Institute of Chartered Accountants Australia

02 May 2014

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Dear Sir/Madam,

Re: Consultation on the proportionate liability model provisions

I refer to the 24 January 2014 letter from Mr Andrew Cappie-Wood, Director General of the Department of Attorney General and Justice, to Mr Lee White, Chief Executive Officer of the Institute of Chartered Accountants Australia (the Institute) concerning consultation on the proportionate liability model provisions. The Department of Attorney General and Justice in NSW is consulting on the model provisions to inform assessment of whether they should be wholly or partially implemented in NSW.

The Institute notes that in October 2013, the Standing Council on Law and Justice considered model proportionate liability provisions developed to address concerns about differences in proportionate liability legislation across the various Australian jurisdictions. Attorneys General agreed to consider introducing the model provisions in their respective jurisdictions.

The Institute has a long standing interest in professional liability reform and has been a supporter and advocate for proportionate liability since the early 1990s, both in our own right and in coalition with other professional bodies, including since the early 2000s via the Liability Reform Steering Group (LRSG).

We welcome the opportunity to further contribute to the consultation process on this matter.

A particular concern prior to the introduction of proportionate liability was that the then law of joint and several liability allowed full recovery in cases involving financial loss from any wrongdoer responsible for causing the loss complained of, regardless of their degree of responsibility. This had long created a class of so-called deep-pocket defendants – professional services firms with PI cover (in many cases to levels mandated by their professional body) and with a continuing legal identity – that became ready targets for aggrieved parties to sue.

Accordingly, the Institute and other professional associations whose members were unable to obtain adequate professional indemnity (PI) insurance at affordable rates, particularly in the insurance crisis of the early 2000s, lobbied government in Australia to introduce measures to address market failure in the provision of PI insurance – namely, that affordable commercial insurance was not available to cover the scale of risk facing professional services firms, including audit firms.

Proportionate liability was a key plank in our reform objectives, to better protect consumers of professional services by ensuring that PI insurance remained affordable and available. Changing the law to make a person's legal liability proportional to the loss their acts or omissions actually caused (i.e. proportionate liability) meant that a professional's PI insurance no longer had to necessarily also underwrite the losses caused by other, uninsured or impecunious parties (as could be the case under joint and several liability).

Australian governments subsequently unanimously agreed to the passage of a package of reforms including proportionate liability and professional standards legislation to address this problem.

Whilst proportionate liability for financial loss was introduced in all Australian jurisdictions, it was not done so in a consistent manner. One of the most prominent inconsistencies related to the ability to exclude the operation of the proportionate liability provisions. "Contracting out" was permissible in NSW, Western Australia and Tasmania. "Contracting out", however, was expressly prohibited in Queensland. The legislation elsewhere was silent on the matter.

In late 2005 Victoria undertook a consultation project on whether its legislation should be amended to permit "contracting out". This project was then referred to the Standing Committee for Attorneys General (SCAG) and more recently to the Standing Council on Law and Justice.

The current consultation on the model provisions is a significant forward step on the long-standing reference to SCAG/SCLJ on national harmonisation of proportionate liability legislation.

The Institute commends the SCLJ and its working group for the work that it has done on this topic since the Draft Proportionate Liability Model Provisions and accompanying Regulation Impact Statement were released for public consultation in September 2011.

In our view the model proportionate liability provisions approved by the SCLJ in October 2013 (the new model provisions or NMP) are a significant improvement over the previous 2011 version. In particular we note and support the position in the NMP with respect to contracting out of proportionate liability; that is, that contracting out should be prohibited for all contracts, except an agreement by a concurrent wrongdoer to contribute to indemnify another concurrent wrongdoer. Allowing contracting out would fundamentally undermine the public policy objectives underpinning the introduction of proportionate liability, namely assisting to make professional indemnity insurance more available and affordable, for the ultimate goal of better protecting all consumers of professional services.

The Institute is a participant in the LRSG and as such we support and endorse the communications sent by the LRSG to all Attorneys General in December 2013 encouraging them to move forward to enact the NMP in their respective jurisdictions, with one essential change.

The change put forward by the LRSG, which is regarded as fundamental to the success of proportionate liability, is to amend Clause 3 of the NMP re: "Non-application to arbitration etc" to make it clear that an entity (other than a court) that is able to make a binding determination about liability in relation to an apportionable claim is required to apply the proportionate liability principles in making a determination. A necessary related amendment is to delete existing Clause 12 (3). (Hereunder Clause 3 and Clause 12 (3) are referred to as "the Arbitration Clauses".)

The Arbitration Clauses are opposed as they loom as "contracting out" clauses under another name. The Arbitration Clauses should be amended to require application of proportionate liability principles in arbitration, otherwise the same problems posed by "contracting out" (which the NMP rightly proposes be prohibited) will again be encountered.

If not amended to require application of proportionate liability principles, the Arbitration Clauses will offer clients with stronger market/bargaining power a ready means to by-pass the operation of proportionate liability and will rapidly become a de-facto across-the-board approach for business and government when contracting with a broad range of professional service providers, negating the effect of proportionate liability. Lack of effective proportionate liability will have a negative effect on the PI insurance market, and impact on the delivery of expected benefits over time in respect of PI insurance cost and availability that proportionate liability has been expected to deliver.

Indeed, if the NMP are enacted nationally with the Arbitration Clauses intact, it is reasonable to expect that the effect on PI insurance will be greater than the effect to date of inconsistent treatment within proportionate liability laws of contracting out, as in the case of the latter this has been permissible only in three jurisdictions.

This risk (of proportionate liability being avoided by use of the Arbitration Clauses) is a less obvious risk than contracting out per se and hence one that will be difficult to educate members our on, especially those in smaller practices. Further, if the NMP with the Arbitration Clauses intact are enacted, it is foreseeable that future PI insurance contracts will be drafted to contain clauses that specifically exclude additional liability incurred as a result of contractual agreements to be bound by the determinations of arbitrators, to the detriment of consumers of professional services.

The threat posed by the Arbitration Clauses is not reduced by the Drafting note to Clause 3 that states "Jurisdictions may choose whether or not to include this provision". On the contrary, this is totally inconsistent with the objective of achieving nationally consistent proportionate liability legislation and inconsistent with the logic and reasoning of the Decision Regulation Impact Statement. Should Clause 3 be adopted by any jurisdictions, the outcome is likely to be "forum shopping" that will result in pressure on professional service providers to agree to contract in the law of those jurisdictions that adopt the Arbitration Clauses; that is those that effectively by-pass the operation of proportionate liability, with all the negative consequences this will entail.

It is imperative that policy-setters remember that proportionate liability was introduced only a relatively short time ago for solid public policy reasons as a response to market failure in PI insurance that put consumers at risk and threatened the continued provision of vital professional services. The Institute and other professions remain strongly of the view that allowing contracting out undermines the intended policy objectives of proportionate liability - namely, to ensure that PI insurance is both affordable and

available in the commercial market to better protect consumers that suffer loss and ensure that vital professional services remain insurable and available to consumers. Whilst we welcome the fact that the NMP contain a prohibition on contracting out, we agree with the LRSG that the Arbitration Clauses of the NMP constitute a similarly fatal flaw that will defeat the purpose and objectives of proportionate liability.

With amendment of the Arbitration Clauses to permit application of proportionate liability principles and addressing the drafting anomaly detailed above, the Institute supports the adoption of the NMP and will be happy to assist Attorneys General to pass this legislation in a nationally consistent way.

On behalf of the Institute, I appreciate the opportunity to comment on the NMP. If you require any further information, please do not hesitate to contact me on (02) 9290 5623 or by email to rob.ward@charteredaccountants.com.au

Yours faithfully,

Rob Ward
Head of Leadership and Advocacy