddy work will result in more careful construction and less defects in the first place;

2. Partially following Queensland's lead by making directors of companies personally liable for any amount that the HBCF pays out up to a limited amount. If this 'halfway' approach is adopted, OCN suggests that the limit on a director's liability for an amount paid out by the HBCF should be tied to the value of the subject contract work (perhaps 50% of the contract sum);

3. Only allowing qualified supervisors for private companies that are directors of the companies (which is a step considered by the discussion paper);

4. Not allowing a licence holder to be a qualified supervisor for more than one company at any one time;

5. Only providing home building licences to individuals and only providing each person with one licence number for life. The eligibility of someone from time to time to contract on their own behalf, or to be a qualified supervisor of a company, or both, and for different categories of work from time to time can all be easily administered via one licence number. That will make a builder's track record much more transparent for consumers and for the HBCF at the underwriting stage. The 'bad apples' will also not be able to hide behind the clean record of a new licence number;

6. If the Fund has had to pay compensation to an owner in relation to a company, any other company that a former director is involved with should be ineligible for insurance unless the amount paid out by the HBCF has first been reimbursed to the HBCF (NB: This would not restrict former directors from continuing to operate by contracting in their own name thereby taking personal responsibility for their ongoing work as per 82% of current contractor licence holders);

7. Having an insurance eligibility category for 3 storey buildings with the licence conditions upon companies that do not have such an eligibility including that such companies may not construct buildings of more than 3 storeys. That would be a small start towards better protecting owners of new multi-storey buildings for which contractors do not need insurance to build.

   Currently, builders who do not have the expertise or financial stability to meet the HBCF's criteria to be eligible for insurance for a building of up to 3 storeys are allowed to construct more complex buildings of more than 3 storeys, as insurance is not required for same. Thus, the construction that should be most regulated is ironically the least regulated.

   Not having any real restriction upon who can build multi-storey buildings is absurd. It encourages the use of $2 companies to evade responsibility for defects and ensures that those $2 companies will ignore their responsibilities. That lack of accountability encourages poor construction practices which results in more defects. It should also be noted that many consumers buying into large buildings are within the most financially vulnerable proportion of home owners and are most in need of protection from phoenix company builders;

8. Notification to the HBCF of building defects proceedings commenced against companies in relation to multi-storey buildings so that the issues arising from same can be factored into considering the company's ongoing 3 storey building insurance eligibility.

9. Investigate whether it is possible to trace through an obligation to rectify so that it follows a company director to new or other entities as a deterrent to simply closing down one entity and continuing to operate via a new or other existing company.

OCN supports a fair and equitable ‘safety net’ system that supports reputable builders and protects vulnerable consumers, and is happy to engage with government on any aspect of this submission, and to work with government to develop solutions to the issues identified.

Sincerely

[redacted]

Karen Stiles
Executive Officer

ANNEXURE 'A'
ANALYSIS OF A SAMPLE OF RECENT HOME OWNERS WARRANTY CLAIMS INVOLVING COMPANIES

No.	Observations
1.	Licence ended 08/07. Two directors have been the directors of a 2nd licenced company with the same name except for 1 letter since 04/06. That 2nd company has been eligible for insurance since 04/10. The same 2 directors have also been the directors of a 3rd licenced company since 12/08. It also has a similar name and has been eligible for insurance since 10/12.
2.	Licence ended 08/10. A director and the supervisor have been operating through another licenced company since 06/10 which is not eligible for insurance. Same director also operating through a 3rd licenced company since 11/15 which is not eligible for insurance.
3.	Licence ended 05/14 (5 insurance claims paid). Two directors still operating through a 2nd licenced company which has been eligible for insurance since 12/13.
4.	Licence ended 03/10 (7 insurance claims paid). One of the directors is operating through similarly named licenced company since 02/09 which has been eligible for insurance since 01/11.
5.	Licence ended 01/06. No ongoing company licences.
6.	Licence ended 08/10. The director and supervisor operated through a 2nd licenced company from 11/10 to 11/13 which was not eligible for insurance.
7.	Licence ended 05/06 (3 insurance claims paid). No ongoing company licences
8.	Licence ended 02/14. (8 insurance claims paid) No ongoing company licences.
9.	Licence ended 02/12. No ongoing company licences.
10.	Licence ended 08/13. The director and supervisor have been operating through a 2nd licenced company since 08/14 that has been eligible for insurance since 07/15.
11.	Licence ended 12/07 (6 insurance claims paid). Directors operated through a 2nd licenced company from 08/07 to 08/13 which had insurance eligibility from 07/09. One director still operating through a 3rd licenced company (with a similar name to the second) from 04/13 which has had insurance eligibility since 10/13.
12.	Licence ended 07/12. No ongoing company licences.
13.	Licence ended 11/09 (3 insurance claims paid). The director and supervisor has been operating through a 2nd licenced company from 05/07 which has been eligible for insurance since 01/09 and a third licenced company (with a similar name to the 2nd licenced company) since 08/09 which has not been eligible for insurance.
14.	Licence ended 02/11 (10 insurance claims paid). No ongoing company licences.
15.	Licence ended 05/08. Director and supervisor operating through 2nd licenced company (with similar name) from 04/08 to 04/15 that did not have insurance eligibility and now through a 3rd licenced company (with another similar name) from 03/15 which has been eligible for insurance since 10/15.
16.	Licence ended 03/11. The supervisor and one time director has been operating (as supervisor only) through a 2nd licenced company since 03/12 which has had insurance eligibility since 6/12.
17.	Licence ended 08/11 (5 insurance claims paid). A director has been operating through a 2nd licenced company which has not had insurance eligibility since 11/12 and a 3rd licenced company which has not had insurance eligibility since 11/14.
18.	Licence ended 05/07. A supervisor has been operating through a second licenced company since 02/07 which has been eligible for insurance for most of that time and is currently eligible.
19.	Licence ended 02/11 (6 insurance claims paid). No ongoing company licences.
20.	Licence ended 12/05. The director and supervisor operated from 08/11 to 08/15 through a 2nd licenced company that was not eligible for insurance.
21.	Licence ended 05/06. No ongoing company licences.

22.	Licence ended 08/08 (3 insurance claims paid). A director and supervisor operated through a 2nd licenced company that was eligible for insurance from 10/08 to 10/12 and has operated through a 3rd licenced company from 09/11 which was eligible for insurance from 10/11 to 06/15.
23.	Licence ended 01/06. No ongoing company licences.
24.	Licence ended 10/05. Director and supervisor operated through 2nd licenced company (#25 below) from 06/07 to 06/12 (5 insurance claims paid). He had a 3rd licenced company from 08/11 to 08/12 which did not obtain eligibility for insurance.
25.	Licence ended 06/12 (5 insurance claims paid). Director and supervisor operated through a 2nd licenced company from 08/11 to 08/12 which did not obtain eligibility for insurance.
26.	Licence ended 04/07. No ongoing company licences.
27.	Licence ended 04/14. A director and supervisor has been operating through a 2nd licenced company since 03/13 which has been eligible for insurance since 01/14.
28.	Licence ended 06/06. No ongoing company licences.
29.	Licence cancelled 07/15 (notice of resolution to wind up lodged with ASIC in 04/15). Director and supervisor operating through a 2nd licenced company since 02/15 which became eligible for insurance in 02/16.
30.	Administrator appointed 07/12. Licence still on register. No other ongoing company licences.
31.	Licence ended 03/10. The director and supervisor for most of the company's duration has been operating since 11/11 through a 2nd licenced company that has not had insurance eligibility.
32.	Licence ended 09/15. The supervisor has since then been the supervisor for a 2nd licenced company which became eligible for insurance in 10/15.
33.	Licence ended 05/14. Director and supervisor was operating through a 2nd licenced company from 10/14 to 02/16 when that company's licence was cancelled due to the 1st company's external administration.
34.	Licence ended 05/14. Director and supervisor has been operating through a 2nd licenced company which has not had insurance eligibility since 05/14.
35.	Licenced ended 04/06. Nominated supervisor has been operating through his own company since 01/02 which has had insurance eligibility at various times including since 04/11.
36.	Licenced ended 07/14 (9 insurance claims paid). A director and supervisor has been operating through a 2nd licenced company that has not had insurance eligibility since 10/13.
37.	Licence cancelled 11/15. No ongoing company licences.
38.	Licence cancelled 01/16. No ongoing company licences.
39.	Liquidator appointed 10/15 (register lists licence as active). No other ongoing company licences.
40.	Licence ended 05/15. Director and supervisor operated through a 2nd licenced company that was not eligible for insurance from 02/13 to 02/16 and has been operating through a 3rd licenced company since 02/06 which has been eligible for insurance since 09/09.
41.	Licenced ended 04/13. Some of the directors and a supervisor have been operating through a 2nd licenced company with the same name except for one letter since 07/13. The 2nd company has not had insurance eligibility.
42.	Licence was from 03/00 to 03/13. One of the directors also operated a 2nd licenced company with similar name from 02/09 to 02/16 which was eligible for insurance throughout that period.
43.	Licence ended 09/05 (4 insurance claims paid). A director and a supervisor operated through a 2nd licenced company with a very similar name from 06/05 to 06/06. That company did not obtain insurance eligibility. That director also operated through a 3rd licenced company from 1988 to 02/11 which did not have insurance eligibility since 02/2000.