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Building & Construction Law 2012
Topical Issues

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INTRODUCTION

This paper takes an omnibus approach and covers several topical issues in brief. The first part of the paper will examine earthquake strengthening issues in the construction sector; followed by an overview of the common issues that arise in remedial construction works for unit owners who have settled a leaky building claim; then we will touch on common issues for purchasers/developers in buying off the plans in residential developments. Lastly we will review the guarantees and warranties on construction works and the associated common issues. Time does not permit us to go into great details in all of these topics, so we will jump through the issues and hopefully leave you with something to think about.

PART I: EARTHQUAKE STRENGTHENING ISSUES AND THE CONSTRUCTION SECTOR

1. Background

1.1 The current Building Act 2004 currently sets out the definitions of "dangerous building", "earthquake-prone building" and "insanitary building".[2] However these are generalised classifications and each territorial authority is required by law to adopt policies regarding these buildings within its district. Particular emphasis is to be placed on the approach of the territorial authority in performing its functions, the priorities in performing its functions and how the policy will apply to heritage buildings.[3]

1.2 The starting point for earthquake strengthening issues is section 122 of the Building Act 2004 which describes an earthquake-prone building ("EPB") as being a building that would likely collapse causing injury or damage or damage to other properties in a moderate earthquake. Regulation 7, 2005/32 sets out what is considered a "moderate earthquake". The corollary of the changes in the 1991 building legislation means that more buildings in Auckland are encompassed by these sections and higher performance and criteria will need to be met for these covered buildings.

1.3 A major policy change in 1976 raised the earthquake standards as decision makers began to think about lateral movements as well as vertical movements, plaster over brick and unreinforced brick masonry contrary to the pre-existing principles. This produced the improved AS/NZS 1170.0 standards. This changed the ways of

[1] The authors would like to particularly acknowledge the contribution from various professional contacts who have provided input into this paper.
[2] Building Act 2004 s121-123.
[3] Ibid s 131.

building and although there is common consensus that buildings built after the series of developments in 1976 are now in a better position the issues are certainly not simplistic. There is a danger of simplifying the complexities involved in assessing buildings as one must consider the materials, design, size, height, type, complexities in addition to the new science that is currently being formed to understanding an EPB. Councils also acknowledge that buildings prior to 1976 have a lack of records which further add to the issues needed to be addressed.

2. Auckland

2.1 Auckland has produced the Earthquake-Prone, Dangerous & Insanitary Buildings Policy (2011 - 2016) ("Auckland's Report") outlining its part. The Policy was adopted in November 2011 and will be reviewed within five years. However Auckland's Report acknowledges that "Auckland's legal councils did not actively pursue a policy of strengthening every earthquake-prone building" and further admits that any strengthening work to date has been undertaken as a result of property owners actively pursuing this option, major upgrades of council-owned heritage buildings or strengthening required through building consents for change of use.

2.2 The Auckland Report has stressed the importance of a pragmatic approach while taking into account the need to protect lives and this highlights the conflicting interests of the need for a seismic resilience as opposed to an economical resilience. The legislations and policies are about saving lives as shown by the responses after the first Christchurch earthquake where buildings were deemed "safe to occupy" as opposed to saying the buildings were "write offs".

2.3 The most notorious policy introduced in the Auckland Report was the National Building Standard ("NBS") and the classifications of buildings. The Auckland Report classifies the current NBS as follows:

(a) Over 66.66% = low risk
(b) Between 33.33% and 66.66% = moderate risk
(c) Under 33.33% = earthquake prone.

2.4 The Auckland Report has further classified assessments into four categories being:

(a) Critical buildings such as hospitals, police stations, fire stations, civil defence buildings and those with special post-disaster functions – these have already been assessed and property owners will have 10 years to carry out seismic strengthening (end of 2021).
(b) EPB that contain people in crowds such as schools, universities, museums and airports – the assessments are to be completed by December 2012 and property owners will have 10 years to carry out seismic strengthening (end of 2022).
(c) Heritage buildings – the assessments are to be completed by December 2015 and property owners will have 30 years to carry out seismic strengthening (end of 2045).
(d) Other potentially EPB with a low degree of hazard to life – the assessments are to be completed by December 2015 and property owners will have 20 years to carry out seismic strengthening (end of 2035).

2.5 As owners of EPB have 10 to 30 years to fix, this appears to be more than sufficient time to fix the building, but in actual fact they will have significant economic pressure to fix earlier. For example, council can require strengthening or demolition where buildings are considered unsafe (e.g. Chao brother's property on Victoria Street) and anyone with a public interest can notify council of their concerns. The

owners will also have pressure from their banks, insurers, tenants, potential purchasers and the public. However, if the Council does not deem the building to be dangerous, earthquake prone, or insanitary and simply provides x years to fix the building, it raises a question of what disclosure obligations the owners have to the banks, insurers and tenants. For example is a tenant entitled to be disclosed the NBS and if so at what point and what circumstances? This will need to be resolved.

2.6 A critical question is what will happen during this limbo time. The NBS is important, but Council will also use an Initial Evaluation Procedure (IEP) set out in the NZ Society for Earthquake Engineering Recommendations for the Assessment and Improvement of the Structural Performance of Buildings in an Earthquake to determine the structural performance score of potentially EPB.

2.7 As buildings under 33.33% of the NBS will be considered EPB, the owners of such buildings will be notified by Council. Such owners will than have 6 months to review this notice and respond. If after this period the owner fails to respond or the Council still consider the building to be earthquake prone, the Council will issue a notice under s124 of the Building Act 2004 requiring a building consent to be obtained and the structural strengthening work to be undertaken. Section 124 states:

> *124 Powers of territorial authorities in respect of dangerous, earthquake-prone, or insanitary buildings*
> *(1) If a territorial authority is satisfied that a building is dangerous, earthquake prone, or insanitary, the territorial authority may—*
> > *(a) put up a hoarding or fence to prevent people from approaching the building nearer than is safe:*
> > *(b) attach in a prominent place on, or adjacent to, the building a notice that warns people not to approach the building:*
> > *(c) give written notice requiring work to be carried out on the building, within a time stated in the notice (which must not be less than 10 days after the notice is given under section 125), to—*
> > > *(i) reduce or remove the danger; or*
> > > *(ii) prevent the building from remaining insanitary.*

2.8 However, a section 124 notice may mean a fatal kill for many buildings which will simply be economically unsustainable to spend the amount of money to fix it. Even if a section 124 is not issued, the records will be available on the buildings LIM report and property file available for the world to see and will adversely affect the owner and the building.

2.9 Owners who have been notified by Council should carry out its own IEP by engaging qualified engineers and consultants to challenge that of Councils and add information to its property file. They have been strongly recommended to get its stair design evaluated if it is concrete. If the NBS is below 33.33%, various consultants will need to be engaged to provide a concept solution and budget. A reliable source has advised that engaging a qualified engineer and consultant will cost between $50,000.00 and $250,000.00 and this is before the owner even begins works to the building. It again questions the economic viability of this proposal and further questions who will pay for this. At the end of the day, owners of commercial buildings will be number sensitive with statistics on returns, monitoring the investment vs income and if the investment outweighs the income, it will simply not be sustainable. This is of particular concern as owners who pour funds into their buildings will not be increasing the net floor area of its building and the valuation of the building is likely to remain at the status quo (if not below) even after a significant capital has been added. The owner will be assessing at what

NBS rate the investment vs income is the most profitable and will therefore be setting its proposal on that figure. This almost contradicts the founding purpose of the earthquake strengthening process which is to simply save lives, not investments. However owners will find it difficult to transport their focus to the issue of seismic resilience as opposed to economic resilience as for many, it will simply be science and mathematics in an investment portfolio.

3. Christchurch

3.1 The Christchurch earthquakes have made us glaringly aware of seismic issues and put the seismic strengthening into the spotlight. Subsequent to the major earthquakes on 4 September 2010, 26 December 2010 and 22 February 2011, terms like "liquefaction" have become a popular idiom that is sporadically used both colloquially and professionally. $30 billion is estimated as the overall rebuild cost of Greater Christchurch (infrastructure repairs to pipes and roads make up an estimated $2.2B and this is expected to be revised). The recommendations from the Canterbury Earthquake Royal Commission have been taken on by various other councils and carefully being considered now for the second Royal Commission Report which is due to be released in November 2012.

3.2 The government passed the Canterbury Earthquake Response and Recovery Act 2010 (now repealed and replaced by the Canterbury Earthquake Recovery Act 2011) and the Canterbury Earthquake (Building Act) Order 2010 after these terrible earthquakes in order to "provide appropriate measures to ensure that greater Christchurch and the councils and their communities respond to, and recover from, the impacts of the Canterbury earthquakes." This was an immediate response and required under urgency. Christchurch had 300 heritage buildings and has now lost 200. Auckland has around 3000 – 4000 heritage buildings and needs to protect this. Recent publications show that Auckland Council has identified around 4500 EPB at this stage. Wellington has already identified 570 inner city commercial buildings which require earthquake strengthening and the nation is in suspense.

3.3 While each territorial authority has passed differing policies to protect buildings and ultimately, lives, systematic clarity is now required and the country now awaits the second Canterbury Royal Commission Report for some educated guidance.

4. Drivers of Policy Changes: Canterbury Royal Commission Report

4.1 The second Canterbury Royal Commission Report deals with failure of buildings as a result of last year's earthquake and has been given to the government in October 2012 and is expected to be released in November 2012. This is bound to have recommendations for updating the building code and increasing the current seismic standard. This will surely impact legislation in the future, but will not necessarily dictate building owners' actions. The main drivers will be economical.

5. Drivers of Policy Changes: Banks

5.1 Banks are the forefront of seismic issues as this ultimately affects the government and market valuation of the bank's security; ability of customers to make repayments and the potential mortgagee saleability of the security should the bank need to exercise this. A building in Wellington has dropped 80% in value decreasing from $10M to $2M because of the seismic issue and such a decrease will have tremendous impact on the owners and especially the bank. Commercial bank managers have advised that if a "well-to do" customer had one EPB, the banks would be more inclined to assist, but would struggle if the customer had

multiple EPBs. Inside information has revealed that banks are not taking a pro-active approach in this issue such as creating their own earthquake strengthening team (much like the leaky building specialist manager heading many of the first tier banks in that issue) or commissioning their own IEP. However when customers obtain an IEP, the banks may require that certain engineers or consultants be used from their list. This position will change when banks are mortgagee in possession and exercising their powers in which case they are bound to take a more active approach.

5.2 Banks and their requirements will drive the market. As different cities will have different risks, some banks maybe more stringent in their requirements in particular cities like Christchurch or Wellington, but in any case many are now requiring up to 80% of code for finance throughout the country.

6. Drivers of Policy Changes: Insurance

6.1 Insurance will be another main drive and there are rumours that even the key numbers (33.33 and 66.66) were dictated by insurers. Premiums are soaring in Christchurch and naturally the market will respond accordingly. The New Zealand Herald published an article on 6 November 2012 revealing that one commercial property in Wellington had its insurance premium rise from $17,000.00 per year to $217,000.00 within a short span of two years. The resounding question is who will pay for this?

6.2 One particular area of concern has been the attempted assignment of claim entitlements in Christchurch property sales. The Property Law Section has recently compiled an array of responses from three insurers and Vero Insurance New Zealand has confirmed their position that "an insurance policy itself is not assignable either at common law or under the terms of our domestic policies". IAG New Zealand Limited has advised that while they are "prepared to provide some of the claim entitlements held by the Owner to the purchaser of a damaged property… These relate solely to making good the physical damaged suffered to the insured property" and they continue to disclaim. Southern Response Earthquake Services Ltd stated that "Southern Response does not consent to the assignment of insurance policies, any Novation of current insurance contracts would require the consent of AMI Insurance." It seems the insurers will fight any assignments.

7. Drivers of Policy Changes: Tenants

7.1 Academic debates have soared examining lease clauses to determine who is responsible for strengthening earthquake-prone buildings and to what extent. The Auckland District Law Society Deed of Lease provides that, where a landlord is required by any legislation or requirement to spend money improving or altering a property, the landlord can charge an amount additional to the rent up until the next rent review date. This potentially gives the landlords the right to pass on earthquake strengthening costs to tenants by way of the improvement rent clauses. A landlord of an EPB who is required by law to make such improvements to the buildings to the current building code will arguably have this right as an improvement is anything of a nature that constitutes betterment of the land which is substantial and permanent. However will this be economically viable?

7.2 A battle will arise as new tenants will look to limit the amount of any contributions payable to strengthening works payable under the improvements rent clauses and further prevent any disruption resulting from the works. This will be met with opposition from the landlords who will aim to maximise their investment by passing

these strengthening costs to tenants and minimise liability. However what will happen to the current landlord and tenants who did now have the luxury of forward thinking?

7.3 A further dilemma will be the tenant employer's obligation to "provide a safe working environment and ensure employees are not exposed to risk or harm in the place of work. Generally, tenant employer must take all reasonable practical steps to eliminate, isolate, or minimize the hazard to satisfy its obligations under the HSEA."[4] Landlords will not be able to turn a blind eye to the requirements of Council to meet the NBS and owners of an EPB will be pushed to actively engage with Council, tenants and consultants to provide a safe building.

7.4 On the other hand, twisting the landlords arms may not be enough. Two months ago a building in Wellington worth $15M and fully tenanted for years was exposed to be 28% of the NBS according to Wellington Council records from 1980. Owners did an assessment and found that repairing the building to code will cost $15M, but as the net floor area would not increase the valuation subsequent to repairs would still remain $15M. The tenants walked out of the property to comply with its obligations to provide a safe and healthy place for its employees, but were still required to continue paying rent to honour their lease. This is litigious but with limited precedence and clarity it is hard to decipher what will result.

7.5 The leaky building saga is estimated to be worth $15B and there have been contrary voices on how much the seismic issue is worth. One bank manager has advised that it is ten times the leaky building issue while a construction industry leader has advised that although this issue is Ben Hur, it could not be worth $100B. Leaky buildings had the option of targeted repairs in addition to a full repair. Will a full repair here be required? Would it be economically sustainable? There will be a greater debate over the economics.

8. Prudent to Wait?

8.1 Some specialists are now advising that owners are best to wait. They should not cut corners or do the bare minimum as the buildings standards are likely to increase and be tweaked which will also affect the public perception. Owners who acted quickly to bring their buildings up to code may find that further works are required shortly after the current code is reassessed. Alternatively, the owners can go beyond the minimum standard (e.g. 70% as opposed to 34%) to ensure compliance even after the changes to the standards occur.

Many owners and consultants believe that further science, technology as well as clarity on law and policy should be expected. For example, there is talk of possible new glue that will save and better the seismic strengthening.

9. Need to Fully Understand

9.1 Many specialists have cautioned the risk of over generalisation or attaching a lot of meaning to one aspect of the seismic strengthening requirements. Simple distillation of complex factors is dangerous. People are getting into one liners and generalisation and forget that the NBS is just **one** small part of measuring and assessing this issue. It is therefore important for owners to discuss the NBS dictated by council as well as the IEP to decode its meaning for that particular building. The size, design, height, complexity, type and material of each building is

[4] Health and Safety in Employment Act 1992

different and we therefore cannot have one common methodology to deal with this issue.

One should be aware of all of these issues and programme matters into one's due diligence, construction agreements, property developments and so on. From the outset one must understand the local authority position, mortgagee position, insurance issues, valuation issues and tenant/purchaser concerns amongst other things. Construction and property law accordingly are reasonable complex area of legal practice and in order to add value to client requirements there is a lot to keep abreast with.

PART II: REMEDIAL CONSTRUCTION WORKS FOR UNIT OWNERS WHO HAVE SETTLED A LEAKY BUILDING CLAIM – THE COMMON ISSUES THAT ARISE

1. Background

1.1 It seems that the nation's focus has been on leaky building *claims* and the owners who have suffered economic, emotional and mental stress in a sad attempt to fix their buildings. Now, we are seeing the repercussions of such battles whereby the owners now have to engage in construction to repair the property after a settlement, government package or court judgment. Various issues are emerging now in the construction industry, after the fact.

2. Financing and bank requirements

2.1 Many owners are finding that their settlement or judgment is simply not enough to fund the whole construction project and find it difficult to accept this. Many settlements are subject and conditional to the project commencing and being finalised within x months from the settlement and it is therefore vital that the owners act fast and efficiently to get the job done.

2.2 Typical situations include a body corporate with multiple owners, some of which will find it difficult to fund the last special levy required to complete the project. Many will be weary and tired and at their limit and simply unable to fund the last special levy required. This will mean that their banks will ultimately have to fund this based on special financial applications not based on income or the financial position of the owner and the unit as at the application, but the financial forecast of the security based on numbers provided as if completed. However, for some owners who are with second tier banks or alternative funding this last special levy will be fatal.

2.3 Recent court judgments have hinted that a section 48 application (not section 74) under the Unit Titles Act should only be a "last resort" and sparingly given. This again puts the body corporate and the owners in a difficult position when they are at the last part of the crusade and are faced with a few owners who are unable or unwilling to comply.

3. Scope of Works

3.1 Difficulties arise when the scope of works at the claim stage is not properly identified. The process having been an adversarial process until the construction stage means that there would have been varying repair "requirements" argued by both the plaintiff and defendant, leaving the owner in an often confused stated as to what is actually required to remedy their building and what was actually betterment.

Client expectations will often be unrealistic or unforgiving and lack of comprehensive scope of works will cause trouble in the construction stage.

3.2 Examples of such issues involve a claim which was substantiated by building reports that outlined the requirements and omitted the fire report. Council often require an upgrade to the fire system in order to grant CCC and if this was never specified or accounted for in the construction contract, this council requirement will unfortunately be a principal driven variation costing the client approximately $40,000.00 to $70,000.00.

3.3 Another example includes the omission of allowing for sufficient paint or re-carpeting. You cannot simply paint one metre of a wall or replace one metre of a carpeted area and if this was not accounted for in the construction contract, it will again be a principal driven variation with the client having to bear such costs.

4. Litigation lawyers ≠ construction lawyers

4.1 As litigation lawyers are often not construction lawyers, such details in the scope of works will naturally be omitted and it questions what kind of requirements or training should be required of the litigation lawyers when preparing and settling such claims.

5. Second Generation Claims

5.1 While the current national focus remains on leaky buildings, second generation claims are a real threat and are now starting to emerge. One Auckland building remediated three years ago has been advised to have failed with the actual steel rotting away! The owners are lost as to what to do.

PART III: RESIDENTIAL DEVELOPMENTS AND COMMON ISSUES FOR PURCHASERS / DEVELOPERS FROM BUYING OFF THE PLANS IN THIS ECONOMY

1. Background

1.1 While many people may see the lack of construction cranes around the city as being a sign that the construction industry in Auckland now as being virtually non-existent apart from the repairs to leaky buildings, we have seen a rise with three apartment developments in the last three months. It appears that many purchasers (often fresh from overseas) are purchasing off the plans without understanding the risks and implications involved.

2. Securities Act

2.1 The recent Supreme Court decision has left practitioners astounded on what constitutes a security under the Securities Act. Many want to take the safe approach and view any representations of rental or returns as one triggering the act and requiring a prospectus. This will need time to be clarified further. Securities lawyers see the decision as social engineering rather than correct application of law.

3. Problematic Terms

3.1 **Sunset clauses:** Surprisingly many off the plans purchases are being signed without sunset clauses being inserted again alarming the legal industry as to what

kind of advice the purchasers are getting. Conveyancing is often viewed as a cheap and competitive package from firms and often, a purchaser buying off the plans will not see the need to obtain proper legal advice on the contract being signed and will either come to the solicitor after signing the document with the real estate agent without legal advice, or the conveyancing solicitor may treat it as a standard sale and not bother to amend the proposed contract or terms. Some law firms have endeavoured to contract out of RMA requirements in terms of substantial progress which is ultra vires.

3.2 **Modification / amendment clauses:** Another problematic area is contracts which do not specify any valid entitlements to the purchasers should the floor area of the unit change or should any materials be substituted and only provide a weak provision whereby the contractor is to use its best endeavours to match the product. If purchasers do not understand this or enter into oral agreements with the vendor or agent which is not properly recorded, this will give rise to a dispute, often at the peril of the purchasers.

3.3 **Defects Liability Period:** As this is expected to be mandated soon, such clauses are now popping up frequently in contracts for new build properties. However purchasers are often finding that if there is no bond linked to this provision, it will remain an empty provision that is hard to enforce.

4. Unit Titles Act and implications

4.1 The new Unit Titles Act 2010 has made several amendments including the requirement to provide a section 146 pre-contract disclosure form as well as a section 147 pre-settlement disclosure form. This makes it difficult for off the plan purchases which will have no information about the unit for the section 146 to be of any use or have any purpose. The further difficulty arises in the provision of the section 147 which is required 5 days before settlement with consequences of non-compliance including cancellation. Vendors will therefore need to very careful about the proposed settlement date being the standard "5 days after the issue of title" as this means that they will be unable to comply with section 147 of the Unit Titles Act and will need for example a waiver and acknowledgment that the agreement will not be cancelled for the late provision.

PART IV: GUARANTEES / WARRANTIES ON CONSTRUCTION WORKS AND ASSOCIATED COMMON ISSUES

1. Background

1.1 New build houses are frequently appearing with no guarantees or warranties. Alternatively the agreement purports to include a guarantee or warranty that will no doubt be ineffective and therefore care and caution is required around this area.

2. Empty Guarantees / Warranties

2.1 Banks and insurance are said to have become stricter on the guarantee requirements often requiring a meaningful guarantee before financing or providing a certificate of insurance for the property. However we are still seeing shocking "one liners" handwritten at the end of a property guaranteeing the works or guarantees by a shelf company with no financial backing.

2.2 Common misnomers from clients have included the belief that their 60 days defects liability period was enough guarantees from their contractors.

2.3 Although producer statements provide most information on products and warranties, one school project involved an electrical engineer requesting the installation of specific lights for his warranty to be effective. Different lights turned up from Italy who would not be bothered standing behind their products installed in New Zealand and the electrical warranty provided was meaningless. It would always be recommended for clients to obtain all relevant warranties and guarantees from the head contractors, the manufacturers and the subcontractors to ensure they are fully covered.

2.4 Care should also be given to any disclaimers or reliance on any warranties provided by the clients who may also limit or nullify the contractor's guarantees for example by way of the client warranting the correctness of the plans and designs.

PART V: DOES SFO ACTION CONSTITUTE AN EXTENSION OF TIME?

1. Background

A recent topical issue in the media sparked this and the question is a joke of course. However it got us to thinking, what could constitute an extension of time? Generally if the contractor is not at fault, they will get the time, but may not get the costs. Normal extensions of time will include force majeure, legislative changes, inclement weather, design related issues and so on.

FINAL COMMENTS

Construction law has never been for the faint-hearted as it is traditionally primarily about confrontation and allocation of blame issues in the context of contentious work at least.

Leaky building syndrome has been quantified at varying numbers, but $20B is the figure we prefer. Senior bankers recently calculated earthquake strengthening work at ten times the leaky building quantum. Some may think a figure of $200B excessive. In any event, the issue is massive and indeed highly topical and in some way will affect all of us.