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CONSULT AUSTRALIA

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TRADE PRACTICES AMENDMENT (AUSTRALIAN CONSUMER LAW) BILL (NO. 2) 2010

SUBMISSION TO THE SENATE STANDING COMMITTEE ON ECONOMICS

SUBMISSION
Australian Consumer Law

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

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CONTENTS

Introduction	**2**
Executive Summary	**3**
Issue	**4**
Background to the TPA exemption for Engineers and Architects	**6**
Implications	**8**
Conclusion	**13**

INTRODUCTION

About Consult Australia

Consult Australia (formerly the Association of Consulting Engineers Australia) is the peak industry body representing consulting companies that provide professional services to the built and natural environment. These services include design, technology and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments. Consult Australia represents over 270 companies, from large multidisciplinary corporations to small niche practices, collectively employing over 50,000 staff.

Consult Australia's vision is to drive business success for consulting companies in the built and natural environment through collaboration, education, support and advocacy. We are dedicated to providing support and advocacy to our members with integrity, commitment, evidence based positioning, responsible actions and respect.

Consult Australia achieves these goals through a range of top down (improving regulation and creating opportunities) and bottom up (building capacity and community to reduce risk) support and services to members.

EXECUTIVE SUMMARY

The new Trade Practices Amendment (Australian Consumer Law) Bill (No.2) 2010 proposes removal of the exemption from the implied fitness for purpose warranty that currently exists for architects and engineers in subsection 74(2) of the Trade Practices Act 1974. If this exemption is removed it will create substantial adverse consequences for engineering and architectural professionals and businesses providing such services in Australia.

Consult Australia asks the Senate Economics Committee to recommend in its report that the exemption for architects and engineers be reintroduced into the Bill. Consult Australia recommends this for the following key reasons.

1) Consumers, when they engage the services of a professional engineer or architect, are well protected by s74(1) of the TPA; the law of negligence; and their contract terms and conditions. The addition of a fitness for purpose warranty provides no meaningful additional protection to a consumer in the context of professional services but it does significantly open up the extent of risk faced by the supplier.

2) Building and construction projects involve multiple parties in the delivery of a project. It is the builder or contractor that delivers the end product and the architect or engineer should not be required to warrant the performance of other parties, particularly as it has no control over the other parties or the quality of their work.

3) The introduction of an implied fitness for purpose warranty introduces substantial risk for engineers, architects and their insurers because it exposes them to the risks associated with the performance and behaviour of other participants involved in delivery of the project. These additional risks will drive up the cost of services and Professional Indemnity Insurance.

4) Absolute fitness for purpose warranties that pose greater liability risk will lead to engineers and architects adopting more conservative approaches in their designs thus increasing project outturn costs and acting to reduce innovation.

5) There is overwhelming evidence that inadequate project scope definition in Australia has led to significant cost wastage, through failed projects and extensive litigation. Engineers and architects should not be responsible for the client's change of scope and purpose or for the time and cost constraints, imposed by the client, that adversely impact on the development of a detailed and specific project and scope definition. Exposing engineers and architects to fitness for purpose warranties will only inflate the wastage further, driving competition out of the industry as many businesses will not survive in such circumstances.

6) Removal for the exemption will particularly impact small businesses working in the residential sector because of increased risk, costs and disputation. This has broader implications for housing affordability if the cost of professional services increases and competition is reduced in the small business sector. These outcomes are contrary to the intention of the Trade Practices Act.

7) There is inadequate policy evidence to demonstrate that the detriment caused to engineers and architects by removal of the exemption, from the implied fitness for purpose warranty, will be outweighed by the benefit to consumers.

8) The New Zealand Consumer Guarantees Act 1993 contains an explicit contracting out provision for agreements between suppliers and consumers that acquire services for the purposes of a business. This exemption has not been carried across into the Australian Consumer Law.

ISSUE

Under the Trade Practices Act 1974 (TPA), section 74(2), when entering into a contract with a supplier for services, there is an implied warranty that the services will be reasonably 'fit for purpose'.

In 1986 an amendment was made to this section of the TPA giving engineers and architects a specific exemption from this provision.

On 12 March 2009, the Federal Minister for Competition Policy and Consumer Affairs announced a review of the Australian law on implied conditions and warranties (implied terms) by the Commonwealth Consumer Affairs Advisory Council (CCAAC). Consult Australia (formerly the Association of Consulting Engineers Australia) and the Australian Institute of Architects made submissions to that review stating the reasons why the provision should remain and not be amended.

The CCAAC has produced its report, which has concluded that the exemption for engineers and architects should be removed.

The CCAAC report states:

> ***Exemption for architects and engineers***
>
> Subsection 74(2) of the Act implies into contracts a warranty that services will be fit for a purpose that a consumer makes known to the supplier. Services provided by architects and engineers are specifically excluded from being subject to this implied warranty. State and territory legislation includes similar exclusions for architects and engineers.
>
> The Australian Institute of Architects indicated that the exemption is motivated by:
>
> - issues with obtaining insurance coverage for 'fitness for purpose';
> - the 'one off' or prototypical nature of architectural and engineering services; and
> - uncertainty about the often subjective and implied purposes for which consumers engage architectural and engineering services.

The Association of Consulting Engineers of Australia indicated that the exemption applies to its industry for the following reasons:

- an engineer will often be providing advice for a small element of a large project;
- clients often do not reveal the purpose for which engineering design advice is provided and purposes might change as a project progresses; and
- insurers for engineering services typically exclude 'fitness for purpose' from warranties for professional indemnity insurance taken out by engineers.

In NZ, there is no exemption for architects and engineers in relation to the consumer guarantees that apply to services under the CGA.

CCAAC does not consider that the exemption for these professions is justified given that the same factors that apply to these professions also apply to many other service industries.

In the interests of simplicity, uniformity and fairness, the exemption should be removed.

Consult Australia believes that there is no robust policy basis for removal of the exemption. Thirty three submissions were made to the CCAAC inquiry. Consult Australia understands that no objections were raised in the consultation process to the exemption for architects or engineers and that only Consult Australia (then ACEA and the Australian Institute of Architects) made mention of the exemption in subsection 74(2). Consult Australia also understands that further analysis into the effects of removal of the exemption has not been conducted.

Consult Australia is concerned that the proposal to remove the exclusion has been made without proper consultation with those industries affected or due consideration of the financial impacts on society including:

- The increased risk of litigation;
- The contraction of designers in the marketplace because of the reduction in the availability of insurance;
- The impact on the cost of engineering/architectural fees due to higher insurance premiums;
- The reduction in design innovation;

There has been no consideration of the difficulties around defining 'purpose' and the role that multiple parties play in delivery of building and construction projects.

This submission intends to provide a briefing on the impact that such a change would have both to engineering and architectural professionals and businesses and the broader economy and consumers.

BACKGROUND TO THE TPA EXEMPTION FOR ENGINEERS AND ARCHITECTS

In 1986 a package of reforms were proposed by the government to the Trade Practices Act. Up until this point the fitness for purpose warranty applied to all Australian service providers, including engineers and architects. This amendment was proposed in the Senate as part of a package of five amendments which were insisted upon by the Senate in order to pass the government's reforms.

The record from the debate held in the Senate reveals the reasoning behind the amendment:

> **Senator HAINES**
>
> "I indicated yesterday, when we were discussing a number of other matters with relation to the Trade Practices Revision Bill 1986, that we would be moving an amendment with regard to clause 38, which is the clause which amends section 74. This is the clause that has probably excited most interest in this chamber, and it has attracted attitudes lined up much more on ideological bases than those on probably any other clause. Essentially, our amendment is to exempt qualified architects and engineers from the ambit of the new legislation, and we do that for a specific reason.
>
> Senator Durack commented yesterday that more and more professionals are incorporating, and that this is particularly true of architects and engineers. This is not our main reason for moving this amendment. In amending the Trade Practices Act through clause 38, the Government is attempting to bring to bear, I suppose, a greater responsibility on the part of professionals in their dealings with their clients. This measure will not do what a number of people have suggested it will do-place an excessive burden on most of those professionals so that if they do not achieve some whimsical desire which may or may not have been made known to them by the client, they will somehow be in dereliction of their duty and will be hauled before the nearest court, and as a consequence, of course, their personal liability insurance is going to skyrocket, costs to the consumer are going to increase, and all sorts of nasty things, including the end of the Western world as we know it, will occur. In fact, that is a nonsense, and I think that most people who are alleging it realise that it is a nonsense.
>
> Doctors will not be expected to cure patients in every case, nor will lawyers be expected to get all their clients off. Nothing of this sort has happened even in the United States, where people are far more prone to litigation on vexatious and frivolous issues than we are here.
>
> The issue with regard to architects and engineers is we believe that they fall into a special category as far as their relationship to their client is concerned;

that is that, while they come up with designs, specifications and so on in accordance with whatever a particular client wishes, in the implementation of those specifications, designs, contracts and so on a fairly significant third party intervenes.

As I said, we do not subscribe to the general argument that has been put in this place over the last few months of debate-that professionals generally should be exempt in the manner in which they have been in the past; that there is somehow a God-given difference between trades people and professional people that allows the professional to have oversight of his or her actions while the tradesperson has to be covered by the law in a more specific way.

In the case of architects and engineers, we believe that the complicating factor of that third party that I mentioned is a reason for amending the legislation as far as the provision of services by those two categories of professionals is concerned.

The particular cause of concern to us is, as I said, the intervention of a third party. A builder, for example, can ignore or deviate from specifications in such a way that the end result is not what was contracted for or expected by the client, and can do so in a manner which is not always readily apparent to the people who may have cause for complaint at the end.

Unravelling who caused what problem is a big enough difficulty when one is dealing even with such things as an ordinary suburban home, let alone with multi-storey buildings, bridges and what-have-you that are dealt with on a regular basis by architects and engineers.

To imply that the architects or engineers are absolutely responsible and that if a building or whatever turns out to be unfit in some way for the purpose they are wholly responsible is to place a far more onerous provision on them, I would have thought, than is placed in any other dealings between another group of professionals and their clients or patients, or whatever they want to call them.

The effect of this amendment being accepted would simply be that architects and engineers would be covered by the common law, as they are at the moment, and that they could then battle their way through the sorts of problems that occur if windows pop out of multi-storey buildings or bridges fall down, as they have in the past. I just hope that the Committee sees fit to support the amendment, for the reasons that I have put."

In debating the legislation Senator Baume, also noted,

"Let us recognise that in Australia the providers of these services are not people with unlimited deep pockets. The users of people in this area will charge rates which will ultimately be forced to be reflected upon the users of those services.

> This kind of law, by encouraging a much more enthusiastic pursuit of providers of services, in effect without fault, or without proof of causation, seems to me a step in the wrong direction in the interests of everyone, not only of the professionals involved, but particularly of the great bulk of users of these services, who are not vexatious litigants, who are not the pains in the neck who in so many instances are funded by government to pursue honest, decent suppliers of goods and services and who, frankly, take advantage of this excessive move by governments like this one into protecting what is, quite frankly, a fringe element of our society which is adding to the disadvantage, discomfort and cost of the great bulk of users of services."

IMPLICATIONS

The arguments put forward by Senator Haines and Senator Baume remain as relevant today as they did in 1986, in fact there is evidence that the commercial environment in which consultants operate has deteriorated further.

Project delivery in building and construction involves multiple parties, the transaction is not solely between the consultant and the consumer ('the client'). This makes engineering and architectural services different from services provided by other professionals (e.g. a lawyer or accountant).

Engineering and architectural consultants provide professional services, they do not deliver the end product. The professional consultant has a duty of care to the consumer that they will render their services with reasonable skill and care, it is then for the builder or contractor that constructs the end product, to provide the fitness for purpose warranty in respect of the physical work that they have carried out.

Removing the exemption for architects and engineers will not provide any added benefit to consumers, who are already well protected from the consequences of negligent advice by an architect or engineer through the common law; their contract with that professional consultant; and the implied duty of care in section 72(1) of the TPA. Faulty workmanship is covered by the fitness for purpose warranty given by the builder.

Conversely the removal of the exemption will result in substantial detriment to engineering and architectural professionals because it will significantly increase the risk of litigation against consultants. Clients will be able to sue a consultant under the TPA warranty regardless of whether or not there has been any fault on the part of the consultant and regardless of the fact that it is the builder that has control over delivery of the final project and not the engineer or architect. Absolute fitness for purpose warranties that pose greater liability risk will lead to engineers and architects adopting more conservative approaches in their designs in order to avoid breaching this obligation. It will also have the potential to drive up professional service fees, as the engineer and architect, in an attempt to minimise their risk exposure, over designs as they try to meet every conceivable 'purpose' in the mind of the client.

Furthermore Professional Indemnity Insurance, which provides insurance for professionals in the event that they are negligent, excludes cover for such warranties. This means the cost of engineering and architecture will increase because of the increased risk exposure for engineers, architects and insurers.

These costs will be passed on to the consumer, which is not in the best interests of individual consumers or the community in general. Increased litigation is also not in the economic interests of consumers or the broader economy of Australia. The number of engineering and architectural business failures will also increase in the event of growing litigation and cost (or loss) of insurance.

Defining fitness for purpose in building and construction

In only November last year, the Cooperative Research Centre (CRC) for Construction Innovation released its findings on disputation in the building and construction industry. It has published a 'Guide to Leading Practice for Dispute Avoidance and Resolution'[1] in an attempt to create a cultural change in the industry given that the report findings show that the total waste (direct and indirect costs of disputes) exceeds $7billion per year.

The Guide states,

> "The Australian construction industry is a significant sector of the economy in its own right, employing close to one million people, and undertaking more than $120billion worth of work annually. It is a critical part of the economy, providing shelter and facilities for all other parts of the economy.
>
> The people who work in the industry, whether clients, designers or constructors are proud of their achievements.
>
> However, the industry is bedevilled with a reputation for tough commercial behaviour, and a propensity to solve problems using formal dispute resolution.
>
> This is the case in Australia, and it is reflected in other developed economies with adversarial-based legal frameworks. Academic and industry journals are replete with studies of the behaviour of the industry, and its predisposition to adversarial problem solving."

The CRC for Construction Innovation identifies that a principle cause for disputation is the failure of clients to adequately specify project scope, i.e. adequately define the purpose and the services required.

Clients will often attempt to insert a specific 'fitness for purpose' warranty clause in their contracts in the absence of it being an 'implied term' under the TPA. This is used as a way to shift the risk of failure to provide an adequate scope definition onto the consultant. Consult Australia and its members have been able to reference the TPA exemption when arguing against the inclusion of such a clause.

Removal of the exemption will mean that consultants will carry liability for inadequate project briefs and consequent project failure in the eyes of their clients, despite there being no fault on the part of the consultant in carrying out their professional duties.

As noted in the CRC for Construction Innovation report there is substantial evidence to support the statement that project scope definition is a major problem.

[1] CRC Construction Innovation, Guide to Leading Practice for Dispute Avoidance and Resolution November 2009, see: http://www.acea.com.au/downloads/dar%20guide.pdf

"Getting It Right The First Time" was a report by the Queensland Division Task Force Engineers Australia in October 2005[2].

The report looks at the specific issue of reversing the declining standards in project design documentation and cites the primary root case as inadequate project briefs based on unrealistic expectations of time and cost for project delivery. The report found that poor documentation was contributing an additional 10-15% to project costs in Australia. It also found that the annual cost of poor documentation was estimated to be $2 billion in Qld, with overall it costs in Australia of $12 billion per year.

The report states,

> "Whilst in the best cases, a project manager is appointed by the client to manage the delivery, in a high proportion of cases, the client/financier is overwhelmingly focused on the commercial or political outcomes and pays little regard to the downstream project delivery aspects, such as design detail, documentation and construction. In maximising narrow project benefits, unworkable demands and unattainable goals are imposed on both designers and constructors."

In a paper on the "Analysis of the Problems Faced by Project Management Companies Managing Construction Briefs"[3], the following observation was made,

> "When dealing with clients, companies appear to be finding it difficult to obtain a client brief, understand the client brief and are finding that this is a poor brief definition. The development of a workable brief is seen as a problem, as the client must have a clear brief if the project is to be successful. The trouble is that many clients want a land-based flying submarine."

In 2006 Blake Dawson & Waldron in collaboration with the Australian Constructors Association published, "Scope for Improvement – A Survey of Pressure Points in Australian Construction and Infrastructure Projects". As this title suggests the report highlighted the ongoing problems with poor project scope definition in Australia that inevitably leads to major pressure points occurring throughout the entire project cycle, resulting in cost overruns, delayed completion and disputes.

Building on the 2006 findings, Blake Dawson, supported by the Australian Constructors Association and Infrastructure Partnerships Australia, undertook further research in 2008 to delve into the issue of inadequate scoping in Australian construction and infrastructure projects.

The report findings showed that scoping inadequacies resulted in 26% of the $1billion+ capital value projects surveyed for the report were more than $200 million over budget and that the situation was getting worse. Engineers and architects are not in a position to effectively underwrite project losses of this magnitude, by way of a warranty, nor are they in a position to bear the cost of the dispute process which then arises.

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[2] Available online at www.qld.engineersaustralia.org.au

[3] Wilkinson Suzanne; An analysis of the problems faced by project management companies managing construction projects; engineering, construction & architectural management, Vol 8, No 3; Blackwell Publishing, Inc; 2001: p160-170

Problems with project definition and scope are emphasised in the domestic sector, because the client is far less informed than a client involved in commercial projects. In addition builders and developers in the domestic market are more susceptible to changing market conditions and are more vulnerable to commercial failure. This means that the effect of removing the exemption will make claims against engineers and architects increase because there is more likelihood of recovering any financial loss from the engineer or architect than the builder.

New Zealand Legislation

Consult Australia acknowledges that one of the drivers for the Australian Consumer Law is to bring about consistency with the New Zealand Consumer Guarantees Act 1993 (CGA). The Australian Consumer Law introduces an amendment to the definition of 'consumer' to bring it into line with the CGA. The CCAAC has reasoned that the exemption for engineers and architects should be removed from the implied fitness for purpose warranty because such an exemption does exist in the CGA. However, the Australian Consumer Law is not consistent with the New Zealand legislation, because the CGA provides a clear contracting out provision for business to business contracts (section 43). This leaves room for the definition of 'consumer' in the Australian Consumer Law to be read more broadly than in New Zealand. The contracting out provision in the CGA gives commercial certainty in business to business contracts.

Consult Australia understands that it is standard commercial practice in New Zealand to contract out for reasons of certainty in business to business contracts.

It should also be noted that in New Zealand there traditionally has been greater use of standard form contracts to engage consultants, unlike Australia where there is a lack of uniformity of contract terms and a high degree of litigation in the building and construction industry.

Consult Australia believes this indicates that further investigation should be conducted by the Governments in both jurisdictions to assess the merits of including the exclusion for professional architects and engineers in the New Zealand legislation.

Insurance implications

The following is an exclusion clause taken from a current Suncorp Metway Insurance Limited Professional Indemnity Insurance policy:

> "Any liability assumed by the Insured under any express warranty, guarantee or agreement unless such liability would have attached the Insured notwithstanding such express warranty, guarantee or agreement."

Professional Indemnity Insurance is a contract between a professional and an insurance company, where the insurer indemnifies losses arising from the conduct of that professional **and only that professional**. The insurer does not allow potential claims to be made through the conduct of an unknown third party. So for this reason any warranties, guarantees or other such agreements (e.g. indemnities) are excluded because such terms make the professional responsible for final project outcomes even though a third party may be at fault.

The insurance industry recognises that the professional engineer or architect is only one party involved in a building and construction project, therefore this exclusion is included in Professional Indemnity policies to protect the insurer against claims arising from the conduct of parties other than the engineer or architect. A fitness for purpose warranty expressly contained in the terms of a contract between a consumer and a professional engineer or architect understandably falls squarely within the insurer's exclusion.

If the exemption from an implied fitness for purpose warranty is removed, the insurance industry would then be exposed to indemnifying claims that are not exclusive to the engineer or architect, but to a number of project participants. This would change the entire risk profile of professional indemnity insurance policies in Australia. At best it would substantially increase professional indemnity insurance premiums and at worst it could make professional indemnity insurance for engineers and architects so unmanageable (as the insurer would not be able to accurately analyse and rate its risk exposure) that insurers would simply cease to provide cover.

This has happened in Australia before when in 2001/02 Australia suffered a major insurance crisis and the cost of Professional Indemnity Insurance premiums escalated by up to 1000 per cent and some insurers withdrew from this line of business. Consult Australia surveyed its members over that period (2002-2005) and the table below highlights the severity of the impact.

Please see over.

Date	Average Policy Increases	Highest Policy Increases	Average Deductible Increases	Highest Deductible Increases
Feb 2002	115%	300%	80%	203%
Aug 2002	205%	1000%	247%	1000%
Jan 2003	114%	1000%	207%	1200%
Feb 2004	36%	400%	32%	1200%
May 2004	47%	500%	46%	400%
Jan 2005	11%	108%	8%	100%
Total increases: 2002-2005	**528%**		**620%**	

Source: Consult Australia – Professional Indemnity Insurance Surveys 2002-2005

All clients in Australia require, through their contracts with the engineer or architect, evidence that they hold a current certificate of insurance. Without Professional Indemnity Insurance an engineer or architect cannot practice. In any event very few engineering or architectural professionals in Australia would have the asset base which would allow them to self-insure against the risks that are potentially involved in the provision of their services.

CONCLUSION

Consult Australia requests that Schedule 1, Section 61 of the Trade Practices Amendment (Australian Consumer Law) Bill (No.2) 2010 be amended to reintroduce the exemption that existed for architects and engineers in Section 74(2) of the Trade Practices Act 1974, as follows:

61 Guarantees as to fitness for a particular purpose etc.

(1) If:

(a) a person (the ***supplier***) supplies, in trade or commerce, services to a consumer **(other than services of a professional nature provided by a qualified architect or engineer)**; and

(b) the consumer, expressly or by implication, makes known to the supplier any particular purpose for which the services are being acquired by the consumer;

there is a guarantee that the services, and any product resulting from the services, will be reasonably fit for that purpose.

(2) If:

(a) a person (the ***supplier***) supplies, in trade or commerce, services to a consumer **(other than services of a professional nature provided by a qualified architect or engineer)**; and

(b) the consumer makes known, expressly or by implication, to:

(i) the supplier; or

(ii) a person by whom any prior negotiations or arrangements in relation to the acquisition of the services were conducted or made;

the result that the consumer wishes the services to achieve;

there is a guarantee that the services, and any product resulting from the services, will be of such a nature, and quality, state or condition, that they might reasonably be expected to achieve that result.

-Ends-