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SOME WEATHERTIGHTNESS ISSUES

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PART 1 – BACKGROUND TO WEATHERTIGHTNESS DISPUTES (Adapted from a paper given by the author to the Lexis Nexis 2002 Weathertightness Conference)

1. The Significance of the Building Code and Relevant Standards

The Building Code

The Building Code does provide, in relation to weathertightness, a performance, or end result, specification.

For example, clause B2 in relation to Durability sets out a clear end result objective in relation to the performance of the building and the building elements.

Clause E2 deals expressly with External Moisture and defines as a Functional Requirement:

> "Buildings shall be constructed to provide adequate resistance to penetration by, **and the accumulation of,** moisture from the outside". (Emphasis added).

The remainder of E2 deals with Performance, again defining the required end results.

Presumably, it is because of these provisions that the government has confidently stated that there has not been a problem with any building which complies with the Building Code.

In a sense, this is quite correct – and this is because of the force of an end result, or performance, requirement.

However, in the case of water and moisture penetration, we have a classic situation where the performance obligations under the Building Code become overtaken by any method specifications in the building contract (for example, flashing and other waterproofing details), or the relevant Acceptable Solutions published by the Building Industry Authority.

The average builder (with no in-house design skills) would normally expect that the method specifications, coupled with a formal inspection of critical work, will result in compliance with the performance obligations of the Building Code.

The obligation to meet those requirements rests fairly and squarely with the designer. In some cases this may be the contractor; in others it may be the responsibility of the owner or developer. But a designer such as an architect, shortchanged on fees, and endeavouring to design to a tight construction budget, is bound to come up with the bare minimum or something a little less than that.

NZS3602:1995 – Specifying timber and wood-based products for use in buildings

The acceptance of untreated timber for certain purposes is expressly qualified, in particular, in clause 105.5:

> **"Radiata pine framing members that have been kiln dried at 74C or above, to 18% moisture content or less and having been planer gauged do not require preservative treatment, provided they are not exposed to ground atmosphere or in any position where the timber moisture content will exceed 18%."**

Putting aside the scientific correctness or otherwise of the 18% moisture threshold, there does appear to be a large body of evidence to the effect that it is very difficult to ensure this threshold is not exceeded.

Like the Building Code, we have a classic example of an end result requirement which begs the question of how to achieve it.

Another obvious issue arises. The law of negligence recognises that in certain circumstances, a duty to warn can arise.

At what point might there arise a duty to warn everyone throughout the design and construction chain of:

- the critical importance of permanent compliance with the 18% threshold, and
- the difficulty of compliance with it, and
- the desirability of considering alternative materials or design mechanisms if there is any reasonable doubt about future compliance.
- And so on; the list could be endless.

Other publications

Members of the industry are familiar with the Building Industry Authority's Acceptable Solutions Publications, particularly E2.

In a sense, this sets out to provide a method solution to the Building Code performance obligations.

Also the BRANZ Bulletins including 302 (Preventing Moisture Problems In Timber Framed Skillion Roofs) and 343 (Moisture In Timber).

These too, provide recommended methods for achieving the performance obligations.

Are they, in law, warranties that if complied with the end result required by the Building Code will be achieved?

2. Identifying the Real Issues in Such a Dispute

It is evident from what has been said that with building failures or defects of the kind in question, there can be many layers of responsibility and many layers of causes of action.

In an arbitration one can deal only with the parties to the arbitration. Usually these will just be the two contracting parties (for example, owner and builder, or the builder and subcontractor, or the appropriate contracting party and the designer or project manager.) The parties to an arbitration can be wider than the two contracting parties only if others come in by agreement.

For this reason, an arbitrator can focus only on the liability of the person being claimed against, even if that person (and the claimant) may have legal redress against another or others to be pursued at a later date.

The position is quite different with court proceedings where everyone who has contributed to the loss can be joined as defendants or, in turn, be joined by a defendant as a third party.

The importance of the factual situation

As every judge, arbitrator and lawyer will correctly say, 90% of disputes are eventually decided on their facts.

So too, with weathertightness disputes. It is essential to focus on design responsibility, design performance, standard of workmanship, quality of supervision by the builder and others, defining the defect and pinpointing the reason for it. There is no end to what may become relevant. For example, the way in which the timber framing was protected from the weather when stored, the way in which it was protected from the weather prior to closing in, how much detailing was left to the builder's discretion, was that a reasonable thing to do, and so on.

Getting other parties involved

It may well be in the interests of two contracting parties (whose contract includes an arbitration clause) to jointly waive the requirement for arbitration and, by agreement, have proceedings launched in court. This will give the claimant the benefit of being able to seek recovery from other defendants or join more parties who may have responsibility or shared responsibility; and it will give the defendants the advantage of being able to seek indemnity from other defendants or join third parties. I can think of many situations where it would be in the mutual interests of both contracting parties to have the matter dealt with in court, for those procedural reasons. Equally, one or more parties who will inevitably be joined if the matter is dealt with in court, might see the writing on the wall (and prefer the confidentiality of arbitration) and agree to be involved in the arbitration process concurrently with the contracting parties.

3. Efficient Undertaking of Remedial Works

By whom

The question often arises as to whether the person responsible (who may or may not be the builder) should directly handle the remedial works, or whether the owner should retain or take control over them. At the end of the day, it is a question of mitigation in that every claimant has a duty to mitigate his or her loss. If the person responsible wishes to undertake the remedial work then that should be permitted if there are savings to be gained, and if there is no reasonable reason to refuse.

For example, if an independent assessment or quotation is for $30,000.00 and the builder or architect or developer says "I can do the work for $15,000.00" then there would have to be good reason why the person responsible should not be permitted to reduce their amount of liability. There may be good reason to refuse but if the refusal is unreasonable an arbitrator or court will award only the amount for which the repairs could have been done.

Security for performance

By the time a dispute has got to arbitration it is usually the case that each side as developed a complete lack of confidence in the other. It is also sometimes the case that, provided remedial works are done properly, a balance of the building price will then be due to the builder. In order to facilitate a speedy attendance to remedial works and to overcome the high degree of mutual suspicion between the parties, I sometimes order that the amount which will be due to the builder upon proper completion of remedial works be paid into an appropriate trust account (usually of the solicitors representing one side or the other) so that the builder can see that the money is there to be paid (on the arbitrator's direction) when the remedial works are satisfactorily completed.

There may or may not be a sound legal basis for this approach but it works.

4. Lessons for the Industry

I believe there are significant lessons which can be simply stated.

(a) If a technical specification requirement is vitally important (such as avoiding exceeding 18% moisture content around kiln dried timber for the future life of the building) then it is really not enough just to say so. The importance of it should be rammed home to everyone in the industry in every possible way with very clear warnings as to what the consequences would otherwise be.

(b) The well known examples of cost cutting (inadequate fees to designers, little or no money spent on proper supervision, negotiating prices which leave no reasonable profit for the contractor) are bound to result in errors and shortcuts.

(c) It is essential to appreciate that, except for the larger construction companies, most of the builders do not have significant in-house design capability and therefore developers and owners should avoid placing any design responsibility whatever on such builders.

(d) Designers should refuse the work unless they are assured of payment of fees sufficient to cover proper design, adequately dealing with an owner's or developer's changed requirements from time to time, the proper production of producer statements and (if no separate project manager is engaged) a proper level of supervision sufficient to ensure compliance with all critical aspects of the work including weathertightness detail, and including sufficiently regular inspections to be able to issue a Certificate of Practical Completion on an informed basis from their personal knowledge.

(e) Project managers should refuse the work unless they are similarly and appropriately engaged.

(f) Never endeavour to conceal an industry problem of the kind which has arisen. If proper warning of it had been given some years ago then everyone in the building chain would have known to take more care and adopt a more conservative approach. They have been denied the opportunity to do that, it could be said, as a result of a failure to warn.

I have intentionally not touched on such matters as the need to review Codes and Standards, the applicability of certain materials, the desirability of reviewing weathertightness details, and any other technical matter as they are better addressed by others.

PART 2 – DISPUTE RESOLUTION OF WEATHERTIGHTNESS CLAIMS (Adapted from a paper given by the author to the Lexis Nexis 2003 Weathertightness Conference)

1. Basic Legal Principles

(a) An aggrieved person must establish what is called a "cause of action". The most commonly known are a breach of contract (where there is a contractual relationship) breach of duty of care (for example, negligence, failure to warn, and the like,) breach of statutory duty (for example, the duty to comply with the Building Act and the Building Code,) or breach of the Fair Trading Act (where deceptive and misleading conduct can be established within the past three years).

(b) The onus of proof is always on the claimant (unless fault is so obvious the onus switches to another party to disprove fault.)

(c) A claimant can usually recover only proven loss from the party or parties who caused that loss.

(d) If a claimant wishes to bring a contractual claim and the contract includes an arbitration clause then the claimant must proceed against that party through arbitration (unless the other contracting party is willing to waive compliance with the arbitration clause). This means that the contractual part of the claim has to be conducted before an arbitrator whereas other claims against other defendants will have to be conducted, in parallel, through the courts.

(e) Where more than one person has acted negligently towards the claimant then those negligent parties are jointly and severally liable for the full amount of damage which they caused. Thus, if a project manager and a local authority have both acted negligently towards a home owner causing a total loss of say $40,000.00 then, even if the project manager was 80% responsible and the local authority 20% responsible, both are liable for the full amount of $40,000.00 (although the claimant cannot, obviously, recover more than a total of $40,000.00). This is very important if one negligent party has become insolvent.

(f) There is no provision in New Zealand for class actions. The courts will sometimes recognise a particular case as a test or representative case if it is seen to be on all fours with other cases of the same kind, but we do not recognise class actions. Even a "representative case" has its limitations because it will have been decided on its own particular facts.

(g) It is therefore possible to have say 10 cases in the courts involving identical damage, identical defendants (but different claimants) and resulting in 10 different outcomes. This is because different contractual provisions or different conduct by the parties with whom there is no contract, can easily lead to different outcomes.

2. Background to the Weathertight Homes Resolution Services Act 2002 – A Personal Perception

When there was a similar breakdown in building industry standards in Canada, the consequences were tragic. In most cases, through no fault of their own, thousands of people ended up with homes or apartments that were worth less than their mortgages. Many of these people were not well off to start with. There were numerous suicides and bankruptcies.

When the time came for New Zealand to face up to a similar problem, with potentially the same social consequences, the matter was initially approached in a less than satisfactory manner. The initial decision of the government was to establish a quick-fire mediation service for those willing to enter into the process voluntarily and otherwise leave those adversely affected to their legal rights through arbitration or the courts, as best they could pursue them.

It was an ill-considered announcement that inevitably drew strong criticism from many commentators and the opposition parties.

It was obviously fallacious to say to these people, “You have your legal rights in arbitration or court action or both”.

For someone whose property is now worth less than the amount of the mortgage, how would such a person pursue arbitration against the builder (because there would probably be an arbitration clause requiring that process) and then, separately, the council inspectors, designers, developers and anyone else through the courts? If there was to be a mediation with only one or two of the potential defendants present, they would point out that they had only shared responsibility with others who were not there and would offer an amount in the region of 25% or less. The claimant would have little or no option but to accept it because the cost of any formal alternative would be prohibitive. It was an example of saying something which sounded wonderful, but which in practical terms was mischievously self-serving.

Fortunately, the criticism was so loud that the government reviewed its position and, to its credit, did a complete u-turn.

When the Weathertight Homes legislation was passed last year, it was a classic example of a responsible reaction to the harsh criticism of the original proposal.

It would have been easy for the government to become entrenched, but to its credit this did not happen.

The new resolution service contains, in principle, a fair and practical solution to what could otherwise have become a significant social problem.

3. Residual Concerns

These are relatively few, but they are, nevertheless, quite important.

One is that a first class proposal could degenerate into a third rate process if appropriate people cannot be recruited to the roles of adjudicators, evaluators, technical assessors and mediators. Since the recruitment process has yet to be completed one must say that the jury is still out. (However, every one of the handful of names I know of who have been appointed or who have applied, seem to be the very kind of people who will make it a success).

Another area of concern is the very real problem of what to do about many early mediated agreements and early adjudicated determinations which occur before the wider liability issues are determined through the

High Court, Court of Appeal, and possibly the Privy Council.

In a submission to the government in mid October 2002 I said, on this topic:

> ***Let's assume that one of the larger groups of apartment owners decides to bring a test case against, for example, the Building Industry Authority. Such an action might be based on the failure by it to perform its statutory duties under the Building Act and, separately, for the failure of a duty to warn those in the industry. It does not appear to have statutory protection. Let's further assume that such a case wends its way through to the Court of Appeal and is successful. It will then be starkly obvious, with the benefit of hindsight, that the BIA should also have been "coerced" to attend the mediation table. If by then say 2000 mediations have been conducted and it is obvious that some claimants would have had the leverage to negotiate a higher figure if the BIA had been at the mediation table, what happens then? Can those settlements be re-opened because the government policy today is to get as many quick-fire settlements as fast as it can? Or do only the next 2000 claimants get the benefit of the newly declared liability of the BIA (or whoever).***

I suspect that this concern has fallen into the "too hard" basket.

A closely related concern is the need for adequate training of assessors and the desirability of a uniform approach throughout New Zealand.

One of the statutory functions of each assessor (section 10 (1) (b) (v)) is to express a formal view as to "… the persons who should be parties to the claims."

Potential parties who are either the government, a government agency, or a statutory body close to the government, and who could potentially be in the firing line include:

- The Minister of Internal Affairs for failing to ensure that the statutory functions set out in the Building Act were properly carried out; and failing to warn members of the industry and the public when the Minister knew or ought to have known there was a problem and the need for special care;

- The Standards Association for, perhaps correctly, defining the circumstances in which certain building products can be used, but then failing to warn the industry and the public of the dire

consequences of not meticulously observing the thresholds stated;

- BRANZ – for similar reasons:

- The Building Industry Authority for possibly failing to perform its statutory functions under the Building Act – effectively, a statutory obligation to be an industry watchdog.

(Many of the relevant technical documents published by the Standards Association and BRANZ were referred to in my paper at the 2002 Weathertight conference).

The possible liability of these persons in certain situations may not be "top of the mind" to the average assessor, particularly when dealing with a home owner who does not have competent legal representation. Even if this is pointed out to him or her, how will such a person appraise the appropriateness of recommending one or more of them be joined as parties; what incentive does the government have to include this in the training of assessors? For how long will an individual assessor continued to be reappointed under section 8 if he or she regularly recommends that the BIA becomes a party?

A final concern is also linked to the training of evaluation panelists, assessors and adjudicators. There are a number of well-developed concepts which are absolutely basic to a consideration of liability in a weathertightness dispute. These include understanding where design obligations begin and end, and ascertaining clearly the true scope of work to be done; for example, whether the specification requirements are of a "method" kind (which state what is to be done), or of a "performance" kind (which state the end result to be achieved). If a builder has done exactly what was required under the contract, there may be no liability even if the house is a total disaster, because the builder may have constructed exactly what was specified by the owner or the developer or the architect. Assessors and adjudicators must also clearly understand the circumstances in which contributory negligence can lead to a reduction of damages for breach of contract; see **Forsikringselskapet Vesta v Butcher** [1986] 2ALL ER 488, 508 which seems to stand consistent with the Contractual Remedies Act 1979; (see also the excellent discussion in **Construction Law in New Zealand,** (1999) Tómas Kennedy-Grant at 2.86.) Will they clearly understand the circumstances when a claim can be brought directly against an insurance company when the insured is bankrupt or in liquidation? Also, the very basic point that if two parties are partly negligent (for example, an independent certifying company as to 99% and the Building Industry Authority as to 1%) the claimant can receive 100% recovery from the party who is only 1% to blame and it is then up to that party to recover

99% indemnity from the person who was 99% to blame. This is all simple "law school" stuff, but unless the assessors and the adjudicators clearly understand it, they will not properly perform their functions.

4. A Strategic Overview of the Legislation

There is no point in labouring what can easily be read.

The following points are worthy of special mention:

The Crown is bound

An act of Parliament does not bind the Crown unless it says so. In section 6 it is expressly stated that this act binds the Crown. This provision, coupled with the fact that the claimant has a free hand to choose the appropriate defendants, means that in a proper case the Crown can be joined as a defendant.

Explanation of effect of a settlement

Section 17 calls for a proper explanation and this, in turn, leads to the binding nature of an agreed settlement. Where a party agrees it is being fully compensated, then no problem arises. If, however, a party (for example a claimant, or defendant seeking contribution from another defendant) is receiving less than it believes it is entitled to, but is accepting a reduced amount because it believes it has no other rights, it might be prudent to point out that when the law settles down in a few years time it might have accepted less than it should.

International convention blown away in relation to the binding nature of an arbitration agreement

After all the trouble which the Law Commission and Parliament went to in 1996 to facilitate the adoption by New Zealand of the UNCITRAL arbitration model, it would take the action of a brave-heart to say that it doesn't apply to disputes involving leaky houses (unless someone gets in first with a notice to arbitrate).

Having said that, rather cheekily, I must say I agree with the provision of section 22 (2). It makes a sensible exception.

The documents come in with the statements of position

The provisions of sections 26 and 28 in this regard follow, generally, the procedure that has applied in Civil Law countries for over 100 years, and are very sensible.

Joinder

Section 33 contains a very important provision empowering an adjudicator, on his or her own initiative, to order a joinder of new parties in adjudication proceedings. This seems very sensible. Hopefully, there will be no resistance to the use of this power in appropriate cases. There is a lingering issue as to whether the section authorises the joinder of third parties where there is no causal connection with the claimant but there is with a respondent. If there is a black hole here it should be corrected.

Powers of adjudicators

Section 36 and Part 2 of the Schedule contain very important provisions. These include the power to act inquisitorially, the power to appoint an expert adviser (who may be a lawyer if the adjudicator is not), the power to inspect, and even the power to issue a subpoena!

I would add a word of caution about the use of inquisitorial powers. This does not mean what some people might think it means. There is a legal obligation to involve the parties and give them an opportunity to comment. The legal authorities to this effect are contained in the joint paper of Tómas Kennedy-Grant and myself presented to an Auckland District Law Society seminar in relation to the Arbitration Act 1996, which contains a similar power for domestic arbitrations.

Powers of adjudicators – what power?

Section 42 (1) provides that an adjudicator may make "any order that a court of competent jurisdiction could make in relation to a claim in accordance with principles of law."

Obviously, this is likely to cover 95% of desirable orders. However, section 12 of the Arbitration Act 1996 contains a similar provision in relation to the powers of arbitrators "when making an award." In its report on that legislation, the Law Commission said, but without reference to authority, that such a provision is not wide enough to include coercive powers of the court. In other words, an arbitrator (and presumably an adjudicator) would not have powers to make Mareva or Anton Piller or similar orders.

Which way to jump?

I have intentionally left until last what is probably the most important (and difficult) strategic issue.

If I understand the legislation correctly, the claimant has the option of proceeding through a court or proceeding through this statutory adjudication process. In most respects, the mechanics are similar – discovery and inspection of documents, power to join anyone as a defendant, power to add and delete parties, power to order contributions between or amongst defendants, and all leading to a binding result.

But, which way to jump? It is probably too early to develop an exhaustive pros and cons exercise in relation to the alternative procedures.

Lawyers may have a conscious or subconscious leaning towards the forum they already know well. Others might simply assume that if the amount at stake is large it may be better to start off in the courts.

I would suggest final judgment be withheld on that issue. A very good adjudicator, steeped in the practice of construction law and construction disputes could well match or surpass the efforts of many judges. Time will tell. This topic could occupy a full conference session at a future conference.