SUBMISSION

ROLE OF THE PRIVATE INSURANCE MARKET – INDEPENDENT STRATEGIC REVIEW: COMMERCIAL ISSURANCE

JUNE 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.

Some of our members include:

AECOM, ARCADIS, ARUP, aurecon, Beca, BG&E, Cardno, CGC Civil Geotechnical Consultants, Douglas Partners Geotechnics / Environment / Groundwater, GHD, Golder, 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

EXECUTIVE SUMMARY

Consult Australia welcomes this opportunity to make a submission to the Insurance Council of Australia (ICA) on its Consultation Paper *Role of the Private Insurance Market - Independent Strategic Review: Commercial Insurance.* This paper comes at a time when we are seeing access and affordability of commercial insurance as a business-critical issue. Consult Australia has been active on alerting government at all levels and in all jurisdictions of this issue. We are pleased that the ICA has now joined us front and centre educating stakeholders on the role of the private insurance market and exploring solutions.

While we see significant issues in the insurance market, particularly in respect of professional indemnity (PI) insurance and directors' and officers' (D&O) insurance we agree with the view in the Consultation Paper view that these issues are not market failures in the true sense. Rather, insurers and underwriters are making commercial decisions based on the risk in the market and the potential (or lack thereof) of profitability – as would any commercial operator. Unfortunately, this commercial side is not always appreciated. For example, 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 private entity has ultimate control on whether 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 agrees with the Consultation Paper that there are certain actions the insurance industry can take (such as consistency), as well as the insured businesses (such as education) to alleviate the current issues. However, we disagree that government intervention is not yet needed. At least in terms of de-risking the market Commonwealth, state/territory and local governments must act now. We have been actively calling on government to prioritise de-risking, whether as clients through procurement and contracting behaviours or as regulators in regulatory reform initiatives.

In response to the Consultation Paper, we urge the ICA to join us to advocate for:

- collaborative and fair contracting by government clients reflecting the positive behaviours in Model Client Policy and informed by market conditions
- legislative reform to civil liability legislation to explicitly prohibit contracting out of proportionate liability in professional services contracts around the country
- legislative reform to the Australian Consumer Law to:
    - ensure protection from unfair contract terms in government contracts
    - limit misleading or deceptive conduct claims to protect consumers and small businesses.

Consult Australia notes the constructive relationship that has developed with the ICA over the past few months and believes that now can be the turning point to alleviate market conditions by working together to advocate for solutions.

PI INSURANCE AND CONSULTANTS

Consult Australia appreciates the discussion in the Consultation Paper on accessibility and affordability. We note the suggested affordability guide to help assess the scale or severity of affordability (particularly for small businesses) of insurance premiums. We are concerned about the conservative nature of the scale, with for example anything up to a 50% increase in premium being only 'low' to 'medium' unaffordability. In respect of PI insurance, the average premium increase in an average year is up to 3%. Therefore, we suggest that a premium hike of even 20% to 30% should be categorised as more than 'low' on the scale of affordability – especially for small businesses.

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 specialise design, advisory, or engineering services will struggle to survive unless action is taken. To be clear it is not just the small consultancy businesses facing PI issues, even global businesses are struggling to get appropriate coverage for their Australian operations. We set out below some case studies from across our sector to demonstrate this point.

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 and if other fire engineering business 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.

GOVERNMENT ACTION – DE-RISKING

We have been talking about the PI insurance market conditions and the impact for government as a client and as a regulator for at least two years. We see increasing commentary, including from AON supporting our concerns:

> 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. [1]

In talking with our members, capacity is already an issue across businesses of all sizes. In the infrastructure sector this is playing out through 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.

We have been advocating for government action in terms of de-risking the sector to assist in alleviating the pressure in the PI insurance market. The key campaigns are outlined below for ICA's consideration.

Collaborative and fair contracting – being a Model Client

Consult Australia has developed a Mode Client Policy, akin to the long-established model litigant policy, to address the inherent bias in favour of government clients when it contracts with the private sector. We believe that by 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.

As part of the Model Client Policy we advocate for the use of standardised contracts and removal of onerous contract terms. For consultants, onerous contract terms include those where limited, or no PI insurance is available under a standard policy. This includes for example fitness for purpose clauses and certain contractual warranties. We also encourage the use a liability caps which are not linked to the consultant's PI policy.

Insurance is the means to finance liability (if it arises) and therefore should be the last step in the risk identification, assessment and allocation process. However, members advise that government clients see insurance as the way to manage risk and it seems from contracts and procurement documents that the consultant's PI policy is seen as being for the benefit of the client or the public not a commercial product purchased by the consultant for the consultant.

The insurance requirements of government clients are often out-of-step with what the consultant can obtain. We provide several case studies below to illustrate this point.

As part of our call for adoption of the Model Client Policy, we also see a need for an education campaign across in-house government legal and procurement resources around the country, to address the knowledge-deficit on the commerciality and market impacts of government contracts. This would minimise the need for agencies to develop bespoke contracts.

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

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. Given the fees and the work the business does, this is sufficient (despite the clients' requests). 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.

Case study 7 – Unreasonable client insurance requirements for a small structural engineering business

A small structural engineering business providing services across Australia is involved in low cost and low risk projects, however clients treat the business the same as a large structural engineering business working on large/complex projects with high risk. Clients ask for significant insurance cover when the business can only get $5million cover – which is sufficient for the work it does (despite the clients' requests).

Legislative reform to civil liability legislation

Consult Australia has called on the Commonwealth as well as state/territory governments to explicitly prohibit contracting out of proportionate liability in professional services contracts. This would realise the original policy intention of the civil liability reforms of the 2001 legislation, which was introduced to address the last hardening of the PI insurance market. Unfortunately, government clients are amongst the worst when it comes to contracting out of proportionate liability in consultancy contracts.

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.[2]

Proportionate liability is a statutory right, which 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

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

and affordability of PI insurance in Australia following the insurance crisis of 2001 when the insurer HIH collapsed.[3]

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.

These 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 while only NSW, Tasmania and WA explicitly allow it (by prohibiting contracting out of other civil liabilities). Contracting out of proportionate liability in professional services contracts undermines the policy goals of the proportionate liability law reform and risks another insurance crisis like the one that led to the reform.

By contracting out of proportionate liability, the consultant and the client are exposed to uninsured risk. Relying on proportionate liability ensures both the client and the consultant is managing their risks and still ensures that the consultant is liable for the economic loss they cause.

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 it seems a reasonable proposition that a client should be able to recover all their losses from a single party despite their contribution to the loss, this fails to understand the complexity of insurance law and risk management practices, and how they affect the delivery of a project. In the building, construction and infrastructure sector 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 also 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.

[3] 2015 Treasury Briefing, 'Aftermath of the HIH collapse'.

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.

Legislative reform to the Australian Consumer Law

To de-risk the market, Consult Australia advocates for 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 business 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 fair 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
- terms that enable the government client (but not the consultant) to terminate the contract
- terms that penalise the consultant (but not the government client) for breaching or terminating the contract
- terms that enable the government client (but not the consultant) to vary the terms of the contract.

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 ambit 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 professionals 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. Unlike individual consumers and small businesses, sophisticated parties can afford appropriate risk allocation negotiations.

The second option recognises that two parties to a contract should be able to agree an effective limitation of liability. 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

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