The Senate

Economics Legislation Committee

Provisions of the Treasury Legislation Amendment (Professional Standards) Bill 2003

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CHAPTER 1

INTRODUCTION

Background

1.1 The Treasury Legislation Amendment (Professional Standards) Bill 2003 was introduced into the House of Representatives on 4 December 2003 by the Hon Ross Cameron, the Parliamentary Secretary to the Treasurer.

Purpose of the bill

1.2 The purpose of the bill is to put in place measures to ensure that State and Territory professional standards law cannot be bypassed by litigants attempting to access uncapped damages payouts under Commonwealth law. To this end, the bill amends the *Trade Practices Act 1974*, the *Australian Securities and Investments Commission Act 2001* and the *Corporations Act 2001*. The amendments ensure that relevant State or Territory legislation applies to limit occupational liability arising under these Commonwealth laws.

1.3 The bill is one aspect of a four part approach to improving access to, and affordability and coverage of, professional indemnity insurance. The other measures are: uniform, national professional standards legislation; proportionate liability; and changes to section 54 of the Insurance Contracts Act.

Reference of the bill

1.4 On 11 February 2004, the Senate adopted the Selection of Bills Committee Report No. 1 of 2004 and referred the provisions of the bill to the Senate Economics Legislation Committee for consideration and report.

Submissions

1.5 The Committee advertised its inquiry into the Treasury Legislation Amendment (Professional Standards) Bill 2003 on the internet and in *The Australian* newspaper. In addition, the Committee contacted a number of organisations alerting them to the inquiry and inviting them to make a submission. A list of submissions received appears at **Appendix 1**.

Hearing and evidence

1.6 The Committee held one public hearing at Parliament House, Canberra, on Monday, 29 March 2004.

1.7 Witnesses who appeared before the Committee at that hearing are listed in **Appendix 2**.

1.8 Copies of the Hansard transcript are tabled for the information of the Senate. They are also available through the internet at http://aph.gov.au/hansard.

Acknowledgment

1.9 The Committee wishes to thank all those who assisted with its inquiry.

CHAPTER 2

THE BILL

Background to the bill

2.1 Professional indemnity insurance covers professional people – accountants, architects, engineers, lawyers, and others – for their legal liability to clients and others relying on their advice and services. It provides indemnity cover if a client suffers a loss, whether material, financial or physical, that is directly attributed to negligent acts of the professional.[1]

2.2 Increasingly, it is claimed that Australian professionals are experiencing difficulty in obtaining affordable professional indemnity insurance. As a consequence, some have reportedly continued to offer professional services without adequate insurance. This may mean that consumers will not be able to obtain appropriate compensation in the event that services are provided negligently.

2.3 The causes of the difficulties in the professional indemnity insurance market are variously attributed to international factors and their impact on the reinsurance market, including the effects of the attacks on the World Trade Center in 2001 and the collapse of Enron and other major corporations, and domestic factors such as the collapse of HIH Insurance, an increase in the size of claims and of damages awards, and an increasingly litigious society. Poor investment returns and a consequent cyclical hardening of the market have compounded these factors. The result is that fewer insurers are offering professional indemnity insurance in Australia, and those that do are severely restricting the scope of services they are prepared to cover.

2.4 According to the Explanatory Memorandum to the bill, the greatest impact of the lack of professional indemnity insurance is being felt by small to medium sized businesses and businesses in regional areas. Less impact is being felt by large firms who have sufficient capital to self-insure up to certain levels and insure above these levels on the international reinsurance market.[2]

2.5 The bill aims to support state and territory attempts to reduce professional indemnity insurance premiums and improve availability of such insurance by implementing professional standards legislation. The bill forms one part of a four part approach to addressing the difficulties experienced in the professional indemnity insurance market.

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1 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance*, Monitoring report, July 2003, p.viii.

2 *Explanatory Memorandum*, Treasury Legislation Amendment (Professional Standards) Bill 2003, p.5.

2.6 Professional standards legislation allows professionals to cap their liability in return for improved standards and complaints procedures. To enable this to operate effectively across the nation, each state and territory must enact Professional Standards Acts in a consistent and complementary form.

State and Territory professional standards legislation

2.7 Three states have enacted professional standards legislation and all states and territories have confirmed their commitment to implement such legislation in their jurisdictions.[3]

2.8 NSW has the longest running Professional Standards Act. The *Professional Standards Act 1994* (NSW) came into operation on 1 May 1995 and is the model on which other jurisdictions are basing their legislation. The Western Australian *Professional Standards Act 1997* commenced on 18 April 1998. Most recently, Victoria enacted its own Professional Standards Act which was assented to on 2 December 2003 but has not yet been proclaimed, and South Australia introduced the Professional Standards Bill 2003 on 12 November 2003. Queensland is currently drafting legislation, and remaining jurisdictions are at various stages in developing their bills.

2.9 The objects of the various state Acts referred to in paragraph 2.8 are as follows:

(a) to enable the creation of schemes to limit the civil liability of professionals and others;

(b) to facilitate the improvement of occupational standards of professionals and others;

(c) to protect the consumers of the services provided by professionals and others; and

(d) to constitute a Professional Standards Council to supervise the preparation and application of schemes and to assist in the improvement of occupational standards and protection of consumers.[4]

2.10 To ensure that there are no advantages in forum shopping between states and territories, which can potentially undermine the effectiveness of professional standards legislation, it is desirable that all jurisdictions implement legislation in a similar form and that a national professional standards framework exists. Consistent legislation means that a professional association can construct a scheme under the legislation in

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3 Joint Communiqué, *Ministerial Meeting on Insurance Issues*, Adelaide, 6 August 2003, at: http://assistant.treasurer.gov.au/atr/content/publications/2003/Insurance_Reform.asp, viewed on 26 February 2004.

4 *Professional Standards Act 1994* (NSW), Section 3. The objects of all three Acts are identical.

one state or territory, and be reasonably sure that it will satisfy the requirements of the legislation in each other jurisdiction. This will assist associations which have schemes in one state to establish mirror schemes in other jurisdictions as quickly as possible once legislation is enacted.

2.11 Despite the desirability of uniform legislation, amendments made to the NSW Act resulted in the NSW and Western Australian Acts becoming dissimilar. However, the Professional Standards Council told the Committee that both Acts are consistent in all material respects.[5]

2.12 Two matters remain open for discussion between state governments: whether schemes will allow contracting out of the liability caps on a contract specific basis; and whether breaches of fiduciary duty are to be excluded from the legislation[6] (as is currently the case with the Victorian Act).

Professional Standards Councils

2.13 The Acts establish Professional Standards Councils as bodies corporate whose role is to advise, monitor, educate and advocate on issues affecting occupational associations, professionals and consumers in general. Members come from a variety of professions and disciplines and are appointed by the relevant state or territory minister (in NSW this is the Attorney-General). The secretariats to the Councils are staffed by a government department.

2.14 It is a goal of the Professional Standards Council that, as the states and territories enact professional standards legislation, representatives from each jurisdiction will be included on a composite national Professional Standards Council which will also include a representative from the Commonwealth. Such a national structure aims to ensure consistency in the administration of the legislation across the country. Under an informal arrangement, the NSW and WA Professional Standards Councils currently are comprised of the same members.

Professional standards schemes

2.15 Under the Professional Standards Acts, occupational associations may submit a professional standards scheme to the Council for its approval. Schemes can apply to all people within an occupational association or to a specified class of people. The schemes allow a cap to be placed on the occupational liability[7] of certain professionals and, in return for this capped liability, the professionals are required to adopt risk management strategies, compulsory insurance cover, professional education, and

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5 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.3.

6 Submission 11, Queensland Government, p.2.

7 The Acts define occupational liability as: civil liability arising (in tort, contract or otherwise) directly or vicariously from anything done or omitted by a member of an occupational association acting in the performance of his or her occupation. (Section 4, *Professional Standards Act 1994* (NSW))

appropriate complaints and disciplinary mechanisms. Anticipated outcomes of the schemes are minimised damages claims through improved standards, lower professional indemnity premiums and more accessible insurance cover.

2.16 The schemes limit occupational liability in respect of a cause of action founded on an act or omission occurring during the period when the scheme is in force. They also limit the amount of damages that may be awarded in respect of an action relating to occupational liability. However, a scheme will not affect claims for damages below $500,000.

2.17 The Professional Standards Council determines the caps that are to apply under schemes. It does so in particular by reference to the history of claims made against the members of the occupational association and the need adequately to protect consumers.[8] The level of the cap will depend on the number, value and frequency of extraordinary, high-end claims. It will vary from scheme to scheme, according to the nature of the industry, and within schemes, according to the size of the practice or, perhaps, the scale of fees. Some examples of caps include the following:[9]

- the Law Society of New South Wales scheme adopts for small firms a cap equivalent to the minimum level of mandatory insurance required under the *Legal Profession Act 1987* (NSW), currently $1.5 million. Larger firms are specified a higher cap up to $50 million;

- the Institute of Consulting Valuers scheme specifies a cap of $5 million, and also provides a different cap of $500,000 for residential valuations to accommodate the different (lower) risk for that kind of work; and

- accountants have caps based on fee size so that generally the typical suburban accountant would have a cap of $500,000 and city firms engaged in work for large clients could have caps up to $20 million.

2.18 This last example uses the multiple of fees approach which takes into account the range of different sized firms within professions. Rather than being set at a fixed amount, the cap is established by reference to the fee for a service which is then multiplied by a predetermined amount. This operates as follows: if the multiple is 10 times the fee, and an accountant charges $1000 for advice that is subsequently found to be misleading and leads to a $50,000 loss, because the $50,000 falls below the $500,000 limit in the legislation, no cap would apply. The client would be entitled to $50,000 in damages. If however, a large accounting firm charged a fee of $2

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8 Bernie Marden, *High Aims for Professional Standards Legislation*, at: http://www.lawlink.nsw.gov.au/lawlink/professional_standards_council/psc_ll.nsf/pages/PSC_index, pp.3-4, viewed on 12 February 2004.

9 Bernie Marden, *High Aims for Professional Standards Legislation*, at: http://www.lawlink.nsw.gov.au/lawlink/professional_standards_council/psc_ll.nsf/pages/PSC_index, p.4, viewed on 12 February 2004.

million and the claim for damages was more than $500,000, the maximum payout would be limited to $20 million.

2.19 Submissions suggest that caps on liability will have an impact on only a small percentage of claims and that the level of the caps is set to meet all consumer claims and the vast majority (more than 95 per cent) of commercial claims.

2.20 Associations seeking approval for their scheme must provide the Professional Standards Council with a detailed list of the risk management strategies that they intend to implement in respect of their members. These strategies might include entry requirements that restrict membership of the association to certain educational or experience levels; codes of ethics to guide business dealings with clients and others; and continuing professional development programs requiring members to complete specified hours of ongoing training over specified periods of time.

2.21 Scheme participants may also have a complaints and discipline system in place, a model code of which is included as a schedule to the Acts.

2.22 Associations with a scheme must report to the Council on the effects of their risk management. The Council assesses and reports on their efforts in its annual reports which are tabled in Parliament and become publicly available.

2.23 Before the Council approves a scheme it must allow for a public consultation period. It notifies the public about the nature and significance of the scheme and where copies can be obtained. It must also invite comments and submissions and, if appropriate, conduct a public hearing. Following approval of the scheme, the Council submits it to the relevant state or territory Minister who may authorise its publication in the *Gazette*. The scheme is then tabled in Parliament where it becomes subject to disallowance provisions of the state or territory parliament.

2.24 The NSW Professional Standards Council annual report for 2003 shows the schemes that were current in NSW at the time:[10]

Scheme	**Administrator**	**No. of participants**
Accountants Scheme	CPA Australia (CPA Aust)	1,135
	Institute of Chartered Accountants in Australia (ICAA)	6,715
Institute of Consulting Valuers Scheme	The Institute of Consulting Valuers (ICV)	64
Investigative and Remedial Engineers Scheme	The College of Investigative and Remedial Consulting Engineers of Australia Inc (CIRCEA)	14
National Institute of Accountants Scheme	National Institute of Accountants (NIA)	633

10 Professional Standards Council, Annual Report 2003, p.18.

Professional Surveyors Scheme	The Professional Surveyors' Occupational Association of NSW Inc (PSOA)	101
Solicitors Scheme	The Law Society of New South Wales (LSNSW)	9,079
Total		**17,741**

2.25 Currently Western Australia has no approved schemes as the WA legislation requires amendment to ensure it is consistent with the NSW legislation.[11] The WA Annual report of the Professional Standards Council for 2002 lists three schemes in various stages before the Council.[12]

Application of the Acts

2.26 The Acts do not apply in relation to all types of professional liability. For example, they do not apply in particular to liability for damages arising from:

(a) the death of or personal injury to a person;

(b) any negligence or other fault of a legal practitioner in acting for a client in a personal injury claim;

(c) a breach of trust; and

(d) fraud or dishonesty.[13]

Additionally, the Acts do not apply to liability which may be the subject of certain proceedings relating to the transfer of land.

Problem with existing Commonwealth legislation

2.27 Remedies for misleading or deceptive conduct available for contraventions of section 52 of the Trade Practices Act, section 1041H of the Corporations Act, and section 12DA of the Australian Securities and Investment Commission Act are not currently subject to any statutory ceiling. This provides an opportunity for plaintiffs to attempt to structure their cases to fall within the ambit of Commonwealth legislation so as to bypass state professional standards laws and potentially gain greater compensation. While the Committee was provided with little data about the extent of this practice, there is concern that it may become more widespread as all the states and territories introduce professional standards legislation.

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11 Submission 1, Western Australia Government.

12 Professional Standards Council, Western Australia Annual Report 2002.

13 Section 5, *Professional Standards Act 1994* (NSW). All three Acts contain the same exclusion clauses except in their reference to the names of the various state property Acts. In addition to the exclusions listed, the Victorian Act does not apply to a breach of fiduciary duty.

2.28 Some submissions[14] argue that there are advantages, such as no requirement to prove fault, in bringing an action under misleading or deceptive conduct provisions of Commonwealth Acts rather than employing other causes of action such as negligence, breach of contract or breach of statutory duty under the relevant state Act.

2.29 Submissions suggest that the reason that the state professional standards legislation has not been more successful, is the existence of these 'loopholes' at the Commonwealth level. For example, the Professional Standards Council told the Committee that one reason there has not been a more radical proliferation of schemes in Western Australia (there are currently none) has been the perceived impact of the availability of forum shopping by bringing proceedings under the Trade Practices Act[15] (or other Commonwealth legislation creating remedies for misleading or deceptive conduct):

> The perception in Western Australia has been that the full benefits of professional standards legislation are not mature until such time as the federal scene is brought in line with the state based legislation.[16]

Substantive changes made by the bill

2.30 The Treasury Legislation Amendment (Professional Standards) Bill 2003 amends the *Australian Securities and Investments Commission Act 2001*, the *Corporations Act 2001* and the *Trade Practices Act 1974*.

2.31 The bill inserts a new section into each Act to specify that if a scheme limiting liability is in force under state professional standards legislation and has been prescribed in Commonwealth regulations, the scheme applies to limit liability under the Commonwealth law in the same way as it limits occupational liability under the state or territory law. In this way, the remedies available to plaintiffs under the relevant sections of the three Acts will be the same as those available under the state or territory law.

2.32 Consequently, once all the states and territories enact professional standards laws, any opportunity for forum shopping will be removed in relation to the following:

- contraventions of section 12DA of the Australian Securities and Investments Commission Act (misleading or deceptive conduct in relation to financial services, excluding dealings in securities);

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14 Submission 5, Association of Consulting Engineers Australia; *and* Submission 2, Professional Standards Council, Attachment 2, *Review of the impact of the Trade Practices Act on the Operation of Professional Standards Schemes*, December 2002, pp.9-16.

15 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.3.

16 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.3.

- contraventions of section 1041H of the Corporations Act (misleading or deceptive conduct (civil liability only)) in relation to financial products and financial services; and

- contraventions of section 52 of the Trade Practices Act (misleading or deceptive conduct – does not apply in relation to financial services).

2.33 The Commonwealth regulations prescribing the schemes are not yet available and will be formulated by the Office of Legislative Drafting when policy issues have been addressed. Regulations will be subject to disallowance provisions of the Commonwealth Parliament.

2.34 Additionally, the bill contains a power to enable the Commonwealth to modify a scheme by regulation. According to the Explanatory Memorandum, this will ensure that capping operates in the interests of the community at large.[17] The control exercisable by the Commonwealth in retaining a capacity to modify schemes is intended as a reserve power whose existence will negate (or significantly diminish) any need for intergovernmental agreements or the implementation of other mechanisms to ensure control over the operations of the Professional Standards Councils.

Impact of the bill on the insurance market

2.35 In addition to the benefits flowing to consumers arising from the improved standards and complaints procedures, it is hoped that benefits in relation to insurance can be achieved by the following:

- a return to the Australian market of insurance companies offering professional indemnity insurance, as the potential for unlimited occupational liability for certain actions is removed;

- a lowering of professional indemnity insurance premiums, as insurance companies are better able to anticipate the cost of claims because the potential for unlimited occupational liability for certain actions is removed;

- a lowering of professional indemnity insurance premiums, as improved professional standards lead to fewer, and less costly damages payouts and insurance companies pass these benefits on to policyholders; and

- an increase in the number of professionals holding professional indemnity insurance as organisations, enticed by the cap on liability into professional standards schemes, are required to hold professional indemnity insurance up to the level of the cap.

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17 *Explanatory Memorandum*, Treasury Legislation Amendment (Professional Standards) Bill 2003, p.19.

CHAPTER 3

POLICY ISSUES

Issues raised in submissions

3.1 The Committee received 14 submissions, and one supplementary submission. Most supported the intention of the legislation to prevent forum shopping when professional standards legislation is enacted throughout Australia.

3.2 However, the Committee notes that while many of the submissions to the inquiry claimed that the bill is integral to the success of state and territory professional standards legislation, there seems as yet to be little hard evidence available on the relationship between professional standards legislation and the state of the insurance market, or on the relationship between the effectiveness of state legislation and the in-principle possibility of forum shopping.

3.3 The lack of data made it difficult for the Committee to analyse the significance of much of the anecdotal information presented. The two monitoring reports of the Australian Competition and Consumer Commission provide the most current information about professional indemnity insurance but these are based on data from insurers whose premium revenue represented between only 49[1] and 58[2] per cent of the professional indemnity class. The more detailed data that has been anticipated from the Australian Prudential Regulation Authority will not be available until the end of 2004.[3]

3.4 The focus of much of the evidence to the inquiry was on general issues relating to state and territory professional standards legislation. These included:

- existence of an insurance crisis;
- impact of professional standards legislation;
- transfer of risk;
- nature of link between caps, improved standards and reduced premium costs;
- flexibility of schemes;
- competition issues;

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1 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance*, Second monitoring report, January 2004, p.4.

2 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance*, Monitoring report, July 2003, p.3.

3 *Transcript of Evidence* (proof copy), 29 March 2004, Chapman, p.52.

- sunset clauses; and
- retrospectivity and transparency.

3.5 The Committee discusses each of these matters below. In the following chapter, the Committee outlines concerns raised about specific aspects of the bill as drafted.

Existence of an insurance crisis

3.6 At the core of submissions from professional organisations and others lies an assumption that we are currently experiencing a crisis in the market for professional indemnity insurance. To remedy the situation, they argue, regulatory intervention is necessary.

3.7 Professional organisations presented evidence about the difficulties experienced by their members in getting adequate professional indemnity cover.[4] For example, engineering services have experienced more than double the reported average increases in premiums, in addition to a 300 per cent average rise for consulting engineers, as for other professions over the last two years.[5]

3.8 Further illustrations provided to support the claim of market failure include examples of exclusions imposed by insurers, an inability to obtain insurance cover at any price, and large increases in premiums. In many cases premiums seem to bear little relationship to claims history. Outcomes of such difficulties for professionals can be idle capacity, laying off of professionals, business closures, withdrawal of services, firms working without insurance, reduced competition for projects, and increases in the cost of professional services to business and the community.

3.9 Ultimately, it is argued, consumers face risks of being unable to access core professional services or to be compensated for valid claims. In addition, where professionals resign their membership of professional associations due to their inability or unwillingness to meet professional indemnity requirements, consumers may be provided with services that are not subject to professional standards and self-regulatory oversight.[6]

3.10 While professional associations often require their members to hold professional indemnity insurance, several are considering removing this as a condition

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4 Submission 4, Institute of Chartered Accountants in Australia; Submission 5, Association of Consulting Engineers Australia; Submission 6, Engineers Australia, pp.2-3; *and* Submission 7, Professions Australia, pp.4-8.

5 Submission 5, Association of Consulting Engineers Australia.

6 Submission 4, Institute of Chartered Accountants in Australia.

of membership, or modifying the level of indemnity required, because of the difficulties experienced by some in obtaining affordable and appropriate cover.[7]

3.11 The Insurance Council of Australia (ICA) told the Committee that professional indemnity insurance has been a difficult line of cover for insurers for a number of years.[8] The industry has experienced increased claims costs, increased premiums and significant underwriting losses. The ACCC's monitoring report[9] shows that the professional indemnity insurance net combined ratio[10] fell from 117 per cent in 2001 to 92 per cent in 2002, but increased again to 98 per cent for the first six months of 2003.

3.12 However, certain submissions were sceptical about the existence of an insurance crisis. The Australian Bankers' Association (ABA) was not convinced that a crisis exists for purchasers of insurance and the Australian Plaintiff Lawyers Association (APLA) questioned whether such a crisis existed at the level of the insurance industry itself.

3.13 The APLA pointed to the significant profits reported recently by the insurance industry, and argued that the industry does not need legislative support at the cost of consumers.[11] It asserts that to date there has been no statistical support showing damages claims or awards to be increasing: rather the evidence is to the contrary. It argues that there is no evidence to prove that increased costs are the driver of increased premiums in the insurance industry let alone the converse, that decreasing costs will lead to decreased premiums.

3.14 The APLA contends that the premise underlying the current round of tort reform, including the introduction of professional standards legislation, is flawed. There is no explosion in litigation and no crisis in the insurance industry. Increases in the costs and availability of professional indemnity cover are a function of the insurance industry and it is in that industry itself that the solutions to the crisis will be found.[12]

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7 For example, Submission 4, Institute of Chartered Accountants in Australia; *and* Submission 5, Association of Consulting Engineers Australia.

8 Submission 12, Insurance Council of Australia, p.6.

9 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance*, Second monitoring report, January 2004, p.27.

10 This ratio shows whether the sum of all costs to insurers (claims costs and expenses) is greater or less than premiums. For example, if the combined ratio is greater than 100 per cent, then premiums are insufficient to cover costs and this would imply an underwriting loss. (ACCC, *Public liability and professional indemnity insurance*, Second monitoring report, January 2004, p.10.

11 Submission 8, Australian Plaintiff Lawyers Association, p.2.

12 Submission 8, Australian Plaintiff Lawyers Association, p.8.

3.15 Similarly, while acknowledging the difficulties experienced in the insurance market for the medical profession, the Australian Bankers' Association asserts that there is no widespread evidence that other professions are unable to obtain affordable insurance.[13] It distinguished between the undeniable increases in cost of professional indemnity insurance premiums over the past five years, and the affordability of those insurance premiums to accountants or other professionals:

> It is therefore by no means clear that there is a problem to be solved at all. Indeed, if proportionate liability and the ability for professionals to practise in incorporated form are introduced … it may become even more likely that capping is unnecessary.[14]

3.16 The ABA recommends that schemes limiting liability should only be permitted where professionals can prove that problems with the affordability of insurance are persisting.

Committee view

3.17 The Committee understands that insurance is an industry known to be affected by cyclical trends. The features of the market cycle and the causes of the current difficulties have been well canvassed in publications by the ACCC, Department of the Treasury and the Productivity Commission. In recent years, professional indemnity has not been a profitable area for insurance companies.[15] The current difficulties for professionals in accessing insurance illustrate the classic corrective response of the market, where capital and capacity are withdrawn in response to the fall in profitability, insurers raise their premiums, and insurance cover becomes unavailable or limited by exclusions.

3.18 While some submissions argue that this shows market failure, the evidence may also suggest that the insurance market is working though a cycle that will resolve itself over time. However, the Committee notes the view of the Law Council of Australia that its support for professional standards legislation does not depend on there being an insurance crisis:

> The Law Council has advocated professional standards legislation since December 1998. It is not a reaction of the Law Council to the so-called insurance crisis; it has been recognised by the Law Council for a number of years that this is an important change required to ensure that consumers have protection. I note with interest that the Plaintiff Lawyers suggest that the professional standards legislation is part of the move towards tort

13 Submission 10, Australian Bankers' Association, p.9.

14 Submission 10, Australian Bankers' Association, p.9.

15 *Transcript of Evidence* (proof copy), 29 March 2004, Booth, p.21; *and* Australian Competition and Consumer Commission, *Insurance Industry Market Pricing Review*, March 2002, pp.ii and 46.

> reform. That simply is not the case. This has been on the table for a considerable number of years.[16]

3.19 The Committee is also cognisant of the ACCC's view that because the causes of the current difficulties with professional indemnity insurance are uncertain, an incremental and minimalist response is appropriate.[17] Governments are currently taking steps to ease the difficulties faced by professionals, and professional standards legislation is one such step.

Impact of professional standards legislation

3.20 According to the Professional Standards Council, professional standards legislation requires participating organisations to have, and continuously improve, systems for self-regulation of their professions for the benefit of the community.[18] From the point of view of insurance companies, this is intended to make participating professionals a better risk to insure. It also serves the desirable social goal of ensuring that those who provide professional services continue to be required to satisfy the highest professional standards.

3.21 Liability caps likewise improve certainty for insurers by allowing a more accurate assessment of the level of their risk exposure. Professionals covered by schemes present to the insurance market an attractive pool of insurable professionals that is actively managing its risk.[19] The outcome of implementing improved standards and liability caps is intended to be reduced premium costs for professionals.

3.22 From the professional viewpoint, caps are likely to reduce insurance premiums in any event as professionals are only required to hold insurance cover, and/or assets up to the level of the cap. They will no longer have the added expense of routinely taking out insurance to protect against catastrophic claims that lie above the level of the cap. Additionally, to the extent that the schemes require insurance cover that is lower than existing policy limits there will be immediate savings for those who are purchasing the cover.

3.23 However, from the point of view of the consumer, there are concerns about the impact of capping liability under professional standards legislation. Ms Jennifer McNeill, Commissioner, ACCC, said:

> In considering capping damages for economic loss caused by misleading and deceptive conduct, one must be cognisant of the fact that capping really shifts the risk from the person best placed to manage the risk to the person

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16 *Transcript of Evidence* (proof copy), 29 March 2004, p.27.

17 *Transcript of Evidence* (proof copy), 29 March 2004, McNeill, p.53.

18 *Transcript of Evidence* (proof copy), 29 March 2004, Wilkinson, p.2.

19 Submission 2, Professional Standards Council, Attachment 1, Submission to the Senate Economics References Committee Inquiry into the impact of public liability and professional indemnity insurance cost increases.

> least able to manage the risk. The loss caused by the conduct is not avoided and does not simply go away because there is a cap on liability. Victims of bad conduct subsidise any resulting constraint or drop in insurance premiums.[20]

3.24 Because of this concern about transfer of risk, a number of witnesses expressed reservations about the introduction of measures to cap liability for professionals as part of professional standards legislation. No submissions were opposed to measures to improve risk management and standards for professionals.

3.25 In the next section, the Committee considers this issue of the transfer of risk to the consumer. It then turns to the question of the nature of the link between professional standards legislation and increased affordability of insurance.

Transfer of risk

3.26 The Australian Competition and Consumer Commission (ACCC) informed the Committee that, while it supports measures to improve professional standards, it does not consider that it is necessary to link those measures to liability caps.[21] Ms McNeill said:

> This transfer of risks alters incentives for professionals such that inefficient levels of care and insurance may be undertaken as a result.[22]

3.27 The Australian Plaintiff Lawyers Association (APLA) also saw the introduction of liability caps as removing any incentive to avoid risky practices by professionals thus introducing a 'moral hazard'.[23]

3.28 The APLA suggested that capping damages may lead to a general erosion of responsibility on the part of professionals to prevent losses occurring and may result in an increase in dangerous and negligently misleading practices. It considered that caps remove the most powerful disincentive against bad behaviour, namely damages commensurate with the loss caused:

> The message to professionals is that no matter how badly you deceive or mislead a client, there is one limit on what you can be charged.[24]

3.29 The APLA also made the point that professional standards legislation has the effect of decreasing the frequency and severity of losses sustained by consumers of professional services, and this is all the more reason why individual cases of large loss

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20 *Transcript of Evidence* (proof copy), 29 March 2004, McNeill, p.53.

21 *Transcript of Evidence* (proof copy), 29 March 2004, McNeill, p.53.

22 *Transcript of Evidence*, 29 March 2004, McNeill, p.53.

23 *Transcript of Evidence* (proof copy), 29 March 2004, Little, p.15; *and* Submission 10, Australian Bankers' Association, p.14.

24 Submission 8, Australian Plaintiff Lawyers Association, p.11.

should be covered by insurance.[25] According to the APLA, the transfer of risk results in losses spread through the community, the cost of which ultimately becomes a burden on the tax system.[26]

3.30 In a similar vein, the Australian Bankers' Association (ABA) contended that capping schemes will make it impossible for firms to fail because of their own negligence. It argued that this is undesirable because it is the fear of failure which is the most significant incentive to produce high quality work.[27] Furthermore, it said, a cap in the context of large transactions and complex work may well be trivial and there is a need to accept a level of risk sufficient to mandate prudence.[28]

3.31 The Committee heard three lines of argument contesting the view that introducing caps on liability unreasonably transfers risk to consumers.

3.32 First, Professions Australia suggested that in some instances, it is the client receiving advice from the professional who is best able to manage the risk of that advice:

> We would contend that a large corporation who is, in a sense, marketing a product—determining who it sells the product to, for what price and under what conditions—is essentially describing the ultimate risk profile of the product and is in a better position to manage the risk than an adviser that is giving specific advice on one particular aspect of it.[29]

3.33 The ABA noted that when there is a systemic transfer of risk to financial institutions this may create a new source of prudential risk.[30] However, while acknowledging the point, Mr Keith Chapman, General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority (APRA), told the Committee that there are many other areas where there are potential limits on liability and that these are routinely taken into account in relation to capital requirements. He said that the prudential standards required when financial institutions choose a professional services firm are the same as those already required when institutions engage in normal outsourcing decisions:[31]

> … the prudential standards on outsourcing put the responsibility where it lies, which is on the institution to pick the provider properly—to have proper due diligence, a proper contractual arrangement and proper risk assessment. The issue with choosing an audit firm, for example, comes

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25 Submission 8, Australian Plaintiff Lawyers Association, p.10.

26 Australian Plaintiff Lawyers Association, Submission 8, p.11.

27 Submission 10, Australian Bankers' Association, p.13.

28 Submission 10, Australian Bankers' Association, p.14.

29 *Transcript of Evidence* (proof copy), 29 March 2004, Malins, p.27.

30 Submission 10, Australian Bankers' Association, p.13.

31 *Transcript of Evidence* (proof copy), 29 March 2004, Chapman, p.51.

> down to: are you getting the best person to do the job? That is far beyond purely: what is the cap on their liability or what is their liability cover within the issue? So I am not saying this does not have an impact. What I am saying is that this impact is little different, in principle, to lots of the other liability impacts that sit there with all the other professions and all the other businesses that do business with our regulated institutions.

3.34 Second, Professions Australia did not accept the proposition that firms enjoying capped liability would be immune from failure. It pointed out that amounts of $20 million or $50 million are not insignificant sums, and a firm suffering a liability claim for that amount of money would be adversely affected in the marketplace, both in its ability to reinsure and in its reputation.[32] It thus contested the view that introducing caps on liability would remove incentives for professionals to avoid poor behaviour.

3.35 Finally, several witnesses suggested that the argument against any transfer of risk to the consumer through introducing caps on liability is misleading, insofar as it assumes that the default situation is genuinely uncapped liability.

3.36 The Insurance Council of Australia (the ICA) noted that uncapped liability is only as good as the insurance held by the defendant. It pointed out that professional indemnity insurance will always have clear limits in relation to the maximum amount of cover provided by the insurance policy. Therefore the availability of unrestricted legal liability will not necessarily be matched by unlimited insurance cover.[33]

3.37 Engineers Australia stated likewise that:

> A right to unlimited damages is of no comfort to consumers when practitioners are underinsured, uninsured or divested of assets. This common situation imposes an arbitrary, inadequate cap.[34]

3.38 Mr Peter McCray, Manager, Financial System Division, Treasury, expressed the opinion that the policy choice reflected by the bill represents an appropriate balance and a sharing of risk between the various parties affected by professional indemnity insurance difficulties. He said that a consumer of a professional service that operates under a capping regime has a reduced likelihood of a claim because the professional is undertaking better risk management. If they have a claim, they are more likely to be compensated because of mandatory insurance cover. The consumer also benefits because professional services are available that might not have been available in the absence of initiatives in this area. The professionals benefit because claims are minimised and they are able to obtain cover at reasonable levels.

> The default comparison, if you like, is not with an uncapped regime where the professional has untrammelled access to insurance and the consumer

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32 *Transcript of Evidence* (proof copy), 29 March 2004, Malins, p.28.

33 Submission 12, Insurance Council of Australia, p.5.

34 Submission 6, Engineers Australia, p.5.

> has all the benefits that go with that. We are not dealing with that as the default scenario. We have been and we are dealing with a scenario of considerable crisis in terms of affordability and availability of insurance.[35]

Committee view

3.39 The Committee referred to the ACCC insurance monitoring reports in order to quantify the likely effect of the transfer of risk from professionals to consumers resulting from the introduction of caps on liability. The reports show that professional indemnity claims over $500,000 that were settled in 2002 constituted only one per cent of total claims settled.[36] Additionally, while the average size of claims settled had increased, it is still well below the proposed minimum cap: in 2002, the average was $19,492 and for the first six months of 2003, the average was $23,248.[37] These findings suggest that the introduction of liability caps will not affect most actions for damages.

3.40 The Committee also notes that the existence of uncapped liability in legal terms does not necessarily translate into an ability for consumers to access uncapped liability in practical terms.

3.41 Nevertheless, the Committee is also concerned that consumers suffering the events of catastrophic negligence not be left without adequate recourse to compensation.

3.42 The Committee turns then to consider the question of the necessity of caps as an element of professional standards legislation.

Nature of the link between caps, improved standards and reduced premium costs

3.43 As noted above, the Professional Standards Council argued that the combination of two elements, namely improved professional standards and caps on liability, will lead to reduced premium costs for professionals.

3.44 The Committee was concerned to establish the relative significance of the two elements within that combination, since some witnesses argued that improved standards alone should deliver the desired improvements in the affordability and availability of insurance.

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35 *Transcript of Evidence* (proof copy), 29 March 2004, McCray, p.56.

36 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance,* Monitoring report, July 2003, p.67.

37 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance,* Monitoring report, January 2004, pp.21-22.

3.45 The two main issues to be considered are, first, the influence of claims volume and spike claims on premium price and, second, the role of caps as an incentive for professionals to adopt improved standards.

Influence of claims volume and spike claims on premium price

3.46 There are two factors which drive affordability and availability of professional indemnity insurance: the probability of a damages claims arising and the likely extent of damages.

3.47 Improved professional standards address the probability or volume of claims arising. The better the risk management frameworks and associated infrastructure that professionals put in place, the less likely it is that there will be conduct resulting in damages claims.

3.48 Placing caps on liability addresses the issue of the extent of damages payable, and in particular the risk of so-called 'spike' or catastrophic claims. When setting premiums, insurers need to have regard to the degree of uncertainty about the size of damages payouts. If there are caps in place they can have more certainty about the volume of damages claims they are likely to have to deal with.

3.49 Witnesses before the inquiry differed about the relative importance of claims volume and spike claims for premium price.

3.50 Several submissions emphasised that the value of liability caps lies in preventing catastrophic insurance damages being awarded. This allows insurance companies to better plan for claims costs which should provide downward pressure on premiums. Professions Australia stated:

> … by eliminating the risk of catastrophic claims, PSL will quickly restore affordability and availability of professional indemnity insurance, once nationally consistent legislation is in place.[38]

3.51 In arguing for the passage of the bill, which removes the possibility of plaintiffs accessing uncapped liability through Commonwealth legislation, Dr David Stephens, Policy Consultant, Professions Australia, told the Committee that:

> … without the amendments in this bill, all of this progress will be nullified. Consumers, professionals and insurers will all fail to receive the benefits that professional standards legislation brings.[39]

3.52 The Committee also notes the advice provided by Mr Timothy Bugg, Executive Member, Law Council of Australia, that capping is an essential part of the solution to professional indemnity insurance problems:

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38 Submission 7, Professions Australia, Attachment, *Protecting Consumers of Professional Services*, p.2.

39 *Transcript of Evidence* (proof copy), 29 March 2004, Stephens, p.26.

> It is part of the solution. The solution consists of a number of arms and capping is one of them. Certainly, capping is seen as an essential part of the scheme.[40]

3.53 However, Mr Dallas Booth, Deputy Chief Executive, Insurance Council of Australia (the ICA) told the Committee that the real benefit of professional standards legislation lies in the improved standards which will result in a reduced number of smaller claims made against firms:

> I would have thought the real issue is not capping at all; the real issue is the number of claims that are coming in around the average claim size level, which, according to ACCC, is $23,000. So whether we are having a debate about a cap at $10 million or $20 million, it is the number of claims for $20,000 to $50,000 that will ultimately drive the price of PI insurance in Australia. The extent to which some professional schemes have already been able to derive improvements from the insurance market may well be a reflection of the fact that the professional schemes have driven better services within those professions—ultimately leading to fewer claims, ultimately leading to lower prices.[41]

3.54 Despite Mr Booth's view of the significance of the volume of smaller claims, the Insurance Council of Australia submission also stated that the existence of uncapped liability at the Commonwealth level has meant that existing schemes have had little, if any, impact on the insurance market in NSW,[42] which is the state that has the longest experience in professional standards legislation.

Committee view

3.55 The Committee was not provided with evidence which would allow it to form a firm view of the relative weight that should be assigned to claims volume and spike claims in driving premium prices.

3.56 However, the Committee notes that the lack of evidence in this area should be remedied to some extent by the monitoring that the ACCC has been asked by the Government to undertake in the public liability and professional indemnity sectors of the insurance. In particular, the ACCC has been asked to give consideration to the impact on insurance premiums resulting from measures taken by governments to reduce and contain legal and claim costs and to improve the data available to insurers to evaluate and price risk. To the extent possible, the ACCC's future monitoring reports will assess the impact made by these measures.

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40 *Transcript of Evidence* (proof copy), 29 March 2004, Bugg, p.27.

41 *Transcript of Evidence* (proof copy), 29 March 2004, Booth, pp.21-22.

42 *Transcript of Evidence* (proof copy), 29 March 2004, Booth, p.22; *and* Submission 12, Insurance Council of Australia, p.5.

Liability caps as an incentive for improved standards

3.57 Some witnesses suggested that, even if it is improved standards that will primarily drive reductions in premium price, caps are needed as an incentive for professionals to join schemes and implement comprehensive risk management strategies.

3.58 Mr Warwick Wilkinson, Chairperson, Professional Standards Council, said:

> I can say there is a great desire in the professions for best practice process but I have to say – and it seems to apply everywhere – that, human nature being what it is, there is a need for an incentive. We have found that this is an effective incentive.[43]

3.59 Similarly, Ms Therese Charles, Chief Executive, Association of Consulting Engineers Australia, said:

> There is no doubt that improvement in standards is a major issue that will in the longer term bring down insurance, but I also think that professionals are going to need the incentive of the cap. My feeling is that the insurers will also need the incentive of a cap to be able to predict what will happen to insurance with particular individuals—that will be necessary in terms of professional standards legislation—and they will need to be certain that people are not going to go around the professional standards legislation by going through loopholes in the Trade Practices Act.[44]

3.60 In other words, the argument is that caps (and the prospect of lower insurance premiums) are the incentive used to entice professionals into professional standards schemes. Once professionals join a scheme, they are obliged to undertake the risk management and other activities referred to previously. Therefore, the improvement in professional standards flows from the schemes rather than from the liability caps themselves.

Committee view

3.61 The Committee was concerned by the suggestion that professionals would not be adopting rigorous risk management procedures and professional standards irrespective of any additional incentive provided by caps. On the other hand, the Committee noted that caps do provide certainty for consumers that professionals who are members of professional standards schemes are adequately covered by insurance. Mr Steven Cole, Council Member, Professional Standards Council, noted that:

> … the cap is one side of the coin; the other side of the coin is the assurance that the consumer has got a claim and that the person against whom the claim is made is worth powder and shot to meet that claim. I think that is the real benefit. It is largely referred to in terms of capping; equally, it

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43 *Transcript of Evidence* (proof copy), 29 March 2004, Wilkinson, p.6.

44 *Transcript of Evidence* (proof copy), 29 March 2004, Charles, p.42.

> should be referred to in terms of assurance of outcome for the consumer and the plaintiff.[45]

3.62 There were two other issues of concern relating to the link between professional standards legislation and the affordability and availability of insurance. These were the time lag between the passage of the legislation and the flow-on reduction in premium prices, and the lack of guarantee that reduction in costs to the insurance industry would in fact result in reduced premiums. The Committee briefly examines those two issues.

Time lag

3.63 While arguing that improved standards and liability caps are expected to improve the affordability and availability of insurance, the insurance industry emphasised that such improvements would take time to become apparent.

3.64 The Insurance Council of Australia (the ICA) informed the Committee that because professional indemnity insurance is usually provided under a 'claims made' policy,[46] any reforms will take some time to have a major impact on the cost of claims. For that reason, savings will take some time to flow through to professional indemnity premiums.[47] Mr Dallas Booth told the Committee that:

> … in the initial years of operation of professional standards legislation, there will be a timing mismatch between occurrence based protection under PSL versus claims-made cover under PI policies, but in due course that timing mismatch will sort itself out.[48]

3.65 The primary impact of the professional standards reforms will be the obligation on professionals to provide a higher quality of service to their customers. According to the ICA this should reduce the number and cost of claims made against professionals under their professional indemnity polices, and the extent to which this occurs will determine the extent to which the insurance market is able to offer more affordable professional indemnity cover to professionals.

Passing on savings in claims costs to policyholders

3.66 There is already some evidence that professional standards schemes can have an impact on the insurance market. For example, according to Professions Australia, the number of claims notified against NSW solicitors fell by almost 50 per cent in two

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45 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.6.

46 'Claims made' policies provide cover to the policyholder in respect of claims made against the professional during the period of the policy, regardless of when the actual loss occurred. Claims may arise out of any negligent act, error or omission that took place many years before the claim is made. (Submission 12, Insurance Council of Australia, p.7)

47 Submission 12, Insurance Council of Australia, pp.7 and 10-11.

48 *Transcript of Evidence* (proof copy), 29 March 2004, Booth, p.20.

years, from 1007 claims in 1999-2000 to 650 claims in 2001-2002.[49] Additionally, the Institute of Chartered Accountants in Australia reported in its submission that a greater availability of insurance cover is already emerging in anticipation of the package of reforms agreed to by Ministers.[50]

3.67 It therefore becomes important that these reduced costs for insurers are passed on to professionals in the form of lower premiums and greater availability of insurance. The APLA was concerned that there is no explicit link between professional standards legislation and lower professional indemnity insurance premiums and availability of insurance.[51] It remarked that:

> Recent experience in other areas of the insurance industry shows that tort reform doesn't decrease premiums, it increases profits.

3.68 The APLA considered that if the overall aim of the bill is to render indemnity cover affordable, then this should be directly covered in the legislation. It submits that at a minimum, the bill should be amended to tie premium price decreases to the introduction of damages caps.[52]

3.69 The Committee heard that the Professional Standards Council does not negotiate directly with the insurance industry to seek premium reductions for professionals in return for scheme participation.[53]

3.70 Professions Australia informed the Committee that, essentially, it is up to the individual professional associations to take advantage of being part of a scheme and to negotiate directly with the insurance companies in relation to premiums.[54]

3.71 The Committee notes that the Government has asked the ACCC to monitor costs and premiums in public liability and professional indemnity insurance to assess the extent to which insurance companies are passing on to consumers the benefits of insurance reforms.

Flexibility of schemes

3.72 The NSW Professional Standards Act is the model on which other states and territories will base their professional standards legislation. However, the Australian Bankers' Association (the ABA) contends that the NSW model is flawed in critical respects, and any framework adopted by other jurisdictions based on such a model

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49 Submission 7, Professions Australia, p.10.

50 Submission 4, Institute of Chartered Accountants in Australia.

51 Submission 8, Australian Plaintiff Lawyers Association, p.11.

52 Submission 8, Australian Plaintiff Lawyers Association, p.12.

53 *Transcript of Evidence* (proof copy), 29 March 2004, Wilkinson, p.12.

54 *Transcript of Evidence* (proof copy), 29 March 2004, Stephens, pp.30-31.

will be similarly flawed.[55] It considers that the Act caps liability in an inappropriate manner because the caps it implements are inflexible.

3.73 The ABA's principal concern is that individual firms cannot 'contract out' of the upper cap on liability unless they are prepared to revert to completely unlimited liability.[56] Contracting out would mean that professional firms could opt for liability caps greater than the caps specified in a scheme. They would be able to opt for higher limits for particular clients, for particular jobs, for particular categories of work or for work of a particular value.[57]

3.74 Although the ABA suggests that the Victorian Professional Standards Act allows contracting out, the Committee understands this is not the case. The Victorian Act contains provisions to give the Professional Standards Council greater flexibility in approving schemes, and section 26 is more detailed than the equivalent section 24 in the NSW Act, but this does not equate to members of an association being able to contract out.

3.75 The ABA argues that the capping mechanism is set and maintained by industry bodies, it is anti-competitive, inefficient, and inequitable and may lead to poorer quality risk management practices.[58] Additionally, it considers that Professional Standards Acts should prohibit schemes which prevent professionals from voluntarily accepting limits higher than scheme limits.

3.76 The ABA advocates the introduction of proportionate liability and the use of limited liability companies. It asserts that both of these could abolish the need for capping entirely.[59] It told the Committee that if the banks were faced with a liability cap from a supplier of services, they would try to find an alternative supplier and would possibly go offshore.[60]

3.77 The Professional Standards Council does not accept that schemes are inflexible. It says that different schemes can apply to different classes of participants in the same professional group. For example, accountants and lawyers have scaled the level of their cap and made it dependent upon the size of the practice base:[61]

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55 Submission 10, Australian Bankers' Association, p.1.

56 Submission 10, Australian Bankers' Association, p.2.

57 Submission 10, Australian Bankers' Association, p.17.

58 Submission 10, Australian Bankers' Association, p.2.

59 *Transcript of Evidence* (proof copy), 29 March 2004, Blignault, p.34.

60 *Transcript of Evidence* (proof copy), 29 March 2004, L'Estrange, p.36; *and* Submission 10, Australian Bankers' Association, p.15.

61 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.4.

> … the cap for a single practitioner accountant is something in the order of $500,000. In the big firms … it can go up to something in the order of $20 million to $30 million.[62]

3.78 The Council told the Committee that some schemes allow for a person to adopt a higher cap within the total range of caps. For example, a two-person practice may opt for a higher cap that would be more common with a 20-partner practice and it could compete on that basis.[63]

3.79 Professions Australia also opposes contracting out. It argues that it would be fatal for professional standards regimes because professionals would be committing to expensive risk management processes and compulsory professional indemnity insurance, but still have to buy as much insurance as they can find and afford. As a result, professionals will leave professional associations rather than join schemes, and schemes will not happen at all, or they will collapse.[64]

3.80 According to Professions Australia, the arguments for contracting out stem from a misunderstanding of how the schemes work:

> In our view all of the problems that need to be dealt with, and that the contracting-out advocates want dealt with, can be addressed through scheme design. Whether you set up a scheme that is a multiple of fees, that depends on the size of the firm or whatever, the main point is that, in the six or eight months that it normally takes for a scheme to go from its first approach to the Professional Standards Council to being authorised by the minister, there would be adequate opportunities for all interested parties, including government purchasers—the big end of town, as we describe them—to provide information about the caps that apply to a particular scheme. There is flexibility of caps within schemes; there is flexibility of caps between schemes. The contracting-out issue is a furphy in a sense.[65]

3.81 The Committee was told that contracting out increases the level of uncertainty from an underwriting perspective. If a profession is made up of businesses which vary in their level of involvement in schemes, underwriters will rate the business according to the claims experience of the profession as a whole, and those who are within a scheme are less likely to get real benefit from it.[66]

3.82 The professional organisations say that the push for contracting out comes from big players, such as banks and government tender managers, who occasionally

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62 *Transcript of Evidence* (proof copy), 29 March 2004, Wilkinson, p.10.

63 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.10.

64 *Transcript of Evidence* (proof copy), 29 March 2004, Stephens, pp.26-27.

65 *Transcript of Evidence* (proof copy), 29 March 2004, Stephens, p.30.

66 *Transcript of Evidence* (proof copy), 29 March 2004, Booth, p.23; *and Transcript of Evidence* (proof copy), 29 March 2004, Harrison, p.41.

sue professional firms for hundreds of millions of dollars.[67] This can be seen as a transfer to professionals via professional indemnity insurance of the entrepreneurial risk in the corporate sector and the public sector risk in the government sector.[68]

3.83 The ACCC view is that if capping is considered desirable, firms should be permitted to compete on caps.

> If the services of firms which choose not to cap are more expensive than those which choose to cap, the market either will or will not be prepared to pay that premium.[69]

Committee view

3.84 The Committee accepts the view of the professions that if contracting out is permitted it will defeat the purpose of professional standards legislation. At the end of the day, participation in schemes is a voluntary decision made by professionals. If the implementation of caps is of sufficient concern to clients, such as banks, that they look elsewhere for professional services, the Committee presumes that professionals will have taken that possibility into account when they decide to establish a scheme.

3.85 The Committee envisages that professionals' involvement in schemes will become another factor on which they can differentiate their fees. For the most part, professional standards legislation is aimed at the small to medium sized business and businesses in regional areas which are less likely to be engaged in work for the larger clients who have concerns about liability caps.

Competition issues

3.86 According to some submissions, current difficulties in the professional indemnity insurance market are reducing competition. For example, Engineers Australia discussed the impact that higher premiums are having on the number of firms able to practise in a profession. It concludes that smaller practices are going out of business because they cannot absorb the cost increases in insurance to the same extent as large firms.[70]

3.87 Additionally, smaller practices which cannot get insurance, are unable to gain work, and therefore must close their business. These practitioners either leave the profession or seek employment with a larger firm. Under both scenarios there are fewer firms practising their profession and a consequent reduction in competition. Reforming the professional indemnity insurance market should improve competition among professional organisations.

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67 *Transcript of Evidence* (proof copy), 29 March 2004, Stephens, p.26.

68 *Transcript of Evidence* (proof copy), 29 March 2004, Stephens, p.27.

69 *Transcript of Evidence* (proof copy), 29 March 2004, McNeill, p.53.

70 Submission 6, Engineers Australia, p.3.

3.88 However, the Australian Bankers' Association (the ABA) considers that capping schemes themselves are anti-competitive in two ways. First, the ABA asserts that in establishing such schemes, industry associations are potentially playing an anti-competitive and anti-consumer role.[71] This is because professional associations, in conjunction with the Professional Standards Council, set the level of the caps rather than individual firms or the market generally. The ABA argues that occupational associations are most likely to act in the interests of their members and not in the interests of consumers.

3.89 To counter this, the ABA considers that the ACCC should review capping schemes. It suggests that no scheme should be permitted unless the ACCC has vetted it for anti-competitive features and decided its anti-competitive effects are no larger than are strictly necessary to achieve the goal of capping, namely to ensure that insurance remains affordable. Additionally, the ABA recommends that the power to approve higher caps should be removed from the occupational association and it should be open to members unilaterally to specify a higher limit of liability, ideally without approval by any person. Failing this, some authority that acts in the interests of consumers (such as the ACCC), should be the approving body rather than professional associations.[72]

3.90 The ABA's second argument against caps is that if firms are unable to choose a higher liability cap, they cannot compete on the basis that their skill, efficiency, and risk management practices might enable them to accept a liability limit larger than that specified in a scheme. This will entrench major players and preclude new entrants from gaining a foothold. Further:

> This rewards poor risk management. It penalises innovation and strong risk management. It chills competition on the basis of quality and will ultimately lead to poorer quality … services than would be available if firms were allowed to compete on the basis of liability caps. This harms consumers and the efficient operation of the economy at large.[73]

Committee view

3.91 In response to the ABA's first argument, the Committee notes that it is the Professional Standards Councils, who do not represent the professions, that set the level of the caps. The persons appointed to the Council are not the representatives of the professions or any other occupational group or interest and are appointed to pursue the public interest purposes of professional standards legislation.[74]

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71 Submission 10, Australian Bankers' Association, p.7.

72 Submission 10, Australian Bankers' Association, p.8.

73 Submission 10, Australian Bankers' Association, p.11.

74 Bernie Marden, *High Aims for Professional Standards Legislation*, at: http://www.lawlink.nsw.gov.au/lawlink/professional_standards_council/psc_ll.nsf/pages/PSC_index, p.2, viewed on 12 February 2004.

3.92 According to Mr Cole from the Professional Standards Council:

> [Setting caps] is probably one of the more intensive areas of interrogation of the council's work—to ensure that there is rigour in the assessment of claims history for that particular profession and for the class covered by that particular scheme, with detailed actuarial advice taken to ensure that the cap is reasonably adequate for the purposes.[75]

3.93 In response to the second, the Committee notes again that participation in professional standards schemes is voluntary.

Sunset clauses

3.94 Because of the uncertainty about the causes and likely resolution of the difficulties surrounding professional indemnity insurance, the Australian Plaintiff Lawyers Association (APLA) and the Australian Bankers' Association (the ABA) suggest that the schemes should contain sunset clauses. This would entail that professional organisations would resubmit their schemes each year on the basis that they still do not have ready access to insurance:

> If the insurance crisis heals itself and we find that people can still get reasonable cover, there will no longer be a need for this scheme to limit people's liability.[76]

3.95 In response to this suggestion, however, Mr Stephen Harrison, Chief Executive Officer, Institute of Chartered Accountants of Australia, said:

> … it seems to me to be quite ludicrous to suggest that there might be an annual review. The marketplace and all the factors that are involved in such a scheme would make it ludicrous to go back and have an annual review of the process. They are on five-year cycles, and there is then an appropriate opportunity for schemes to be reviewed.[77]

3.96 Aside from the practical difficulties of this approach, the Committee notes that effectively there is a sunset clause in the state Acts. Schemes remain in force for a period as determined by the Professional Standards Council, but not to exceed five years. They may be extended but for not more than a further year.

Retrospectivity and transparency

3.97 Some witnesses were concerned that the caps on liability would operate retrospectively:

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75 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.5.

76 *Transcript of Evidence* (proof copy), 29 March 2004, Cochrane, p.15.

77 *Transcript of Evidence* (proof copy), 29 March 2004, Harrison, p.41.

> Why should we allow the professions an unlimited cap on causes of action that accrued long before they introduced higher levels of risk management?[78]

3.98 The Committee notes that the state legislation is not retrospective. It specifies that a scheme limits the occupational liability in respect of a cause of action founded on an act or omission occurring during the period when the scheme is in force.[79]

3.99 Additionally, the Australian Competition and Consumer Commission is of the view that caps should be disclosed to consumers whether they are individuals or businesses. The Committee notes that the Acts contain provisions mandating that clients and prospective clients are informed that the professional's liability is limited.[80] For example, subsection 33(1) of the NSW Act reads as follows:

> **33 Notification of limitation of liability**
>
> (1) If a person's occupational liability is limited in accordance with this Part, all documents given by the person to a client or prospective client that promote or advertise the person or person's occupation, including official correspondence ordinarily used by the person in the performance of the person's occupation and similar documents, must carry a statement to that effect.[81]

78 *Transcript of Evidence* (proof copy), 29 March 2004, Cochrane, pp.15-16.

79 For example, Section 28, *Professional Standards Act 1994* (NSW); and Section 30, *Professional Standards Act 2003* (Vic).

80 For example, Section 33, *Professional Standards Act 1994* (NSW); and Section 35, *Professional Standards Act 2003* (Vic).

81 Subsection 33(1), *Professional Standards Act 1994* (NSW).

CHAPTER 4

EVIDENCE ON THE BILL

4.1 Evidence provided on the bill before the Committee focused on the following three issues:

- the need to close loopholes provided by Commonwealth legislation;
- the scope of the bill; and
- the mechanism to prescribe professional standards schemes.

4.2 The Committee discusses each of these issues in turn.

The need to close loopholes provided by Commonwealth legislation

4.3 The purpose of the bill before the Committee is to ensure that plaintiffs cannot, by framing proceedings for damages for misleading and deceptive conduct under the Trade Practices Act or other Commonwealth legislation, avoid the schemes established by the state Acts. In short, the bill aims to prevent 'forum shopping' which might undermine the efficacy of state professional standards legislation in limiting the liability of participating professionals.

4.4 There was debate in evidence to the Committee about the need to close these avenues of redress under Commonwealth laws.

4.5 Some submissions argued that, although professional standards schemes have been in operation for several years in NSW, the Trade Practices Act and other Commonwealth legislation undermine their efficacy and provide a means to avoid the operation of schemes. For example, the Professional Surveyors' Occupational Association NSW Inc described in its submission that it established a professional standards scheme, but lost 68 from a total of 151 members who resigned from the scheme. The reasons given for this were:[1]

- the failure of the scheme to protect against claims brought under the Trade Practices Act;
- the failure of the scheme to cover for work undertaken outside of NSW; and
- no differentiation in insurance premiums to scheme members.

4.6 Engineers Australia also offered a scheme to its members between 1996 and August 2000, for which there was a very low take up rate. The association blamed the

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1 Submission 3, Professional Surveyors' Occupational Association NSW Inc.

fact that the limits on liability given under state law could be bypassed by actions brought under the Trade Practices Act, as well as there being no national coverage of professional standards legislation.[2]

4.7 Furthermore, although both NSW and Western Australia have had professional standards legislation for some time now, the Insurance Council of Australia suggests that exposure of professionals under Commonwealth laws during the period has meant that existing schemes in these states have had little, if any, impact on the insurance market.[3]

4.8 Witnesses who support the bill also claim that not only are damages payouts under Commonwealth law uncapped, but that it is easier for claims to succeed, providing ample incentive to bypass the state laws where possible. For example, the Institute of Chartered Accountants argues that claims under section 52 of the Trade Practices Act are broader and defences narrower than claims under common law, and that Trade Practices Act liability is more onerous than common law as, for example, foreseeability of damage is not a test and there is no contributory negligence to mitigate damages.[4]

4.9 However, while submissions referred to the increasingly routine use of section 52 of the Trade Practices Act to bring an action against professionals where it is alleged professional negligence has occurred,[5] the evidence about the practice seems to be more anecdotal than concrete. Mr John Little, ACT President, Australian Plaintiff Lawyers Association, observed:

> We do not know how many instances there are where the imposition of Commonwealth legislation has undermined state PSL. There seems to be no data. People have some feeling, some concept—some premonition perhaps—but I do not think there is any data around at all.[6]

4.10 Stage One of the *Review of the Impact of the Trade Practices Act on the Operation of Professional Standards Schemes* (December 2002), conducted by Professor Christopher Arup for the Professional Standards Council, found that:

- … there is a disappointing lack of systematic and consistent data on claims …

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2 Submission 6, Engineers Australia, p.4.

3 Submission 12, Insurance Council of Australia, p.5.

4 Submission 4, Institute of Chartered Accountants in Australia.

5 For example: *Transcript of Evidence* (proof copy), 29 March 2004, Malins, p.46; Submission 2, Professional Standards Council, Attachment 2, *Review of the impact of the Trade Practices Act on the Operation of Professional Standards Schemes*, December 2002; *and* Submission 3, Professional Surveyors' Occupational Association NSW Inc.

6 *Transcript of Evidence* (proof copy), 29 March 2004, Little, p.14.

- the claims administrators are reluctant to put a figure on the proportion of claims in which the Trade Practices Act (TPA) features, but they recognise its presence and believe it to be growing …

- the feed-back indicates that the TPA has not yet taken the amounts of compensation beyond the caps for civil liability; the caps themselves have not been exceeded …

- while they cannot quantify it, the professional associations are concerned about the potential of the TPA to found a one-off claim that is catastrophic, a 'spike' in the graph of claims experience.[7]

4.11 The Committee is also mindful of the evidence given by the ACCC to its inquiry into the Trade Practices Amendment (Personal Injuries and Death) Bill 2003, where the ACCC noted that it is common practice among legal practitioners to plead section 52 as an alternative claim to their primary pleading of negligence. However, if the court decides the case on the negligence claim it will not rule on the alternative pleading of the section 52 claim. Consequently, while section 52 is pleaded regularly it is not reflected in the statistics, because it is not a factor that influences the final decision.[8]

4.12 In relation to the Committee's current inquiry, the ACCC indicated that it was unconvinced that an increase in Trade Practices Act claims has caused the difficulties in professional indemnity insurance.[9]

4.13 The APLA was also sceptical about the assertions made in relation to the issue:

> The Trade Practices Act has been around for 30 years and some would say it has done a very good job. The common law of negligence, as we understand it, has probably been around for over 70 years. I do not think that any of the submissions to this committee have demonstrated that there is anything particularly broken about the Trade Practices Act or the common law that requires a piece of Commonwealth legislation to cure a problem that no-one can actually identify.[10]

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7 Submission 2, Professional Standards Council, Attachment 2, *Review of the impact of the Trade Practices Act on the Operation of Professional Standards Schemes*, December 2002, pp.1, 2 and 3.

8 Economics Legislation Committee, *Provisions of the Trade Practices Amendment (Personal Injuries and Death) Bill 2003*, August 2003, p.7.

9 *Transcript of Evidence* (proof copy), 29 March 2004, McNeill, p.53.

10 *Transcript of Evidence* (proof copy), 29 March 2004, Little, p.15.

4.14 However, the Committee notes that in many cases witnesses were expressing concern about the potential use of section 52 once professional standards legislation was established nationally, rather than about an existing phenomenon. Professor Arup's review noted that:

- [professional associations] expect greater 'migration' to the TPA, as reforms limit civil liability;
- the insurers and legal practitioners expect increasingly creative use of the TPA, though at the same time they sense that the claims from commercial disputes, are easing off.[11]

Committee view

4.15 The Committee accepts the possibility that certain plaintiffs will look for other avenues of redress if they find that their claim for damages will be limited by state legislation. However, this argument would have more weight were there to be more evidence of its occurrence in New South Wales. The NSW legislation has been in operation since 1995 and has presumably provided ample opportunity for plaintiffs to attempt to bypass it at the Commonwealth level.

Scope of the bill

4.16 As noted earlier, the bill aims to prevent forum shopping between federal and state jurisdictions in relation to contraventions of Commonwealth Acts for misleading and deceptive conduct. It targets section 52 of the Trade Practices Act and similar provisions of the Corporations Act (section 1041H) and the Australian Securities and Investment Commission Act (section 12DA).

4.17 Some submissions[12] consider that, in addition to these sections, there are other provisions in the Trade Practices Act, also replicated in other areas of Commonwealth law, that should be targeted by the bill. For example, the Insurance Council of Australia suggested that the continuing availability of alternative remedies under Commonwealth legislation may limit the extent of any beneficial impact of reform on professional indemnity insurance.[13]

4.18 Additional provisions referred to by witnesses include the following:

- provisions regulating disclosure of information such as those found in the Corporations Act;

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11 Submission 2, Professional Standards Council, Attachment 2, *Review of the impact of the Trade Practices Act on the Operation of Professional Standards Schemes*, December 2002, p.3.

12 For example, Submission 2, Professional Standards Council; Submission 7, Professions Australia, p.13; Submission 9, Law Council of Australia, p.4; *and* Submission 12, Insurance Council of Australia, pp.8, 9 and 11-12.

13 Submission 12, Insurance Council of Australia, p.8.

- provisions such as sections 71 and 74 of the Trade Practices Act imposing warranties in respect of the supply of goods or the supply of services;[14] and

- provisions covering unconscionable conduct, unfair practice and false representations, misleading conduct, and other conduct.[15]

4.19 The ICA considers that the bill should completely close the gap between liability caps under state and territory professional standards schemes and any remedies available under Commonwealth law. It is concerned that the purpose of the bill will not be achieved with its current, limited scope. Professions Australia also considers that the coverage of the bill should be broadened to include other potential heads of liability.[16]

Committee view

4.20 The Committee notes the view of the ACCC that a minimalist and incremental approach needs to be adopted to any reform of the Trade Practices Act. Additionally, given that the evidence about Commonwealth laws being used to bypass professional standards legislation is not clear, the Committee considers that the scope of the bill should not be widened at this stage. However, the Committee recommends that the Government monitor the legislation having regard to the concerns raised by submissions before the inquiry, with a view to possible legislative reform in the future.

Mechanism to prescribe professional standards schemes

4.21 The application of state professional standards laws to contraventions of specific provisions in Commonwealth Acts outlined in the bill will only occur in relation to schemes that have been prescribed by Commonwealth regulations. The bill gives the Commonwealth a reserve power to modify such schemes and also to disregard amendments or revocations to schemes made subsequent to the original prescribing of the scheme. This reserve power is problematic for some.

4.22 A number of submissions were concerned at the effect that the power would have on the efficacy of the state legislation in general and on the Professional Standards Council in particular.[17] The Law Council of Australia[18] and Professions Australia believe that the reserve power is superfluous:

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14 Submission 12, Insurance Council of Australia, p.9.

15 Submission 2, Professional Standards Council.

16 Submission 7, Professions Australia, p.13.

17 For example: Submission 2, Professional Standards Council; Submission 7, Professions Australia, p.12; *and* Submission 9, Law Council of Australia, p.4.

18 Submission 9, Law Council of Australia, p.4.

> The Commonwealth will be represented on the national PSC [Professional Standards Council], which will have the task of approving schemes from all States and Territories. It would be a threat to the viability of the PSC if the Commonwealth had a 'second bite' at schemes via a reserve power.[19]

4.23 Professions Australia considers that if a minister is of the view that a scheme needs to be amended, it is appropriate that the scheme be returned to the Professional Standards Council for further assessment and consultation. Allowing the Commonwealth to amend schemes gives it a power not held by the state and territory ministers. For example, while the state or territory ministers give final authorisation to schemes, they may decide not to authorise the schemes but they do not have the power to amend them. If they require an amendment to an authorised scheme, they must direct the Professional Standards Council to prepare such an amendment.

4.24 Therefore, Professions Australia argues that similar powers should apply to the Commonwealth Minister as they do to state and territory ministers:

> A ministerial power to amend, whether lying with the Commonwealth or state Minister, would dilute the independence of the Professional Standards Council, a core principle of the model.[20]

4.25 The Professional Standards Council believes that the reserve power allows the Commonwealth to choose unilaterally which approved schemes it will adopt (scheme-by-scheme, state-by-state) and also to change schemes at will.[21] The process by which professional standards schemes are approved by the Professional Standards Councils is a public process, as is the basis upon which an approval decision is made. The Council considers that in contrast to this process the bill provides no clear and expressed basis upon which the Commonwealth must base its actions. Consequently, the Council holds that the bill undermines its role and is inconsistent with the professional standards legislation approach for prescribing schemes into law.

4.26 The Council considers that the Commonwealth should recognise, without alteration, all schemes and caps that go through the professional standards legislation approval process as this process is sufficiently rigorous and transparent to protect consumers. The Commonwealth, along with the general public, already has sufficient opportunity to scrutinise schemes in their formative stages during the period of public consultation prior to their approval.[22]

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19 Submission 7, Professions Australia, p.12.

20 Submission 7, Professions Australia, p.12.

21 Submission 2, Professional Standards Council.

22 *Transcript of Evidence* (proof copy), 29 March 2004, Wilkinson, p.11.

4.27 The Law Council of Australia also expressed concern that this reserve power suggests a lack of confidence in the professional standards process, which is not warranted by the experience with such schemes to date:[23]

> The inclusion of the power must raise a question mark over how effective the Bill will be over time, as it raises the possibility of high-level federal political intervention into the details of schemes becoming the norm.

4.28 Another problem with the Commonwealth having its own requirements for schemes was outlined by the Professional Surveyors' Occupational Association NSW Inc, which drew the Committee's attention to the difficulties for professional organisations in trying to meet the requirements of two different jurisdictions. For example, it was concerned about the possible duplication of effort necessary to meet both state and federal requirements in relation to preparing schemes:[24]

> The process of preparing a scheme that was acceptable to the Professional Standards Council in New South Wales required considerable effort. Ample opportunity was given for amendments to fulfil the legislative requirements of the Act including a time of public display before gazettal. For administration purposes we are concerned that there should only be one scheme that meets the requirements of both state and federal bodies. In our opinion if amendments are required to meet federal requirements these should be advised at the time of application or renewal so that gazettal at state and federal levels can be achieved at the same time.

4.29 This point was echoed in the Professional Standards Council evidence, when Mr Cole told the Committee that while the Council would welcome any input from the ACCC or the Commonwealth, the most efficient way of receiving that input would be at a primary determination level. To have one body process schemes and pass them to another body would be an inefficient process.[25]

4.30 Other submissions, however, take the opposite view. The Australian Bankers' Association has significant concerns with the legislation, but advocates a solution based on the Commonwealth making full use of its power to ensure that the state schemes prescribed in Commonwealth regulations conform to certain minimum standards specified in the regulations.[26] The APLA too suggests that the Commonwealth use the power to be more prescriptive in its requirements of state schemes.[27]

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23 Submission 9, Law Council of Australia, p.5.

24 Submission 3, Professional Surveyors' Occupational Association NSW Inc.

25 *Transcript of Evidence* (proof copy), 29 March 2004, Cole, p.11.

26 Submission 10, Australian Bankers' Association, pp.4-5.

27 *Transcript of Evidence* (proof copy), 29 March 2004, Cochrane, p.16.

Committee view

4.31 The Committee notes Mr Wilkinson's comment that the basic responsibility for professional standards legislation lies with the states.[28] It also recognises, however, that the basic responsibility for Commonwealth legislation lies with the Commonwealth.

4.32 Because the policy issues in relation to the regulations are still to be determined, there is little the Committee can comment on, as it is unaware on what basis the Commonwealth intends to use the power. However, the Committee considers that it is prudent for the Commonwealth to retain an element of control when it comes to applying state legislation to actions brought under Commonwealth Acts.

Conclusion

4.33 All state, territory and commonwealth governments have agreed to the introduction of professional standards legislation, along with supporting amendments to Commonwealth legislation.

4.34 Given that the amendments in the bill will only apply in relation to professionals that participate in professional standards schemes, and that participation in the schemes is voluntary, the Committee considers on balance that the benefits expected to be obtained from the schemes outweigh the cost of restricting the rights of certain plaintiffs.

Recommendation 1

The Committee recommends that the Senate pass the bill.

Senator George Brandis
Chairman

28 *Transcript of Evidence* (proof copy), 29 March 2004, Wilkinson, p.11.

MINORITY REPORT BY LABOR SENATORS

This Bill is intended to support professional standards schemes developed under State and Territory law. These schemes involve a trade off. In return for a cap on their liability, professionals agree to adopt improved risk management strategies, compulsory insurance cover, professional education and stringent complaints and disciplinary procedures.

Labor members support improved professional standards. The evidence presented to the Committee clearly indicated that it is better standards that will ultimately drive down the cost of professional indemnity insurance. Improved standards will lead to fewer errors, less litigation against professionals and lower claims costs.

The key issue before the committee centred on the role of caps on liability as part of professional standards schemes.

Labor Senators have a number of concerns about capping.

Firstly, as a matter of principle, capping involves the transfer of risk from professionals to consumers of professional services. Liability for losses above the cap is transferred to consumers. Labor Senators agree with the ACCC's view that 'capping really shifts risk from the person best placed to manage the risk to the person least able to manage the risk".[1] One possible effect of the introduction of a cap is that professionals may be less diligent in assessing risk.

Secondly, capping raises the risk of losses being borne by taxpayers. While the explanatory memorandum states that this Bill has no financial impact on the Commonwealth, this is clearly incorrect. The Commonwealth is a large consumer of professional services. Its ability to recover for losses sustained as a result of misleading conduct by its contractors will be constrained by any cap that is in force under this legislation. Liability for losses above the cap is effectively transferred to the taxpayer.

Most fundamentally, we are disturbed by the fact that some professionals need an incentive in the form of capping in order to lift professional standards. It is clearly in the interests of the professions to improve standards. Labor Senators endorse the view expressed in the Government's CLERP 9 paper in September 2002 which stated:
"While the objective of improving professional standards, including the introduction of compulsory professional indemnity insurance and risk management programs is admirable, professional bodies should be implementing such measures as a matter of best practice and should not require the incentive of a capping regime to achieve them."[2]

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[1] Transcript of Evidence (proof copy), 29 March 2004, McNeill, p. 53.

[2] Corporate Law Economic Reform Program, *Paper No.9: Proposals for Reform –Corporate Disclosure*, September 2002, p.100.

Effect of capping on premiums

Evidence from the Insurance Council Australia indicates that capping is essentially irrelevant to professional indemnity premiums. While supportive of the Bill, Mr Booth, the Chief Executive of the Insurance Council of Australia told the Committee

"I would have thought that the real issue is not capping at all; the real issue is the number of claims coming in around the average claim level'[3]. He went on to say that "the true claims cost in PI is driven by the $20,000 to $50,000 claims, not the $20 million claims'.[4] In the ICA's view it is improved standards that will bring down premiums overtime.

Insurers can and do already cap their liability by capping the amount payable under a professional indemnity policy. In no way does capping give insurers any certainty that they do not already have now.

The professions themselves admitted that the push for capping under professional standards schemes is not a response to the recent difficulties in obtaining professional indemnity cover. The Professional Standards Council stated the professional groups have been campaigning for a cap for around 20 years.[5]

Labor Senators believe that, other reforms, particularly the introduction of proportionate liability, are more likely to have a significant impact on premiums.

Contracting Out of Caps

Notwithstanding our concerns about the impact of caps, Labor Senators note the view of State and Territory Governments that professional standards schemes involving caps are necessary to improve protection for consumers through the introduction of compulsory insurance and improved disciplinary measures for professionals.

Labor Senators believe that some of the concerns with capping outlined above can be ameliorated by ensuring that caps applied under professional services schemes are sufficiently flexible.

State and Territory governments have acknowledged the importance of flexibility. At the Meeting of Insurance Ministers in Hobart in February 2004 all Governments agreed "that any legislation or schemes being developed should be flexible enough to meet the concerns of large purchasers of professional services".

The Committee was told that caps are set by Professional Standards Council to capture all consumer claims and 95 per cent of commercial claims. Large consumers of professional services such as banks and the property industry have argued that it should be possible to negotiate higher caps to reflect the nature of their business.

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[3] Transcript of Evidence (proof copy), 29 March 2004, Booth, p. 21.

[4] Ibid, p.22.

[5] Transcript of Evidence (proof copy), 29 March 2004, Wilkinson, pp 36/

These groups have argued that all professional standards schemes should allow contracting out. That is, professionals should have the capacity to accept liability greater than caps specified in the scheme on a case by case basis. The Australian Banker's Association put forward an amendment to the Bill specifying that no professional schemes should be designated under Commonwealth law unless they permitted contracting out.

Professional groups have opposed contracting out arguing that:

- It would force professionals to buy insurance above the cap and
- Erode the benefits of being in the scheme because insurers will underwrite on the basis that the capping scheme does not exist.

Labor Senators are not persuaded by these arguments.

In assessing the case for contracting out it, it is necessary to consider the likely reaction to large consumers of professional services to the introduction of a cap.

The ABA indicated that banks would respond to higher caps by seeking to find firms outside a scheme or going offshore to purchase professional services.[6] Labor Senators believe that this also likely to be the response from other large consumers.

A prohibition on contracting out will not force consumers to do business with professionals covered by a scheme. It would however prevent members of schemes from negotiating a cap acceptable both to them and the consumer.

While no professional would be forced to contract out, if they did they would have need to find insurance. Insurers would decide whether they wanted to take on this extra risk and at what price. Presumably the cost of that extra insurance is something that would be reflected in the price charged by the professional contracting out of a scheme to the consumer.

Contracting out would allow firms to compete on the basis of their risk management practices. Labor Senators note the view of the ACCC that if capping is considered desirable 'firms should be permitted to compete on caps'.[7]

Labor Senators do not accept that permitting contracting out would defeat the purpose of legislation. The purpose of legislation is to improve professional standards. Professionals would still have an incentive to join the scheme because they would still obtain capped liability. As the majority report notes 'for the most part, professional standards legislation is aimed at the small and medium business and business in regional areas which are less likely to work for the larger clients who have concerns about liability caps."[8]

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[6] Transcript of Evidence (proof copy), 29 March 2004, L'Estrange, pp 36/37.

[7] Transcript of Evidence (proof copy), 29 March 2004, McNeill, p. 53.

[8] Paragraph 3.85

Labor Senators understand that the question of whether schemes should permit contracting out is currently being considered by a working party of State Government officials.

One option under consideration is the approach in the Victorian legislation which allows a firm to apply to their professional association seeking a higher cap.

It is not clear to Labor Senators why the professional association should have this 'gatekeeper' role. There is a potential that such a mechanism could operate anti-competitively. It allows a professional organisation to refuse to allow one of its members to compete on the basis of better risk management procedures.

Labor Senators believe that it would be preferable to await the outcome of the deliberations of the working group before this Bill is debated in the Parliament. While this Bill is designed to support State and Territory professional services legislation, the Commonwealth Parliament still does not know the final shape of that legislation.

If however the Government wishes to proceed with the Bill before the working group has reported, Labor Senators believe that the Bill should be amended to provide that no schemes will be prescribed under Commonwealth law unless they permit contracting out.

Senator Ursula Stephens
Deputy Chair

Appendix 1

SUBMISSIONS RECEIVED

Submission Number	Submittor
1	Western Australia Government
2	Professional Standards Council
3	Professional Surveyors' Occupational Association Inc
4	Institute of Chartered Accountants in Australia (ICAA)
5	Association of Consulting Engineers Australia (ACEA)
6	Engineers Australia
7	Professions Australia
7a	Professions Australia
8	Australian Plaintiff Lawyers Association (APLA)
9	Law Council of Australia
10	Australian Bankers' Association (ABA)
11	Queensland Government
12	Insurance Council of Australia
13	Northern Territory Government
14	Property Council of Australia

Appendix 2

PUBLIC HEARING AND WITNESSES

MONDAY, 29 MARCH 2004 – CANBERRA

ANTICH, Mr Robert, General Manager, Compliance Strategies Branch
Australian Competition and Consumer Commission

BLIGNAULT, Mrs Ardele, Director, Government and Stakeholder Relations
Australian Bankers' Association

BOOTH, Mr Dallas, Deputy Chief Executive
Insurance Council of Australia

BUGG, Mr Timothy Gerard, Executive Member
Law Council of Australia

CHAPMAN, Mr Keith, General Manager, Diversified Institutions Division
Australian Prudential Regulation Authority

CHARLES, Ms Therese Anne, Chief Executive
Association of Consulting Engineers Australia

COCHRANE, Mr Benjamin Robert, Legal and Policy Officer
Australian Plaintiff Lawyers Association

COLE, Mr Steven, Council Member
Professional Standards Council

HARDWICKE, Ms Leanne, Director, Public Policy
Engineers Australia

HARRISON, Mr Stephen Barry Morgan, Chief Executive Officer
Institute of Chartered Accountants in Australia

L'ESTRANGE, Mr Timothy Ignatius, Member
Australian Bankers' Association

LITTLE, Mr John, ACT President
Australian Plaintiff Lawyers Association

MALINS, Mr James Peter, Consultant Advising on Professional Liability Issues
Professions Australia

McCRAY, Mr Peter, Manager, Financial System Division
Department of the Treasury

McNEILL, Ms Jennifer, Commissioner
Australian Competition and Consumer Commission

MINTY, Mr David Julian, Partner, Trowbridge Deloitte
Fellow of the Institute of Actuaries of Australia; and Consultant
Professions Australia

O'SULLIVAN, Mr John Kevin, Member
Australian Bankers' Association

STEPHENS, Dr David Hector, Policy Consultant
Professions Australia

TAYLOR, Mr Peter, Chief Executive
Engineers Australia

TEMPERLEY, Mr Raymond Thomas, Senior Adviser
Competition and Consumer Policy Division
Department of the Treasury

WILKINSON, Mr Warwick, Chairperson,
Professional Standards Council