

Legal update - Joint and several liability

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There has long been concern (particularly in the building industry) that the joint and several liability rule leaves well-resourced defendants and their insurers "carrying the can". Any change to the rule could impact significantly on the liability of defendants involved in cases arising from situations such as the leaky homes crisis.

The Law Commission has now released an Issues Paper on joint and several liability, and is seeking submissions on the Paper. It is likely that corporate trustees, auditors, and those involved in the building sector will take a particular interest in this issue.

Current scheme and issue

Under the current joint and several liability scheme, if two or more defendants are responsible for a loss, each is potentially liable for the full amount of the loss. If one defendant is absent or insolvent and cannot pay, the other defendant has to cover their costs. The main alternative to this scheme is a system of proportionate liability. Under this system a defendant would only be liable for a share of the total loss, relative to their responsibility in causing the loss.

When applied to the leaky homes crisis, the joint and several liability system allocates the risk to councils, who are usually the "deepest pockets" in a dispute of this kind. If the builders and developers have become insolvent, the joint and several liability system means that the homeowner may recover all of their costs from the council. Under a proportionate liability scheme, the risk is transferred to the homeowner. The homeowner would need to identify and claim proportionate costs from each liable party. If a council was, for example, 30% responsible, then they would only be required to pay 30% of the costs, regardless of the availability of other parties.

Fundamentally, the policy issue comes down to a choice between an innocent plaintiff paying for an absent defendant, or an innocent co-defendant paying more than their fair share of a loss.

Law Commission's Issues Paper – our views

In examining the issue, the Law Commission makes reference to a report written by Buddle Findlay and Sapere Research Group. That report recommended against moving to proportionate liability for the building industry. However, the report noted that if such a move was made, it would be "essential" to establish compulsory home warranty insurance so homeowners could then mitigate their risk. Yet ultimately, homeowners would still bear the costs through insurance payments. Both the report and the Law Commission's Issues Paper acknowledge the difficulty and cost of setting up an effective warranty scheme.

In addition to the building industry, the joint and several liability rule is also particularly relevant to corporate trustees and auditors. Those entities are potential defendants in claims brought by depositors and investors in relation to failed investment schemes. The Law Commission addresses whether the global financial crisis has increased the potential liability of auditors and others to such a disproportionate extent that some form of limitation is justified. It concludes that auditors (and others) can protect themselves from liability by taking reasonable care in their dealings.

Australia has made the shift from joint and several liability to proportionate liability. The change addressed concerns of perceived unfairness to defendants, and builders' warranty insurance mitigated the increased unfairness to plaintiffs. Commentary on the move has led to the tentative conclusion that the system has caused a considerable increase in complexity and cost. The Law Commission considers whether the Closer Economic Relations agreement (CER) between Australia and New Zealand should influence our decision. The Law Commission concludes that closer integration will only really affect firms operating on both sides of the Tasman, and points out that 80% of building contractors are small local firms.

On the other hand, the professional services industry is increasingly multinational, especially in the banking sector. A common trans-Tasman regime could benefit the sector, and potentially result in more certainty, lower transaction costs and lower insurance costs. The Law Commission considers CER a relevant consideration for law review and welcomes submissions on the desirability of harmonisation.

Other jurisdictions approach liability in a variety of ways. The United Kingdom Law Commission considered a change to proportionate liability but decided to remain with joint and several liability. In Canada, joint and several liability was reviewed a

number of times between 1979 and 1998, and in general has been retained. In the United States of America (USA) there has been a marked shift from joint and several liability to a form of proportionate liability. Six jurisdictions in the USA retain joint and several liability with a variety of limitations.

The Law Commission cites an economic analysis of the two main potential liability schemes. That analysis concludes that both schemes have similar economic efficiency. The authors of the analysis found that both schemes create similar incentives to take the same level of care. As the Buddle Findlay and Sapere Report also notes, the degree to which one liability scheme is more effective than the other will depend on the specific industry, case, or jurisdiction.

The Law Commission's overall conclusion is that there are no compelling efficiency grounds for proportionate liability. Other options include limiting joint and several liability to principal defendants, with minor defendants only liable proportionately. However, a distinction between major and minor defendants will inevitably be arbitrary. Another option is applying proportionate liability where the plaintiff has contributed to the loss, and joint and several liability where the plaintiff is blameless.

The Law Commission concludes that a change to proportionate liability could not be limited to the building sector. This is because in order to harmonise Australian and New Zealand law, proportionate liability would have to be extended to all negligence actions for economic loss. The final decision will be based on an overall assessment of the system. The key considerations will be how each rule allocates risk, and the extent to which each system produces results that are efficient and fair to both parties.

Submissions to the Law Commission close on 31 January 2013.

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