mccabes

3 June 2014

Your Ref:
Our Ref: AYS:PLConsult

By email: justice.policy@agd.nsw.gov.au

Mr Andrew Cappie-Wood
Secretary
Department of Police and Justice
GPO Box 6
SYDNEY NSW 2001

Dear Sir

A. Consultation on the Proportionate Liability Model Provisions

1. McCabes Lawyers is a New South Wales based law firm. It is recognised as a leading provider of legal services to the insurance industry. It has deep relationships with insurers, government, insurance brokers and professional associations each of which are stakeholders in the consultation on the Proportionate Liability Model Provisions. Various of those stakeholders have made separate submissions as part of this and prior consultations.

2. We are thankful for the opportunity to provide a submission to the Department of Police and Justice in relation to the possible implementation of the Proportionate Liability Model Provisions ("Model Provisions").

3. The focus of our submissions is on the effect of the Model Provisions upon the public policy on which the introduction of the proportionate liability was based with particular regard to the potential impact of the proposed changes on:

    a. the insurance industry with respect to claims performance, assumption of risks by underwriters and insurance premiums.

    b. the consequential exposure of professionals and others who provide goods and services to higher insurance premiums, potential uninsured losses and, in some case, the lack of availability of affordable (or any) insurance.

B. Public Policy Considerations

4. McCabes supports the aim of achieving harmonisation of the proportionate liability legislation.

5. However, it is critical that the consideration of any proposed reforms is undertaken by reference to the same public policy objectives that formed the basis for the introduction of proportionate liability initially, namely to:

    a. ensure available, affordable professional indemnity and public liability insurance;

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b. minimise procedural complexity;

c. create greater clarity and certainty when it comes to apportioning "blame" and therefore reducing the instances of litigated disputes or further litigation;

d. creating legislation that will lead to more practical resolutions and court efficiency; and

e. ensure fair results for both plaintiffs and defendants when it comes to resolving their disputes[1].

C. Preferred Model

6. McCabes strongly supports the adoption of Option 3. That is, uniform legislation which:

   a. broadly defines an apportionable claim; and

   b. prohibits contracting out.

7. Our support for Option 3 is on the basis that it overwhelmingly achieves the best balance of the public policy outcomes sought to be achieved.

8. Option 3 and Option 5 both propose a prohibition on contracting out. McCabes supports that position on the basis that it best achieves the underlying public policy objectives of the legislation.

9. McCabes has considerable concerns that the adoption of Option 5 would seriously undermine the consistency and certainty required in order to derive the public policy benefits which underlie the legislation.

10. That is because, the introduction of the proposed narrow definition of 'apportionable claim' would lead to inconsistent and unpredictable application of the proportionate liability legislation dependant primarily on form (namely the form of contracts and the form of pleadings) rather than substance (the nature of the defendant's conduct).

Contracting Out

11. The proposed prohibition on contracting out should be supported.

12. Firstly, in practice, any right to contract out would result in an unfair transfer of risk from parties with relatively greater bargaining power to parties with relatively lesser bargaining power. In the context of the supply of goods and services (including professional services), this would have an undesirable impact on, particularly, small business (companies, partnerships and sole traders) often to the benefit of large corporations.

13. Good public policy requires that the relative positions of plaintiffs and defendants be determined by substantive factors relating to the nature of the conduct of the

[1] Standing Committee on Law and Justice, *Proportionate Liability Model Provisions Decision Regulation Impact Statement*, October 2013

defendant rather than the respective bargaining power of each. Any model which allows risk allocation to be determined by bargaining power will benefit large corporations to the disadvantage of small business and individuals.

14. In the professional context large corporate users of professional services such as development companies and multi-national head contractors would benefit from any right to contract out to the disadvantage of smaller sub-consultants and professional service providers. Service providers such as engineers would be likely to bear a greater proportion of liability than their relative responsibility for the loss or damage.

15. Similarly large corporate users of legal or valuation services such as banks would be likely to be able to use their relatively stronger bargaining power to transfer risk to professional service providers.

16. Secondly, prohibiting the right to contract our of proportionate liability, by creating certainty of application, will advance the public policy in enhancing the availability, affordability and effectiveness of professional indemnity insurance to the benefit of professionals and consumers alike.

17. From the point of view of the insurance market, the application of proportionate liability needs to be certain and consistent in order for insurers to be able to take the availability of proportionate liability into account when setting premiums or determining whether to underwrite a particular risk or class of risks.

18. Moreover, in a variety of insurance contexts including high risk liability classes (such as product importers/distributors and mining services) and professional indemnity classes, there is a limited (if any) market for insurance which covers contractual liability where such liability is greater than the liability which would otherwise exist in the absence of the contract. Such liability is usually subject to an express exclusion (particularly in the case of smaller insureds).

19. Thus, where such insured has contracted out, the insured will often not be insured for that part of its liability which is greater than its liability if it had not contracted out of proportionate liability. In such cases, legislation allowing parties to contract out of proportionate liability may result in partially uninsured losses which may lead to the insolvency of defendants (usually smaller businesses and professionals with lesser bargaining power) by reason of their exposure to liability greater than that reflective of their responsibility for the loss and damage suffered by the plaintiff.

20. Based on our experience and recent enquiries of underwriters in the professional indemnity insurance sector, such exclusions are widespread and there would be a great reluctance to remove such exclusions particularly for higher risk professionals such as engineers, accountants and valuers. These impacts will be relatively more pronounced in a 'hard' insurance market. While the current insurance market is experiencing a 'soft' stage in the insurance cycle (meaning relatively greater premium and coverage competition), this is unlikely to continue indefinitely. This public policy outcomes of the proportionate liability regime must be able to withstand a hardening of the insurance market. Our discussions with a number of insurers suggest that there is evidence in specific parts of the professional indemnity insurance market of early hardening in the market including the exit of insurers from particular professional classes.

21. Where the effect of a contractual liability exclusion would be that part of a professional indemnity claim is covered (being that damage which would have been awarded against the insured defendant if proportionate liability had applied) and part of the claim is excluded (being that additional liability incurred by reason of the insured defendant contracting out of proportionate liability), the conflicts between the interests of the insurer and the insured defendant would product results which would be antithetical to the public policy objectives of encouraging more practical resolutions and court efficiency.

22. Thirdly, the closer the correlation between the incidence of liability and the conduct responsible for the loss, the more efficient the allocation of investment to risk management at the right stages of the relevant production/service provision process. Both the client and other parties involved in the provision of services, will be likely to have less regard to their own risk management in situations where a 'downstream' service provider has contracted to assume full liability. Comparatively, where liability is shared in proportion to the conduct giving rise to the loss, the parties will have strong incentives to work together to develop collaborative solutions to managing risk.

Proposal to narrow the definition of "apportionable claim"

23. The Model Provisions propose a definition of *apportionable claim* by which proportionate liability would apply[2] to claims for economic loss or damage to property, only where a failure to take reasonable care is an element of the cause of action[3].

24. Accordingly, the Proportionate Liability regime would not operate in respect of a cause of action based upon a party's breach of a strict contractual obligation or duty other than one which expressly requires that party to take reasonable care.

25. This condition represents a significant departure from the present proportionate liability regimes in respect of which the weight of judicial authority supports a construction whereby the question of whether a claim is apportionable is to be determined by the factual enquiry as to whether the breach occurred as the result of a failure to take reasonable care (subject matter/substance), rather than upon the cause of the action on which a claim is based (classification/form)[4].

26. It is submitted that the current approach is preferable because it provides certainty and consistency of the application of proportionate liability according to the substantive conduct of the defendant which constitutes the relevant breach rather than the form in which a contractual provision or pleading is drafted.

27. Any proportionate liability regime based upon the form of drafting of contractual terms is open to the criticism that it would be to allow a de-facto 'contracting out' of proportionate liability. That is, in most contexts, a party seeking to avoid the operation of proportionate liability could simply include in any contract a series of

[2] Subject to the exceptions contained in section 2(3)(a)-(g) of the Model Provisions
[3] Section 2(a) of the Model Provisions
[4] See Reinhold v New South Wales Lotteries Corporation (No. 2) [2008] NSWSC 187 at [20] – [30]; Dartberg Pty Ltd v Wealthcare Financial Planning Pty Ltd [2007] FCA 1216; Chadra v Perpetual Trustees Victoria Ltd [2007] NSWSC 694: cf obiter dicta of Macfarlan JA in Perpetual Trustee Co Ltd v CTC Group Pty Ltd (No 2) [2013] NSWCA 58

performance criteria framed as strict contractual requirements (and independent of any notion of taking reasonable care) so as to avoid the operation of proportionate liability.

28. In circumstances where the Model Provisions reflect the view that the underlying public policy considerations support a prohibition on contracting out, the compromise inherent in Option 5, immediately jeopardises those policy outcomes by creating a de-facto way for parties to 'contract out' of (or 'contract around') the operation of proportionate liability.

29. As such, each of the submissions made above in support of the proposed prohibition on contracting out apply similarly to support the retention of a definition of "apportionable claim" which focusses on the substance of the defendant's conduct rather than the form in which the contractual term is drafted or the form of legal pleadings where a claim is made.

30. Moreover, the ability to 'contract around' the application of proportionate liability by drafting contracts which include strict liability performance obligations is likely to have an even greater adverse impact on the underlying public policy of proportionate liability than permitting contracting out. That is because, many contracting parties (particular smaller less sophisticated parties) are unlikely to appreciate that small changes to the way in which contractual provisions are express would have the effect of negating the application of proportionate liability.

31. As noted above, in the context of contracting out, from the point of view of the insurance market, the application of proportionate liability needs to be certain and consistent in order for insurers to be able to take the availability of proportionate liability into account when setting premiums or determining whether to underwriter a particular risk or class of risks. This consideration militates strongly in favour of an approach based upon substance rather than form. Insurers cannot know or exercise effective control over what contractual terms an insured enters into nor the form in which a cause of action may be pleaded.

32. Professional service providers are likely to be particularly susceptible to losing the benefit of proportionate liability legislation in the event that the definition of "apportionable claim" is narrowed in the manner proposed.

33. While he Decision Regulation Impact Statement[5] acknowledges that participants in the construction industry (including professional architects and engineers) are likely to be adversely affected by this change, it appears to assume that Proportionate Liability would still (generally) be applicable to other contracts for professional services, such as those provided by auditors or accountants, in that the terms upon which they are engaged do not usually involve strict contractual duties, but instead an obligation to render their professional services with reasonable care.[6]

34. It is submitted that such assumption is unlikely to be the case in practice. In our experience, it is common for professional retainers to include a number of strict contractual stipulations which are expressed without reference to the element of 'reasonable care'.

[5] *Standing Council on Law and Justice Proportionate Liability Model Provisions Decision Regulation Impact Statement*- October 2013
[6] *Ibid*, page 18

35. Thus, most retainers of auditors and accountants contain conditions requiring the professional to strictly comply with detailed, technically specific, auditing and/or accounting standards. If, by reason of a failure to take reasonable care, the professional departs from such standard in a particular respect, it is highly arguable that such professional would not be entitled to the benefit of proportionate liability. There is little distinction in practice between a technical specification in an engineer's brief requiring compliance with an Australian Standard and a technical specification of this nature in an auditor's retainer.

36. Many other professional retainers include similar types of conditions. For example the Australian Banking & Finance Industry Residential Valuation Standing Instructions require that the valuers appointed are compliant with the requirements of membership to their Industry Body, and that the reports are in accordance with the API Property PRO format. Other valuation retainers commonly require compliance with relevant Australia & New Zealand Professional Valuation Standards.

37. Even where professional retainers do not currently contain conditions of this type or other strict contractual stipulations requiring of particular thing to be done or outcome achieved (though in our experience most do to some extent), in the event that the Model Provisions are enacted, it is likely that lawyers drafting professional service contracts would add a raft of very specific contractual requirements in an attempt to avoid the application of proportionate liability. The ability of clients to draft retainers so as to convert most foreseeable failures to take reasonable care into specific conditions is limited only by the ingenuity of the clients' lawyers.

Conclusion – Preferred Model

38. It is submitted that the New South Wales Attorney General should support the adoption of Option 3. That is, uniform legislation which:

    a. broadly defines an apportionable claim; and

    b. prohibits contracting out.

39. Further, we recommend that, to ensure certainty in light of the present state of judicial authority, the legislation include an express provision to make clear the legislative choice that proportionate liability should apply where the defendant's failure to take reasonable care is held to be a cause of the relevant loss (regardless of whether the cause of action is framed in contract, tort or breach of statute).

D. Consumer Claims

40. The Model Provisions propose an exclusion of consumer claims.

41. Consumer claims are defined as claims:

    a. by an individual;

    b. where the costs of the goods or services are less than $40,000 (as calculated in accordance with ss 3(4) to 3(9) of the Australian Consumer Law (ACL);

    c. excluding goods acquired for the purposes set out at ACL s3(2).

42. McCabes supports the proposal that consumer claims be limited to Option 1 discussed on page 21 of the Decision Regulation Impact Statement. That is, the inclusion of Model Provision 2(3)(b) only. This would be consistent with the existing public policy solution currently provided by the ACL and ensure consistency between the Model Provisions and the Federal proportionate liability regime under the existing ACL.

43. In the event that Option 2 is to be retained (by the inclusion of Model Provision 2(3)(c)), McCabes supports limiting the definition to claims brought by individuals (meaning natural persons).

44. However, McCabes has concerns in relation to two aspects of the proposed definition of 'consumer claim' in proposed s2(3)(c):

    a. the use of the costs of goods or services by reference (solely) to a monetary threshold of 'less than $40,000'; and

    b. the absence of any exceptions in respect of services.

45. The proposed Option 2 exemption of consumer claims from the scope of proportionate liability (as presently drafted) will have the effect of reducing the certainty of application of proportionate liability for a large cohort of professionals.

46. For example, in residential construction contexts, it is common for smaller trades and professions to charge fees of less than $40,000 in the context of large, often multi-million dollar projects. For example, geotechnical, engineering and architectural advice would often fall below this price threshold exposing those professionals to potentially large liability notwithstanding that their relative responsibility may be low. Paradoxically, the builder on such a project, who may have a significantly greater responsibility for defects, would obtain the advantage of proportionate liability.

47. Similarly, a lawyer may charge less than $40,000 to provide advice to individuals on very large commercial transactions. For example, a lawyer might provide advice to an individual acting as guarantor of a large commercial loan in favour of a company of which the individual is a director and major shareholder.

48. These examples illustrate the difficulties with the use of a $40,000 price threshold as the determinative factor in ousting the operation of proportionate liability:

    a. Firstly, there will often be little or no correlation between the fee paid and the nature of the overall transaction or undertaking of the individual to whom such advice is provided;

    b. Secondly, the types of professionals or contractors who commonly provide services for low fees are more likely to be small businesses or sole practitioners who require the protection of proportionate liability. Yet those businesses will not have the benefit of proportionate liability. Other entities which play a larger role in the same transaction, which are more likely to be large corporations, will obtain the benefit of proportionate liability.

    c. Thirdly, those parties to a transaction or undertaking which charge relatively lower fees will often have a relatively lower responsibility for losses incurred. Again, it is those parties who are most in need of the protection of proportionate liability.

49. The potential for the proposed consumer exemption to the application of proportionate liability to have a significant effect on particular professional claims (and cohorts of professionals) is likely to have an immediate and disadvantageous effect on the insurance market for such professionals in terms of affordability and availability of cover. That is particularly the case in respect of professionals who frequently provide high risk advice in relation to large transactions/undertakings by individuals for a relatively low fee.

50. It is submitted that a fair balance between the rights of individual consumers and professional service providers could be achieved by amending the inclusive and exclusive parts of the definition of 'consumer claim' for the purpose of Model Provision 2(3)(c):

    a. to include only claims by an individual in respect of goods or services where:

        i. the amount paid or payable for the goods or services does not exceed $40,000; and

        ii. the goods or services were of a kind ordinarily acquired for personal, domestic or household use or consumption.

    b. to exclude services, other than financial services, which are provided in respect of:

        i. construction, maintenance or renovation of a residential dwelling where the total project cost of such construction, maintenance or renovation exceeds $40,000;

        ii. the purchase of a residential property;

        iii. a mortgage loan.

    c. to exclude financial services unless the individual is a retail client within the meaning of the Corporations Act 2001.

51. These proposed amendments would go some way to reducing the distortionary effects on the insurance market of the proposed Option 2 exemption of consumer claims and to achieving a more appropriate and tailored balance between the rights of plaintiffs and defendants.

E. Arbitration and External Dispute Resolution Processes

52. At present, proportionate liability is only available in Court proceedings. The proposals confirm that proportionate liability will not apply to arbitrations[7].

53. If Proportionate Liability is prohibited or limited, contracting parties may agree that all disputes will be resolved through arbitration, thereby acting as a de-facto means of contracting out of Proportionate Liability.

54. In circumstances where proportionate liability represents appropriate public policy, there seems little justification for allowing non-court tribunals (whether pursuant to a requirement in a contract or as a matter of the adjudicator's discretion) to ignore the

[7] Section 3 of the Model Provisions

relative culpability and causal efficacy of a party to an arbitration/EDR process by reference to other third party wrongdoers in causing the complainant's loss.

55. Plaintiffs will have the choice of taking their action by way of arbitration or EDR process (which they are likely to do where the party to the arbitration agreement or EDR scheme has a relatively greater relative responsibility for the plaintiff's loss) or pursuing their action in the court system against all concurrent wrongdoers.

56. In those cases where the application of proportionate liability to arbitral or EDR processes would act as a strong discouragement to plaintiffs utilising those forms of ADR (which will be principally be where the party to the arbitration agreement or EDR scheme has a relatively lesser relative responsibility for the plaintiff's loss) the prejudice to the defendant of having 100% liability imposed upon it is relatively greater than the prejudice of requiring the plaintiff to pursue court proceedings to obtain full recovery.

57. It is submitted that:

    a. section 3 should be stated in the affirmative and the word "not" deleted; and

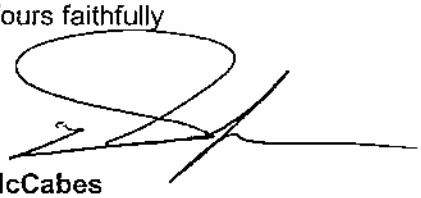
    b. section 12(3) may be omitted.

F. Definition of 'Concurrent Wrongdoer'

58. McCabes considers that the proposal to supplement the phrase 'the loss or damage the subject of the claim' in the definition of 'concurrent wrongdoer' with the phrase 'or substantially or materially similar loss or damage" (s4(1) of the Model Provisions) will create unnecessary uncertainty in circumstances where the High Court has brought clarity (and an appropriate balance) to the present wording of the legislation in *Hunt & Hunt Lawyers v Mitchell Morgan Nominees Pty Ltd [2013] HCA 10.*

59. McCabes otherwise supports the revision to the definition to bring uniformity to the legislation by including the words "independently or jointly of each other'.

Yours faithfully



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