

Annex 2

REGULATORY IMPACT STATEMENT: WEATHERTIGHTNESS ADVISORY AND DISPUTE RESOLUTION SERVICE

Statement of the problem and the need for action

1. A growing number of new housing constructions are now showing signs of water damage and rotting timbers. The most significant incidences are in up-market, one-off single dwellings and multi-unit, condominium-type apartments. These dwellings are most prevalent in Auckland.
2. Many of the houses have been built using monolithic panel systems. The claddings are now demonstrating an inability to prevent external water from entering the framework, and do not have eaves and flashings. Once water has got into framework, it has been unable to get out.
3. In addition, since about 1998 most new houses have been built with untreated timber¹. At the time the regulations were passed it was thought that boron was useful only for protecting against insect infestations. We now know that it also prevented rot.
4. An Overview Group established in February 2002 estimated that the total population of at risk dwellings to be around 18,000. The Overview Group estimated that if half of the monolithic clad dwellings built over the last decade required repair at an average cost of \$20,000 the cost of rectifying the problem would be within the range of \$120 million and \$240 million.
5. The Overview Group's assessment is that a confluence of factors has led a major systemic breakdown that has now become commonly known as the "leaky building" problem. These include:
 - Changes in responsibilities and relationships of designers and builders.
 - Town planning criteria relating to plot ratio and yard distances that inadvertently lead to particular building solutions or contribute to the choice of building style.
 - Lack of professional and trade skills and good judgments.
 - Changes in on-site structures and responsibilities.
 - Imperatives of cost and speed.
 - Emphasis among product manufactures on products rather than on building systems.

¹ In 1995 regulatory changes allowed the use of untreated kiln dried timber in housing construction. Previously any timber used in housing construction had to be boron treated.

- Lack of effective supervision / inspection practices.
 - Lack of detail, prescription, performance criteria, and guidance in the Approved Documents regarding weathertightness compared to other aspects such as structural integrity.
6. The extent to which any of these factors contribute to a problem will differ on a case-by-case basis, and so too the mix of parties involved
7. Homeowners with a leaky building problem may:
- struggle to pinpoint the root cause of their problems;
 - have difficulty identifying all the parties involved in the construction of their dwellings;
 - have difficulty identifying relevant companies, as some may have ceased to exist by the time the problem has come to light;
 - have difficulty finding someone to take overall responsibility for the project anymore, given the multitude of different parties that could be involved (namely, builders, other building trades and sub-contractors, product manufacturers, developers, architects, draughtspeople, project managers, insurers, building certifiers (individual and corporate), local authorities, and the Building Industry Authority);
 - have little idea regarding the legal channels that are available to address their problems;
 - find the cost of pursuing a legal remedy unduly onerous - court fees are significant² and the cost of legal advice can be many thousands of dollars;
 - be very confused given the complex nature of the factual and legal issues that may be involved, the multiplicity of parties with potential liabilities under a wide range of different legal causes of action, and the undeveloped state of the law; and
 - find themselves pitting their wits and limited resources against the resources available to large corporates. If the value of homeowner's primary asset – their home – is at stake, they may feel particularly vulnerable.
8. In October 2002 an Expert Panel was established to examine how best to provide a process to settle disputes. The Panel's assessment is that the current legal framework does not provide simple and readily accessible remedies for building disputes. Alternative services and processes are recommended.

² It costs \$120 to lodge a claim with the district court, another \$450 for a fixture and the first half day of hearings, and \$450 for each half day thereafter. The disputes could conceivably last many days.

Statement of the public policy objective

9. The two primary public policy objectives underpinning the proposals to establish weathertightness advisory and dispute resolution services are that homeowners of leaky buildings have:
- access to independent advice on the options available for redressing their problems and
 - affordable access to fast and effective disputes resolution processes.

Statement of options for achieving the desired outcome

Information and advice

Status quo

10. Under this option the estimated 18,000 homeowners whose homes are at risk, have to try and find information on leaky buildings themselves (there is no formal body charged with educating the public in relation to the weathertightness of buildings). Homeowners who suspect they may have a problem will wish to know:
- the way in which a problem can occur;
 - what happens if it does occur;
 - the steps that can be taken to remedy the problem;
 - the likely costs of such steps;
 - the parties who may be responsible; and
 - the ways in which recovery may be sought from those parties.

Weathertightness advisory service (preferred option)

11. The preferred option is the establishment of a weathertightness advisory service to provide public education by the use of all types of media, publication of pamphlets, booklets and videos. The advisory service would:
- help individual homeowners understand the general information contained in the service's publications and, in particular, to make an informed choice between the various methods of dispute resolution available to obtain compensation for damage caused by leakage through the external wall cladding systems of their homes; and
 - advise individual homeowners who choose to use any stand-alone dispute resolution service about their options under that service and what they need to do to take advantage of it.

Disputes resolution

Status quo

12. The dispute resolution options currently available to parties to a building dispute include:
- direct negotiation;
 - a claim to a Disputes Tribunal; or
 - a claim in a District Court or the High Court.

Dispute resolution service (preferred option)

13. The preferred option is that a disputes resolution service be established to address specific cases of leaky buildings. This would not preclude homeowners seeking legal redress through existing mechanisms. Key elements of the service would include:
- an 0800 line and website where homeowners can obtain information about accessing the service;
 - a face value assessment to ensure that applicants meet the criteria for entry into the service;
 - appointment of a case manager to every application once it is registered;
 - a report by an independent assessor to determine if the applicant has a bona fide case and, if so, a description of the problem and the work required to remedy it;
 - if elected by applicants and accepted by other parties, voluntary mediation on issues concerns and legal rights;
 - a signed agreement on mediated outcomes;
 - if elected by applicants, compulsory adjudication limited to establishing legal liability, and awarding a remedy;
 - adjudicated decisions that are enforceable in the same manner as a judgment of a court or similar;
 - an assumption of self-representation;
 - allowance of legal representation and other assistance; and
 - right of appeal to the courts. Officials have recommended that the grounds for appeal be limited in the same manner as appeals from the District Court.
14. This is the preferred option given the complexity of the factual and legal issues and the desire for fast and effective resolution.

Statement of net benefit of this proposal

Benefits

15. The benefits of a specialist advisory and disputes resolution service are that:

- homeowners will be better informed and less uncertain as they have access to information in relation to the weathertightness of buildings;
- homeowners will be able to make informed decisions about disputes resolution processes;
- homeowners will have access to a wider range of disputes resolution processes; and
- the services will aim to provide a credible fast and effective alternative to the courts system.

Costs

16. The costs of the services will variously fall upon the Government, homeowners and other parties.

Government

17. The cost of providing advisory and disputes resolution services over the 26 months to December 2006 have been estimated to lie between \$15 million and \$50 million. This large variation is driven by the uncertainty over the volume of demand for the mediation and adjudication phases.

18. However, at this point in time officials consider that the costs are more likely to be in the range of \$15 million to \$25 million, based on the Panel's view of what is the most likely volume, and supplemented by initial indications of a lower than anticipated response to the 0800 call center. The establishment team and Treasury are further refining the resource requirements for the proposed service.

19. Not all the costs associated with the services will necessarily be borne by the Crown. Limited costs may be recovered if Ministers agree to modest fees being charged for use of the services. It may also be possible to access some of the Building Industry Authority's accumulated reserves. Ministers might also consider seeking financial assistance from Local Government New Zealand and the building industry.

Homeowners

20. The costs that may be faced by homeowners include:

- Any fees that may be charged for access to the services. This may be eased if a sharing of fees is part of any mediated outcome, and if an adjudicator awards costs. In cases of financial hardship, the Chief Executive of the department responsible for the services should be granted the power to waive fees.
- The cost of collecting and analysing relevant information. These costs will be minimised by the proposed information and advisory services and are, therefore, likely to be less onerous than attempting to progress a claim in the absence of such services.
- The cost of any legal representation and other assistance. As self-representation is encouraged, the cost of legal representation can be avoided. In complex cases and/or cases where the stakes are high, however, it is likely that such assistance will be sought. Officials have recommended that legal aid be available on the same basis as if the matter was taken to a court.
- Homeowners time. The Expert Panel has estimated that the most likely timing for mediation and adjudication is respectively two days and 3.25 days. In addition to the time spent in these processes, homeowners are likely to spend considerable time sourcing and analysing information, talking to lawyers and technical experts, and so on. Nonetheless, the time involved here is very likely to be less than what homeowners would have otherwise found necessary to spend had the advisory and disputes resolution services not been available.
- As the value of what is likely to be a homeowner's primary asset is at stake, the stress of progressing a weathertightness dispute is likely to be considerable. This is particularly so given the potential factual and legal complexity of issues, and the undeveloped state of the law. The specialist services recommended here should serve to ease some of this stress.

Other Parties There could

21. potentially be a large number of other parties involved in any one dispute. These include builders, other building trades and sub-contractors, product manufacturers, developers, architects, draughtspeople, project managers, insurers, building certifiers (individual and corporate), local authorities, and the Building Industry Authority. The costs to these parties could include:

- Paying a share of the fees for mediation, if cost sharing is part of the mediated outcome reached.
- Full or part payment of the fees for adjudication, should the adjudicator choose to award costs.
- The cost of collecting and analysing relevant information, the cost of any legal representation and other assistance, time, and stress. However, as for homeowners, the key features of the advisory and disputes resolution services are likely to mean that these costs are less than what other parties would have incurred had these services not been available to them.
- The opportunity cost of time. That is, the cost of not being available to work.

Consultation

22. Advice on the proposals for advisory and disputes resolution services has involved a core group of officials from the Department of Internal Affairs (lead), Ministry of Justice, Department for Courts, Ministry of Economic Development, Ministry of Consumer Affairs, Ministry of Housing, the Treasury, State Services Commission and the Department of the Prime Minister and Cabinet.
23. Their comments on how to minimise any costs and what refinements are required to gain greatest benefit from the advisory and disputes resolution services proposed by the Expert Panel, form the basis of the Cabinet paper.
24. Given the tight timeframe that was available to the Expert Panel, only limited consultation took place with non-government stakeholders. A summary of stakeholders' responses is included as Annex E to the Panel's report. Their comments covered the:
 - appropriateness of the entry criteria;
 - funding of services;
 - role and necessary competencies of assessors, mediators and adjudicators;
 - assessment process;
 - duration of services;
 - whether mediation should be voluntary or consultancy;
 - consequential insurance implications of claims; and
 - extent of liability.
25. All of the concerns of stakeholders have been covered off in either the report of the Expert Panel or the paper prepared by officials for Cabinet.

BUSINESS COMPLIANCE COST STATEMENT

Sources of compliance costs

26. Sources of compliance costs for affected business arise from:
 - Learning the new system. This cost is minimised by the proposed information and advisory service. While the service has been designed with homeowners in mind, it is also likely to prove valuable to businesses. The general role of the service would be one of public education. An Expert Panel, which in October 2002 advised on the purpose and role of information, advisory and dispute resolution services, has proposed that the service could provide information in a number of different ways, including publicity in the media, and the publication of pamphlets, booklets and videos.

- Legal fees. As self-representation is encouraged, the cost of legal representation can be avoided. In complex cases and/or cases where the stakes are high, however, it is likely that such assistance will be sought.
- Fees charged by technical experts. While homeowners' need for an expert's opinion on the cause of leaks and extent of damages is minimised, if not avoided, by the proposal that an independent assessors report be prepared on their behalf, the same does not hold for businesses. To the contrary, the report is likely to make it even more pertinent that businesses seek the advice of experts working on their behalves.
- Staff time and cost. The Expert Panel has estimated that the most likely timing for mediation and adjudication is respectively two days and 3.25 days. In addition to the time spent in these processes, staff are likely to spend time sourcing and analysing information, talking to lawyers and technical experts, and generally preparing for mediation or adjudication. Nonetheless, the time involved here is very likely to be less than what businesses would have otherwise found necessary to spend had the advisory and disputes resolution services not been available.
- Form filling and other administrative costs. A number of forms will need to be filled out and signed by parties at different stages of the disputes resolution process, including a registration form, mediation and adjudication protocols and agreements, and agreements to be bound by mediated outcomes.
- Costs implied by enforcement processes. If found liable, there are likely to be compliance costs arising from providing assurances that remedial work has been undertaken to a satisfactory standard or that damages have been paid.
- Travel and accommodation costs. If hearings are held away from where a business is located, travel and accommodation costs may be incurred.

Parties likely to be affected

27. The list of parties that may be affected by a weathertightness dispute is large. Parties include, but are not limited to:

- builders;
- product manufacturers;
- other building trades;
- sub-contractors;
- developers;
- architects;
- draughtspeople;
- project managers;
- insurers;
- building certifiers (individual and corporate);
- local authorities; and
- the Building Industry Authority.

28. The number of parties that may be affected is unknown. The Expert Panel has assessed that the number of at risk dwellings to be 18,000. It's "most likely" scenario is that 30% or 5,400 of cases will be accepted into the disputes resolution service, and 50% or 2,700 of these will meet the service's acceptance criteria. Forty percent (1,100) of accepted cases are expected to be progressed through mediation, and 60% (1,600) through adjudication. For each of these mediated and adjudicated processes there will be a different mix of affected parties. It will be the role of the independent assessor to identify who those parties are.
29. The size of businesses impacted is likely to span the whole spectrum. For example, sitting at one end of the spectrum is the self-employed builder; at the other end is the corporate giant involved in property development.

Estimated compliance costs of the proposal

30. Given the time available to develop this proposal, no robust quantitative or qualitative estimate of compliance costs can be provided. The size of compliance costs will differ on a case-by-case basis. A simple case involving only a homeowner and a builder may be speedily resolved through mediation in less than half a day. A more complicated case involving a large number of different parties, some of whom may not be easily located, progressed through adjudication may involve considerable time, effort and consequential compliance costs.
31. Compliance costs will be more or less burdensome relative to the estimated value of damages that homeowners are seeking to remedy or recover, and the financial situation of affected parties.
32. If no more cases are heard than what would have been heard if this alternative disputes resolution avenue had not been available, then compliance costs are likely to be no more than, and generally less than, those that would have been incurred should this alternative avenue for disputes resolution not have been available. However, if this new service encourages a greater number of claims to be made, then the total quantum of compliance costs could be greater. The net effect is unknown.

Longer term implications of the compliance costs

33. If the processes of mediation or adjudication lead to the final resolution of weathertightness disputes, then the compliance costs incurred by affected parties are likely to be one-off and non-recurring.
34. Should, however, the determination of an adjudicated process be appealed, then the costs will continue until a final resolution is reached in the courts. It is not uncommon for appeals to take up to five years to resolve.

Level of confidence of compliance costs estimates

35. As previously noted, given the time available to develop this proposal, no robust quantitative or qualitative estimate of compliance costs can be provided.
36. And commented above, the net effect on compliance costs is unknown. If no additional cases are heard, then costs are likely to be no more than, and generally less than, those that would have otherwise been incurred. If this new service encourages a greater number of claims to be made, then the total costs could be greater.

Key compliance cost issues identified in consultation

37. One of the key public policy intents of the proposed advisory and disputes resolution services is affordable access to fast and effective disputes resolution processes. It is with this overarching intent in mind that a team of officials prepared the Cabinet paper commenting on the proposals of the Expert Panel. The content and recommendations of that paper reflect the policy intent. The core group of officials involved were from the Department of Internal Affairs (lead), Ministry of Justice, Department for Courts, Ministry of Economic Development, Ministry of Consumer Affairs, Ministry of Housing, the Treasury, State Services Commission and the Department of the Prime Minister and Cabinet.
38. Given the tight timeframe that was available to the Expert Panel, only limited consultation has taken place with non-government stakeholders. A summary of stakeholders' responses is included as Annex E to the Panel's report. All of the concerns of stakeholders have been covered off in either the report of the Expert Panel or the paper prepared by officials for Cabinet.

Overlapping compliance requirements

39. Officials have recommended in favour of facilitating homeowners to make informed decisions regarding which disputes resolution path is best. No paths are closed off. Disputes may be settled through negotiation, mediation, adjudication, by a Disputes Tribunal, or in court.
40. Rather than overlaps, there are synergies associated with having the proposed weathertightness advisory and disputes resolution services, sitting alongside existing disputes resolutions services. For example, the information and advisory services will make businesses more aware of the issues and the options, regardless of which disputes resolution path is ultimately taken. And the independent report of assessors is a valuable input into any legal proceedings.

41. A potential overlap may occur where a dispute is commenced within the service, only to discover part way through the process that the matters would be better heard before the courts, due to the complexity and/or novelty of the case. In these instances, officials have proposed that adjudicators have the power to transfer proceedings to the courts.
42. The flipside is where a case has commenced in the courts prior to the option of a mediated or adjudicated alternative disputes resolution service becoming available. Officials propose that the presiding judge determine whether or not it is in the best interests of justice for the case to be transferred to the new service.

Steps taken to minimise compliance costs

43. As previously noted, one of the key public policy intents of the proposed advisory and disputes resolution services is affordable access to fast and effective disputes resolution processes. Minimising compliance costs is key to this. Steps taken to further minimise compliance costs include, but are not limited to, the:

- provision of information and advice;
- use of electronic technology and an 0800 number to facilitate the accessibility of services;
- preparation of reports by independent assessors;
- assignment of an impartial case manager to manage each successful application;
- user friendly form designs;
- ability to agree on the protocols for mediated and adjudicated processes that allow greater flexibility than court proceedings; and
- speedier results through mediation or adjudication.