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Senate Economic Legislation Committee

Inquiry into the Treasury Legislation Amendment (Professional Standards) Bill 2003

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Part one – Executive Summary

1.1 APLA

This document has been prepared by APLA Lawyers for the People, in response to an invitation from the Senate Economics Committee to contribute to its report to the Senate on the *Treasury Legislation Amendment (Professional Standards) Bill 2003* (the Bill). APLA welcomes the opportunity to comment on the Bill.

1.2 The Bill

The Bill brings remedies for misleading and deceptive conduct contained in Commonwealth legislation within the ambit of state professional standards legislation (PSL). PSL sets standards for professional conduct and regulation and limits damages payable for breach of those standards.

APLA opposed the introduction of state PSL and opposes the expansion of these laws into the federal sphere. The *Trade Practices Act 1974* (TPA) and allied corporate and securities legislation provide important, and now well understood, restraints on professionals providing services to consumers. It plays an important role in ensuring that services provided to consumers are safe, honest and reliable.

1.3 Tort reform?

The current Bill is part of the reform of the law of negligence that has recently swept state and federal legislatures. This reform starts from the position that damages awards are unsustainable and need to be limited to allow insurance to function effectively.¹

To date there has been no statistical support showing damages claims, or awards, to be increasing. The evidence is to the contrary. 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.

The posting of record profits across the Australian insurance industry shows that the private insurance industry does not need legislative support at the cost of consumers: It is thriving.

1.4 Alternatives

This submission considers the effect of the Bill, which is essentially to bring Commonwealth remedies within the scope of State law. It then moves on to consider the function and effect of PSL at the state and territory level.

Some aspects of PSL are welcomed by APLA. The capping of damages awards is not one such aspect. Capping damages simply moves the risk associated with the provision of professional services away from the parties best able to manage that risk; professionals themselves and their insurers, and places it with consumers.

¹ The Honorable David Andrew Ipp *et al*, "Review of the Law of Negligence – Final Report" September 2002
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Moreover, once consumers are saddled with losses that they cannot recover from the professional who misled or deceived them, the real costs will frequently be passed on to government as small business people are forced onto welfare and the elderly from superannuation to the pension.

APLA submits that all the recommendations contained in PSL are sensible and progressive attempts to decrease the risk of professional practice – barring only caps to damages. As the effect of the current Bill is to render those caps applicable to remedies available under Commonwealth law, APLA opposes the Bill.

1.5 Conclusion

Although APLA members are professionals and would benefit from caps on damages, we always consider the benefits to our members as secondary to supporting what is right, or speaking out against what we see as wrong.

Self-interest would dictate that we support this Bill. We cannot, however, in the interests of the consumers of professional services support the capping of damages where loss has occurred through the misconduct of a professional.

The submission concludes with a number of illustrations of the egregious and unjust outcomes that would result from the passage of the Bill.

Part two – Background

2.1 Insurance crisis

The call to limit the 'exponential increase in professional indemnity premiums'² is not an isolated insurance issue. Premiums in all classes of insurance have increased substantially in recent times.

Insurance is a necessary product in our society. It provides security for the insured as well as those who suffer injury. Insurance is widely accepted as a necessary business expense and provides peace of mind knowing that if an injury or loss occurs, fair and just compensation can be paid to the victim.

However, recently the cost and availability of insurance has been a problem with increasing premiums and the threatened withdrawal of coverage in certain areas. Various groups have entered the debate over this issue, and many differing views have been brought forward to explain the underlying causes and possible solutions.

2.2 Litigation explosion?

It is often suggested that increased litigation and consequent damages payouts are the prime cause of escalating insurance premiums. The veracity of these arguments is questionable given the lack of credible quantitative or qualitative evidence to support them.

According to the Australian Productivity Commission, litigation has not increased in Australia; rather it has decreased at an average annual rate of 11.8% over the last four years (see Table 1 below).³

The claim about Australia's growing litigiousness is a good marketing tool for insurance providers. The insurance industry has a vested interest in promoting this idea. However, there is no evidence to suggest that there is a litigation explosion or that increases in professional indemnity premiums are due to any litigation increase, but rather, there is evidence to reject those assertions.

² Joint Communiqué – Ministerial Meeting on Public Liability Insurance Brisbane 15 November 2002

³ Australian Productivity Commission, *Report on Government Services 2003*, Table 6A.2.

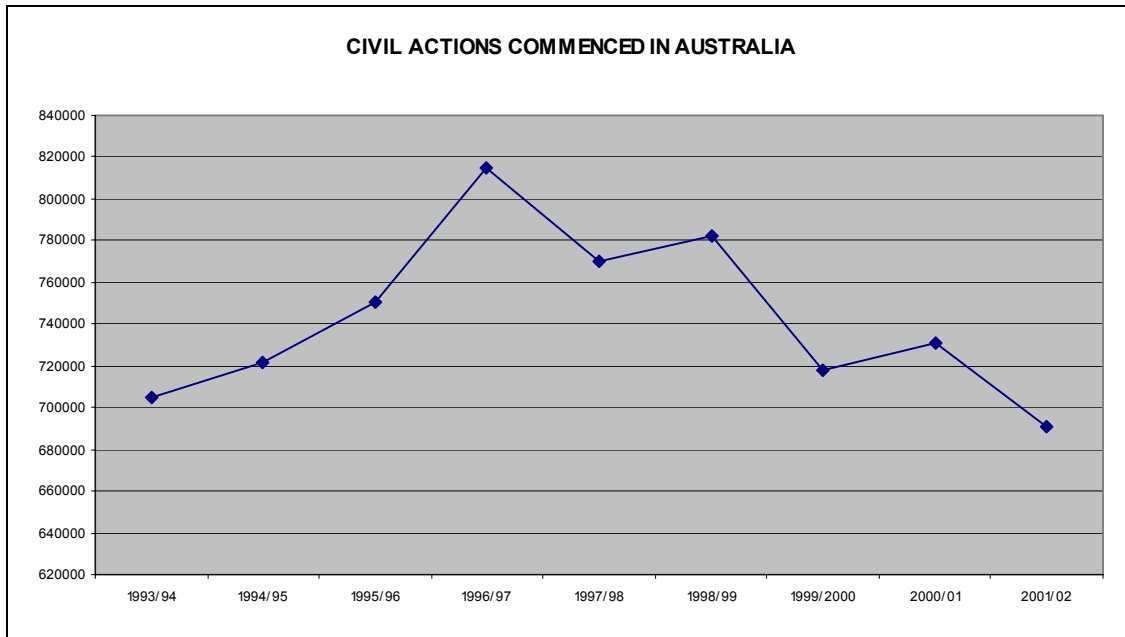


Table 1 Civil Actions Commenced in Australia⁴

There is also suggestion that damages payouts in Australia are increasing. Again, this assertion is made without any reliable data. Such data as there is suggests that damages payout figures are more or less static. According to figures on public liability damages provided by the insurance industry itself, damages awards may actually be in decline.

Year	Average Damages
1988	\$258,016
1989	\$58,174
1990	\$108,029
1991	\$198,522
1992	\$364,379
1993	\$133,139
1994	\$550,877
1995	\$157,284
1996	\$250,987
1997	\$196,376
1998	\$175,271
1999	\$120,471
2000	\$216,201

Table 2 Damages Awards 1988 - 2000⁵

⁴ Based on data reported in Table 6A.2 of Australian Productivity Commission, *Report on Government Services 2003* and Table 9A.1 of Australian Productivity Commission, *Report on Government Services 2001*.

⁵ Insurance industry figures quoted by Justice GL Davies in, "Negligence: Where Lies the Future", Paper of the Supreme and Federal Court Judges' Conference on the Ipp Report, Adelaide January 2003: www.courts.qld.gov.au/publications/articles/speeches/2003/Davies230103.pdf

If litigation and damages payouts are not increasing, then there must be alternative factors driving the increase in insurance premiums.

2.3 Alternative explanation for premium increases

2.3.1 Decline in international investment market

Insurers take premiums today in exchange for the risk that they may have to pay out in the future. Insurers invest the money they collect and use the earnings on those investments to increase their profitability.

On top of poorly performing international equity markets, the world economic outlook changed considerably after September 11. Interest rates have been at their lowest levels for decades. Rate reductions in the United States of America produced a real interest return after inflation of zero percent. The real rate in Australia is little better though this is slowly improving.

The impact of September 11 on international equity markets and the returns achieved by insurers is illustrated in the example of Victoria's Transport Accident Commission. This government-owned insurer recorded its first ever loss in 2001, due entirely to the downturn in international equity markets. In its annual report for 2000/2001, an after-tax operating loss of \$192 million was recorded.⁶ Further, TAC's investment return of 2% was well below the budget of 7.5%, all due to the poor returns from international equity markets during that year.⁷

Since September 11, the world insurance market has been thrown into turmoil, most notably with the hardening of the availability of reinsurance.

2.3.2 Increasing reinsurance costs

Most local insurers, particularly the small to medium ones, do not insure for the total risk under policies they write. Usually they will take the bottom layer of risk and will reinsure to cover themselves if claims exceed that layer. Often many different reinsurers will hold part of the risk on a particular policy, with their liability only arising once earlier layers have burnt through.

⁶ In 1999/2000 the TAC achieved a profit of \$447 million.

⁷ Transport Accident Commission, Victoria, *Annual Report 2000-2001*, p 35.

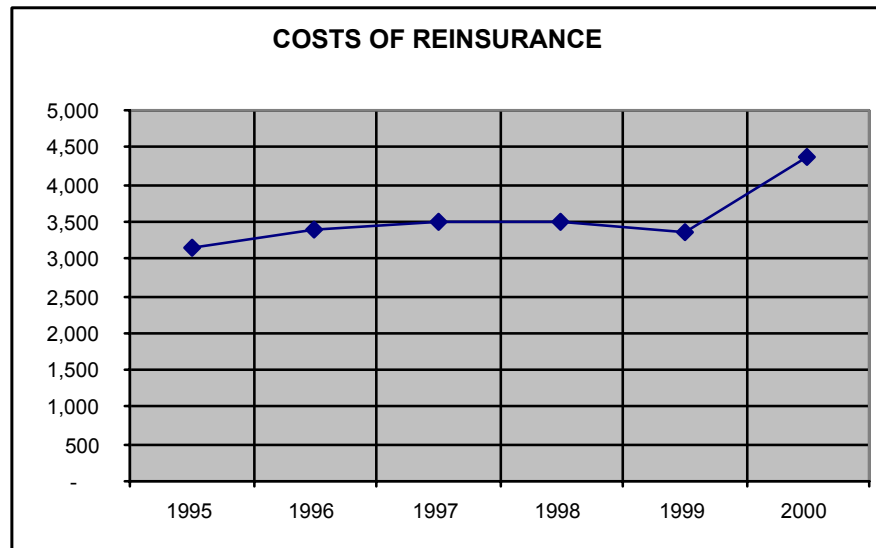


Table 3 Costs of Reinsurance⁸

This means that premiums charged by local insurers reflect the cost of reinsurance in the global marketplace. The events of September 11 have produced a contraction in the reinsurance market, as major overseas insurers are now focusing on their local markets rather than assuming risks in less well-understood markets, such as Australia.

The Australian share market was very weak during the 2002/03 financial year, which was reflective of international equity markets. International markets suffered because of the uncertainties surrounding the war and global growth prospects.⁹ During this period, the downturn in investment returns effected the global insurance industry and had a particularly negative impact on the reinsurance sector. Reinsurers underwent an erosion of capital which decreased their ability to absorb risk.¹⁰ The result has been greatly increased reinsurance costs.

Insurance is an international industry. Events that occur in other parts of the world directly impact on global reinsurance rates.

2.4 Recent insurance industry profit reports

Recent statements by Australia's five major private insurers, and some statutory bodies such as the Victorian WorkCover Authority (VWA), have shown record profits and astronomical increases compared with recent years.

The VWA reported a \$491 million half year profit, comprised of \$331 million profit on insurance operations and \$130 million investment profit in March 2004.¹¹

⁸ Based on data in the Australian Prudential Regulation Authority (APRA), *Annual Report 1996 to 2000*.

⁹ Australian Prudential Regulation Authority (APRA), *Annual Report 2002-03* p 3.

¹⁰ Ibid.

¹¹ *Australian Financial Review*, 1 March 2004.

Private insurers fared no worse, all reporting explosive performances in February 2004:

Insurer	Reported Profit	Increase on last period
QBE	\$572 million	105%
IAG (Half year)	\$302 million	490%
AXA	\$926 million	281%
Suncorp (Half year)	\$281 million	81%
Promina	\$298 million	On debut

Table 4 Insurance industry profits¹²

The claim by insurers that premiums are unsustainably low and must increase to account for record increases in damages claims and payouts simply does not stand the test of scrutiny. Insurance industry profits depressed by international equity markets and high reinsurance costs are rebounding on the back of resurgent world financial markets and the post September 11 recovery of the international insurance industry.

The premise that underlies the current round of tort reform, including the introduction of PSL 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. It is in the insurance industry that the solutions to this crisis will be found.

¹² *Weekend Australian*, 28 February 2004.

Part three – The proposed Bill

3.1 Effect of the Bill

The *Treasury Legislation Amendment (Professional Standards) Bill 2003* would have the effect of applying the limits on liability contained in state and territory based PSL legislation to three Commonwealth statutes:

- *Trade Practices Act 1974*;
- *Australian Securities and Investment Act 2001*; and
- *Corporations Act 2001*.

The target of the proposed reforms is the operation of the section 52 TPA proscription against misleading and deceptive conduct, and equivalent provisions in the other two statutes.

The real effect of the Bill is therefore controlled by the state PSL legislation.

3.2 State professional standards legislation

PSL aims to improve access to and affordability of professional indemnity cover by four means.¹³

- Capping liability;
- Enhancing professional standards through education;
- Providing consumer protection through complaints procedures and compulsory insurance cover;
- Providing supervision and disciplinary measures by professional bodies.

Professional standards legislation is underpinned by self-regulation. It purports to protect consumers by requiring compulsory insurance cover and imposing risk management procedures.

The enforcement of compulsory insurance cover means that when damages awards are made they are more likely to be met. It decreases the risk to consumers caused by professionals who 'go bare', that is, operate without insurance cover.

Risk management education, professional self-regulation and disciplinary procedures are offered as a trade off against capped liability. Increased regulation of a profession as a whole is intended to reduce the severity and frequency of losses to consumers. While decreased frequency and severity of losses are outcomes that professionals, insurers and consumers would all welcome, they are unlikely to console a consumer whose losses exceed the amount recoverable under the cap.

¹³ Parliament of Australia, Parliamentary Library, "Bills Digest No. 75 2003-04", page 2

3.3 Risk management and professional standards

Concentrating on managing the risks involved in protecting the public, rather than focusing on the costs involved in insuring the risk, is a long term solution to lowering the cost of professional indemnity insurance and a solution that APLA strongly endorses.

Improving the safety standards employed by professionals, more pervasive monitoring of professional performance and increased sanctions for disciplinary infringements are all integral to professional practice in a progressive society.

To practise risk management professionals must look at their activities and explore the options to cover themselves. Risks need to be identified and evaluated and solutions or mitigation strategies considered for each risk, then implemented and monitored.

The more information that insurance companies have about a professional's activities and potential risks, the better they are able to assess risks under the policy and minimise premium costs. This means that when risk management techniques are applied, less indemnity cover is required and this lowers the cost of the premium.

APLA believes it is the responsibility of all professionals to hold adequate insurance so that in the event of negligence the wronged person is returned as far as is monetarily possible, to the position they would have been in if the wrong did not occur. Compulsory insurance cover is one aspect of PSL that APLA endorses unreservedly. In this 'user pays' era, the welfare of innocent consumers should be protected by mandatory non-discretionary insurance as a precondition for professional practice.

Support for the risk management aspects of PSL does not imply support for capped damages. On the contrary, if PSL has the effect of decreasing the frequency and severity of losses sustained by consumers of professional services, this is all the more reason why individual cases of large loss should be covered by insurance.

Capping this payment only shifts the blame on to the injured person and their family, and on to the public system. APLA believes that no professional should have their liability in negligence capped just because they are experiencing increases in insurance premiums.

Whilst APLA applauds initiatives that reduce risks and hence the amount of negligently caused losses, we do not believe that people wronged by professionals should not be compensated for the losses they suffer. In addition, cost savings should not come at the expense of injured people, who are often the most vulnerable in our society.

3.4 Restricting the size of compensation

Our common law system has developed over many years and means that each case is determined on the basis of its individual facts.¹⁴ Compensation is designed, as far as is monetarily possible, to restore a victim to the position they would have been in had the incident not occurred.

¹⁴ New South Wales Law Reform Commission Report 43 (1984) *Accident Compensation: A Transport Accidents Scheme for New South Wales*, Report 43, Chapter 3, 1984.

Damages caps undermine an individual's right to compensation as well as undermining the Court's decision in awarding fair compensation to successful plaintiffs. In fact, in several states in the USA, caps have been declared unconstitutional.¹⁵

Restricting the amount that people can be compensated does not mean that the costs of the injury or loss disappears. If a payment is not large enough to cover business losses, medical expenses or superannuation savings, then cost-shifting occurs. Medical expenses are paid through the public health system, lost superannuation results in a greater burden on the pension and business casualties caused by professional negligence result in bankruptcies that in turn cause losses down the supply chain.

Capping damages removes the incentive to minimise potential losses by implementing risk management strategies. This leads to a general erosion of responsibility to prevent losses occurring. It may result in an increase in dangerous and negligently misleading practices exposing individuals to injury and loss.¹⁶

Current PSL at once imposes risk management to encourage sound professional practice and removes the most powerful disincentive: 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.

APLA does not believe that there is any evidence that the introduction of caps has so far had any influence on the price of medical indemnity insurance premiums in those states where reform has already been instituted. Evidence from overseas indicates that tort reform generally does nothing to guarantee decreased premiums.¹⁷

The essential outcome of the introduction of PSL is the transfer of risk. Risk that was formerly assumed by professionals is, under PSL, borne by the consumer. When risks eventuate and losses are spread through the community, the cost of those losses becomes a burden on the tax system.

That transfer of risk and consequent erosion in consumer rights might be considered proportionate to the good of ensuring an adequate system of professional indemnity cover. Yet neither the proposed Bill, nor state PSL contains any requirement that insurers pass on cost savings in the form of decreased premiums, or that they guarantee to provide indemnity at all. Recent experience in other areas of the insurance industry shows that tort reform doesn't decrease premiums, it increases profits.

¹⁵ Center for Justice and Democracy, *Glossary of "Tort Reforms"*, 2002, <http://www.centerjd.org> (Accessed 20 March 2002).

¹⁶ Center for Justice and Democracy, *Mythbuster: The Real Costs of Our Legal System*, 2002, <http://www.centerjd.org> (Accessed 20 March 2002).

¹⁷ J. Robert Hunter and Joanne Doroshow *Premium Deceit: The Failure of "Tort Reform" to Cut Insurance Prices*, Citizens for Corporate Accountability and Individual Rights, New York, 1999

Part four - Alternatives

4.1 Modified PSL – Professional standards without caps

The commentary on PSL legislation set out in the preceding section notes the clear benefits of risk management strategies. While these strategies are offered together with capped damages as a package in present PSL, there is no reason why the two remedies need to be offered together.

APLA supports risk management strategies and submits that their introduction as compulsory requirements of professional practice can only benefit the community. APLA further submits that regulation of professional bodies need not rest within the professions themselves. Particularly where disciplinary measures for poor professional practice or a failure to maintain adequate indemnity cover are concerns, APLA supports the additional incentive of criminal sanction and permanent removal of practicing rights.

4.2 Increased prudential regulation

Mismanagement in the insurance industry has led to the present premium crisis. The collapse of HIH in particular, and the subsequent Commission, point up the failure of existing regulatory authorities to detect and prevent appalling mismanagement.

Little seems to have changed. State government promises of Insurance Commissioners with substantial powers (e.g. in Victoria) have come to nothing. The Australian Competition and Consumer Commission should be given extensive powers to examine and control premium pricing and funding to enforce appropriate premium setting to prevent repetitions of HIH and the recent blow out in premiums.

Insofar as the present Bill and other government law reform initiatives aim to reduce the impact of rising insurance premiums, even of a complete flight by some insurers from certain sectors, APLA submits that regulation of the insurance industry needs to be contemplated.

4.3 Decreased premiums tied to PSL damages caps

In the event that the Committee decides against the recommendations listed by APLA, it is submitted that a minimum amendment to the Bill be made to tie premium price decreases to the introduction of damages caps. If the overall aim of the legislation is to render indemnity cover affordable, then this should be directly traversed in the legislation. Evidence to date indicates that no amount of state based reform to the law of negligence has reduced premium prices. The same is true of the tort reform experience in the USA.

Part five - Conclusion

5.1 Illustrations

Following are several illustrations of circumstances in which the proposed Bill would limit the rights of consumers to gain just redress for professional negligence. They demonstrate the folly and injustice of reforms that simply transfer the risk of professional practice away from the professional, and away from their insurance companies, and onto consumers who are in no position to assess those risks.

5.1.1 False statements in property dealings

A person purchases a unit in a new development. The promotional material asserts that the units are constructed to the highest specifications and standards. In the contracts for purchase of the units, there is a waiver of liability for negligence on the part of the corporate developer. Four years after purchasing the unit, whilst the owner is entertaining half a dozen people on the balcony of the unit, the balcony collapses killing one person and seriously injuring two others. The owner himself suffers serious spinal injuries which confine him to a wheel chair for the rest of his life.

5.1.2 Misleading conduct in investment scheme

A retiree invests all their superannuation in a tenanted holiday unit complex on the strength of guaranteed returns. The promotional material provided to the investor by her financial adviser proves to be misleading and the investment makes no income and loses value resulting in substantial losses. The retiree cannot recoup her losses because of the cap and consequently draws a pension for the rest of her life.

5.1.3 Deceptive conduct by lawyer

A small catering company relies on their lawyer in entering into a large and lucrative contract with a new hotel client. After expending considerable resources moving their kitchens and acquiring stock to meet the contract, the new client goes into liquidation. While the small business owner suspects that the lawyer had a business relationship with the hotel, she can't prove fraud. She can prove that the lawyer's advice on the contract was misleading, but her damages are capped.

5.2 Conclusion

When a plumber calls to fix your taps you expect the work done right and the tradesperson to be accountable for any losses that their poor work might cause. And they are.

Why then should professionals be any different, just because they are organised into a more influential lobby. Insurance premiums are high in some areas, but then so are the financial rewards and social standing enjoyed by professionals.

Premium costs continue to increase despite record profits in the insurance industry. Despite claims to the contrary there is no evidence to show that an excess of litigation or claims caused the abrupt crisis in the insurance industry to which this Bill is a response. Rather the industry points to the root of the problem being in the insurance industry itself.

Even if evidence clearly showed that a radical increase of litigation and successful claims had caused a crisis, it does not follow that removing consumer rights is the solution, that should be an option of last resort.

The purpose of insurance is to share risk, and to do so in such a way that allocates responsibility to minimise risk to those parties best placed to do so. The result of the present Bill will be a simple movement of risk from the insurer to the consumer.

It is hard to comprehend how a responsible government could act to remove the rights of everyday citizens to the benefit of privileged professionals and a highly profitable industry. Surely the answer lies in regulation of the insurance industry to ensure healthy profits, reasonable premiums and a safe community in which detrimental outcomes for consumers can be fully recompensed.

APLA opposed the introduction of PSL at the state level and opposes the *Treasury Legislation Amendment (Professional Standards) Bill 2003*.