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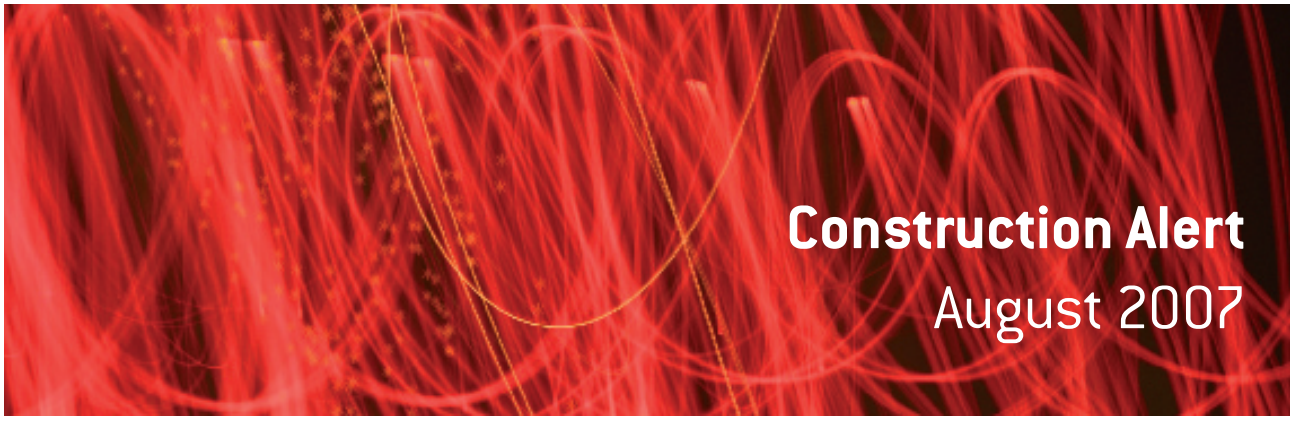


When BIGCorp Comes Knocking

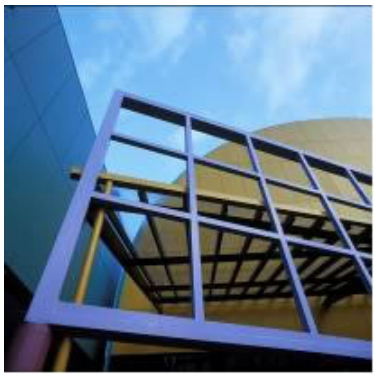
BIGCorp and Recoveries Against Builders

"What should a builder do when faced with a demand from BIGCorp to reimburse it for money paid out under a Home Owner Warranty (HOW) policy?"

On 15 March 2001 HIH Casualty and General Insurance Limited (**HIH**) was placed into provisional liquidation and as a result, suddenly both HIH and FAI General Insurance Company Limited (**FAI**) home owner warranty (**HOW**) insurance policies were no longer worth the proverbial "paper on which they were written."

This development was not only a shock to all those people who were beneficiaries under the HOW policies (being the home or unit owners), but also to the NSW Government - as the *Home Building Act 1989* (**HB Act**) required that companies providing HOW insurance be approved by the NSW Government. The HB Act (as at 15 March 2001) never contemplated or made any provision for a HOW insurer going into liquidation and thereby not honouring their HOW policies.

The NSW Government responded to this problem by passing the *Insurance (Policy Holders Protection) Legislation Amendment Act 2001* which commenced on 30 June 2001, and inserted Part 6A – Insolvent Insurers provisions into the HB Act.



Under the new Part 6A of the HB Act, the NSW Government agreed to indemnify beneficiaries of HIH and FAI HOW Policies (subject to certain conditions) and created the Building Insurer's Guarantee Corporation (now affectionately know as **BIGCorp**) to assess claims and insurance payouts from the newly created Building Insurer's Guarantee Fund (**the Fund**) into which the NSW Government had tipped $20m as a start up grant.

However, with one eye to the future, the NSW Government (also under Part 6A) bestowed upon BIGCorp powers to recover from both builders and developers (as defined by the HB Act), the money which it would pay out to the home and unit owners as beneficiaries under the HIH and FAI HOW policies.

These powers include:

> Section 103M – whereby all beneficiaries who receive payments are deemed to assign their rights under the relevant building contract to BIGCorp, thereby allowing it to seek to recover the money paid out against the Builder and Developer - these are commonly known as subrogated rights.

> Section 103N – which states that BIGCorp "*may direct the Builder concerned to pay to the Building Insurer's Guarantee Fund any amount paid out of the Fund on that claim" however only "to the extent that an insolvent insurer (if it was not insolvent) would be able to require …..a payment to the insurer by the builder, under the relevant insolvent insurer's policy."*

> Section 103ZB - which empowers BIGCorp to stand in the shoes of HIH or FAI in relation to any indemnities or personal guarantees previously obtained by the now insolvent insurers against builders, developers or even personal guarantors. Section 103ZB states that BIGCorp in cases "*where an insolvent insurer would have been entitled to recover any sum under a guarantee or indemnity given by a builder or any other person" is "entitled to the benefit of and may exercise the rights and powers of the insolvent insurer under that guarantee or indemnity so as to enable the Guarantee Corporation to recover from the builder or any other person and pay into the Building Insurer's Guarantee Fund the amount due under that guarantee or indemnity.*"

The 2006 Annual report for BIGCorp published on the NSW Office of Fair Trading website reveals some very dry but interesting information for builders, namely that:

> from 1 July 2006 the management and processing of BIGCorp claims was brought in-house rather than external claims consultants continuing to be used - they claimed that this would lead to "*improved efficiencies in dealing with claims and other parties;*"

- for the financial year 2005-2006 BIGCorp paid 217 claims for a total of approx $16m with a further 528 claims still under assessment and 197 new claims received during that year;

- BIGCorp's financial statements show non–current assets (being debtors against whom BIGCorp can seek to recover payments made out) of $95m. However the statements also show that BIGCorp has made a provision for doubtful debts (ie being unable to recover the amounts paid out from builders and developers) at 98% ($93.12m) leaving only 2% ($1.9m) as the stated estimated recovery.

Given the extensive recovery powers awarded to BIGCorp under Sections 103M, 103N and 103ZB of the HB Act, the very low estimated recovery rate of 2% would appear to indicate that virtually all builders, developers or guarantors against whom HOW have a right of recovery, have been wound-up, made bankrupt or have insufficient assets to make recovery by BIGCorp not commercially viable.

It would therefore appear that there is only a low theoretical probability of BIGCorp seeking to recover money paid out under a HOW Policy against a solvent builder, however empirical reports appear to point to the contrary. In some instances, the HOW claim and BIGCorp's payout has even occurred without the builder's knowledge and in instances where there is substantial evidence that the builder was not the cause of the defect.

This therefore leads to the question - *what should a builder do when faced with a demand from BIGCorp to reimburse it for money paid out under a HOW policy?*

On being presented with a demand for payment, a Builder should request from BIGCorp detailed particulars of the alleged right to recovery, the defects, their rectification and cost. BIGCorp may be reluctant to supply such information or argue that there is no entitlement to the information as the amount being recovered is a debt and it does not have to prove particulars of its claim. The NSW Court of Appeal in **Builder's Licensing Board v Inglis** when dealing with a similar provision under the Builder's Licensing Act 1971 held that "*the entitlement to recover as a debt should not, in my view, bypass the normal requirement that, when a claim is disputed, he who alleges must particularise and prove.*"

This may be partly why BIGCorp has estimated its recovery rate at 2%.

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Accordingly, if the recovery proceedings by BIGCorp are defended by the builder on the basis that BIGCorp has paid out either incorrectly or excessively, then the claim may turn into defended legal proceedings with all the problems associated with standard building litigation - not the least of which is all parties incurring considerable legal fees.

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