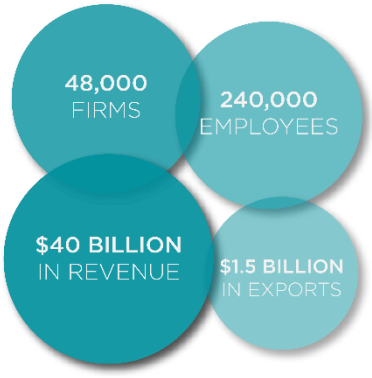
Procurement Practices for Government-Funded Infrastructure

SUBMISSION TO THE PARLIAMENTARY STANDING COMMITTEE ON INFRASTRUCTURE, TRANSPORT AND CITIES

JULY 2021

ABOUT US



Consult Australia is the industry association representing consulting businesses in design, advisory and engineering. Our industry comprises some 48,000 businesses across Australia, ranging from sole practitioners through to some of Australia's top 500 companies, providing solutions for individual consumers through to major companies in the private sector and across all tiers of government. Our industry is a job creator for the Australian economy, directly employing 240,000 people. The services we provide unlock many more jobs across the construction industry and the broader community.

Our members include:

AECOM, ARCADIS, ARUP, aurecon, Beca, BG&E, Cardno, CGC Civil Geotechnical Consultants, Douglas Partners Geotechnics / Environment / Groundwater, GHD, HDR, Jacobs, KBR, LSEC Lovell Structural Engineering Consultancy, mlei Consulting Engineers, Northrop, pitt&sherry, RED, RLB Rider Levett Bucknall, SMEC Member of the Surbana Jurong Group, Stantec, tonkin, umwelt

SUBMISSION TO STANDING COMMITTEE

INQUIRY INTO PROCUREMENT PRACTICES FOR GOVERNMENT-FUNDED INFRASTRUCTURE

EXECUTIVE SUMMARY

Consult Australia welcomes this opportunity to make a submission to the House of Representatives Standing Committee on Infrastructure, Transport and Cities in respect of the Inquiry into Procurement Practices for Government-Funded Infrastructure.

Consult Australia, and many other industry groups and thought leaders, have called for procurement reform over many years on the basis that this will unlock greater productivity for the sector and the economy as a whole. For example, in 2015 Consult Australia commissioned Deloitte Access Economics (see Appendix 1) to quantify the costs associated with sub-optimal procurement practices. The findings showed that with improvements in briefs, delivery models and contracts, the following efficiencies can be gained:

- reduce the costs of projects by 5.4%
- reduce delays to projects by 7%
- improve the quality of projects by 7%.

In the same year we published 'Better Buying, Better Outcomes' setting out a series of findings and recommendations arising from the work undertaken by Deloitte Access Economics (see Appendix 2). These recommendations aimed to improve procurement and thus unlock greater productivity not only during the course of the project and but also over the asset's lifecycle.

Reform recommendations made by Consult Australia and other organisations, including in reports prior to and post 2015, have all converge on the same themes. There is an urgent need to create a more collaborative procurement and contracting framework, with balanced commercial structures, that will improve the culture across the industry, which will result in greater productivity.

In late 2020 we published our Uplifting Productivity Report (see Appendix 3) which draws on recent successful projects. These projects show how improved collaboration and communication through all stages (from scoping, tendering, contracting, delivery and post-completion) can drive productivity growth.

Reform is now more urgent than ever before because of two factors coming to bear on the industry:

1. The size and scale of the infrastructure task at hand across Australia
   The scale of the infrastructure demand is well known and will be well covered by other submissions to this Inquiry, so we have not sought to repeat that detail here.
2. The diminishing health of the industry as a whole
   High levels of disputation and the 'master, servant' approach in procurement and contracting have resulted in issues of skills retention, mental health issues, reduction in the availability and affordability of essential business insurance and the introduction of broad reaching exclusions in Professional Indemnity (PI) insurance policies. These problems are not limited to the consulting sector of the industry, but can also be seen in the construction sector, which is particularly vulnerable to business failure, which is very damaging to all areas of the industry. Our industry needs a healthy ecosystem of consultants, contractors, suppliers etc to sustain itself and deliver great project outcomes for the people of Australia.

Procurement practice reform recommendations

The Commonwealth should adopt the following reforms needed to procurement practice:

1. Mandate the use of this collaborative procurement policy in releasing funds to the states and territories for infrastructure.
2. Recommend to state and territory governments, where Commonwealth funding is not involved, that they abolish the devolved model of procurement and establish Centres for Procurement Excellence that set out the procurement and contracting policies to be followed by all agencies.
3. Support the above principles by developing guidance and training for procurement officers on risk assessment and management, insurance, and contract management.

Statutory reform recommendations

The Commonwealth should take the lead on the following statutory reforms to support best practice in procurement by:

1. Amend the civil liability laws around the country to explicitly prohibit the contracting out of proportionate liability in professional services contracts (in-line with the civil liability law in QLD which already has such a provision). This will require working with state and territory governments to amend existing civil liability laws.
2. Make all government contracts subject to the unfair contract terms protections of the Australian Consumer Law.
3. Amend the misleading or deceptive conduct provisions in the Australian Consumer Law so that the provisions are limited and apply only to protect consumers and small businesses, not sophisticated business parties in a business-to-business contract.

THE CASE FOR REFORM

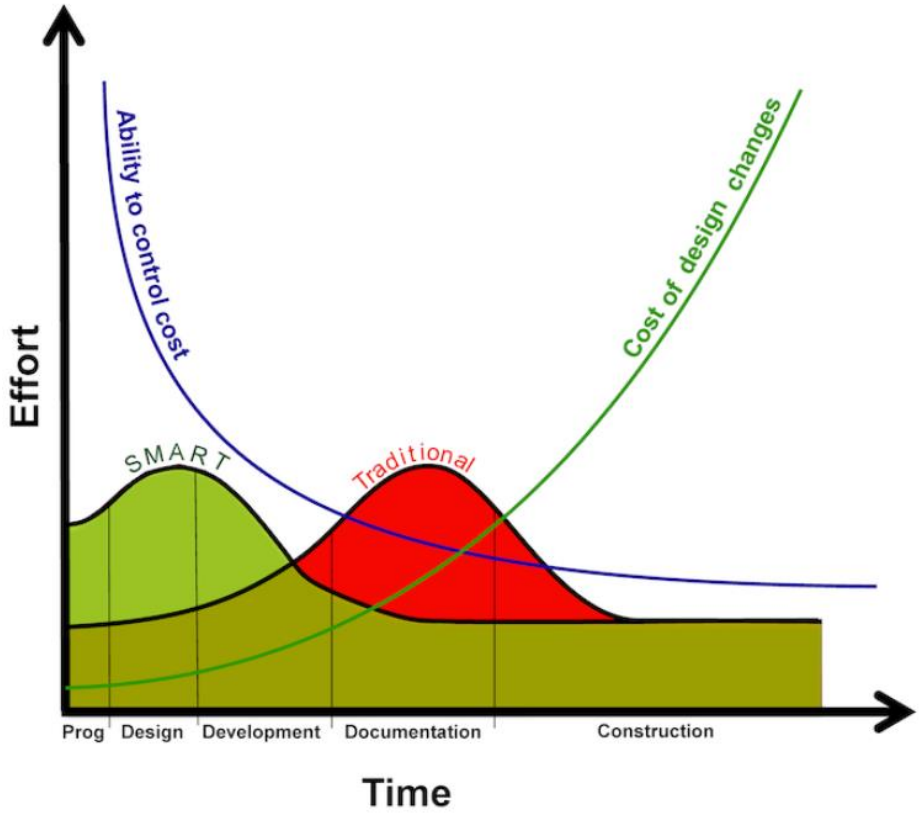
Our industry needs a healthy ecosystem of consultants, contractors, suppliers etc to sustain itself and deliver great project outcomes for the people of Australia. The current building and construction industry has had diminishing health over many years. Industry agrees that collaboration, capacity, and insurance are the driving factors making action vital now.

COLLABORATION

There is no build without design.

While professional services make up a relatively small proportion of the total amount spent on delivering public infrastructure, it is well established that errors made in the early phases of a project can multiply significantly when that project reaches the construction phase.

The MacLeamy Curve[1] below illustrates how investment in resources early in the design process optimises the design and correcting mistakes early is easier and more cost effective (see the 'smart' green curve). In contrast, putting peak effort in later during documentation and construction phases is more challenging, costly and is more likely to lead to disputes (see the 'traditional' red curve). This simple illustration shows the benefit of an integrated design process.



[1] Patrick MacLeamy: https://macleamy.com/about/

This diagram was first used in a paper by the United States of America Architectural/Engineering Productivity Committee in 2004. The Committee was comprised of representatives from the architectural, engineering, construction, building management, operations, technology and building products industries. It was convened by the Construction Users Roundtable (CURT) to address the perception of inadequate, poorly coordinated architectural/engineering drawings and the resulting difficulties in the field. The Committee concluded that:

> …the difficulties experienced in typical construction projects, including those identified by CURT members, are artifacts of a construction process fraught by lack of cooperation and poor information integration. The goal of everyone in the industry should be better, faster, more capable project delivery created by fully integrated, collaborative teams. Owners must be the ones to drive this change, by leading the creation of collaborative, cross-functional teams comprised of design, construction, and facility management professionals. [2]

The Committee made four recommendations that are entirely relevant to the way in which projects are run in Australia:

1. Owner leadership: as the integrating influence in the process, owners must be actively engaged in and drive collaboration.
2. Integrated project structure: the structure needs to be set to enable full collaboration, which means setting up a commercial framework and contracts that drive collaborative problem-solving and reduces silos and disputation.
3. Open information sharing: to support the lifecycle of a project, information sharing should be open, timely and reliable.
4. Virtual building information models: effectively designed and deployed information technology supports information sharing and leads to a more effective design/build/manage process.

Similar problems were identified in the United Kingdom, where it was also recognised that the transactional model for delivering major infrastructure projects and programmes was broken:

> It prevents efficient delivery, prohibits innovation and therefore fails to provide the high-performing infrastructure networks that businesses and the public require.

In the UK, there is an enterprise approach being adopted, known as Project 13:

> The shift to an enterprise model for infrastructure delivery is core to the Project 13 approach […] An enterprise brings together owners, partners, advisers and suppliers, working in more integrated and collaborative arrangements, underpinned by long term relationships. Participating organisations are incentivised to deliver better outcomes.[3]

The reform principles of Project 13 are aligned to those identified in USA approach, capable owner, governance, integration, organisation and digital transformation.

[2] The Construction Users Roundtable, Collaboration, Integrated Information, and the Project Lifecycle in Building Design, Construction and Operation' WP1202, August 2004 available at: https://kcuc.org/wp-content/uploads/2013/11/Collaboration-Integrated-Information-and-the-Project-Lifecycle.pdf

[3] For more about Project 13, see: https://www.project13.info/about-project13/

Sadly, our approach in Australia carries the same inefficient and detrimental hallmarks of the problems that have been identified in the USA and the UK. Numerous reports have been released in the last 2-3 years highlighting industry issues. Infrastructure Australia's 2019 Infrastructure Audit found amongst other issues:

> Truncated bidding timelines, unnecessary documentation requirements, and under-resourced government project teams are leading to poor procurement and delivery outcomes. This results in higher levels of risk and uncertainty being priced into tenders. These costs are ultimately carried by the users through poor quality services or additional costs, or met through government reimbursements.[4]

The UK and the USA may be further down the path of reform than we are, however, all of industry operating in Australia is aligned on what the problems are, and the key solutions needed. The way forward is for government in both its role as policymaker and client to play its role in the reform agenda because no one party in the ecosystem, that is the building and construction industry, can realise the change alone.

Although not available at the time of writing this submission, it is Consult Australia's understanding that the 2021 Australian Infrastructure Plan, being developed by Infrastructure Australia and due for release in mid-August 2021, will contain a chapter on industry productivity and innovation. We anticipate that it will report on the procurement issues identified by industry and make a series of recommendations for reform. Whilst it is difficult to pre-empt this section of the report in its entirety, Consult Australia anticipates that it will support the reform package proposed and is likely to recommend that the Commonwealth, state and territory governments work with industry to adopt them without delay.

CAPACITY

This Inquiry comes at a time when we are seeing significant capacity as a leading business-critical issues for consulting businesses. Our latest Industry Health Check Pulse Survey of April 2021 called this out. More than half (56%) of members are concerned about pressures on workforce capacity to deliver the expected volume of work over the next six months. Skill shortages, exacerbated by limited access to skilled migration and a 'hot' market, is impacting the industry's confidence to deliver a growing pipeline of infrastructure (and related) projects, which in turn may impact Australia's COVID-19 recovery efforts.

In this submission, we have chosen not to focus on the skills constraints that will impact the delivery of the infrastructure project pipeline. This is because it involves matters outside the scope of the inquiry, such as education and training, and planning/sequencing of the infrastructure pipeline. What we will say is that if we resolve the procurement issues this will go some way to addressing our capacity issues because it will:

- reduce the level of disputation across the industry, which has a significant impact on the psychological safety of our workforce
- inform more realistic time tabling for the delivery of projects
- allow for greater workforce diversity.

[4] Infrastructure Australia, Australian Infrastructure Audit 2019, see in particular pages 208-259 available here: https://www.infrastructureaustralia.gov.au/sites/default/files/2019-08/industry_efficiency_capacity_and_capability_-_2019_australian_infrastructure_audit.pdf

INSURANCE

The availability and affordability of insurance is also a leading business-critical issue for consulting businesses. Our latest Industry Health Check Pulse Survey of April 2021 demonstrates that around 90% of businesses have experienced significant premium increases to their professional indemnity (PI) insurance, with 11% even reporting that they have experienced increases of over 100% in the last 12 months.

With the current issues in the insurance market, both globally and for Australia across a range of products but most particularly PI insurance, it is essential that action is taken to de-risk the industry by governments at all levels. This can be achieved by procurement practices that promote healthy, well-balanced, and sustainable contractual relationships.

PI insurance is business insurance that a consulting business can fall back on in the unlikely event that they have made an error, act, or omission that has given rise to a claim for loss in the provision of their services. It provides businesses with the ability to settle a claim without jeopardising the entire business (depending on the size of the claim and the sum of insurance held). An insurance policy is generally not obtained to cover the liabilities of a business under one contract but covers all relevant liabilities across all their contracts to provide business services to their clients. As a client is not a party to the insurance policy, it generally has no rights to claim on the consultant's insurance because the insurance policy is a contract between the insurance underwriter and the consulting business.

Client organisations (public and private sector) are increasingly expecting the consulting business' policy of insurance to cover them and their project in the face of any losses or issues, often regardless of the fault of the consulting business. In some cases, this is due to a lack of understanding regarding the role of the consultant and their insurance.

We see increasing commentary from the insurance market about the issues that arise in the procurement and delivery of projects which is feeding the decline in availability and affordability of PI insurance across consulting businesses of all sizes. These issues relate to risk being transferred to consulting businesses via contractual warranties, indemnities, high levels of (or unlimited) liability, and cross-liabilities for matters that are unlikely to be in the full control of the consultant. For example, the global insurance broker AON said this of the Australian market:

> Australian insurers are focused on cost over-runs, loss mitigation, warranties and cross liability, with related exclusions and sub-limits commonplace. As the Australian government tries to kick start the economy with infrastructure investments, capacity may become an issue.[5]

Our members report to us that capacity is already an issue across businesses of all sizes (as evidenced in our Health Check Survey noted earlier). In the infrastructure sector we see significantly diminished access to project specific PI insurance, because Australia's building and construction sector is now considered one of the highest risk industries in the world for PI insurance. To understand why we only need to look at the dispute data.

[5] See AON's Global Insurance Market Conditions Q2 2020.

Dispute data

Prior to 2017, the PI market was in a relative 'soft' cycle, meaning that there was broad availability and business were able to access various extensions to their policy cover (typically not on offer previously).

An insurance agency needs to earn approximately $1.00 for every 70 cents of claims incurred to break even. In Australia, gross claims incurred was $1.25 billion at the end of 2017. This value was 86% of total premiums earned in the Australian market. This means that the average insurer *lost* 16 cents for every $1.00 earned. As a result of this declining profitability, the market has tightened in the years following 2017 and has continued to do so at a rapid rate, with some underwriters withdrawing entirely. Looking at the experience of consultancy businesses across Australia throughout 2020 and 2021, it is difficult to say that we are experiencing a periodic 'hard' cycle – it is more critical than that and we are at risk of long-term lack of capacity in the insurance market.

Unfortunately, the commercial nature of insurance is not readily appreciated, even by government agencies tendering for contracts or delivering law reform agendas. Insurance underwriters are making commercial decisions based on the risk of claims in the market and the potential (or lack thereof) of profitability – as would any commercial operator. In government contracts, procurement guidance, and even in regulation, we see an underlying assumption that a private entity's insurance policy is there for the government client or the community as a safeguard. Further, there is an expectation that a consulting business has full control over the terms on which it can obtain and maintain insurance coverage, which is in stark contrast to any other consumer of any other commercial product. Imagine requiring a consumer to guarantee they would source the same product, with the same specifications for every year for the next five to ten years.

Consult Australia analysed a sample of 124 infrastructure projects completed since 2015, which have all been subject to legal or fee withheld claims. These projects were all delivered using the Design and Construct (D&C) procurement model. The D&C model was chosen specifically as we have observed that it constitutes a disproportionate amount of the overall claims against consultants and is one where there is generally a noticeable back-to-back pass-through of risk from the head client. The results are not encouraging.

> *Across the 124 projects reviewed the value of legal claims against consultants reached almost $1.4 billion. This represents 51.2% of the consultants' gross revenue against those projects.*

While the financial impact of legal disputation is having a dramatic impact on consultants, the value of the claims is only a small percentage of the total construction costs on those projects, explaining why these disputes raise little attention in the eyes of the government owner/client.

> *The cost of legal disputes against consultants, accounts for just 0.9% of the total construction costs.*

The claims data captured here is just one aspect of the impact on our industry as it only looks at the dollar sum of legal claims made and amounts of consultant fees withheld. This data does not include the:

- level of claims and fees withheld across the consulting sector, the majority of which is made up of small and medium enterprises (SMEs)
- financial cost to consultants of defending the claims
- financial impact on consultant's PI insurance premiums and coverage

- financial cost to contractors in bringing the claims
- the escalation of fees caused by the increase in likelihood of claims
- lost productivity within consultancy businesses of design experts and business leaders being distracted by internal business risk rather than focusing entirely on project outcomes
- lost productivity within client organisations, contractor businesses and consultancy businesses in re-litigating at every problematic contract term – this often involves procurement officers, client internal and external legal advisors, as well as commercial managers and legal advisors in the contractor and consultancy businesses
- lost productivity of senior management (including company directors) considering risk pass-through of every contract rather than on the governance of the business as a whole
- lost innovation caused by conservatism in design and in back-room effort
- impact to the mental health wellbeing of the individuals involved in being taken off projects to defend claims.

The data provided should therefore be seen as a snapshot only, it represents the tip of the iceberg. For example, costs associated with addressing a claim can average 10% of the sum of the claim, this can rise to 25% on average if a matter goes before a court.

This data irrefutably demonstrates that there is significant wastage to the economy, particularly as the significant proportion of these claims are seeking to redress commercial loss through underbidding of projects or inappropriate contingency allocations and not *actual loss* caused by defect rectification in the end-product. It is recognised that defects may occur, and those matters should be addressed with the responsible party (who would likely rely on their relevant insurance) but claims should go to rectification of the defect and not be made to redress unrelated issues, such as narrow profit margins.

The claims data also evidences that, at least in the D&C model, the level of risk transfer is breeding a culture of disputation rather than collaboration. A different way of working is needed – where the contract is used to engender a collaborative approach that incentives problem solving, and the value and role of each party delivering the project is understood and respected.

The legal disputation in the Australian market is resulting in insurers significantly reducing capacity and availability. Insurers prepared to continue underwriting PI insurance policies are placing far greater scrutiny on their underwriting assessment, rates, and the liability exposure for consultants through their contractual terms and conditions with clients.

Insurance impacts small businesses to global businesses

The insurance issues are hitting businesses of all sizes, with global businesses struggling to get appropriate coverage for their Australian operations. We have set out below some case studies from across our sector to demonstrate this point.

However, our small business members advise that PI insurance premiums are their largest business expense and year on year premiums are increasing while coverage amounts decrease – irrespective of claim history.

The number of underwriters providing any sort of coverage has become extremely limited. Small companies providing specialised design, advisory, or engineering services will struggle to survive unless action is taken.

While affordability is a key issue, we are now seeing small businesses and sole traders face forced business closures and early retirement based solely on the fact they can no longer get insurance at any price (let alone at an affordable premium).

We are increasingly hearing stories from consultants that multiple brokers specialising in engineering and professional services cover are advising that there is no cover from any insurers, underwriters, or other markets (at any price). Various options have been explored for these businesses including:

- a renewal or new policy at a lower sum insured and with the retroactive date intact
- a renewal or new policy at any sum insured with a reduced retroactive date
- a renewal or new policy with no retroactive cover
- a renewal or new policy with cover for personal injury excluded
- a renewal or a new policy with a high level of deductible
- a combination of all the above.

This is an untenable position for these consulting businesses that have successfully operated and could still contribute to the Australian economy, but for the current state of the PI insurance market. The worsening PI insurance market combined with the economic downturn caused by COVID-19, is significantly impacting the ongoing sustainability of our industry and that is why it is time to look at potential solutions.

Case study 1 – Premium increase of less than 25% for a small business

A small structural and civil engineering business that provides services across Australia renewed their PI insurance with a 7% increase in fees and a 23% increase in the premium (which the broker stated was 'a good result in the current market' and the only other main option had pricing at least $50,000 more). While they were seeking a $20million coverage, no insurer was able to offer that. The business therefore has primary layer cover of $10million.

Case study 2 – Premium increase of over 400% for a small business

A small structural engineering business that provides services across Australia previously paid a $60,000 premium for $3million PI insurance cover. The renewed policy in 2020 has a premium of $250,000.

Case study 3 – Potential premium savings for a global business

Large global consulting businesses in the built environment have advised that they could save 40% on their premium if they carved out Australian operations.

Case study 4 – No cover at any price for a sole trading structural engineer

A sole trading structural engineer has been forced into early retirement because they cannot secure PI insurance. This is despite having a long-term client of over 20 years, a steady stream of work and income and no claims in over 15 years.

Without PI insurance, this sole trader cannot operate, even as a verifier of other's work, as insurance is a legislative requirement. Further, they are unable to secure run-off insurance, to cover any claims that may arise during retirement for past work. Essentially, this engineer is self-insuring, putting at risk savings and property holding/s.

The cover required by this engineer to continue working with their long-time client is only $2-3 million. In past years the premium for the PI insurance was $6,500 this increased to $22,000 in 2019. Multiple brokers specialising in engineering and professional services cover have advised this member that there is no cover 'from any insurers, underwriters, or other markets (at any price)'.

Case study 5 – No cover at any price for a small fire engineering business

A small fire engineering business has recently sought renewal of its PI insurance. The previous policy had a limitation excluding all cladding related work and was obtained at a substantial increase in premium. In 2021, there is no offer of insurance with brokers advising that due to the nature of the business activity there is no insurance available.

Without insurance this business cannot continue to operate. If other fire engineering businesses face the same situation this will have a significant impact on the broader construction industry as the Building Code of Australia requires fire engineers to complete the verification method and any cladding product that passes the large-scale testing needs a fire engineer to complete the verification report.

To alleviate the current issues in the insurance market we need urgent action from governments as both policy makers and clients to work with industry to prioritise de-risking projects through their procurement and contracting behaviours and regulatory reform initiatives. We have set out how this can be achieved in the solutions section of this submission.

PROPOSED SOLUTIONS

Consult Australia calls on the Commonwealth to undertake both procurement policy reform as well as statutory reform to address the issues identified above.

PROCUREMENT POLICY REFORM RECOMMENDATIONS

The Commonwealth should adopt the following reforms needed to procurement practice:

1. Mandate a collaborative procurement policy in line with our Uplifting Productivity Report and Model Client Policy across its own procurement practices applicable to all agencies through the Commonwealth Centre for Procurement Excellence.[6]
2. Mandate this collaborative procurement policy in releasing funds to the states and territories for infrastructure.
3. Recommend to state and territory governments, where Commonwealth funding is not involved, that they abolish the devolved model of procurement and establish Centres for Procurement Excellence that set out the procurement and contracting policies to be followed by all agencies.
4. Support this by developing guidance and training for procurement officers on risk assessment and management, insurance, and contract management.

Uplifting productivity through collaboration

Our 2020 Uplifting Productivity Report sets out nine recommendations to help maximise the economic benefits from projects via procurement reform. We have provided this as Appendix 3 rather than recreate within this submission and should be read alongside this submission. Case studies are included in the report to support each recommendation. Productivity gains can be found in every phase of the project, pre-tendering, tendering, contracting, project delivery and post-completion.

Model Client Policy

Consult Australia has developed a Model Client Policy, akin to the long-established model litigant policy, to address the inherent and substantial power imbalance in favour of government clients when it contracts with the private sector. We believe that government clients signing-up to the Model Client Policy and delivering fair and collaborative contracting would significantly de-risk the Australian building and construction industry as litigious avenues would no longer be available/needed. Please note that the Model Client Policy is provided as Appendix 4 to supplement to this submission and should be read alongside this submission.

[6] See: https://sellingtogov.finance.gov.au/guide

Standard form contracts

Recognised standardised contracts should be adopted to underpin the collaboration required to the deliver the project, together with early warning mechanisms and dispute avoidance. There are examples of international contracts which are highly regarded by overseas government clients and are well known to businesses/practitioners that have worked on substantial overseas infrastructure projects. Examples include the New Engineering Contract (NEC) Suite[7] and the International Federation of Consulting Engineers (FIDIC)[8] suite of contracts. These are well supported by successful case studies in multiple international jurisdictions.

It is interesting to note that government owned corporations are ahead in exploring these options, for example:

- NEC has been adopted as a contracting suite by Sydney Water in Australia,[9] which is also the first government entity to partner with Project 13 to introduce partnering for success[10]
- Snowy Hydro 2.0 has based its approach on the FIDIC Emerald Book Contract form for underground construction.[11]

The Australian Standard for the Engagement of Consultants, AS4122-2010 was negotiated by government representatives and industry and has been used successfully by many government agencies, however over time it has become heavily amended through the use of 'special conditions' that change the risk profile. This negates the purpose and intent to create a more collaborative and balanced contract. These amendments, drafted by legal advisers to clients creating significant expense both in their development and in their review and subsequent attempts at negotiation by the supplier of the services. It is essential therefore that once a standard form is agreed by industry and government, that it is not then subject to substantive amendments that are extremely difficult to negotiate in a live environment. This is where our industry sees the most onerous contracting conditions come into play.

As part of our call for adoption of the Model Client Policy, we also see the need for an education campaign across in-house government legal and procurement resources around the country, to address the knowledge-deficit regarding the impact that risk averse, master-servant contracts have on project outcomes and the damage they do to relationships across the industry and our very sustainability. For example, some of the most onerous contract terms relate to a consulting businesses PI insurance policy. The insertion of such clauses (or pass down of these clauses in a D&C example) bear little or no relation to genuine risk identification and assessment. Rather, members advise that government clients see a consultant's insurance as the way to 'manage risk' and underwrite the project in the event of problems. The expectations of government clients are now frequently out-of-step with what the insurance market is willing to offer and therefore the consulting business can obtain.

[7] See: About NEC - NEC Contracts

[8] See: FIDIC | Why Use FIDIC Contracts? | International Federation of Consulting Engineers

[9] See: https://www.sydneywater.com.au/web/groups/publicwebcontent/documents/document/zgrf/mtg0/~edisp/dd_184324.pdf

[10] See: NEC news and articles (neccontract.com)

[11] See: http://www.smec.com/infocus/portfolio/snowy-2-0-the-next-generation-of-hydropower-in-australia/

Case study 6 – Unreasonable client insurance requirements for a small maritime engineering business

A new small maritime engineering business providing services across Australia with an estimated initial turnover of under $1million is paying approximately $80,000 in premiums per annum for PI insurance. While clients request $5-10million PI insurance coverage from the consultancy, the business was only able to obtain $2million PI insurance coverage. The business notes that this policy was difficult to obtain, extremely limited in terms of underwriters and with premiums prohibitively high for small turnover. This insurance premium is the businesses largest business expenditure. Brokers have advised that this is unlikely to change in the coming year.

The adoption of standard contracts and the Model Client Policy together with guidance and training for procurement officers on risk, contracting, and insurance would result in greater productivity and reduced costs for governments because it would reduce requests for standard contract amendments and renegotiation of the terms on almost every project.

STATUTORY REFORM RECOMMENDATIONS

The Commonwealth should take the lead on the following statutory reforms to support best practice in procurement by:

1. Amend the civil liability laws around the country to explicitly prohibit the contracting out of proportionate liability in professional services contracts (in-line with the civil liability law in QLD which already has such a provision). This will require working with state and territory governments to amend existing civil liability laws.
2. Make all government contracts subject to the unfair contract terms protections of the Australian Consumer Law.
3. Amend the misleading or deceptive conduct provisions in the Australian Consumer Law so that the provisions are limited and apply only to protect consumers and small businesses, not sophisticated business parties in a business-to-business contract.

Civil liability reform

Since the introduction of proportionate liability into Australia's civil liability laws Consult Australia has called on the Commonwealth as well as state and territory governments to explicitly prohibit contracting out of proportionate liability in professional services contracts. Regrettably Consult Australia must point out that government clients are amongst the worst in insisting that consultant businesses contract out of this statutory right if they want to win the job and enter into the contract. Access to the proportionate liability scheme is often excluded in government contracts, in addition to arbitration being mandated as the dispute resolution forum. This position is extremely problematic for consultants because as a consensual process, only the parties to an arbitration agreement can be referred to arbitration. Third parties involved in a dispute cannot be compelled to join an arbitration without their consent.

Accordingly, if there was a dispute that was arbitrated and the parties have contracted out of the proportionate liability legislation, the consultant could be exposed to all of the liability without the option of claiming contribution from other wrongdoers.

Amending the legislation to expressly prohibit contracting out of this provision in the law would realise the original policy intention of the civil liability reforms, which were introduced to de-risk the market the last time the PI insurance severely contracted in Australia.

On 15 November 2002, Commonwealth, state and territory Ministers and the Senior Vice President of the Australian Local Government Association met to discuss issues regarding the availability and affordability of public liability and related insurances. The resulting Joint Communiqué included the following statement:

> The operation of insurance and the law of joint and several liability has given rise to professionals often being singled out as the sole target for legal action in proceedings for property damage and purely financial loss even when the professional is only one of the parties involved and may have only contributed in a minor way to the loss. These factors have led to an exponential increase in professional indemnity premiums which are not sustainable.[12]

Proportionate liability was therefore introduced as a statutory right through Commonwealth, state and territory civil liability legislation. Proportionate liability ensures that a party is only liable in damages for the proportion of the suffered loss that is attributable to that party. It only applies to financial harm and economic loss, not to cases involving personal injury or death. Proportionate liability was introduced nationally through state and territory civil liability legislation to improve the availability and affordability of PI insurance in Australia following the insurance crisis of 2001 when the insurer HIH collapsed.[13]

The key policy objective of proportionate liability – helping to ensure that PI insurance is available, affordable and dependable – is undermined if consultants are required by a client to contract out of the proportionate liability legislation.

The original reforms were positively received by local and international insurers. Anecdotal evidence indicates these measures assisted in improving the allocation of capital to Australian PI insurers. However, insurers have also indicated that if the application of proportionate liability can be by-passed contractually the insurance market will price and allocate capital to Australian PI risk as if proportionate liability does not apply.

Only Queensland's legislation explicitly prohibits contracting out of proportionate liability. NSW, Tasmania and WA explicitly allows contracting parties to contract out. The remaining state and territory laws do not specify either way, which makes the position unclear. Contracting out of proportionate liability in professional services contracts undermines the policy goals of the proportionate liability law reform and introducing a provision to prohibit contracting out for professional services would be a straightforward step in de-risking PI insurers exposure to claims.

The operation of proportionate liability ensures both the client, and the consultant is managing their risks and still ensures that the consultant is liable for any direct economic loss they cause.

[12] https://ministers.treasury.gov.au/ministers/helen-coonan-2001/publications/joint-communique-ministerial-meeting-public-liability-2

[13] 2015 Treasury Briefing, 'Aftermath of the HIH collapse'.

There are three key arguments often levelled against proportionate liability:

- A client should be able to recover their losses regardless of contribution
- It is easier to file a claim against a single party than multiple claims against multiple parties
- It is a good form of risk management.

While from the client's perspective it seems a reasonable proposition that they should be able to recover all their losses from a single party despite their contribution to the loss, this fails to recognise the complexity of insurance law and risk management practices, and how they affect the delivery of a project.

A disproportionate number of claims are made against professional services providers. They are seen as the most likely source for recouping losses because of their PI insurance (i.e. 'the deep pockets syndrome') as builders and contractors are assumed more likely to file for bankruptcy.

Reverting to unlimited joint and several liability perpetuates the deep pockets syndrome and undermines the policy intention to stabilise the PI insurance market. It is also a dangerous assumption for a client to assume that requiring their consultant to contract out of proportionate liability ensures that all their losses will be recovered. A party's real ability to make good the accountability which results from joint and several-liability is only as good as the balance sheet or insurance available to that consultant.

Placing the entire liability with one party also encourages less desirable risk management practices, where one party can essentially 'wash their hands' of any responsibility for problems the project may encounter. Proportionate liability, together with a proper risk assessment at the outset of a project will lead to better outcomes in terms of cost and time, as well as reduced disputation and litigation.

Frequently clients cite the convenience of filing a single claim as their reason for contracting out of proportionate liability. However, when this is the case, greater resources are devoted to costly legal proceedings, owing to cross-claims that are filed to recover money. In any event, consultants are responsible for the sub-consultants they engage, and contracting out does not change that.

Australian consumer law reform

To further and effectively de-risk the market, Consult Australia also recommends reform to the Australian Consumer Law (ACL) in two key areas:

- protection from unfair contract terms
- limiting the application of misleading or deceptive conduct claims.

Protection from unfair contract terms

The ACL provides protections to consumers and small businesses from unfair contract terms. We note announcements in 2020 and 2021 enhancing those protections. The key aspect missing from these protections is the application to all government contracts.

As a leading procurer of consultancy services in Australia, government at all levels should be leading the way in collaborative and balanced contracting (as per our advocacy on the Model Client Policy). This commitment would be guaranteed by the modification of the ACL.

We have seen in government contracts terms that have been considered unfair in other contexts, for example terms that:

- enable the government client (but not the consultant) to avoid or limit their obligations under the contract
- enable the government client (but not the consultant) to terminate the contract
- penalise the consultant (but not the government client) for breaching or terminating the contract
- enable the government client (but not the consultant) to vary the terms of the contract
- require the consultant to contract out of their statutory rights.

Limiting the application of misleading or deceptive conduct claims

An ongoing concern for Consult Australia members is the use of misleading or deceptive conduct claims by sophisticated contracting parties brought in lieu of, or (more commonly) in addition to, breach of contract claims. We believe that by limiting misleading or deceptive conduct claims legitimate grievances could still be pursued but unfounded litigious behaviour would be appropriately constrained.

The use of misleading or deceptive conduct claims in business-to-business contracting increases the likelihood of insurance claims, thereby impacting the insurance market as a whole. The detrimental impact of a constrained insurance market is not limited to coverage for these claims and these consulting businesses, but can impact all types of projects, businesses and clients.

Consult Australia recommends that misleading or deceptive conduct claims be limited by either:

a. only protecting consumers and small businesses consistent with the unfair contract term protections; or

b. allowing contracting parties the ability to exclude liability for misleading and deceptive conduct in business to business contracts.

The first option ensures that sophisticated parties will dispute contracts within the existing contractual and common law remedies. Whereas the second option empowers businesses to seek liability exclusions for misleading or deceptive conduct claims – but only where contracting with other businesses (not consumers). Either option would assist in limiting the risk to insurers and consulting businesses within our industry, although the first option will have a more significant and consistent impact.

Both options recognise the need to protect more vulnerable parties, those that often do not have the resources to guard against loss or launch a dispute. The first option protects both individual consumers and small businesses from misrepresentations which may cause them to suffer financial or non-financial detriment, while the second option provides ultimate protection to consumers.

Sophisticated parties, such as large businesses and government, often utilise inhouse or external legal counsel to negotiate contractual agreements. Therefore, the first option acknowledges that these parties do not need protection from misleading or deceptive conduct claims.

The second option recognises that two parties to a contract should be able to agree an effective limitation of liability (noting that currently claims for misleading and deceptive conduct cannot be capped by contract). It is accepted across the market, that for a consultant to offer fees which are competitive, an appropriate limitation of liability clause is agreed. This also gives the insurance market confidence in the risk it is insuring.

While both options are presented, our preference is to limit misleading or deceptive conduct claims to individual consumers and small businesses. This would ensure that vulnerable parties are still protected, and legitimate grievances can be pursued while also avoiding unnecessary financial and non-financial detriment. This proposal also is consistent with the unfair contract term protections of the ACL (see section 23) which protect both consumers and small businesses.

As the economy seeks to recover from the current and ongoing impacts of COVID-19, it is crucial that market power is balanced and fair. It is extremely important that insurance confidence is taken into consideration. If misleading or deceptive conduct claims continue to be allowed between sophisticated contracting parties, the ongoing risk to business will deepen.

CONTACT

We would welcome any opportunity to further discuss the issues raised in this submission.

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