

**INSURERS OF DOMESTIC BUILDING WORKS LIABLE TO INDEMNIFY FOR
MINIMUM 120% OF CONTRACT PRICE FOR NON-COMPLETION**

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*Building & Construction; Domestic Building Contracts; Non-completion of domestic building works;
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The inclusion in some domestic building insurance policies of clauses to the effect that insurers are permitted to limit their liability for non-completion of domestic building works to 20% of the domestic building contract price appears to be inappropriate. It is submitted that a proper reading of the relevant Ministerial Order in fact shows that insurers are only entitled to limit their liability for incomplete works to a minimum of 120% of the contract price and any attempt by insurers to vary such limitation will be of no effect.

This may not be good news for those insurers who appear to have been attempting to limit their liability under domestic building contract insurance policies for incomplete works contrary to the limits that have been set.

S.135 *Building Act* 1993 provides that:

“(1) The Minister may, by order published in the Government Gazette ...

(c) specify the kinds of insurance by which building practitioners and persons in each specified category or class or part of a category or class are required to be covered.”

Ministerial Order No. S122 was published on 30 October 1998 and amended on 12 November 1998 ("the Order"). The Order revoked the previous Ministerial Order made 1 October 1996.

The Order provides that a policy for domestic building insurance shall contain terms and conditions that have, *inter alia*, the following effect:

"5.1 - The policy shall indemnify the building owner ("the insured") in respect of loss and damage, which results from ...

5.1.3 non-completion of domestic building work due to the:

- a) death or legal incapacity of the builder;*
- b) disappearance of the builder;*
- c) builder becoming insolvent;*
- e) builder becoming an externally administered corporation;*
- f) cancellation or suspension of the builder's registration as a practitioner under the Building Act 1993 without reinstatement of such registration within 30 days, or*
- g) early termination of the major domestic building contract by the building owner as a result of the builder's failure or refusal to complete the domestic building work; ..."*

The Order provides, at clause 5.5.6 in respect to builders and 6.3.3 in respect to owner-builders, that the policy of insurance may exclude or limit claims under a policy:

“... made under the indemnity for non-completion of domestic building work required by clause 5.1.3 to the extent that the cost of completing the domestic building work (excluding the cost of rectifying any defective building work) exceeds the contract price under the relevant major domestic building contract by more than 20%” (my emphasis).

The phrase “*contract price*” is defined in the *Domestic Building Contracts Act 1995* to mean “*the total amount payable under a domestic building contract*”.

It has apparently been considered by some that clauses 5.5.6 and 6.3.3 of the Order limit the liability of insurers for claims for non-completion of domestic building works under clause 5.1.3 to 20% of the contract price.

At least one insurer includes in its builders domestic building insurance policy the following clause

“3.3 Policy Exclusions”:

“The insurer shall not be liable to indemnify or compensate the Insured for loss or damage arising from:

3.3.4 “a claim for compensation exceeding an amount representing 20% of the contract price stated in the Major Domestic Building Contract which claim results from any of the events referred to in sections (as provided in clause 5.1.3 of the Ministerial Order)” (my emphasis).

It is worth noting that the wording in the example policy clause, which appears quite clear in its meaning, differs significantly from the wording of the Order.

It should also be noted that clause 9.1 of the Order provides that:

“A policy must not contain any provision which limits, modifies, varies, avoids or excludes any of the requirements for a policy set out in this Order or which, subject to this clause provides for limitations or exclusions to the policy not expressly permitted by this Order.”

It is my opinion that, contrary to the view adopted in the example policy referred to above, clauses 5.5.6 and 6.3.3 of the Order do not allow the insurer to limit its indemnity to “*an amount representing 20% of the contract price*”. By use of the words “*exceeds the contract price ... by more than 20%*” the Minister in fact allows the insurer to limit its liability, should the insurer seek to take advantage of such limitation, only to that amount which exceeds the contract price by more than 20% or, in other words, that amount which is in excess of 120% of the contract price.

It may be helpful in understanding the wording of the Order to paraphrase the Order as:

‘the policy may limit claims made under clause 5.1.3 to the extent that the cost of completing the work exceeds the contract price by more than 20%.’

Or put another way:

‘an insurer may limit its liability for claims made under clause 5.1.3 for any amount that exceeds the contract price by more than 20%.’

To assist further I set out below two examples in which the builder has failed to complete the works for any one of the reasons set out in clause 5.1.3 of the Order. These examples are to be read subject to the \$100,000 limitation permitted by clause 7.2 of the Order.

Example 1.

Contract price	\$100,000
Paid under contract	\$ 50,000
Costs to complete	\$110,000

In this example for "*the cost of completing the domestic building work*" to exceed "*the contract price ... by more than 20%*" the cost of completing must be more than the contract price plus 20% namely \$120,000. Here the cost of completing is \$110,000 which sum "*exceeds the contract price*" by 10%, not by 20%. The insurer is therefore liable to pay the full \$110,000 plus "*the cost of rectifying any defective building work*" less the \$50,000 left in the contract.

Example 2.

Contract price	\$100,000
Paid under contract	\$ 50,000
Costs to complete	\$150,000

Again, as in example 1, for "*the cost of completing the domestic building work*" to exceed "*the contract price ... by more than 20%*" the cost of completing must be more than the contract price plus 20% namely \$120,000. Here the cost of completing is \$150,000 which sum "*exceeds the contract price*" by 50%. The Order provides that the policy may exclude from the claim that amount by which the costs to complete "*exceed the contract price ... by more than 20%*" namely 30% of the contract price or \$30,000. The insurer is therefore liable to pay only \$120,000, plus "*the cost of rectifying any defective building work*" less the \$50,000 left in the contract.

If the insurer's interpretation of the Order seen in the example policy clause is correct then the insurer's liability in each of the above examples is limited to \$20,000 being 20% of the contract price. One might ask however, if the Order means what the insurer wants it to mean, why did the insurer use different wording to that in the Order? It appears that the insurer, by deviating from the wording of the Order has sought to impose a limitation not allowed by the Order. The limiting effect sought after appears to be "*expressly not permitted*" by the Order and is of no assistance to the insurer. As a consequence there is, in the example policy, arguably no limit to the insurer's liability for the cost of completion of the works.

In my opinion, if insurers choose to limit their level of liability for incomplete building works, given the provisions of the Order, they can only do so to a minimum of 120% of the contract price.