CONSULT AUSTRALIA

PROPORTIONATE LIABILITY

RESPONSE TO THE SCLJ MODEL PROVISIONS

CONSULT AUSTRALIA SUBMISSION TO THE NSW GOVERNMENT

Proportionate Liability
Response to the SCLJ Model Provisions

Driving Business Success for Consulting Firms in the Built and Natural Environment

CONSULT AUSTRALIA

About Consult Australia

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sectors. These services include design, engineering, architecture, technology, survey, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments.

We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $40 billion a year.

Approximately 40 percent of our industry's work is undertaken for public sector clients, and our member firms have played vital roles in the creation of some of Australia's iconic public infrastructure, including road, rail, hospital, airport, educational facilities, water and energy utilities, justice, aged care, sports stadia, and urban renewal projects.

Liability Reform Steering Group

Consult Australia is part of the Liability Reform Steering Group (LRSG), a broad coalition of professional organisations and firms with a shared interest in liability issues as they impact on members of the professions in Australia. The LRSG was initially convened in 2002 to discuss the emerging evidence of market failure in PI insurance in Australia and the available options for reform to ameliorate this situation.

The LRSG currently includes representatives of the Australian Institute of Architects, Consult Australia, CPA Australia, Engineers Australia, the Institute of Chartered Accountants in Australia, the Institute of Public Accountants, the Law Institute of Victoria, Professions Australia, representatives of the large national accounting firms such as KPMG and Deloittes, actuaries and the large national law firms.

Since its establishment, the LRSG has been pushing for a uniform national position against contracting out of proportionate liability.

For Further Information

For further information or to discuss any issue(s) raised in this submission, please contact Robin Schuck, our Senior Policy Advisor, Policy and Government Relations. He can be reached at (02) 9922 4711 and by email at robin@consultaustralia.com.au. Consult Australia will be pleased to assist in promoting the successful resolution of this issue in any way we can.

Executive Summary

Proportionate liability was an important reform introduced in the wake of the insurance crisis over a decade ago. The move to proportionate liability from joint and several liability was designed to ensure the availability at commercial rates of professional indemnity and public liability insurance. However, as each jurisdiction drafted and passed its legislation to give effect to this reform, some states, including New South Wales, allowed parties to contract out of proportionate liability, while others either remained silent on the issue, or expressly prohibited the practice.

While contracting out of proportionate liability theoretically allows the parties to a contract to allocate risk between themselves to better manage that risk, our experience is that in reality the party with the strongest bargaining power simply offloads risk without regard to the consequences, including the ability of other parties to the contract to manage or bear that risk. In turn, this increases the probability of any one of a number of negative consequences being realised.

The first and most obvious is that contracting out of proportionate liability defeats the very policy intent that the reform was designed to achieve: namely ensuring that professional indemnity and public liability insurance will be available on commercial terms when the insurance market experiences its "hard years". Because the global insurance market is cyclical by nature, there will be times when the global pool of funds will be reduced, and Australia will be a less desirable market to sell policies and take on the associated business risk. While insurance is freely available at other times, when the market hardens, premiums dramatically increase, and a large number of parties will simply be unable to purchase insurance at all.

Other risks however also arise from this practice. They include the possibility that professional indemnity insurance will not respond to claims where a contract has assumed risk beyond the common law position, including the contracting out of proportionate liability. Contracting out also drives less desirable project outcomes, including higher cost, more delays, and greater disputation. These arise as risks are not managed by the party best placed to manage each them, and hence are more likely to lead to a loss being realised. They also mean fewer firms will have the appetite to take on project risk and decide not to tender for work, reducing competitive pressures in the bid phase of project delivery. Conversely, proportionate liability moves parties away from a "deep pockets" approach to litigation, and instead towards working for the best project outcomes, ensuring certainty for business.

Aside from driving better project outcomes, proportionate liability also ensures fairer outcomes for all parties to the contract.

In making this submission on behalf of professional services providers in the built environment sector, the contracting and procurement practices of other parties our members work with need to be considered. It is common for risk to be offloaded rather than managed, often without understanding of the consequences. For the reasons set out in this submission, Consult Australia has argued for a nationally uniform position against contracting out of proportionate liability since its inception.

When evaluating the proposal in question, the merits of achieving uniform laws also warrant further consideration. By overcoming differences between jurisdictions, business certainty is increased, and issues that arise when parties to a contract exist in different states are also resolved. Nevertheless, when laws between states are harmonised, it is essential that the model legislation achieves the right outcomes.

The model provisions subject to this consultation represent a positive step that should be seriously considered by all jurisdictions. The new definition of an "apportionable claim" is likely to eliminate a major

reason clients choose to contract out of proportionate liability, and limits its application primarily to the professional services sector, rather than contractors, who warrant the outcome of their work on a "no fault" basis. However, the arbitration provisions are problematic as they offer a loophole that will be exploited by parties with strong bargaining power seeking to contract out of proportionate liability, while other parties risk unknowingly contracting out of proportionate liability. These clauses threaten to undermine this entire reform.

Other issues have also been identified in the model provisions that warrant further consideration, although to a lesser degree than the arbitration clauses. The definition of consumer claims is problematic, in that it may potentially exclude large claims between two businesses inadvertently, while the grandfather clauses should not be enacted in every state.

As well as modifying these aspects of the legislation, the NSW Government should also take a leading role in calling on other jurisdictions to prohibit the contracting out of proportionate liability, and to this end, Consult Australia calls on the Government to write to each other state or territory government, calling on them to amend their legislation to enact the prohibition on contracting out, and addressing the concerns we have raised through this submission.

Recommendations

Recommendation 1: Uniform, national legislation prohibiting contracting out of proportionate liability is essential

Recommendation 2: That NSW pass the model legislation presented for feedback, subject to the adoption of Recommendation 3.

Recommendation 3: That the arbitration provisions at s3 and s12(3) be amended so that proportionate liability applies to arbitration, or otherwise these provisions be removed. If this Recommendation is not adopted, our position in Recommendation 2 will change.

Recommendation 4: Under the existing definition of consumer claims, business to business transactions worth millions of dollars fall within that definition. While the model provisions make reference to "individuals," they could be strengthened by further limiting the exclusion to natural persons only, with the option of further qualifying the definition by imposing a transactional limit.

Recommendation 5: The grandfather clauses at s12(1) and s12(2) are inappropriate in all jurisdictions other than NSW, WA and Tasmania. The NSW Government should write to the other jurisdictions to promote this issue.

Recommendation 6: That care be taken when the final draft Bill is revised to ensure that indemnities cannot be used as a means to overcome the prohibition on contracting out of proportionate liability.

Recommendation 7: That the legislation be reviewed in ten years' time, or following the completion of a full cycle of the insurance market – whichever happens later.

Recommendation 8: The NSW Government should write to all other Australian jurisdictions urging them to adopt the same positions as outlined throughout this submission. This will ensure that the full benefits of harmonisation are realised.

Background – Context

In response to the insurance crisis of 2001, a package of reforms including proportionate liability legislation was enacted to replace the doctrine of "joint and several" liability. Under joint and several liability, several parties may have combined to cause loss to a plaintiff, but any one of them could have been held fully liable, irrespective of their individual contribution to the loss. Proportionate liability divides loss among the defendants according to their share of responsibility.

Under proportionate liability, liability is allocated to the parties according to who is able to manage the risk, rather than the party with the deepest pockets. However, when these reforms were implemented, the enacting legislation had a crucial difference between jurisdictions, with the ability to contract out of proportionate liability included in some states' legislation, but not others.

The express ability to contract out of proportionate liability legislation in New South Wales, Western Australia and Tasmania has encouraged poor risk management by a range of parties working across the building and construction industry. Contracting out of PL encourages the allocation of unmanageable risks and liabilities upon consultants that would otherwise be acceptable to clients as a normal part of project development. The consequences of this behaviour are far reaching with implications across jurisdictions. Conversely, contracting out of proportionate liability is expressly prohibited in Queensland, while the remaining jurisdictions are silent on the issue.

In making this submission, Consult Australia notes the overall objectives of government action as set out at p9 of the Regulatory Impact Statement (RIS). We strongly commend these objectives as worthy public policy goals, and note that they strongly align with our objectives. Indeed, the very position set out in this submission is premised on four of those five objectives[1].

Our Industry

Consult Australia represents professional services providers within the built and natural environment sector. Our members undertake a diverse range of activities, with the common factor being that they provide a service, based on professional expertise. Services include scoping studies, environmental impact assessments, through to designs, reviews and certifications. They are provided on a range of projects varying from mining and resources, through to the development of public infrastructure to designing residential houses.

Depending on the nature of the project, the engagement of a consultant may potentially form part of a complex web of contractual relationships. For major public infrastructure projects, for example, it is common for the client to engage a developer, who in turn will engage a consultant for design elements under the "design and construct" delivery mechanism. Other projects will see a client directly engage a consultant, while others still might see the formation of an alliance body where each party shares in the risk and rewards on offer. The interaction between consultant, client, constructor, and any sub-contractors or sub-consultants engaged is a major aspect of the environment in which our industry operates. Each has a distinct role to play in successful project delivery, with different roles, responsibilities, and mechanisms for resolving issues that arise throughout the project.

[1] Objectives 1, 3, 4, 5 as identified in Standing Council on Law and Justice, *Proportionate Liability Model Provisions – Decision Regulation Impact Statement* (October 2013) at p9.

A common theme throughout contracting in the built environment sector is the contractual offloading of risk, often at the expense of proper risk management activity, and generally based around market power, rather than the ability to manage risk, determining where that risk falls. While we recognise the important role consultants play in successful project delivery, they are also often the party with the least bargaining power, and hence the party to whom most contractual liability is shifted. This has major implications for insurance coverage of their work, but also represents a major impost on the industry in terms of the risk burden, and resources allocated to resolve disputes.

Insurance and the Consulting Industry

Consulting firms that make up Consult Australia's membership play a crucial role in the built and natural environment sector. They provide the expertise used to scope potential infrastructure, to develop plans to build a project, and come up with solutions to overcome obstacles encountered along the way. Because they are not the final service provider, they are often involved in a potentially complicated web of contractual relationships with the client, contractors that undertake the actual works on site, and sub-consultants to whom specialist tasks may be outsourced.

The consulting industry as a whole is an asset poor class of people and organisations when compared to the parties they are contracting with. Because the service they provide is professional expertise rather than a tangible good, they depend on insurance to cover any liabilities that arise, including contract disputes or failures in the delivery of a final product. Consultants take out extensive and often expensive insurance policies to cover any liabilities that arise, and to ensure they and their businesses don't suffer financial losses.

What is often not appreciated, however, is the interaction between insurance policies and contractual terms and conditions such as those that allocate liability between the parties.

An important principle at the centre of this issue is that insurance will generally only cover a party for losses that they would be liable for at common law. Any contract that assumes liability beyond the common law position risks creating an uninsurable risk, and harming both parties to that contract. Contracting out of proportionate liability falls into this category, and represents a major risk to the ability of a consultant's professional indemnity policy to respond to any claim made against them.

Risk Allocation and Management

The allocation of risk between parties represents a significant issue impacting the cost and outcomes of procurement in relation to the built environment generally. Liability must be managed equitably, with regard to good risk management and the ability of professional indemnity insurance to respond to claims and cover losses. It is important to note that consultants generally have few assets beyond their insurance cover, and hence limited ability to cover liabilities that go beyond that level of insurance cover, or where insurance doesn't respond to a claim.

It is common practice amongst many clients (especially including public sector clients) to offload all risk and contractual liability to the service provider they are contracting, even where the impact of this move runs contrary to government policies. This includes contracting out of proportionate liability, as well as a range of other onerous terms that have been canvassed in other submissions to government.

One important consequence of clients allocating liability to service providers is that they believe they have managed the risk associated with their project, when in fact they have done the opposite by allocating it to a party less able to manage that risk for the overall benefit of the project.

Consult Australia is opposed to requirements of excessive liability contained in a contract on the basis that these requirements promote the acceptance of risks which are beyond the control of any consulting firm. Such practices threaten the sustainability of our industry, produce uncertainty and higher costs for clients and do not promote good risk management to the expectation of the community. This submission will outline some of the impacts of this practice in greater detail at pages 11-16.

The imposition of onerous clauses, including the contracting out of proportional liability legislation in contracts with these firms, put at risk the affordability and availability of professional indemnity (PI) insurance covering services provided by professionals and providing protection to the consumers of those services.

Such practices ignore good risk management and see the parties responsible assume unknown risks where insurance is not available to cover the liabilities sought. Such behaviour distorts the terms on which firms compete for work, and expose all parties to the possibility of project failure, unforseen costs and poor value for money outcomes.

Despite the insurance crisis of the early 2000s and the consequent passage of Proportionate Liability (PL), and Professional Standards Legislation (PSL) by Australian governments, public sector procurement practices, as well as many private sector client practices, have yet to reflect the policy intent of these legislative reforms.

Indeed, it can be argued that the reforms brought in at that time have not been fully implemented, as the crisis ended due to other factors, before the reforms were properly and uniformly rolled out. In the eyes of policy makers, the problem had been resolved and there was little impetus for further change. The challenge of this proposal is to bring about change ahead of the next hardening of the insurance market, in order to prevent a crisis from arising in the first instance.

Procurement Practices and Client Understanding

The tendency of clients to issue contracts with onerous terms, and to contract out of proportionate liability as a default position may also reflect a particular culture that exists amongst procurement professionals today.

We have already discussed the common practice of offloading risk rather than managing it, even though this practice generally leads to less desirable outcomes. Previous studies, such as the *Scope for Improvement* reports[2], as well as our own experience from our membership has found that while allocating risk is common, the best project outcomes are realised when the parties work together to address issues encountered, rather than taking a "standard form" approach to procuring services.

Another element of the culture surrounding procurement is knowledge and understanding of the ramifications of particular behaviours and practices, including the effect of particular contractual terms.

[2] Three *Scope for Improvement* reports were prepared in 2006, 2008 and 2011 respectively by Blake Dawson Waldron (now Ashurst). They can be accessed online by following the links at: http://www.ashurst.com/expertise-detail.aspx?id_Content=6580&pageNo=1

Unfortunately, many of the people responsible for procuring professional services don't always have the required understanding of the impact on insurance of offloading contractual risk. In our experience, the knowledge amongst clients of the impact of contracting out of proportionate liability is particularly poor, or is based on less important considerations.

For example, we frequently encounter client organisations wanting to contract out of proportionate liability, to ensure that a sub-consultant who makes an error does not avoid liability for any losses that result from that error. However, this ignores that the sub-consultant would still be liable under the head consultant's proportion of the liability, and contracting out does not improve a client's ability to reach them.

Another oft cited reason for contracting out of proportionate liability is that the client would prefer to only lodge one claim and allow each of the parties to cross claim against each other. While this may appear to be a simpler solution for the client, the additional legal resources required for the various cross claims would very likely lead to a more expensive outcome for all parties.

In the public sector, we have encountered individual government agencies contracting out of proportionate liability as a default position, even where there are "whole of government" policies recommending they take a more considered position, and avoid contracting out by default[3].

The examples reflect a frustration frequently felt by our industry, that clients seldom properly understand proportionate liability, and are generally slow moving when it comes to adopting new and better practices.

Freedom of Contract and the "Level Playing Field"

In analysing contractual behaviour, many problems are derived from the premise of "freedom of contract," with the notion that all contractual terms are the result of negotiation and agreement between parties.

Unfortunately, this premise is seldom the case, as uneven bargaining power is common, and means one party tends to dictate terms, while the other is forced to accept those terms. Even where negotiations take place, the common outcome is that at best, only minor changes result.

Where parties to a contract have unequal bargaining power, the concept of "freedom of contract" is illusory. Most professional services firms are small businesses and even those that are not operate in very competitive markets where contracts are offered on a "take it or leave it" basis. Very few, if any, professional firms are in a position to "walk away" from work, even where the work is offered on harsh contractual terms. This is particularly the case in tougher economic environments.

The uneven nature of the negotiation process means that onerous terms which a consultant might be unable to meet often find their way into a contract. This especially includes contracting out of proportionate liability.

In Consult Australia's experience, many clients will generally make contracts as aggressive as the law allows them to. When taken together with the uneven basis of negotiations described above, this leads to highly aggressive contracts offered to our members with little ability to address those terms that might not be satisfactory, or could lead to harmful outcomes. The Regulation Impact Statement (RIS) makes a similar

[3] See for example the NSW policy at: http://www.procurepoint.nsw.gov.au/sites/default/files/documents/procurement_policy_framework_july_2013_0.doc, with the relevant sections at pages 42-43.

observation at p7, noting that contracting out of proportionate liability "predominantly occurs where there is a significant imbalance in the bargaining power of the contracting parties."

Thus, where the law operates on the theory that a free contract is being reached, providing options for the parties to agree to in terms of how they manage their risks and liabilities, the reality is quite different. This is particularly the case with the proportionate liability reforms that are the subject of this submission.

Harmonisation

A recent dynamic of policymaking around Australia has been the understanding that uniform or harmonised laws should exist across all Australian jurisdictions. Eliminating differences between the states, territories and Commonwealth is a positive move, eliminating costly red tape, and making it easier for business to function in multiple states without having to learn new sets of laws each time they grow.

In the legal context, greater uniformity also prevents forum shopping, a point acknowledged at p7 of the RIS. Another benefit is that by its very nature proportionate liability involves multiple parties, and there is a strong likelihood they will exist in multiple jurisdictions. Greater uniformity between the states and territories means that many of the complex procedural issues faced can now be overcome.

The experience of other laws being harmonised or made uniform has also allowed the business community to learn lessons as to when such moves are beneficial. A recent lesson has been that laws should not be harmonised just for the sake of achieving greater uniformity, but should be used as an opportunity to achieve "best practice" across Australia. Harmonising bad law is less desirable than having piecemeal legislation across Australia where some states retain "best practice" laws.

In the context of considering this specific piece of legislation being enacted in NSW, uniform national legislation is ideal. We call on NSW to pass this legislation, making the changes suggested in this submission, and we further call on the NSW Government to approach other jurisdictions, urging them to do the same, as the benefits of doing so will be realised across Australia. However, even if other jurisdictions decide not to implement this legislation, the benefits of NSW "going alone" still outweigh the status quo position, where contracting out is allowed and leads to a range of negative consequences.

Removing the Ability to Contract Out

Public and private sector clients around Australia continue to apply pressure to consulting firms to contract out of proportionate liability legislation. As with other onerous contract terms, clients are seeking to make consulting firms liable for risks beyond those they would normally or reasonably expect to have within their responsibility, control or management.

In the experience of our members, where contracting out of proportionate liability is available, clients take up that option when drawing up their contracts. The uneven nature of contract negotiations, as canvassed already in this submission, means that consultants are generally unable to reinstate this term, a fact acknowledged in the RIS[4]. This action undermines the intent of the proportionate liability regime as it was originally designed, and risks a return to the situation that the original policy reform was implemented to avoid.

Even in Queensland, where contracting out of proportionate liability is explicitly prohibited in the legislation, our members have reported the use of indemnities attempting to override the protections granted in the legislation, with the client requiring the consultant to indemnify them for any liability apportioned to other concurrent wrongdoers under proportionate liability legislation.

Contracting out of proportionate liability, or circumventing it through the use of indemnities, not only threatens the sustainability of our industry and other similar professional occupations, but also potentially exposes the community to uncertain and unmanageable risk and liability. The ability to contract out of PL is of national concern, where it leaves the market for professional indemnity insurance vulnerable to the same kind of market failure as occurred during the insurance crisis of 2001: with the creation of exposure to uninsurable risks beyond the control of policy holders.

Ultimately the ability to contract out defeats the purpose of proportionate liability legislation, and the tort and liability reforms sensibly introduced in response to that crisis.

It is for this reason, as well as those listed below, that we strongly support moves to develop and implement nationally uniform legislation to prohibit contracting out of proportionate liability.

Recommendation of Expert Opinion

Two independent experts were engaged by the Standing Committee of Attorneys General (SCAG, now the SCLJ) in 2007 and 2008 to report on proposals to achieve national consistency in proportionate liability legislation[5]. After considering the arguments for and against contracting out of proportionate liability, both recommended that nationally uniform proportionate liability legislation should be enacted that expressly prohibits parties from contracting out. The RIS draws heavily on these opinions in reaching the conclusion it has, leading to the development of model legislation.

[4] *Regulation Impact Statement* at pp7-8

[5] Tony Horan (2007), *Proportionate Liability: Towards National Consistency* and Professor Jim Davis (2008), *Proportionate Liability: Proposals to Achieve National Uniformity*

Affordable and Available Insurance for Our Industry and Professional Services Generally

Proportionate liability was introduced nationally to improve the availability and affordability of professional indemnity and public liability insurance in Australia following the insurance crisis of 2001.

These reforms were positively received by local and international insurers. Anecdotal evidence indicates these measures have assisted in improving the allocation of capital to insure Australian professional indemnity (PI) insurance risk. 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.

As a consequence, the key policy objective of proportionate liability – helping to ensure that PI insurance is available, affordable and dependable – will be undermined should contracting out be permitted.

It should be noted that where the RIS discusses the impact on the insurance market of these reforms[6], it focuses primarily on premiums as a measure of whether the reforms have worked, and whether a problem exists for further redress. Consult Australia urges extreme caution in reaching any conclusion that the problem has been solved, and we suggest that the price of premiums might not the most appropriate measure to reach such a conclusion.

Firstly, the focus on premiums over the past decade avoids the issue that in hard market years, professional indemnity or public liability insurance may simply not be available for many professional services providers in our industry, as insurers move away from the Australian market to focus on other, less risky markets. While it is true that larger firms with an international operation and a global professional indemnity policy may be able to retain cover, other firms less appealing to insurers may struggle to find appropriate insurance cover at all in hard market years.

By way of example, during the insurance crisis of 2001, a number of our member firms reported premiums increasing by as much as 1000%, while other firms, including large or long established firms, were simply unable to obtain appropriate insurance cover. Amongst our membership at the time, 26 firms approached Consult Australia (then known as the Association of Consulting Engineers of Australia) to seek our assistance as they were unable to obtain any cover. We were able to assist 23 of those firms, but the remaining three simply closed down, unable to obtain insurance, with their assets taken over by rival practices.

Secondly, the insurance market is cyclical in nature, and hence a reduction in premiums over the past decade does not alleviate concern that when the market next hardens, the same problems experienced a decade ago might be realised again.

Business Certainty – Project Insurance

In the event that project risk is realised, consultants are dependent on insurance to meet any liabilities that will arise. Without that insurance, they are asset poor and have limited ability to meet any damages due. Accordingly, where their insurance does not respond to a claim, there is a strong risk that the consultant may become insolvent, while the client in turn will be unable to recover the loss.

[6] For example, at p6

Where a professional contracts to assume additional risk beyond what they would be liable for under common law by contracting out of proportionate liability, they may be exposing themselves (and their client) to the risk of uninsured liability. Indeed, depending on the terms of the insurance policy, in some cases assuming additional risk by contracting out of proportionate liability could invalidate the professional's insurance cover entirely.

Where insurance won't respond to a claim and a client wishes to recover monies from the professional to cover damages, the professional will need to directly pay for those damages without the use of insurance. In the most extreme cases, they could go into liquidation or become bankrupt and the client will have no recourse to recover monies owed. In this situation both parties are considerably worse off.

From Deep Pockets to Better Risk Management Practices

There is evidence that permitting contracting out encourages poor risk management, as both the client and other parties involved in the provision of services will have less regard to their own risk management in situations where a "lead" service provider has contracted to assume full liability. Where liability is shared, the parties have strong incentives to work together to develop collaborative solutions to managing risk. Furthermore, under proportionate liability, risk is allocated to the party best able to manage each risk.

It follows therefore that contracting out of proportionate liability is focused more on the (often illusory) ability to recover maximum damages in litigation than on the successful delivery of a project.

Given the desire of government for proportionate liability policy to both reduce the likelihood of litigation, and be workable in terms of commercial outcomes, the ability to contract out runs contrary to these important policy objectives. Indeed, without reference to the separate policy goals related to insurance issues or simple notions of fairness, contracting out of proportionate liability undermines the significant and important policy objective of supporting business to best manage risk.

The RIS at p4 correctly identifies that proportionate liability was designed to address "deep pocket" syndrome, and yet the move to contract out is made with the express purpose of allowing a client access to those same deep pockets. In doing so, clients with sufficient bargaining power are able to retain their focus on maximising damages awarded at litigation, rather than successful risk management, and hence successful project delivery.

Improved Project Outcomes – Lower Cost, Reduced Delay, Fewer Disputes

In the case of public sector clients, contracting out of proportionate liability serves to increase costs and is therefore a disincentive to tendering for government contracts. The unreasonable allocation of risk to a consultant means that they will need to purchase a greater level of PI cover (which may not be available) or otherwise price the additional risk they face, and manage risks without the support of other parties to the contract. Limiting liability has been shown to lead to reduced cost, time and disputation on a project.

When faced with taking out a higher level of PI cover or greater project risk, our member firms generally are faced with a small number of options:

- They can pass on the cost of that additional cover or risk to the client, meaning a higher fee will be charged for that work;

- They can decide not to bid for certain work, also driving up costs through reduced competitive pressures in the tender phase; or
- They can decide to absorb that additional cost or risk in order to win the tender, although this may affect the ongoing viability of that business in the longer term.

In each of these cases, greater project costs are the long term outcome, which is undesirable for all parties.

Other project outcomes are also affected when proportionate liability is bypassed, flowing from the increased likelihood of disputation and delays. As proportionate liability allocates risk management to the party or parties best placed to managed each risk, its use reduces the likelihood of a risk being realised.

Conversely, contracting out of proportionate liability increases the likelihood of less desirable risk management, as already discussed. The impact of that risk being realised, combined with the notion of "deep pockets," is that the likelihood of a resulting dispute is greater, and there is also less incentive for the parties to resolve the dispute prior to litigation. In turn, litigation is generally the most costly outcome for each party to the dispute in question, and the costs will have to be absorbed by both service providers and their clients.

While the RIS mentions that some stakeholders argued that litigation is more complex (and hence more costly) where proportionate liability applies, it can be argued in response that litigation is less likely to occur in those situations. Furthermore, this argument is an extension of the "deep pockets" approach, but focusing on the nature of litigation rather than successful project outcomes.

Where contracting out of proportionate liability occurs, additional costs will be realised in the form of higher insurance premiums (if cover is available), as well as protracted contractual negotiations, legal review, and reduced competition in supply of services where some suppliers decide not to tender for work. Where these costs affect service providers, they are invariably passed on to their clients. A Lateral Economics study (commissioned by the Liability Reform Steering Group) into the costs of contracting out of proportionate liability estimated the overall cost of contracting out to be as much as $151 million in hard market years.

Freedom of Contract and Allocation of Risk are Illusory

As already discussed in this submission, freedom of contract is illusory, owing to the uneven nature of bargaining power between the parties. Supporters of contracting out cite the principle of "freedom of contract" and argue that government should not interfere with this principle unless justified on public policy grounds.

In its discussion of the reasons raised for contracting out, the RIS identifies the argument that contracting out allows the parties who wish to do so to contractually allocate risk between themselves with certainty[7]. In reality however, risk is not so much allocated as offloaded, with the party who has drawn up the contract - generally the party with the most bargaining power - simply transferring all risk to other parties with less bargaining power, with little regard to their ability to manage that risk.

This issue is particularly felt in the construction sector, where complex contractual arrangements often exist. It is common practice for contractors to be paid in the form of profit, in return for taking a risk. Accordingly, they are able warrant their work on a "no fault" basis. Professionals, such as our membership, on the other hand charge an hourly rate to compensate them for the effort they make.

[7] *Regulation Impact Statement* at p48.

When the "design and construct" delivery mechanism is used by a client, the client engages a constructor, who in turn is responsible for contracting the consultant to undertake (for example) design elements of the project. Not only does unequal bargaining power exist between the client and consultant, but also between the building contractor and consultant. In such a situation, it is possible for constructor and consultant to be concurrent wrongdoers, but for a contractor to offload their risk to the consultant in the same way the client may have offloaded theirs. This issue was recognised at p49 of the RIS.

This submission has already raised the practice that the contracts presented to our industry by clients are generally as aggressive as the law permits, with little scope for amendment, even where this practice may lead to less desirable outcomes. This is particularly felt with regard to proportionate liability. Where the law allows a client (including government agencies) to contract out of proportionate liability, it will almost always do so.

The certainty cited as an advantage of this approach is illusory, owing to both the strong possibility that insurance might not respond to a claim, and the likelihood that risk is less likely to be properly managed. For both these reasons, risk is actually exacerbated rather than managed when contracting out occurs.

Where a policy such as proportionate liability has been implemented to prevent one party being overburdened with risk or to stave off a future insurance crisis, any legal methods included in the law to avoid that policy will inevitably be used, and defeat the policy intent behind those initiatives.

Consult Australia accordingly believes that in this case there are grounds for government to intervene and prohibit contracting out for the public policy ground of maintaining a viable, thriving professional community backed by adequate levels of PI insurance, as well as creating an environment to support better commercial outcomes.

Fairer Outcomes

Fairness is identified at p9 of the RIS as one of the objectives of government action, and as a general driver of government policy. Proportionate liability is inherently a fairer method of allocating risk between the parties to a project, as each party is only responsible for those risks they can control and manage, rather than being responsible for the risks others are better placed to control. Generally, where proportionate liability does not apply, the party to whom most liability will fall will be the party with the deepest pocket (through their insurance policy), and the party or parties with the least bargaining power. Consult Australia is of the view that as well as leading to less desirable project outcomes, the results of contracting out of proportionate liability fail a simple test of fairness.

Unintentional Contracting Out

While supporters of allowing parties to contract out of proportionate liability cite that better commercial outcomes may result if the parties are able to allocate risk between themselves, a flaw in this argument is that contracting out is not always a conscious decision reached between two consenting parties.

In some situations, language inconsistent with the legislation may be enough to contract out of proportionate liability, even where the parties are unaware that this is the effect of those terms. A recent

case found that no particular form of words is required to contract out, including the possibility that no reference need be made to the specific legislation setting out the terms that contract out[8]. A subsequent case in NSW found that inconsistent language may be enough to give effect to the act of contracting out from proportionate liability[9]. These decisions will apply in NSW, Tasmania, and possibly also in Western Australia, where contracting out of proportionate liability is explicitly allowed under the legislation.

Given the need for certainty and the likelihood of PI insurance not responding to claims operating in these circumstances, this issue is a significant problem for businesses in assessing their potential liabilities and insurance requirements. It could also be argued that this outcome is not consistent with the policy intent when the relevant legislation was developed.

While Consult Australia is opposed to contracting out of proportionate liability generally, the ability for contracting out to occur without the knowledge of one or more of the parties seems unconscionable. This goes further than the other policy issues that form the basis for our opposition to contracting out of proportionate liability.

[8] *Aquagenics Pty Ltd v Break O'Day Council* [2010] TASFC 3 (Aquagenics), and cited in Frank Lawson and Mark Dodd, *Unintentional Contracting Out of Proportionate Liability. Brief*, July 2013, 40(6) at pp 37-38.

[9] *Perpetual Trustee Company Ltd v CTC Group Pty Ltd* (No 2) [2013] NSWCA 58, cited in *ibid.*

Opportunities for Change

We are of the view that of the five options for reform identified in the RIS at page 10, *Option 5* is our preferred option. This section of our submission discusses those options and the rationale for this being the best policy response to this issue.

Consult Australia has consistently sought positive reform to proportionate liability laws over the past decade, to improve business operating conditions, to allow better contracting outcomes for all parties generally, to support a viable professional indemnity market for our industry, and in pursuit of fair outcomes for our member firms, whereby risk and reward are appropriately shared between the parties.

The basis of our position in this submission is that contracting out of proportionate liability runs contrary to each of these motives, and should be prohibited. We have also consistently argued for harmonisation of proportionate liability laws across Australia, with the caveat that harmonising laws to increase the ability to contract out would represent a giant step backwards.

This is the lense through which we have considered each of the five identified options for reform, discussed at pages 10-19 of the RIS.

Given our support for proportionate liability explained throughout this submission, *Option 2*, which repeals proportionate liability legislation in each jurisdiction represents a massive step backwards and one that we cannot support.

Option 4 would achieve national harmonisation, but would expand the ability to contract out of proportionate liability from the three states where it is currently allowed (NSW, WA and Tasmania) to all 9 Australian jurisdictions, including Queensland, where contracting out is currently prohibited. By expanding the ability to contract out, this option also represents a move backwards and should not be supported.

Meanwhile, *Option 1* represents the status quo, which is less than ideal given that it both allows contracting out in some locations, and is not harmonised. It is preferable to *Options 2* and *4*, but less desirable than *Options 3* and *5*, which both represent moves forward.

Both *Options 3* and *5* achieve our stated aim of a nationally uniform position where contracting out of proportionate liability is prohibited, with the difference between the two proposals being their different definition of what constitutes an apportionable claim. Ultimately, Option 5 is our preferred option, owing to the new and narrow definition of an apportionable claim as one where a failure to take reasonable care is an element of the action. That new definition appears to address the concerns often cited by parties contracting out of proportionate liability, and acknowledges the unique challenges faced by the professional services sector, to whom the new definition will predominantly apply. This will be discussed in greater detail below.

Apportionable Claim

One challenge often faced by our industry in the drawing up of contracts to engage their services arises from a failure to recognise the fundamental difference between the services offered by each different party. Where builders produce a tangible item, an appropriate standard of care for them may be that the final product is "fit for purpose". Consultants however provide professional expertise rather than a tangible good, meaning that the appropriate standard of care for them is to have taken "reasonable care" in the provision of their expertise. Consultants cannot take responsibility for how their client may use the information or advice they have provided, or indeed if a structure is constructed to the specifications set out in their design.

This is an issue that often gets lost in the complex contractual web in the built environment sector, particularly when the end client is less certain of which party will ultimately be responsible for each aspect of a project.

The model provisions move from a definition of "apportionable claim" that applies to strict liability for economic loss, to one where failure to take reasonable care must be an element of the claim in order for proportionate liability to apply. In doing so, the new draft legislation addresses a major concern raised with our members when clients seek to contract out of proportionate liability. The exclusion of strict liability claims means that proportionate liability will not apply where a party has represented in the contract that the product it provides will be "fit for purpose," as they essentially have represented in the contract that they will be responsible in its entirety for the fitness of that item. This will also provide comfort to clients entering contracts making this representation.

Accordingly, as acknowledged at p18 of the RIS, the prohibition on contracting out is also likely to have a narrower application, while ensuring that professional services providers receive appropriate protection.

In the built environment sector, this definition means that proportionate liability will not apply where a contractor has represented to construct a "fit for purpose" structure, but will apply where a claim is based on the negligence (for example) of a consultant together with concurrent wrongdoers. The definition ensures that PI cover will available to our industry and will drive appropriate contractual outcomes.

We note the concern raised in the RIS that this new definition of an apportionable claim is a new legal concept, and hence one without legal precedence which may give rise to a degree of uncertainty. However, we believe this issue is overcome by the benefits realised and the certainty provided by the very nature of the new definition[10], and further note that case law around this definition will develop in time to provide further the desired level of certainty to business.

In terms of uncertainty, a greater concern arises from the arbitration clause in the model legislation, which will be discussed at length in the next section of this submission.

Based on this definition of "apportionable claim", Consult Australia supports *Option 5* as the most appropriate path for reform.

[10] See p20 of the RIS for example.

The SCLJ Proposed Model Legislation - Legislative Loopholes that Defeat the Reform

As set out in the RIS, *Option 5* entails the passage of the accompanying model legislation by each Australian jurisdiction. The model legislation, while giving effect to this proposed change, also contains clauses that risk defeating the entire reform. Our attention now turns to each of these. It should be noted that while the arbitration clauses represent sufficiently great a risk that the whole reform could be defeated, the other issues represent opportunities for improvement, but not necessarily issues that would defeat the entire reform in the same manner.

Arbitration Clauses

One of the major defects of the model legislation is the inclusion of Clause 3 and Clause 12(3) regarding arbitration. These clauses as they stand are likely to become the "loophole" used by parties to a contract to overcome the very reform this legislation is designed to overcome, by providing a new back door avenue for parties to contract out of proportionate liability. Indeed, Consult Australia would go so far as to suggest that enacting the model legislation with these clauses as they currently stand would not only undermine the entire reform, but actually represent a backward step.

Through the inclusion of these provisions in the legislation, it is likely that all contracts subject to this legislation will by default include arbitration as a means to overcome the prohibition on contracting out of proportionate liability, undermining the very foundation of this proposed reform. In turn, the positive impact on the professional indemnity insurance market and improved business outcomes from these contracts that were the intended result of this proposal will be nullified.

Indeed, the inclusion of these arbitration clauses as a mechanism to avoid proportionate liability might lead to negative consequences more problematic than the status quo position. These include the possibility that future professional insurance policies exclude additional liability incurred as a result of contractual agreements to be bound by the determinations of arbitrators. This could be realised through the standard exclusion for assumed liability, but could also give rise to a specific exclusion for liability assumed by contracting out following an agreement to include arbitration in the contract.

Another possible consequence is that parties will be pushed into arbitration as a dispute resolution mechanism when another form of dispute resolution, including the option of litigation, is more appropriate.

If the arbitration clauses are included in the legislation, a further possible outcome is that many parties will find themselves in situations where they have unknowingly contracted out of proportionate liability by agreeing to arbitration proceedings. It is very likely that many parties will go down this path without being aware of, let alone supporting, the consequent outcomes. Other parties still may be aware of the consequences, but not disclose the effect of agreeing to arbitration to the party they are contracting with. We submit that any legislative mechanisms that can be used for a party to contract out of proportionate liability without the other party's knowledge, let alone consent, should not be supported.

We acknowledge the problem presented by arbitration to proportionate liability, namely the difficulty in joining other concurrent wrongdoers to an arbitration proceeding, especially in Victoria.

In response, Consult Australia is of the view that these Clauses are unnecessary in this legislation for a couple of reasons. Firstly, given the new definition of an "apportionable" claim which requires that a failure

to take reasonable care is an element of the claimant's action, proportionate liability will not be a relevant factor in the majority cases that reach arbitration. Secondly, where this same failure to take reasonable care is an element of the claimant's action and the matter does reach arbitration, the arbitrator should be able to take proportionate liability into account when reaching their decision. As providers of professional services, our industry generally does not use arbitration in the event of disputes, which can involve complex matters of law, and use other alternative dispute resolution methods. Furthermore, our industry should not be prevented from having access to the courts as the ultimate adjudicator of disputes as is likely to occur if the legislation is enacted as drafted, with arbitration becoming the default dispute resolution mechanism.

Accordingly, we suggest one of two options to overcome this problem. The first and our preferred option is that these clauses be amended to explicitly state that proportionate liability does apply to arbitration, with consideration given to accompanying reforms that might overcome the procedural issue of joining concurrent wrongdoers to an action subject to arbitration. The other option is that Clause 3 simply be deleted from the draft legislation before it is presented to Parliament. We note that the draft legislation gives each jurisdiction the option of enacting this clause. Given the gravity of this issue, we are of the view that this is insufficient to address the problem, and the NSW Government should consider raising this issue with other jurisdictions through the appropriate forums.

Consumer Claims

Under the proposed legislation, consumer claims are excluded from proportionate liability, on the grounds that parties may not have the resources to locate and commence litigation against a number of parties, or to negotiate separately with multiple parties[11]. Consult Australia accepts this rationale, and the ultimate intent of this move, subject to a couple of issues being resolved.

Under the definition used in this legislation, arising out of the ACT enactment of Australian Consumer Law, the term "consumer" has been applied more widely than simply "mums and dads", as presumably was originally intended. Given the $40,000 fee threshold, it is possible that disputes involving multi-million dollar fees between corporations could fall within the definition of a consumer claim, provided the relevant party charged a fee of less than $40,000. For example, in the case of *BHP Coal Pty Ltd v O & K Orenstein & Koppel AG*[12], the dispute was between two businesses over a sum greater than $50 million, based on a consultant charging a fee of $27,000. While this issue is addressed through the use of the term, "individual," the intent of using this definition should be further strengthened with a reference to "natural persons".

This definition also potentially prevents consumers from recovering in the event of a loss, by excluding them from the scope of an "apportionable claim". An argument can be made that this is the opposite effect to what was intended.

The other issue posed by excluding consumer claims is that there may be a small number of these cases where an action is for a large sum of money. For example, in our industry a consumer building a large clifftop house may wish to take action against a geotechnical surveyor for an error involved in the process of constructing the structure. While such cases are admittedly rare, there is still the potential to experience some of the same negative outcomes as realised in business to business transactions, such as increased cost and disputation.

[11] RIS at p38.

[12] *BHP Coal Pty Ltd v O & K Orenstein & Koppel AG* [2008] QSC 141 at para 263.

Grandfather Clauses

Another issue in the drafting worth taking note of, but not relevant to the NSW context, is the inclusion of grandfather clauses at ss12(2) and 12(3), that allow existing contracts operating having contracted out of proportionate liability to continue to operate in that way until their conclusion. While it is appropriate to include these clauses in the states where contracting is currently allowed (NSW, WA, Tasmania), including these clauses in other jurisdictions risks opening a loophole to allow contracting out.

In determining its next steps, the NSW Government should be aware of this issue and raise it with other Australian governments as they consider and enact this legislation.

The SCLJ Proposal – Other issues

Concurrent wrongdoers

The procedural elements of joining concurrent wrongdoers warrant further investigation and discussion. The RIS discusses at great length which notification responsibilities should lie with the plaintiff, and which with the first defendant, as well as what constitutes appropriate notification.

The existing position that a defendant needs to inform the plaintiff of the existence of concurrent wrongdoers, before the plaintiff is then obliged to inform those parties of their status as a concurrent wrongdoer is a sensible position that has worked well.

In practical terms, further guidance will be required as to the appropriate form of notification between parties, as discussed at p31 of the RIS. It is important that the parties are able to provide the information necessary to ensure the practical application of proportionate liability, but there must also be understanding that parties will not always be able to assist the plaintiff in contacting a particular party, and such information may also be contained within otherwise confidential information. An issue worth considering in this context is that in some situations the plaintiff may have the best knowledge of who the concurrent wrongdoers are, and where they can be reached. The law needs to account for this possibility, and in these situations consideration should be given to relieving defendants of their notification obligations, as there is the risk this could become administratively burdensome.

Indemnities

The RIS, at pages 46-47, discusses the issue of indemnities between the parties, and how these operate under proportionate liability. The RIS notes that in most jurisdictions there is a prohibition on claims for contribution or indemnity between concurrent wrongdoers, such as at s26 of the *Civil Liability Act* 2002 (NSW), although this position is not uniform.

The use of indemnities, by definition, is a contractual mechanism to allocate liability other than through proportionate liability. It follows therefore that indemnities should not be allowed as a vehicle used to overcome proportionate liability when contracting out is prohibited. Such an allowance defeats the policy intent of the legislation, and hence risks the very outcomes the legislation is designed to prevent. Consult Australia has found that in Queensland, where contracting out of proportionate liability is expressly

prohibited, some parties are now requiring other parties to the contract with less bargaining power to indemnify them for their share of proportionate liability. This practice is an attempt to manufacture a loophole, and all care should be taken to ensure it is not allowed when this legislation is enacted.

Review of Legislation

Consult Australia notes the suggestion in the RIS at page 24 that a review of this legislation take place in ten years' time, once the law has had the chance to operate. This proposal is a sensible one, although one clarification we suggest is that the government specifically consider the cyclical nature of the insurance market in determining the timeframe to review these laws, to ensure that an entire cycle passes. This will allow for a proper evaluation to take place against all relevant market conditions.

Conclusion

Following its introduction around a decade ago, proportionate liability has served an important role in ensuring that each party to a contract is only liable for those risks that they are best placed to manage, and those liabilities they are responsible for. Proportionate liability has served to ensure the availability of professional indemnity and public liability insurance, drives better contractual outcomes for all parties, ensures better risk management during the operation of a contract, rather than focusing on "deep pockets" through litigation, and supports the pursuit of fair outcomes for business where risk and reward are appropriately shared between the parties.

However, the ability to contract out of proportionate liability undermines these policy goals, and also runs the risk that a professional service provider's insurance policy might not respond to a claim. For these reasons, Consult Australia has consistently argued that reform has been needed to achieve a uniform national position whereby contracting out is prohibited. Even in the absence of other jurisdictions making this move, business would realise the benefits of NSW implementing this reform.

Accordingly, the draft legislation that is the subject of this consultation is a big step forward, subject to some changes being made to the draft before its introduction to Parliament. The inclusion of the arbitration provisions at Clause 3 and Clause 12(3) are highly problematic, as they offer a loophole that will be exploited by parties with strong bargaining power seeking to contract out of proportionate liability. These clauses should be amended to either ensure that proportionate liability does apply to arbitration, or should be removed altogether. If these clauses are not changed, the draft legislation actually represents a step backwards from the current position. However, if they are changed, this legislation will be a significant positive reform for NSW and the rest of Australia.

Other issues have also been identified in the draft legislation that merit further consideration, although they are less significant than the arbitration clauses. The new definition of an apportionable claim is a positive move that will narrow the application of proportionate liability to those sectors of the economy that most rely on it. The definition of consumer claims may lead to unintended outcomes, while the grandfather clauses should not be passed in other states that do not currently allow contracting out of proportionate liability. Meanwhile, guidance on the issue of notifying concurrent wrongdoers should be developed.

We also believe that the NSW Government should play a role in pushing for these reforms to be adopted in each Australian jurisdiction, and to that end we call on the Government to write to each other jurisdiction urging them to address the issues raised in this submission, and to pass the amended legislation.

SUBMISSION BY THE

Housing Industry Association

to the

NSW Department of Attorney General and Justice

on the

Consultation Draft Proportionate Liability Model Provisions

28 March 2014

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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 43,000 builders, contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.

1 Executive summary

On 24th January 2014, the Housing Industry Association (HIA) received correspondence from the NSW Department of Attorney General and Justice seeking to consult on the appropriateness of the inclusion of model proportionate liability provisions (**Model Provisions**) in the *NSW Civil and Liability Act* (**CLA**).

The HIA welcomes the opportunity to provide feedback on this proposal.

It is of note that in October 2011 (**2011 Submission**) HIA made submissions in response to a request by the Standing Committee of Attorney Generals for feedback on these model provisions.

HIA sees this as an important topic covering a number of areas most notably contracting and dispute resolution in the residential building industry.

HIA wishes to raise a number of particular issues of importance when considering if the Model Provisions are appropriate for inclusion in the NSW CLA including:

- National consistency of proportionate liability laws.
- Whether or not proportionate liability provisions should apply to home building statutory warranty and insurance schemes, specifically the interaction between the NSW *Home Building Act 1989* (**HBA**) and the CLA.
- The availability of "contracting out".

2 National consistency?

HIA acknowledges that each State and Territory having its own approach to proportionate liability is problematic. Where it is possible and practical to do, HIA supports efforts in achieving national consistency in proportionate liability legislation. However, HIA does not agree with creating "harmonised" laws for harmonisation's sake, particularly if it is achieved at the expense of genuine, positive regulatory reform for the housing industry.

The introduction of private building certification was a key driver in the change from joint and several liability to proportionate liability in the building industry. Proportionate liability is considered to be an essential element of this regime, enabling surveyors/private certifiers to purchase affordable professional indemnity insurance. The industry consensus is that private certification has led to a more efficient and cost effective building control model.

In this regard whilst there are similarities across the jurisdictions, each state and territory regulates building work differently, with different licensing regimes, building approval processes, certifier accreditation and consumer protection laws.

Summary of HIA's position

HIA supports efforts in achieving national consistency in proportionate liability legislation provided it is practical to do so and does not compromise private certification.

3 Domestic building and proportionate liability

Whilst proportionate liability laws have applied in the commercial building sector for a number of years, it has generally been understood within the residential building industry that that contractual responsibility (including the responsibility for statutory warranties implied into the building contract) rests with the licensed builder and this builder is responsible for the actions of its subcontractors[1]. Whilst there are at times practical and commercial difficulties in getting subcontractors to return to fix up defects, this is accepted as being the builder's responsibility.

HIA notes that the 2010 decisions of the NSW Supreme Court in *Owners SP 72357 v Dasco Constructions Pty Ltd & Ors* and *The Owners of Strata Plan v Brookfield Multiplex Limited* have caused some controversy. HIA does not concur with the view of some that the Court was wrong.

As a result of these decisions in October 2011 the NSW Government amended the HBA to prevent the apportioning of liability in relation to a claim for a breach of statutory warranty. It is of note that the Model Provision does not contain this exclusion.

As a matter of general principle HIA would submit that the extension of proportionate liability defences to statutory warranty claims brought by homeowners is problematic:

1. Firstly, the existing regulatory framework for residential building work includes a number of elements focused on consumer protection including builder licensing, implied statutory warranties, regulated contract terms, mandatory warranty insurance and fast, easy and accessible dispute resolution.

   The balance in this regulatory environment is clearly weighted in favour of the consumer and at times can arbitrarily and unfairly operate against the licensed builder.

   For instance, as between the builder and owner, a builder is usually held strictly liable for the structural failure of a residential building even though four major parties determine structural building quality – the engineer, the designer/architect, the builder and the certifying authority (whether that is the Council or private certifier). The onus is on the builder to separately join the concurrent wrong doers. Such joinder is not always guaranteed as it is a discretion exercised by the Courts under court rules, and Courts may determine that the consumer action not be confused or complicated with multi-party actions.

   On the other hand, an extension of proportionate liability would considerably shift the risk in dispute resolution circumstances to the owner.

   The conduct of proportionate liability proceedings are long, drawn out, expensive and complicated involving:

   - An identification of which (if any) claims are apportionable breach of duty claims and which are purely contractual claims and not apportionable.
   - Applications for joinder for further parties.
   - Directions hearings dealing with Tribunals as to the appropriate pleadings of the apportionment claims.
   - Difficulties created when one or more parties try and settle with the plaintiff.
   - Difficulties in identifying and serving all possible parties.
   - Difficulties when a potential or actual defendant who is not required to hold Home Warranty insurance becomes insolvent, dies or disappears.

[1] HIA notes that is arguable that in it also appears to be the case that builders are entitled to limit their liability for breach of statutory warranties (at least as they related to failure to take reasonable care) under the Domestic Building Contracts Act . See: Lawley v Terrace Designs Pty Ltd

It is difficult to see how in these circumstances, proportionate liability fits (or is capable of effectively operating) with the overall policy objectives of the consumer protection framework.

2. Additionally "last resort" home warranty insurance provides protection for home owners against non-completion claims and defective work claims where the builder dies, disappears becomes insolvent or NSW, fails to comply with a money order of the Court.

   Warranty insurance is paid for by the builder and the policy is based on and assessed against an individual builder's eligibility.

   In HIA's view, warranty insurance provides an effective safety net for consumers.

   However in a proportionate liability regime in the event of a defective works claim, if a builder is responsible for only a portion of the loss, then the warranty insurance will only cover this amount (in the further event access to the policy is triggered).

   This again, is inconsistent with the intent of the warranty scheme as it is likely that warranty insurance should apply up to the full amount of the policy.

   HIA consider it is important that consumer confidence in the home building industry, including the availability of effective last resort insurance, be preserved.

3. Whilst HIA opposes proportionate liability applying as a general rule in statutory warranty claims, there are several situations where it would be unreasonable and unfair for a builder not to have access to appropriate proportionate liability defences.

   For example, in NSW the *Home Building Act* 1989 allows a builder to apportion liability where the building works failure relates solely to a design or specification prepared by or on behalf of the owner. That is, where the client has engaged an architect who has supplied the plans to the builder that are not compliant with the Building Code of Australia, the builder has and should remain to have the right to apportion liability with the architect.

   HIA notes that in *Ownit Homes Pty Ltd v. Batchelor* [1983] 2 Qd.R. 124, the Court held that in circumstances where a plan was defective:

   > *"The builder is entitled to build the structure strictly in accordance with the defective plan and be paid the full contract price."*

   Consistent with common law decisions like Ownit Homes, the builder should have the benefit of a proportionate liability defence in the event the builder has relied on plans and/or documents provided by the owner's expert.

   Additionally HIA supports the extension of proportionate liability defenses to statutory warranty claims for multi-story residential work where the defendant is not a licensed builder, or in the case of tortious claims regarding building work that that is not covered by home owners warranty insurance.

   In this regard, HIA does not agree with the notion that a developer of multi-story residential work, where Parliament has seen fit that warranty insurance is not required, should nevertheless be held strictly liable for the actions of the licensed builder. A developer, like any other client, is entitled to rely on the builder fulfilling its contractual duties. It is inappropriate and unfair to deprive a developer of the opportunity to raise a defence of proportionate liability in such circumstances.

Summary of HIA's position

(1) HIA only supports proportionate liability laws applying:

(a) where the builder has relied upon and used plans or designs provided by the owner or the owner's consultants or otherwise where the owner or the owner's consultants or contractors have contributed to the loss;

(b) to those statutory warranty claims for multi-story residential work where the defendant is not a licensed builder, or in the case of tortious claims regarding building work that that is not covered by home owners warranty insurance.

(2) Otherwise HIA opposes proportionate liability laws applying to statutory warranty claims. Therefore in the event that the NSW Government sees fit to adopt the Model Provisions HIA submits that they maintain the current exclusion within the CLA.

4 Contracting out

HIA believes that, in a commercial construction context, parties should be free to contractually allocate risk as they see fit, especially at the upper end of the market.

HIA notes that in October 2013 the Standing Council on Law and Justice released a Regulation Impact Statement (**RIS**) in relation to the Model Provision. The RIS outlined a number of options, including an option to allow for parties to 'contract out' of the Model Provision.

Generally speaking it would be in the interests of the client to contract out, but it is a risk that can be priced and is likely to affect the price whether or not risk allocation is able to be negotiated. This is particularly likely to be the case in a large commercial contract with a fully informed and properly advised business client. If the law does not allow contracting out, the risk will be with the client and in a perfect market a business client will be able to deduct the price of that risk from the contract price. In theory, then, there is no argument for preventing large commercial clients in major contracts from contracting out if both parties agree.

It is unclear as to whether the ability to 'contract out' is being considered in the NSW context.

Summary of HIA's position

HIA supports the option of contracting out of proportionate liability provisions for commercial projects.