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Who's left holding the baby?

Under our system of joint and several liability, some parties to leaky homes litigation seem to pay more than their fair share. But is there a case for changing to proportionate liability?

A MAJOR ISSUE arising from the leaky homes saga is, who should share in the liability? It was a question asked by the Law Commission in its report completed in June 2014 considering the relative merits of joint and several liability versus proportionate liability.

Currently, when a Court imposes joint and several liability and any party to the litigation cannot pay their share, the other parties must contribute to the shortfall.

Law Commission's thinking

The Law Commission is strongly of the view that New Zealand should retain joint and several liability, but it has suggested some changes to make the system fairer for all. The government will respond to the recommendations early next year.

The response will be of interest to everyone in the building industry. Its decisions will affect both the contractual relationships and the legal structures employed by businesses seeking to minimise their potential exposure to co-contractors, subcontractors, local authorities and industry professionals such as engineers and architects.

It's an old discussion

The Commission noted that the discussion of the relative merits of joint and several liability versus proportionate liability has been ongoing for at least 20 years. The Commission last reported on it in 1998.

The leaky homes cases have brought renewed calls to deal with perceived problems with joint and several liability.

The large numbers involved in any significant building project readily translates to a number of potential defendants for a leaky home claim. Each potential defendant will, most likely, be held to bear differing shares of responsibility while still being jointly and severally liable for the plaintiff's indivisible damage - primary liability.

Liable defendants often unavailable

The sheer scale of the leaky homes issue in the building industry has contributed to an increasing number of liable defendants becoming unavailable because of personal insolvency or corporate collapse.

A shrinking supply of solvent liable defendants have been left to meet some or all of the uncollectable share left by insolvent liable defendants, a situation perceived as unfair by solvent liable defendants, especially if they bore only a small or very small share of overall responsibility.

The impact of uncollectable shares has also fallen disproportionately on certain liable defendants, especially local authorities.

Commission's recommendations

The Commission concludes that the protection of joint and several liability should continue to be afforded to the innocent party. Therefore, liable defendants who have actually caused the harm should bear the risk of uncollectable shares of other defendants.

It has recommended several adjustments to deliver fairer outcomes:

- Giving the Courts the power to make orders that would mitigate the full application of joint and several liability where this would create a clear injustice to defendants who have only a minor responsibility.
- Changing the rules of contribution so that the costs of an uncollectable share can be spread proportionately among the remaining solvent and liable defendants.
- Introducing liability caps for building consent authorities for new liabilities after the leaky home claims have been dealt with.

Is the building sector a special case?

It is interesting to look at the direction taken by Australia in the 1990s. Between 1993 and 1995, three states and both federal territories introduced proportionate liability for building certifiers and building practitioners. From 2002, this has been replaced by jurisdiction-wide proportionate liability.

A trans-Tasman harmonisation argument suggests that a similar approach could be taken in New Zealand.

However, the Commission is not convinced there is a case for proportionate liability across the building sector in New Zealand:

- The Australian approach is backed up by compulsory insurance and state-mandated building guarantee or warranty schemes. The difficulty in establishing and maintaining a similar warranty scheme in New Zealand is another factor when considering the potential problems with an industry proportionate liability.
- There is no evidence that solvent liable defendants being required to meet part or all of uncollectable shares is a systemic problem, except for local authority participants.
- Joint and several liability is often blamed for results it does not cause, and proportionate liability is expected to bring changes that it would not. The allocation of liability and costs between head contractor-builders and subcontractors demonstrates this point.

A proportionate liability regime would not enable the builder to automatically pass on portions of liability to a variety of subcontractors. The builder would remain liable for what they have contracted to deliver and what the statutory warranties require - a building built with reasonable care and skill and fit for its identified purpose, for example. Such liability forms part of the builder's primary liability and would not be overridden by a secondary rule of proportionate liability.

The majority of cases where building contractors are held to bear substantial liability are because of their primary obligations arising in contract, from statute or both. Compared to local authorities, head contractor-builders have a relatively low likelihood of having to meet an uncollected share, and if they do, it will usually be for a much smaller additional share.

Has this addressed the problem?

As business advisors, we are often asked by our building industry clients whether they should form special-purpose companies for a project and wind them up at the completion of the project.

This strategy is sometimes recommended by lawyers as a way to limit possible exposure to future liability. Other clients keep the company but make sure it has minimal assets or retained earnings that a creditor could take if the company gets hit with a substantial claim.

These practices are a reasonably sensible and predictable response to the risks posed by a joint and several liability system.

The Commission may be correct that the changes to make the liability proportional may not actually improve the situation, but I wonder whether the Commission has really addressed the nub of the problem for the building industry and its customers.

Note This is intended as general advice only. Contact your advisor or Staples Rodway if you have any specific questions about this topic.