



# **VICTORIAN BUILDING INDUSTRY PROFESSIONAL INDEMNITY INSURANCE FORUM**

***WORKING GROUP  
RECOMMENDATIONS***

***10 DECEMBER 2002***



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# 1. Introduction: Goals and criteria

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## Goals

Why does Victoria have compulsory professional indemnity (PI) insurance within its building industry? The fundamental public policy goals have been clear since the analysis and debate leading to the introduction of the Building Act 1993:

- Protection of consumers
- Protection of professionals
- Reinforcement of proportionate liability
- Support of private-sector building surveying
- Enhancement of building industry performance overall.

Most other Australian jurisdictions also have some form of compulsory PI insurance operating in their building industries for similar reasons.

## Consumer protection

The prevailing public policy view is that most consumers who purchase building services need insurance-based protection against the possible negligence of building professionals. Reliance on the 'buyer-beware' principle is not seen as adequate because most consumers, at least most typical domestic (versus business or institutional) building project consumers, cannot be reasonably expected to have sufficient knowledge about the services they are purchasing. In addition, for typical domestic buyers of the services, the purchases are often part of the largest investment of their lives and the damage from negligence could be catastrophic.

If insurance is not available to consumers as a means of compensation for negligence, no other means of redress may be available. Building professionals subject to a claim for compensation may have no or insufficient accessible assets. Insurance is intended to make sure this circumstance does not arise.

## Professionals protection

Just as consumers want protection against the negligence of building professionals, the professionals themselves want protection against claims of negligence by their clients or others. Most professionals do not wish to be forced into hiding assets or bankruptcy as a means of avoiding costs arising from a negligence claim. The professionals want protection against the possibility of financial ruin through an error or claimed error.

Many professionals obtain such protection even when it is not mandatory, though operating without insurance and removing all assets from the operating entity are also common practices in jurisdictions where insurance is not a legal requirement.

## Proportionate liability

Victoria requires the application of the proportionate liability principle in an award of damages in building legal actions, although the principle does not apply to death and personal injury damages. Proportionate liability is regarded as a valuable reform by building industry professionals and by the insurance industry. Claims for negligence in building projects frequently involve multiple parties as defendants, and the principle that defendants' individual joint and several liability for damages should be limited to the degree of the individual defendant's responsibility for the damages clearly appears fair at face value.

A major disadvantage of the principle for consumers arises however if one or more of the defendants is uninsured and has no other means of providing an awarded compensation. If such cases occurred with any frequency, the proportionate liability principle would be overturned or undermined. Mandating insurance for all professionals involved in building work is key to proportionate liability reform.

### **Support for private sector building surveying**

Buyers of building surveyor services would have reason to prefer local government providers if insurance was not mandatory for private building surveyors. Ongoing adequate insurance cover for the work of municipal building surveyors is virtually guaranteed as part of local government insurance, whereas the same certainty of client protection would not exist for private building surveyors.

Knowledgeable buyers of these services would prefer municipal building surveyors if insurance coverage for private surveyors was not assured. Just as Victoria has experienced a rapid shift from 100% of building surveying services being provided by Councils to 83% (as measured by proportion of value of building work in 2001) being provided by private building surveyors, the pendulum could shift back just as quickly.

Victoria's building industry is generally considered to have achieved major efficiency gains through the introduction of a highly flexible private building surveying profession. A shift back to municipal surveyors may reverse those gains.

### **Enhancement of building industry performance overall**

In Victoria's building regulation system, private sector insurance (both PI and builders warranty) is intended to perform as a means of quality control. The theory is that poor performance will show up in insurance notifications and claims, that poorer quality practitioners will be required to pay higher premiums, and that consequently poorer practitioners will have an incentive to lift their game. At the extreme, very poor performers as identified by insurance claims would be forced out of the market. They will be unable to obtain insurance, or unable to obtain insurance at rates allowing them to compete successfully with others in their marketplaces.

In other words, the role of insurance was supposed to enhance the efficiency of the building marketplace. Good performers would gain ground because of the impact of insurance; poor performers would have to improve or pay the price.

### **Criteria**

To fulfil the public policy goals, building industry PI insurance needs to be:

- Available
- Affordable
- Substantial
- Comprehensive
- Linked to risk management
- Sustainable over the long term.

### **Available PI**

Obviously PI insurance will not be able to achieve its public policy goals if it is not obtainable at all or not obtainable without extreme difficulty. Professionals also need to be able to obtain a policy in a timely way, and the demands of the application process should not be excessive.

### **Affordable PI**

Building professionals clearly need to be able to pay for the available policies. They need to be able to handle the level of excess (or deductibility) specified in their policies as well as have a capacity to meet the premium payments.

Affordability is not a straightforward judgement though, because professionals typically can pass on a cost increase in the form of higher fees to their clients. The ability to pay for insurance by building industry firms and their clients is nevertheless an important criterion for judging whether building industry PI insurance is serving its public policy aims.

The justification, versus the affordability, of the level of insurance pricing is also a valid criterion for making an assessment of building industry PI insurance. This dimension is addressed below in the context of the long term sustainability of building industry PI insurance arrangements.

### **Substantial PI**

PI insurance will not perform adequately in meeting the public policy goals if it does not have sufficient depth and breadth in the insurance protection it provides. The policies should give indemnity for all or an acceptable proportion of building services performed. There is little point in having 'Claytons' policies with insufficient indemnification.

### **Comprehensive PI**

Particularly for the goal of reinforcing the proportionate liability principle, the coverage of the Victorian population of building professionals has to be complete rather than partial. The proportionality reform of joint and several liability in the Building Act will be endangered if even a small percentage of professionals are able to avoid their awarded share of damages compensation by having insufficient assets.

Beyond reinforcement of proportionate liability, PI insurance needs to be held by all building professionals to meet the goal of consumer protection. If it is not held comprehensively, gaps in consumer protection result.

### **PI linked to risk management**

PI insurance should have a strong direct link to risk management (including risk minimisation) practices in the building professions particularly because of the public policy goal of enhancing building professionals' quality and efficiency. Insurance notification and claim statistics for categories of building professionals should be readily available, to inform the building industry and regulators about where improvements are needed. Building industry insurance arrangements should provide the information feedback needed for effective risk management.

## **PI sustainable over the long term**

Individual professionals and the building and construction industry as a whole need reasonable certainty and predictability about PI insurance products being supplied in the long term, at least over several years. Building professional firms want to be able to budget for insurance costs over one to two year periods at least. More fundamentally, building professional firms need to have certainty about whether or not insurance will be available.

The presence or otherwise of insurance has an impact on firms' ability and willingness to operate, as well as on their methods of operation. Uncertainty about whether affordable insurance will be available in future has led to some firms avoiding making commitments and others deciding to change the nature of their business or close down.

In addition to understanding sustainability from an economic perspective, the criterion has a political dimension. If building industry PI insurance arrangements are to be sustainable long term, they need to be seen as legitimate by the stakeholders involved. For instance, if the levels of insurance premiums and excesses for carrying out building professional work are seen as unjustifiably high, the arrangements will break down over time through political action or other means.

As noted in the prior discussion of public policy goals, regulators of the building industry rely on the presence of comprehensive and substantial insurance to assist in meeting regulators' aims. Governments need reasonable certainty about the policy tools on which they rely.

The current system of building industry operation assumes a viable form of building industry PI insurance will be in place indefinitely. The justification or otherwise for this working assumption needs to be clear.

## **2. Background: Evolution of the issues**

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### **Excess supply brought high demand**

The nature, level and expectations on the demand side of the Victorian building industry PI insurance market were largely determined in the mid 1990's. In that period, the building PI market was in a state of excess supply.

The supply at that time can be characterised as excessive, not merely abundant, because it is now clear that the insurance pricing and product features offered at the time were unsustainable. FAI and HIH led the charge over the cliff and the other insurers largely followed.

The mid 1990s negotiation of automatic 10 year runoff as a legally-mandated product feature is illustrative of the excess supply prevailing when many of the current characteristics of the demand side of the market were established.

All insurers at the time, except one, saw automatic 10 year runoff cover as unacceptable as a legally-mandated feature of the building industry PI insurance product. The insurers' opposition was for the same, basically technical, reasons they put forward this year in requesting removal of the automatic runoff provision. (They regard automatic runoff as unacceptable basically because of the actuarial and provisioning difficulties involved and because of their need to adhere to global standards of product definition.)

However Australian Prudential Regulation Authority statistics show that the mid 1990s was a peak period for return-on-shareholders-funds in the Australian PI insurance market. And this period happened to coincide with the timing of the introduction of the Building Act and the negotiation of the Building Practitioners Insurance Ministerial Order.

All insurers at the time were aggressive in pursuing market share, and one insurer was aggressive enough to accept mandatory automatic runoff cover. Only one acceptance of automatic runoff was necessary to put it in place, at least in the market climate prevailing at the time. Once one insurer had agreed, and regulation requiring it could then be issued, other insurers complied because they wanted a share in the market. So automatic runoff and other comparatively generous product features became legal requirements.

More broadly than automatic runoff, it is clear from the prior description of public policy goals that insurance was assigned a major ongoing role in generating protection and other outcomes wanted by the community. This demand put on insurance was planned and accepted with the assumption that the supply of insurance would remain plentiful and a comparatively inexpensive means to the public policy ends.

Beyond the role planned for insurance by building industry regulators, excess supply has also resulted in a high demand for it by the buyers of building professionals' services. Private sector and government clients of building professionals have pushed the contractually requested scope and amount of insurance higher and higher. Working on the assumption that insurance was readily available at affordable prices, buyers have looked for higher and higher insurance-based protection of their interests.

As discussed in detail in the Rebalancing Risk Allocation section following, the clients of building professionals have greatly widened the areas in which they have gained indemnification and increased the level of compensation obtainable. In summary, the demand for and reliance on PI insurance in relation to building work has ballooned, because insurance can in theory perform wide-ranging protective functions and aid efficiency in the operation of the market for professional building services. These roles for insurance have increased to high levels because the product was readily available at comparatively low cost.

Insurance is even substituting for management competencies and acceptance of entrepreneurial risk on the buyer side. A buyer of building services does not have to be well versed in the requirements and management of building projects if insurance gives protection against anything going wrong.

Given that the suppliers to the building industry PI market were offering plentiful insurance, with generous features at low prices, the buyers understandably responded by increasing the level of their purchases. The nature of the role insurance is still playing in the system of building regulation and the building contractual arrangements was evolved in this climate.

Court decisions are ultimately driven by the views of Governments and legislation, and the outcomes of legal actions in this area have over time also generated an increased need for insurance by building professionals.

### **Supply has fallen dramatically and rapidly**

While the recent quantum increases in prices and excesses and extreme shortages in availability have captured attention, the business cycle in building industry PI insurance has been moving away from the excess supply of the mid 1990s for several years. Some insurers with comparatively long exposure to the building PI market, such as CGU, decided to move to lower levels of supply more than two years ago. Some insurers have entirely left certain market segments, such as the upper end of engineering, although they have continued to supply other market segments.

Other insurers looked at their financial returns from taking a share in an excess-supply market environment and decided to depart the market entirely. Insurers that have decided to exit the market over the past few years have included: Suncorp Metway, AMP, GIO, Markel (formerly RE Brown) and St Paul.

The inevitable swing away from the market conditions prevailing in the mid 1990s became a drastic and damaging change over the past year. This occurred because of the cumulative impact of a wide range of factors, including:

- The collapse of HIH, an unprecedented event in the Australian insurance market, which in a single stroke removed a major source of insurance for building professionals (HIH had more than 30% market share)
- Much more demanding APRA and other regulator demands as a consequence of the HIH collapse, including higher requirements for capital backing, especially for 'long tail' insurance such as building industry PI
- The major decline in the level of return obtainable from the insurers' investments in global equities markets, forcing insurers to need underwriting profits rather than relying on investment returns to offset underwriting losses
- The extraordinary cost of September 11 to the insurance industry, resulting in a massive loss of its capacity to fund the supply of insurance
- The overall unattractiveness of the Australian insurance market compared to the other markets open to insurers and reinsurers around the world, because of

Australia's high rate of litigation, the strength of consumer protection sentiments and trends in legal decisions contrary to the interests of insurers.

This convergence of factors has resulted in only a small number of substantial suppliers to the market. Measuring market share from the viewpoint of Building Practitioners Board registration, only two insurers provide policies for about two thirds of Victoria's registered building professionals and one other insurer provides a further ten percent. A fourth insurer is a substantial participant in a key segment but has no current capacity to take on any new business.

Two further underwriting agencies play a substantial part in particular niches, but they basically face the same capacity shortages as the main insurance firms. For some segments of the market, such as higher-end consulting engineering, there is only one substantial Australian source of supply.

The top managements overseeing the Australian building industry PI insurance divisions of their companies have major problems in providing insurance capacity for their businesses overall. The supply of building industry PI is threatened by competing opportunities for the use of the much more limited capital now available to these firms. The building industry PI operations will need to show high returns or they will simply be eliminated as lines of business.

Further, looking past the direct insurers in the supply chain, the supply of reinsurance capacity to the building industry PI underwriters is the critical underlying factor. Like the insurance firms, the global reinsurers as a whole are presently confronting massive capital shortage problems and Victorian building industry PI insurance needs to compete with many competing demands on their remaining capital.

### **Demand has not fallen commensurately**

Much of the current demand for building industry PI insurance can be characterised as a 'need' because it has become in-built through regulations and market-typical contractual arrangements.

For this reason, in addition to the speed in the change in supply conditions and inevitable time lags and inertia, the demand side of the building industry PI insurance market has not fallen to match the change in supply.

Typical building contracts still want extensive indemnification for high amounts of cover. While automatic runoff has been removed, regulations still mandate insurance with now expensive product features. Legislators have not introduced changes to the Trade Practices Act and other laws that result in a high need for protection and a high cost of providing it.

### **An industry and public policy crisis has resulted**

The current major mismatch between supply and demand has resulted in wide ranging PI problems for the building and construction industry nationally. The term crisis is probably appropriate because building industry PI insurance is starting to perform poorly in terms of the criteria defined above, and consequently the fulfilment of the associated public policy goals is threatened. The following section gives an overview of this performance versus the criteria and goals.

### **3. Assessment: Performance versus criteria & goals**

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#### **Criteria**

Assessing performance in terms of the criteria identified in the Introduction, there are clear major problems or at least question marks with respect to all of the criteria.

#### **PI availability: on the edge**

A complete withdrawal of supply from the beginning of 2003 onwards was recently threatened over the issue of the mandatory automatic 10 year runoff provision.

This immediate prospect has been averted and the great majority of Victorian building professionals have at least been able to obtain a policy. Nearly 2000 professionals required new insurance policies at the end of October 2002 and only a comparatively small number were unable to obtain a policy at all.

While most practitioners have been able to obtain a policy, availability should still be described as extremely tight because of the small number of suppliers. Buyers at present have little or no choice of suppliers. This circumstance appears to have added impetus to the factors driving recent price rises. The small number of suppliers means that the industry has to operate day-to-day on the brink of not having sufficient or any insurance available.

Further, certain categories are being declined by all or virtually all insurers. The categories that presently find it difficult or impossible to gain PI include:

- Fire protection engineers
- Water treatment practitioners, particularly those directly involved in control of the legionella bacteria
- Geotechnical engineers
- Engineers doing waste management and environmental management work
- Building surveyors doing work outside tasks directly associated with issuing Building Permits
- Practitioners with substantial insurance claims in their work history.

#### **PI affordability: quantum price & excess increases**

Price rises and increases in excesses have been unprecedented in size and rapidity. The extent, speed and unanticipated nature of the change have in themselves created problems, irrespective of the dollar amounts involved. Many firms have found the changes difficult or impossible to adequately manage, from cashflow, work costing and general business planning perspectives.

Some practitioners have not been able to pass on the increases to clients because of contractual arrangements or market barriers. They have needed to absorb the increase in insurance costs, and consequently have lowered their profitability. Part-time and periodical participants in the building professionals industry are being forced out because the minimum or base level of insurance premiums have become unaffordable for small-scale businesses.

While increases in premium are a comparatively straightforward management problem, increases in the level of excess require very difficult judgements. An excess that is high relative to firm's liquid assets and cashflow creates a high

business risk. It increases the probability of a firm suffering long term damage as a result of an insurance claim. Prudent firms with higher excesses should place more liquid assets into reserve, which reduces the available operating capital for the firms.

### **PI substance: increased exclusions of liability**

There is anecdotal information that policies are now more restricted in the scope of the protection they provide. Evidence about the actual impact of the liability exclusions on the needed level of protection is not clear, but exclusions of liability are greater in current policies compared to policies prevalent in the mid 1990s.

The 1996 Building Practitioners Insurance Ministerial Order attempted to draw a line in the sand concerning this issue. A clause in the Order in effect states that the wording of PI policies standard in 1996 are to remain into the future. The intent of the clause is to avoid any undermining of the substance of Victorian PI policies by insurers adding new exclusions.

The intent of the clause has good justification, but its assumption that the wording of policies could be kept static indefinitely was unrealistic. The environment of PI insurance has changed and the wording of policies has evolved. In particular, exclusions of liability arising from terrorism and date-related software issues (Y2000) are now standard in insurance policies, whereas they were not contemplated in 1996. Accordingly, the Building Commission is investigating changing the Insurance Ministerial Order to add flexibility and reflect realities in this respect.

Beyond terrorism and Y2000 reductions in the scope of coverage, some insurers are also excluding coverage for certain types of building work that are of key importance to the community and/or are types of building work that practitioners wish to perform. These exclusions are reducing the substance of PI insurance policies in the building industry.

### **PI comprehensiveness: gaps appearing**

While not believed to be widespread, there is some evidence of avoidance of Building Practitioner Board registration and consequent avoidance of the accompanying mandatory PI insurance by a number of people offering professional building services. Systematic data is not available on this issue, but anecdotal reports suggest that some people are operating in the building professionals market without insurance protection for their clients or themselves.

### **PI link to risk management: little feedback from insurance experience to professional improvement**

Victorian professions such as the solicitors and the architects have very good feedback mechanisms for risk management through means of insurance claims data. By contrast, Victoria's engineers, draftspersons, building surveyors, building inspectors and quantity surveyors – the five professions registered by the Building Commission – do not have similar mechanisms. It is a key gap in the efforts to lessen and manage the level of underlying risk in building and construction work.

### **PI sustainability: high uncertainty about the future**

Most of the PI insurance issues facing the building and construction industry are national and global rather than State-level in their scope. This point is especially evident with respect to the predictability of Victorian building industry PI insurance. Events well out of the control of Victoria and in some cases, Australia, are determining the outcomes concerning the sustainability of Victorian PI insurance.

Analysis of the global insurance markets is uniformly gloomy. There appears to be little hope of a major improvement in capital availability for at least two or three years. The Australian PI insurance market is driven heavily by overseas developments, although influences and circumstances particular to this country are also important. Without going into detail, all of the large suppliers of Australian building PI insurance have question marks over their medium to long term futures in the Victorian building PI market.

Long term sustainability is also questionable from the viewpoint of the demand side of the market. Irrespective of whether insurance prices are affordable by professionals because cost increases can be passed onto their clients, the public policy goals will not be met if insurance prices, refusals to provide insurance coverage and other practices of insurers are widely seen as unjustifiable by industry participants and their clients. Ongoing anger and protest over the justification of pricing and other decisions by insurers will over time bring the building regulatory system and insurers' into disrepute.

## Goals

As noted in the Introduction, the Victorian public policy goals for PI insurance in the building industry are: protection of consumers and professionals; reinforcement of proportionate liability; support of private-sector building surveying; and enhancement of building industry performance overall.

While assessment of the current situation versus the criteria shows that fulfilment of the goals is threatened, it should also be recognised that the PI insurance arrangements to date have largely fulfilled these public policy goals.

Consumers have received a substantial level of protection against negligence as a result of the mandated building industry PI insurance arrangements since the mid 1990s. The building professionals have also, by and large, had an effective system in place for protecting their interests.

Proportionate liability has been maintained over the period as a reform. Victoria is still in advance of many jurisdictions in this respect. The Victorian insurance requirements have played a part in supporting the major expansion of private building surveying in the State, which is generally seen as bringing major benefits to building practitioners and their clients.

With respect to enhancement of Victoria's building performance overall, the main idea is that insurance will play a quality control role. Poor performance will result in insurance claims and higher premiums for those with poor claims histories. Poor performers should have an insurance incentive to lift their game. At the extreme, the insurers would exclude practitioners with unacceptable track histories as recorded by the insurers.

This theory has not worked well. The quality control function had little impact when insurance was in excess supply. Poor performers were unlikely to be adequately scrutinised and faced difficulties in that type of market. Now that the pendulum has swung to the other extreme, poor performers are finding accessibility difficult, but so are many good performers.

While some needed discrimination on the basis of performance has occurred in the market, and is happening more strongly now, the impacts have been largely at the broad brush level. The insurers' judgements are taking place primarily per category of professional work versus per individual professional. Over the past ten years or so, the market has not had the expected positive impact on promoting better performance because of its swings from one extreme to another.

In short, of the five public policy goals, the Victorian building industry PI insurance arrangements have done well in fulfilling four of the five. The quality control, or gatekeeper, function is an attractive idea in principle but has not operated as expected in practice.

## 4. Direction: Overview of the path forward

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In essence, the situation is:

- Excess supply in mid 1990s PI insurance market brought high demand, including a high built-in or mandated need
- Supply of PI insurance to the building industry market has fallen greatly, especially in the past year
- The demand side of the market has not fallen to match supply
- The major mismatch between building PI demand and supply has brought wide ranging problems for the industry and Government.

Consequently the building industry faces fundamental options: cut demand, increase supply or both. Increasing supply is more difficult than cutting demand. On the other hand, cutting demand is constrained by the need to keep substance. And unless demand can be cut to zero, at least some level of supply needs to be certain. In short, both main paths – cutting demand and increasing supply – will need to be pursued.

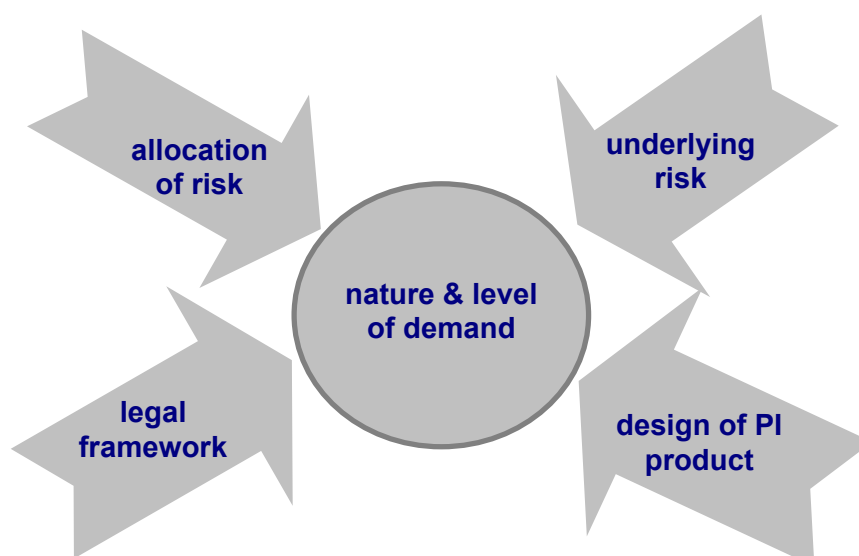
The Building Commission facilitated an industry-wide process in Victoria to provide a vehicle for the development of recommendations to address the PI crisis. Over a five month period, four PI Forums were conducted with building industry associations participating in the process. An action plan was developed and it identified five key areas to be addressed. Attachment 1 lists the chairs and members of the five Working Groups.

The 'strategy map' on page 16 gives an overview of the recommendations of the five Working Groups in the form of a one-page diagram.

### Overview of cutting demand

Cutting the demand for insurance, both the in-built (legislated, market-standard) level of need and the more discretionary level of demand, comprises the great majority of change initiatives that have been put forward to date. The broad approaches to cutting demand identified by the PI Forum include:

- Changing the legal framework
- Reducing underlying risk
- Rebalancing allocation of risk
- Redesigning the building PI regulations and mandatory PI product.



Recommendations in each of these areas are detailed in the PI Forum Working Group sections that follow. The main recommendations include:

- Changing the purchasing policies of public sector bodies and other major clients of building professionals to lower the typical scope of indemnification and amounts of insurance required in building and construction contracts
- Shortening the liability period of building professionals to less than the current period of 10 years
- Increasing the hurdles to making insurance claims through changes to VCAT and Court rules
- Promotion of alternative – non-insurance – ways of resolving disputes and negligence claims
- Efforts to reduce the level of underlying risk through continuous improvement of work practices with the aid of CPD, codes of practice, improved regulations, higher competency requirements and so forth
- Improving performance in managing irreducible risk
- Promoting greater self-insurance and allowing higher excesses, while keeping the resulting higher business risk within acceptable limits
- Changes of approach among both public and private sector buyers aimed at the clients taking back more responsibility for entrepreneurial risk and agreeing to more appropriate allocations of liability
- Trade Practices Act and other legislative changes aimed at lessening the legal liability weight now on the shoulders of building professionals.

In short, there appear to be a large number of worthwhile and feasible ways to reduce demand. Most of the initiatives will require substantial time and effort but overall the strategy of cutting demand appears worth pursuing.

Conceivably, the cut-demand strategy could be taken to the point of reducing the need for PI insurance to zero. In principle, non-insurance ways of achieving the wanted protection for consumers and professionals, reinforcement of proportionate liability and support for private sector building could entirely replace the role insurance currently plays.

At this stage though, it appears that the need for PI insurance will continue and indeed that the contribution of PI insurance to Victoria's public policy goals will remain fundamental. Even if the various recommendations succeed in achieving the strategy of cutting demand, the level of demand will remain well above zero. The need for a substantial and certain supply of insurance will remain even if the level of demand is cut significantly in accord with the Working Group recommendations.

### **Overview of increasing supply**

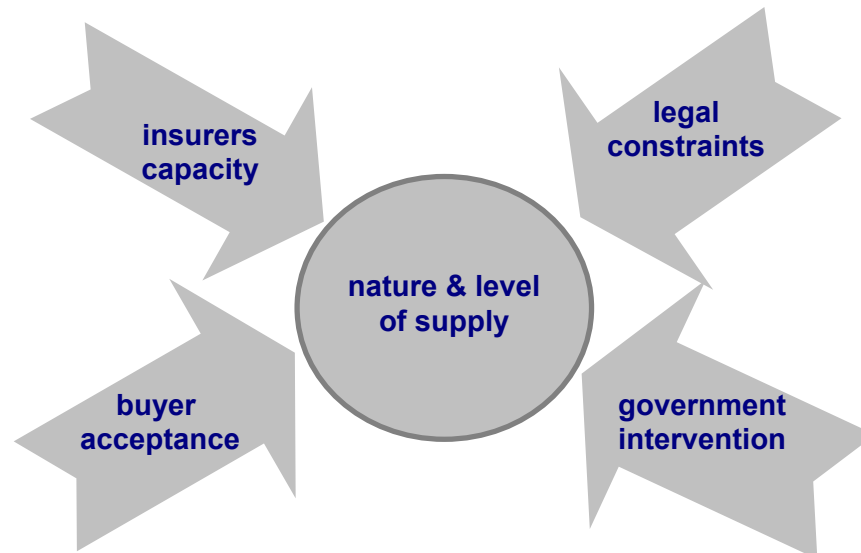
As noted above, Victoria will probably need to pursue increasing supply of insurance as well as aim at lowering the demand.

There are two main reasons for having a focus on ways of retaining and increasing insurance supply:

- Pursuit of a better match between the current level of supply and the preferred level of demand
- Having a contingency plan for supplying needed insurance if there is clearly insufficient available supply or a complete withdrawal of supply by the currently available sources.

Broadly, approaches to increasing supply include:

- Obtaining higher supply by current suppliers
- Obtaining new supply capacity
- Lowering legal constraints on supply
- Aiding buyer management of higher prices &/or less product content.



The Working Group recommendations include making a commitment to a form of runoff cover as a replacement for the removed automatic version previously mandated by the Building Practitioners Insurance Ministerial Order. Fulfilling this recommendation would in effect be an increase in supply.

No other Working Group recommendations directly address ways to increase supply. Given agreement with the argument that a supply-increase strategy is essential, leaders of the building industry will need to ensure that adequate means of pursuing it are in place.

It should be noted though, that a number of the methods for cutting the need and demand for insurance will also have the effect of increasing the attractiveness of the market from the perspective of insurers, and that this development may in itself prompt decisions to increase the level of supply.

Still, even if increased supply is obtained in the short term from the present set of insurance sources as a result of higher market attractiveness, the building industry and its regulators need to consider the future scenario of complete or major withdrawal of supply.

Exactly this prospect was recently faced by the building industry over the runoff issue. A less dramatic but credible scenario would simply require decisions by one or more of the top management groups of the remaining small band of suppliers to further cut or completely eliminate their exposure to Victorian building industry long tail insurance.

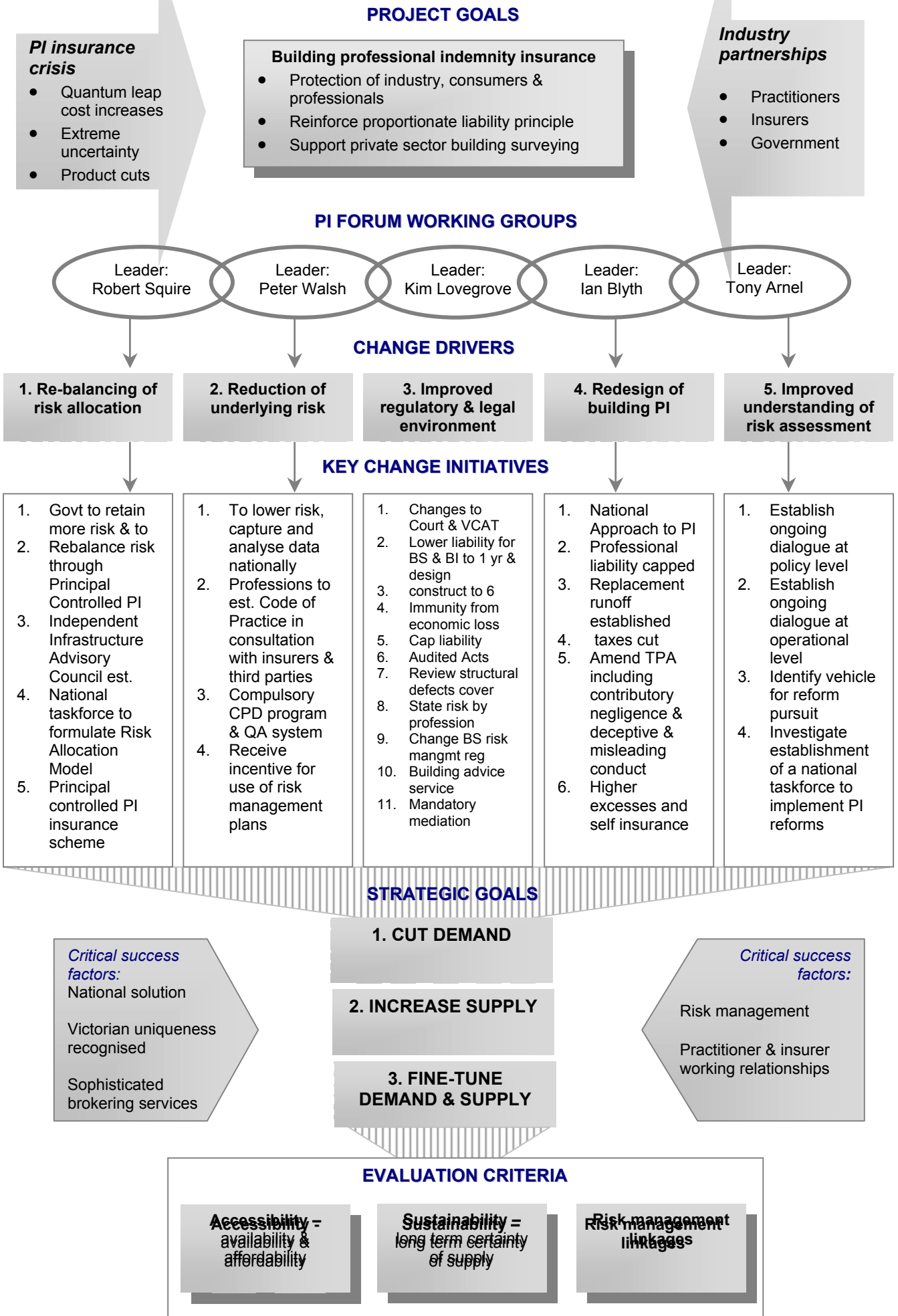
With the number of substantial suppliers having dwindled to three or four, the supply side is only a couple of steps away from no supply or an unacceptably low level of supply.

If this scenario occurred, say sometime next year, what steps could be taken by the building industry and regulators? To keep the building industry operating day-to-day, industry and government would want a replacement form of insurance protection immediately.

At this point however, the capacity to step into a breach is not in place. Undoubtedly, if an emergency of this kind developed, an answer would be found. Insurers are required to give notice of withdrawal and this mechanism would provide some time for action. But a new insurance scheme for large numbers of building professionals would require substantial time and effort. New legislation would be required, Parliament would need to be in session and other priorities for Government action would have to be overridden. A requirement of several months is probable, whereas not even a short period of the building industry operating without insurance protection is acceptable from a public policy perspective.

In short, new means of insurance supply must be part of the strategy for addressing the current PI issues, even if only as a contingency plan.

# Building Industry PI Forum: Strategy Map



## 5. Change Driver 1: Re-balancing of risk allocation

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### 5.1 Project Summary

**Project Leader:** Robert Squire

#### Background

Significant project delivery changes in Australia over the past decade include:

- Major private sector investment in infrastructure
- Decline in public sector technical capability & experience in understanding of the design or construction process
- Major shifts by project initiators to substantially reduce risk and allocate it to others in the construction process
- Significant developments in the method of project delivery; Design & Construct, Build Own Operate Transfer and its variations, Alliancing, Joint Venture, Private Public Partnership
- Novation involving conflicting responsibilities and duties to multiple parties

A key underlying assumption in these changes has been the ready availability and major role of insurance. The crisis in insurance has far reaching effects for the building and construction industry.

#### Key Issues

- Allocation of risk beyond parties' control
- Unlimited liability including liability for economic & consequential loss
- Open ended 'no fault' indemnity clauses
- Guarantees of outcomes that cannot be guaranteed
- Unreasonable/impossible insurance levels & requirements
- Lump sum fees not commensurate to risk
- Uninsurable standards of care & liabilities
- Total disclaimers of responsibility for client provided information & input
- Novation deeds that release & indemnify Principals

- Liquidated damages
- Inappropriate & misconceived certification requirements
- Bar on claims clauses
- Qualifications to tender conditions
- Continued application of joint & several liability
- Evolution of the application of the Trade Practices Act
- Complex & costly court processes
- Series of High Court decisions

#### Key Recommendations

Review the code of practice of the building & construction industry

Government to retain more risk

Establish an independent Vic Infrastructure Advisory Council

National Risk Allocation Model established by National Taskforce

Develop a principal controlled PI scheme for consultants of construction projects

## 5.2 Background

*“Without liability insurance the tort system would long ago have collapsed under the weight of the demands put on it.”*

(Professor JG Fleming “The Law of Torts”)

Significant changes have occurred in project delivery in Australia in the last decade or more, involving:

- Major private sector investment in infrastructure
- A decline in public sector technical capability and experience in understanding of the design or construction process
- A major shift by project initiators to substantially reduce their risk and allocate it to others in the construction process
- Significant developments in methods of project delivery: Design & Construction, Build Own Operate Transfer and its variations, alliancing, Joint Venture, Public Private Partnership
- Novation involving conflicting responsibilities and duties to multiple parties.

A key underlying assumption in these changes has been the availability and role of insurance. The recent crisis in insurance has far reaching implications for the construction industry.

HIH has collapsed and QBE has withdrawn from the PI insurance market at the large end of the engineering/construction industry market in Australia. HIH was reputed to be Australia’s leading PI insurer in the engineering market and QBE was reputed to be the second largest insurer. Since 11 September 2001, other insurers have pulled out of the Australian market, including St Paul.

The insurers continuing to offer PI insurance are doing so on terms that involve significantly higher premiums and deductibles and more restrictive terms. The October 2002 report by the Senate Economics References Committee following its review of public liability and professional indemnity Insurance notes, in relation to the effect of the insurance crisis on Engineers, that “many firms report increases of 20 – 50 per cent during 2001; in some cases more than 100%. Some perceived high-risk categories are becoming difficult or impossible to insure, and insurers are only offering policies with excesses/deductibles, which are between 5 and 20 times what they were in 2000”.

Risk management and risk allocation practices in the building and construction industry involve clients and beneficial owners with significant market power (including Government) shifting excessive, uninsurable and sometimes all risk and liability to contractors and prevent any recourse to the client through extremely onerous deeds. The risk reward equation for 20 year BOOT reward liabilities is unbalanced.

While there has not been evidence of significant claims by Governments on contractors, there has been a further shift of client risk by contractors to smaller players such as professional consulting firms and sub-contractors. At the end of the line, the only recourse to management of the risk so shifted is insurance.

Reliance on professional consultants’ PI insurance has become a standard business strategy by contractors to transfer their own risk and contractual obligations and to offload their costs. The changes that have taken place in project delivery have resulted in inadequately defined design criteria and insufficient time for tender preparation and design development.

The table below provides information on the building and construction sectors value over the past three years and projections to 2006.

### Value of Victorian construction activity (\$million)

Construction Activity	1999	2000	2001	2002	2003	2004	2005	2006
Residential Building	9741	8562	9622	8556	7797	7968	8337	8903
Non-Residential Building	3433	3400	3771	3891	4090	3777	3415	3479
Engineering Construction	3488	3148	3072	3388	3391	3704	3597	3554
<b>Total Construction (\$M)</b>	16662	15110	16466	15836	15278	15448	15349	15935

*\*All values referenced to 2000 and represent value of work done. Data prepared by NIEIR for the APCC*

## 5.3 Issues

### Onerous contract regime

The last 3 to 5 years have been marked by an increasingly onerous contract regime, especially in major projects, to a large extent initiated directly or indirectly by at all levels, involving, amongst other matters:

- Allocation of risk beyond parties' control
- Unlimited liability, including liability for economic and consequential loss
- Open ended "no-fault" indemnity clauses. Lawyers acting for principals, including government principals, quite openly advise their clients not to agree to make the clauses dependent on fault because, if the clause is left unqualified, all the client has to do is prove that it has suffered loss and damage and liability is automatically established. The intended strategy is to actually make parties liable for losses that are not their fault.
- Guarantees of outcomes that cannot be guaranteed – for example, unqualified fitness for purpose warranties, warranties about defect free / free from error design. There is an inadequate understanding of the design process and in particular a misconception that design is a precise process.
- Unreasonable and sometime impossible insurance levels and requirements. Until recent times, even the largest projects in Australia had contractual requirements for consultant PI insurance of no more than \$5 million in the aggregate. That contracted level of cover has been pushed through the \$10 million barrier, then the \$20 million barrier, then the \$50 million barrier and finally the \$100 million barrier. It is little surprise that the PI insurance market has reacted adversely. The attitude of underwriters is that they are no longer willing to be viewed purely as capital underwriters of major public infrastructure works in place of s whose roles previously included the burden of such risk. Even after the insurance crisis, contractors continue to require PI insurance to be maintained for indefinite periods. Such requirements ignore the realities of how PI insurance operates. Except for Project Specific insurance that is both

difficult and extremely costly to obtain, PI insurance is generally annually renewable insurance. It is impossible to provide guarantees that PI insurance will be maintained for periods of 10 years or longer. Such provisions highlight the dependence on insurance in project delivery.

- Lump sum fees that are not commensurate to the risk. Selection criteria for tenders almost invariably favour the lowest price over quality. The pressure on price almost invariably places pressure on quality of delivery. Issues related to quality of delivery are frequently cited as the reason for making contracts onerous. All in all a classic “Catch 22”.
- Uninsurable standards of care and liabilities. Apart from using such clauses as a threat, it is submitted that the imposition of uninsurable standards of care and liabilities is counterproductive. It will increase the likelihood of underwriters denying liability to indemnify. If there is no insurance, there may be little else. It is submitted that the imposition of unlimited liability and uninsurable standards of care and liabilities provide illusory security and comfort at the end of the day to principals.
- Total disclaimers of responsibility for client-provided information and input. These disclaimers represent the high water mark of risk shedding.
- Novation deeds that release and indemnify principals from and against pre novation liabilities, leaving other parties to bear the burden of liabilities caused by the principal – for example, inadequate briefing – plus encouraging the contractor to impose the same terms on others
- Liquidated damages. The regime of liquidated damages can have crippling and inequitable consequences, particularly in the context of their “flow on” effect down the contract chain. Consultants are frequently under pressure to accept liability for the significant liquidated damages imposed on contractors, including delays that may not even be the consultant’s fault
- Inappropriate and misconceived certification requirements. Project Deeds frequently contain certification requirements that are based on misconceptions about the roles of contractors, engineers and architects
- Bar on claims clauses. These clauses bar claims not notified within what are often short periods and extend even to claims for contribution in proceedings brought by third parties
- Tender conditions that prohibit and make a tender nonconforming if concerns with risk allocation or contract conditions are even raised.

### **Costly Legal Environment**

This contracting regime has been encouraged by a lack of development or inappropriate developments in the law and legislation, including:

- The continued application of joint and several liability that targets the insured party or parties
- The evolution of the application of the Trade Practices Act in a way that was not intended or anticipated. A 1986 amendment to the Trade Practices Act exempted architects and engineers from provisions of the Trade Practices Act by which a consumer relying on a corporation’s skill or judgment has the benefit of an implied warranty of fitness for purpose. The purpose of the amendment was to recognise the inappropriateness of implying such a warranty in the provision of architectural or engineering services. The effect of that amendment has all but been rendered ineffective by the way in which the misleading and deceptive conduct provisions of the Trade Practices Act have been interpreted, applied and used in recent years. The first line of attack in construction industry disputes is now often allegations of misleading and

deceptive conduct under the Trade Practices Act. The State Fair Trading Acts mirror the same provisions

- Complex and costly court processes
- A series of High Court decisions that have resulted in a severe imbalance of risk and exposure, especially for parties at the end of the contract chain. Namely the decision in *Astley v Austrust* with an as yet lack of uniform national legislative response to that decision. The recent High Court decisions holding that the Trade Practices Act leaves no room for the application of doctrines of contributory negligence and/or apportionment of damages. The High Court decision in *FAI General v Australian Hospital Care* with the resulting uncertainty about the operation and efficacy of claims made policies.

### **Design and Construct method of delivery**

Specific mention should be made about the Design and Construct method of delivery. It creates particularly high risks for parties lower down the contract chain because every party above them seeks to push the risks down the chain. Because it is design consultants who often sit near or at the bottom of the chain, their PI insurance policies are constantly under pressure to underwrite what are economic and commercial losses suffered by contractors higher up the chain.

By contrast, the level of reward for consultants on such projects is in inverse proportion to the risk they are expected to bear. At times Governments allow insufficient time for tender preparation and design development and select successful tenderers on price rather than quality. By using devices to create the perfect guaranteed lump sum price contracts, Governments have created an environment where there is a high risk for construction contractors to make commercial losses because of unanticipated circumstances. Contractors in turn try to pass that risk down the contractual chain to the point where somebody else's insurance policy can be made to respond to what is essentially a commercial loss. The PI insurance market recognises this and is resisting it.

The comments made in relation to the Design and Construct method of delivery is equally applicable in relation to the BOOT and similar methods of project delivery. The Institution of Engineers Australia has undertaken as part of its 'Finding Solutions' initiative an intensive review of current practices and policies relating to major infrastructure projects in Victoria. As a result of the many significant concerns raised during the review, the Institution recommends the establishment of a Victorian Infrastructure Advisory Council (VIAC) made up of members with the appropriate level of professional expertise, nominated by relevant industry, professional or community bodies.

VIAC would provide independent policy advice to Government on infrastructure policy, provide advice on long term strategic planning of infrastructure and provide independent advice to ensure optimal project delivery models are adopted, on a project by project basis, with proper management of project risk. This initiative will lead to better outcomes for the provision of infrastructure for Victorian communities and provide best value for money solutions in the long term.

### **PI insurance to professional consultants**

The uncertainty over the availability of PI Insurance to professional consultants has become a major risk to public sector clients. Clients are exposed to the risk of insurance non-renewal or policy changes during any engagement or period of consultant liability. Clients are seeking levels of cover that have become difficult to obtain for many practitioners or at a high level of premium. Public sector clients are in

a position to manage the PI insurance risk by implementing, subject to availability, a Principal Controlled PI Insurance scheme applicable to all professional consultant services in public construction.

This would provide public sector clients with certainty over the currency, levels of cover and provisions of the policy. As public sector projects are believed to result in fewer PI claims than the industry generally a financial benefit may also result to Government in relation to its favourable claims history related to the processes it employs in selecting higher performing professional consultants. In theory reduction in PI cover being provided by consultants should reduce excessive insurance costs being passed on to clients in fee proposals

### Cost of insurance to Victorians

The table below provides estimates of the cost of insurance in Victoria for 2001 when a total of \$16.5 billion was spent on building activity. The insurance component has been estimated to be 5% to 20% of project cost depending on the type of activity. The money saved from insurance will build additional new assets for the future. Every 1% reduction in insurance cost in 2001 would have made an additional \$16.5 million for building and construction – the equivalent of a 160 bed hospital or 164 kilometers of railway track per year.

### Estimated cost of insurance for Victorian construction activity 2001 (\$million)

Construction Activity	Value 2001	Insurance at 5%	Insurance at 7.5%	Insurance at 10%	Insurance at 15%	Insurance at 20%
Residential Building	9622	481	722	962	1443	1924
Non-Residential Building	3771	189	283	377	566	754
Engineering Construction	3072	154	230	307	461	614
<b>Total (\$million)</b>	<b>16466</b>	<b>824</b>	<b>1235</b>	<b>1646</b>	<b>2470</b>	<b>3293</b>

\*All values referenced to 2000 and represent value of work done

## 5.4 Recommendations

- 1) Review the Victorian Code of Practice of the Building and Construction Industry, including:
  - Improvements to the complaints and compliance regime by greater industry participation
  - Reviewing processes to permit discussion that results in determination of appropriate risk allocation;
  - Placing a greater emphasis on quality and non-price issues as selection criteria.
- 2) Redress the risk allocation balance with Government retaining more risk to insure competition in the market amongst suppliers. This can be implemented by:
  - The acceptance of limited liability or defining liability in a more certain way

- The introduction of fairer Australian Standards or standard forms of contracts, including fault based liability
  - Amendments to the Trade Practices Act and corresponding State Acts to restrict the operation of the legislation to true consumer protection and in any event to provide for apportionment of fault
  - The replacement of joint and several liability with proportionate liability at a national level
  - Use of Bills of Materials as a risk management tool by defining and controlling cost management of projects.
- 3) The establishment of an independent expert Victorian Infrastructure Advisory Council (VIAC) to provide strategic advice on the long term planning of infrastructure and to provide independent oversight on significant aspects of infrastructure delivery. This would include the selection of optimal project delivery models, proper management and allocation of risk.
  - 4) The establishment of a National Task Force representative of all industry sectors to formulate a National Risk Allocation Model.
  - 5) A review of court processes to discourage parties that launch dubious or inadequately articulated claims as a strategy to force payment out of parties who cannot afford the cost of fighting litigation.
  - 6) Development and implementation of a Principal Controlled PI insurance scheme for public construction projects.

## 6. Change Driver 2: Reduction of underlying risk

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### 6.1 Project Summary

**Project Leader:** Peter Walsh

**Background:**

Professional associations identified risk reduction as a high priority to support the accessibility and sustainability of building professional indemnity insurance. The objective of Action Step 4 was to facilitate a process to develop recommendations to reduce underlying risk for professionals over the long term. The parties with significant input to this process are the professionals, their associations, the registrar and the insurers.

There is scope for insurers, practitioners, their associations and the Building Commission to work together to better understand and reduce underlying risk. The insurance industry has made it clear that unless all levels of risk associated with the building industry are addressed, they are unlikely to continue to offer complying PI. As the insurers generally apply a national approach to risk assessment for Australia, a national approach to managing underlying risk is required.

#### Key Issues

- Clearly risk management is a key issue to be addressed by all the professionals, their associations and the insurers. However for each party to make an informed contribution to managing and therefore reducing underlying risk, the risk needs to be identified and quantified
- Insurance companies have admitted a lack of appropriate statistics to identifying specific risks in the Building Industry. This results in inconsistent quotes for PI insurance
- Insurers do not assist customers with risk management strategies in Australia
- Insurers assess the building and construction sector in Australia on a national basis. Therefore risk management is a national challenge and associations can promote a national approach
- In response to a strong industry mandate the Commission and the Building Practitioners Board are proposing the introduction of a compulsory building industry CPD program
- Alternative dispute resolution processes will provide opportunity to resolve disputes without claiming on insurance

#### Key Recommendations

To lower risk capture and analyse data nationally	Establish a compulsory CPD program & 'quality assurance' system linked to registration	Each building profession to establish a code of practice subject to review	Review incentives for use of risk management plans

## 6.2 Background

Professional associations identified risk reduction as a high priority to support the accessibility and sustainability of building professional indemnity insurance. The objective of this Working Group was to facilitate a process to develop recommendations to reduce underlying risk for professionals over the long term. The parties with significant input to this process are the professionals, their associations, the regulators, the insurers and consumers.

Prerequisites for the six categories of building professional covered by the Ministerial Order to operate include registration and the ability to obtain compliant PI insurance. Those who do not meet the requirement to register or obtain insurance cannot register. These two prerequisites largely regulate the professionals covered by the Order. Several other building industry professional categories are not required to register.

To register practitioners need to meet certain professional standards (qualifications and experience) and in some cases participate in a CPD program. To obtain PI insurance, insurers take account of a range of criteria including: annual billings, type of work done, claims history and the size of the company.

There are approximately 4,700 professionals registered with the Building Commission and over 3,000 architects registered with the Architects Registration Board. The table provides details.

### VICTORIAN PRACTITIONER REGISTRATION REQUIREMENTS

Practitioner Class	Total Practitioners (VIC)	Compliant PI Required for Registration	Compulsory CPD Programs <sup>1</sup>	Voluntary CPD Programs
Architect	3322	No	No	Yes
Building Inspector	398	Yes	No	Yes
Building Surveyor	476	Yes	No	Yes
Draftsperson	1995	Yes	No	Yes
Engineer	1685	Yes	Yes (CPEng status only) <sup>2</sup>	Yes
Quantity Surveyor	101	Yes	Yes (corporate members only)	Yes

Practitioner Associations range in size and generally consist of a national body with State Chapters or Divisions. Memberships of Associations vary according to the level of membership and the particular requirements of the Association involved.

<sup>1</sup> \* CPD Programs offered by a range of Professional Associations including the RAIA, BDAV, MBAV, AIQS, IEA, AIBS, ACSEV, AIB and ACEA.

<sup>2</sup> Not for resignation purposes

Generally, however, membership requirements consist of three main elements:

- Academic: Degree / Diploma / Trade Certificate in said profession
- Competency: Determined by references / nominations by current members / determined by the Board, and
- Experience: This requirement ranges from 3 to 10 years experience

The role of these organisations is to be a representative body for their particular profession and to:

- Promote the views of their members
- Advance their profession
- Develop the highest standards of professionalism through codes of conduct, best practice policies and membership requirements
- Support and encourage education and training of members in the form of CPD programs.

Practitioner Associations in Australia generally offer CPD programs in a voluntary capacity to their members and actively encourage participation in CPD to maintain professional standards.

Practitioner Associations in the United Kingdom usually offer CPD programs on a voluntary basis, however it is a compulsory requirement of membership of select classes of practitioners such as architects. Both the Chartered Institute of Landscape Architects United Kingdom and the Royal Institute of British Architects state that participation in CPD is a mandatory requirement of membership.

In contrast, practitioner associations in the United States advise members that the satisfactory completion of specified activities is a condition mandated by most States for the renewal of the individual's professional license. Whether a State adopts a Continuing Professional Competency (CPC) requirement is ultimately decided by the state's legislature, licensing board, and/or professional society.<sup>3</sup> Most associations have Professional Development resources for members to access.

Insurers are applying more rigorous assessment criteria and this is contributing to PI becoming less accessible (less available and affordable). The market in Australia is concentrated with three main PI providers mainly internationally owned. All reinsurers are international companies.

There is a lack of data and, as a result, information to make informed decisions about risk. Insurers do not necessarily understand or consider state differences in relation to registration requirements and the regulatory environment, nor is there reliable publicly available industry data on PI claims history, premium and policy changes. Both factors impact on insurers ability to assess and address underlying risk issues. Quotes for PI vary considerably amongst professionals often with no apparent justification.

At the same time past market practices, capital obligations, and claims with a wide ranging liability effect are causing the insurance industry to consolidate and reassess their business practices – a major factor causing less accessibility of PI insurance.

The insurance industry in the United Kingdom has recently become more interested in the risk management strategies and plans linked to CPD programs as they may reduce claims made for professional indemnity insurance. Some insurance

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<sup>3</sup> National Society of Professional Engineers, [www.nspe.org](http://www.nspe.org), *CPC Status in the States*, 08/06/2002.

companies in the UK, and one in Australia, are now recognising CPD programs within a company as one element to be considered when calculating the premium for a professional indemnity policy.<sup>4</sup>

The insurance industry in the United States is proactive with regard to supporting practitioners who participate in Continuing Professional Development schemes. This support varies from rewards and incentives for participants (e.g. premium reductions or broader coverage) and advice regarding risk management education programs, to mandatory and voluntary loss prevention programs tailored specifically for the building practitioner market.

Some US insurance companies identified the difficulties facing small firms in obtaining PI Insurance and offer mandatory risk management education programs as a requirement for obtaining small firm professional indemnity insurance.<sup>5</sup>

The changing emphasis placed upon loss prevention schemes in the US has been a contributing factor to the significant decrease in claims by practitioners. As the number of claims has decreased, accordingly this has led to greater competition amongst insurers. RA&MCO Insurance Services, for instance, state that as engineers have become better risk managers, premiums have decreased and incentives, such as broader coverage, are being offered as competitors try to outdo each other.<sup>6</sup>

### **6.3 Issues**

Clearly risk management is a key issue to be addressed by all the professionals, their associations and the insurers. However for each party to make an informed contribution to managing and therefore reducing underlying risk, the risk needs to be identified and quantified. Therefore each profession needs to be able to provide better information on exactly what they do when delivering specific services.

Most associations are in the process of developing risk management and code of practice guidelines for members. CPD programs offered by practitioner associations are however actively promoted on a voluntary basis. Compulsory CPD programs are currently under consideration as a prerequisite for registration.

New market entrants are experiencing great difficulties in obtaining PI insurance in the current market.

#### **Registration**

The Building Practitioners' Insurance Ministerial Order specifies six categories of building practitioners and their insurance requirement for registration. The table above provides information on registrations for 2002.

The link between registration and mandatory complying PI insurance has become a major issue for building professionals in Victoria. There are concerns about the accessibility and sustainability of the product. Professionals need to meet the requirements for registration as set out in the Application for registration under the Mutual Recognition (Victoria) Act 1998 and the Commission competencies

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<sup>4</sup> The CPD Certification Service, [www.cpd.uk.co.uk](http://www.cpd.uk.co.uk), *Introduction to Continuing Professional /Personal Development*, p.2.

<sup>5</sup> David Siegel, *Engineering Times*, *Engineers Find More Insurance Options, Lower Costs*, 01/1996. Refer to Appendix for DPIC Companies Program Overview.

<sup>6</sup> David Siegel, *Op Cit*. Specific examples regarding engineers are cited in the article.

requirements and registration process. Architects are deemed to be registered as a Building Practitioner if registered with the Architects Registration Board, who has no mandatory requirement for PI.

### **Insurance**

Insurers are adding exclusions, increasing deductibles and/or greatly increasing premiums, for certain categories of practitioners. Major areas of policy restriction are being introduced including asbestos and biological treatments. Certain categories of consultants are experiencing great difficulty in obtaining insurance cover including geotechnical engineers, fire safety inspectors and water treatment service providers. In some cases little justification is provided for their decisions and the link to underlying risk of the individual practitioner or the functions they perform are unclear.

At present insurers do not assist customers with risk management strategies and plans in Australia.

### **Associations**

How can associations play a role to ensure that members make fewer claims and understand the risk of all the activities they perform? Associations are working towards assisting their members to better understand and manage risk. However currently, most associations have not fully documented the competencies required of each activity performed by a practitioner, thus making it difficult to foresee and identify risks associated with particular tasks. An opportunity exists for them to comprehensively document roles, functions, risk management strategies and a code of practice for their members.

Insurers generally assess the building and construction sector in Australia on a national basis. Therefore risk management is a national challenge and associations need to promote a national approach and support a regional dialogue as appropriate.

Associations do actively promote CPD programs to their members. Participation in a compulsory CPD initiative, in conjunction with a best practice document, would help members better understand and manage their risks. However it is not mandatory to be a member of any professional association to register.

### **Continuing professional development & risk management**

There are few professional organisations that are subject to registration requirements through an Act of Parliament and even fewer where participation in a CPD program is a condition of registration. An exception to this is the medical profession where CPD is compulsory and is a condition of registration.

Architects are required to register with a statutory authority (Architects Registration Board) with the CPD program managed by the professional association (RAIA). In this case the CPD scheme is voluntary and not tied to registration nor is it a requirement under the Act. Other registered building practitioners are subject to registration with a statutory body and most do have voluntary CPD programmes.

In response to a strong industry mandate the Commission and the Building Practitioners Board are proposing the introduction of a compulsory building industry CPD program. The program will be linked to annual registration across all registered practitioner categories.

The CPD program will benefit consumers, the building industry and registered practitioners. Through improved knowledge, skill and performance standards practitioners will be better placed to manage and reduce underlying risk.

The ACEA are developing a Code of Practice with a strong emphasis on risk management and reduction of underlying risk.

Quality assurance systems focus on complying with professional standards on a day-to-day basis. Development and/or adherence to QA system to be monitored.

### **Independent data**

It is essential that the building and construction industry have in its possession statistical data relating to the claims experience (both historical and current) of building practitioner categories and of the industry generally. Many disputes are however settled out of court.

A mechanism needs to be put in place that enables the monitoring of future claims made against building professionals. The new regime for monitoring claims experience may be implemented centrally or via the various industry associations representing the building practitioner categories.

The objectives of such an analysis and continuing monitoring regime are as follows:

- To enable the industry, industry associations and Government agencies to have a comprehensive and accurate understanding of the actual claims experience of the industry generally and the discrete facets of the industry.
- To enable building practitioners and industry associations to implement appropriate risk management and professional development strategies.
- To assist the building and construction industry in premium and contract negotiations with insurers.
- To protect and enhance the reputation and status of the industry and prevent disinformation.

### **Use of alternative dispute resolution**

With the changes to builders warranty insurance from first to last resort insurance, a dispute resolution process, the Building Advice Conciliation Victoria (BACV) has been put in place. This service will strengthen consumers protection measures and promote a better standard of building.

Alternative dispute resolution processes will provide an opportunity to resolve disputes without claiming on insurance. Dispute minimisation guidelines for practitioners and consumers will educate all parties to a contract of their obligations and assist to manage expectation.

There is scope for insurers, practitioners, their associations and the Building Commission to work together to better understand and reduce underlying risk. The insurance industry has made it clear that unless all levels of risk associated with the building industry are addressed, they are unlikely to continue to offer complying PI. As the insurers generally apply a national approach to risk assessment for Australia a national approach to managing underlying risk is required.

## 6.4 Recommendations

- 1) Practitioners, associations, insurers and the Building Commission to work in partnership to manage and reduce underlying risk in Victoria and nationally.

Examples of areas to examine include:

- Alternative dispute resolution processes and dispute minimisation guidelines developed for practitioners and consumers
  - Associations to develop a Code of Practice and Risk Management guidelines for members in consultation with insurers and independent parties
  - Record exactly what each profession does in the delivery of specific services with the associations taking the major role
  - Insurers to work with professionals to develop risk minimisation strategies
  - Insurers to acknowledge CPD participation when calculating premiums for PI Insurance.
- 2) Compulsory CPD program and “quality assurance” system to be introduced and linked to registration:
    - A minimum number of CPD point to be dedicated to risk management with random audits of risk management procedures
    - Adherence to professional standards in day-to-day operations.
  - 3) An independent national claims experience data collection and monitoring regime established.
  - 4) All practitioner categories covered under the Ministerial Order to provide proof of complying PI for registration.

## 7. Change Driver 3: Improved regulatory & legal environment

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### 7.1 Project Summary

**Project Leader:** Kim Lovegrove

#### **Background:**

The reforms set out in the Building Act such as joint and several liability, the introduction of a 10 year cap on liability for building actions, registration and insurance requirements demonstrate the holistic nature of the Act. Joint and several liability reform and the 10 year cap would not have been allowed without the demonstrated need for it as part of the private certification process.

Compulsory insurance helps maintain community confidence in the private system because it provides a capacity for key players to contribute financially in the event of a legal action replacing the “deep pocket” funded through council ratepayers. Without insurance the joint and several liability reforms in the Building Act would be negated, as courts would be unlikely to allow unfinancial building practitioners to be joined in a legal action. Without a fair distribution of the costs of a legal action it is unlikely insurers would be prepared to provide PI insurance at reasonable cost (if at all) therefore making the private system an unattractive option to the community.

#### **Key Issues**

- Better define responsibility under the Building Act 1993
- Better risk management by building surveyors
- Increasing pressure on professional fees and the impact this has on the quality of advice and service
- The Ministerial Orders have traditionally been general in nature and on the levels of accountabilities for the different categories and classes. This may have a detrimental effect of creating confusion or blurring the liabilities
- Penalise / legislate to discourage vexatious litigation

- Accountability and risk need to be better identified
- The Trade Practices Act should be amended to ensure that it is not used to negate the joint and several liability reforms and the 10 year cap established by the Building Act 1993
- There is a need to explore the value of a building legislation advisory service for all practitioners
- To protect the industry, consumers and practitioners a national approach is required to address a national problem

#### **Key Recommendations**

- Lower BS & BI liability period to 1 year

- Change regulations to strengthen BS risk management

- Court & VCAT rules reviewed
- Mandatory mediation

- MO to state risk & accountability by profession
- Audit Acts for compatibility

- Improve BCA, regs & BA understanding est. BC advisory service

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- Immunity from economic loss
- Cap liability

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## 7.2 Background

The Building Act 1993 is based on the Model Building Act which was developed by the predecessor to the Australian Building Codes Board for use by the State and Territories as template legislation for the introduction of private certification as an alternative to the council based building permit system.

The reforms set out in the Building Act such as joint and several liability, the introduction of a 10 year cap on liability for building actions, registration and insurance requirements demonstrate the holistic nature of the Act. Joint and several liability reform and the 10 year cap would not have been allowed without the demonstrated need for it as part of the private certification process.

Compulsory insurance helps maintain community confidence in the private system because it provides a capacity for key players to contribute financially in the event of a legal action replacing the “deep pocket” funded through council ratepayers. Without insurance the joint and several liability reforms in the Building Act would be negated, as courts would be unlikely to allow unfinancial building practitioners to be joined in a legal action. Without a fair distribution of the costs of legal actions, it is unlikely insurers would be prepared to provide PI insurance at a reasonable cost (if at all) therefore making the private system an unattractive option to the community.

The Ministerial Order which set out PI insurance specifications included a requirement for “runoff” as it was recognised that without run-off current building practitioners would progressively end up shouldering the burden for those who left the industry through retirements or other reasons. This is because those practitioners no longer in the industry, could not be prevented from disposing of assets rendering them immune from litigation.

Insurers were prohibited from charging an explicit extra fee as they could not guarantee continuity of runoff indefinitely because of the annual nature of re-insurance. A trade off for not being able to charge an explicit fee for runoff was that insurers could cease to provide runoff if they exited the market and gave one month’s notice to the insured. It was anticipated that a portion of the annual renewal premiums would be set aside to cover runoff however the competitive nature of the insurance market and the cost of claims have left insurers unable to continue to meet the requirement for runoff under the existing terms.

The PI insurance market has hardened significantly as described in the introduction. In this context, steps to redefine and redistribute the level of exposure faced by insurers without detracting from protection needed to support the Building Act have assumed high importance. On their own, these wild swings in market conditions will not be repeated but they may assist to provide a more defined risk platform for the insurance industry.

## 7.3 Issues

### Changes to the Court and VCAT rules

- **Penalise vexatious litigation**

A great many cases initiated by plaintiffs are for sums of money that far exceed the real worth of the claim. Hence the expressions “ambit claim” or “vexatious litigation”. It has been claimed that more than 50% of building cases are characterised by ambit claims where the claims are more than 500% above the odds and in one case a plaintiff sued for \$350,000 but its real worth was less than \$15,000.

Penalties for ambit claims would put pressure on plaintiffs to apply more rigour to claims quantification and reduce the incentive to manufacture causes of action, thereby reducing litigation and court time.

There should be penalties for vexatious litigation to reduce claims inflation as occurs at present where rejection of a reasonable offer can be penalised by the plaintiff having to cover some or all of a defendant’s costs.

- **Legislate to discourage litigation**

Some overseas jurisdictions have legislative disincentives built into their systems to discourage vexatious litigation. One Scandinavian country imposes a high claims lodgement fee. In Japan a plaintiff has to pay into the Court a filing fee that is equivalent to 1% of the total amount claimed in the case. A compulsory filing fee related to the cost of a claim increase funding for the system and help to make it more efficient and effective by dealing with the demand and supply aspects through the same strategy.

A compulsory filing fee related to the cost of a claim should be introduced in all jurisdictions.

- **Independent experts and expert assessment**

The use of the adversarial approach through the engagement of competing technical experts to help determine the extent of and liability for building defects is arguably no longer sustainable and a new model is appropriate. The simple act of determining technical facts in a building action can waste many days of court time. Independent experts can reduce the scope for disputation and the length of disputes could be significantly reduced thus lowering the overall cost structure for PI insurers.

Parties to a dispute should be required to jointly fund a neutral expert appointed by a third party such as the Building Commission.

- **More use to be made of experts at VCAT**

The practises and procedures of VCAT should be reviewed to simplify the process and speed up hearings by using more experts on the hearing panels instead of relying on competing experts.

- **Fairer negligence test**

A fairer threshold test for negligence by building practitioners should be developed and articulated which is based on peer review/standards and is not simply outcome driven.

- **The Crown should ease pressure on PI insurance**

The Working Group noted the increased risk posed by the use of novated contracts in the public sector as a special issue and the appetite of the Crown for unrealistic levels of PI cover/indemnity from professionals it engages.

The Crown should play a constructive role in reducing the pressure on PI insurance.

### **Changes to the Act/Regulations**

- **Better define responsibility under the Building Act 1993**

Building surveyors are primarily responsible for ensuring that what is built is safe, and fit for occupation on behalf of the community. Section 24(1(a) of the Building Act requires the relevant building surveyor to be satisfied that “the building work and building permit will comply with this Act and the building regulations. Their involvement on a building site is also far more limited than that of a builder, yet there is an expectation on the part of the community and the Courts that building surveyors are an ultimate community backstop for quality control.

These are onerous responsibilities that arguably load the liability risk unfairly against the relevant building surveyor (RBS).

The Building Act should be reviewed to articulate the responsibility of each building practitioner category. The RBS does not specify, determine or nominate design criteria to which a proposal must comply. It is the responsibility of the designers to investigate, determine and document a design, to comply with the Building Code and any relevant Australian Standards.

The RBS must determine that the building work complies with the Regulations. In carrying out mandatory inspections of building work a RBS must ensure that the building work complies fully or substantially with the building permit issued. An inspection is not an inspection that determines or confirms a level or degree of quality, standard of workmanship, durability or level of finish to a building. This is the responsibility of the architect / project manager / engineer and / or the builder and may be subject to contractual arrangements with the land and building owners.

An Occupancy Permit is a certificate, which as indicated above, is a certificate confirming suitability of occupation, not compliance with the Building Act or Regulations. The responsibility of a RBS in regard to issuing an Occupancy Permit is to have due regard to when the building works are substantially completed and when the building is suitable for occupation.

- **Better risk management by building surveyors**

Scolaro's case demonstrated clearly that liability protection of section 128 of the Building Act would not apply if the building surveyor has not acted in good faith in accepting and relying on a Form 14 compliance certificate. In this case the judge held good faith was not present because the Form 14 was inadequately filled in, the building surveyor's knowledge of the skills and experience of the building inspector who issued the form was lacking, there was a lack of oversight of the building inspector's activities and the low rate of remuneration which averaged at \$10 per visit (which should have alerted the relevant building surveyor could be a temptation to cut corners.

Building surveyors should be alerted to their responsibilities to use appropriate judgment when accepting certificates of compliance issued under Regulation 15.7 of the Building Regulations 1994. The processes under the Building Act and regulations to be strengthened to reinforce obligations of the RBS in accepting certificates.

- **Immunity from economic loss claims for building surveyors**

The *Dutton v Bognor Regis* in the UK ruling granted building surveyors immunity from liability for economic loss because of their role in carrying out a statutory function. Giving building surveyors immunity from claims for economic loss would improve their insurability and help maintain the long term viability of private certification.

- **Shorten the 10 year liability tail**

Under section 134 of the Building Act a plaintiff has 10 years to initiate legal proceedings. The 10-year tail was an "import" from the French *liabilitie decennial* concept, which dated back to the Napoleon Code. It was also based on the fact that by year 10, there were virtually no claims in respect of buildings built 10 years prior. The market however is now balking at the requirement to provide indemnification for this period of time.

Consideration could be given to a shorter tail as in the Limitation of Actions Acts that prescribes a period of six years for the initiation of legal proceedings. *(However, a decision in this area falls within the jurisdiction of the Attorney General)*

Possibly distinguish between "design / construction practitioners" and the "approval practitioners" (i.e. building surveyor and inspector) with regard to their function, role and responsibility. In turn then the relevance of the tail should be determined for each practitioner group.

It is considered that 10 years may be appropriate for design / construction practitioners as their responsibility extends to quality, workmanship, functionality, durability, finish etc. The responsibility of the approval practitioners is limited to regulatory compliance and suitability for occupation wherein a shorter tail e.g. 1 year is possibly more appropriate.

- **Cap level of liability**

A great source of concern is the increasing pressure on professional fees and the impact this has on the quality of advice and service. An incentive should be provided to encourage a more realistic attitude to fees among clients in an environment where the Trade Practices Act can limit the level of guidance that can be provided in respect of professional fee setting. A capping on the quantum of liability should be considered that creates a nexus between liability and the level of fees.

- **Legislate for mediation as a first resort**

The VCAT experience suggests that 70% of cases are resolved through mediation.

The Domestic Building Contracts Act could be amended to require that building industry contracts should contain a mediation clause in it with:

- Each party to pay for the costs of the mediation on a 50/50 basis
- No claim can be made upon either an insurer or a building practitioner unless the mediation route has been attempted.
- Dictate that any contract dispute must at first instance be referred to mediation

The Building Commission should establish an accredited panel of independent experts to adjudicate and provide evidence on technical building matters.

- **Strengthen requirements for documentation of performance-based decisions made by building surveyors.**

If a building that complies with the Building Code of Australia (BCA) is deemed to satisfy provisions this should normally be a complete defence at common law.

Mr Justice Eames in Scolaro's case noted that compliance with any referenced Australian Standard or any particular material, component, design or construction method set out in a deemed-to-satisfy provision is conclusive proof that the relevant performance requirement of the BCA has been met. He also noted that despite expert evidence to the contrary a 1000mm is not a mandatory provision of the Building Code of Australia, but if it is not, "the question whether a balustrade complied with the Code would be determined by whether or not it restricted accidental falling".

Building surveyors should be made aware that they must be more careful when making performance based decisions. They cannot ignore designs or as built building work which departs from the deemed to satisfy provisions of the BCA. They must at the very least document any decisions and be able to justify them in terms of the relevant performance requirements.

The Building Act and/or the building regulations should be amended to strengthen requirements for documentation of performance-based decisions made by building surveyors.

There is a need to revise the current legislative processes in the Building Act 1993 to ensure a minimum standard of building surveying independence is achieved. Perhaps most importantly there is a need to remove the influence of the person paying for the building permit from direct and indirect persuasion on the decision making process.

One possible method of achieving this is to mandate for independent 3<sup>rd</sup> party approval (under the control and direction (engagement) of the RBS) for significant departures from the Building Code of Australia deemed-to-satisfy provisions. The mandating of minimum process and documented justification will dramatically reduce risk by ensuring good practice becomes the accepted minimum.

Review the administrative arrangements for the Building Code of Australia and the administrative arrangements in the Building Act 1993 to ensure community building standards are being maintained.

### **Change to Trade Practices Act**

The Trade Practices Act should be amended to ensure that it is not used to negate the joint and several liability reforms and the 10 year cap established by the Building Act 1993.

### **Changes to the Ministerial Order**

- **Amend and re-state runoff requirement**  
It is paramount that a “Mark 2” runoff policy be promulgated early next year as indicated in the Minister’s Media Release.
- **Accountability and risk need to be better identified**  
The Ministerial Orders have traditionally been general in nature and on the levels of accountabilities for the different categories and classes. This may have a detrimental effect of creating confusion or blurring the liabilities. This would provide guidance to the courts and enable insurers to be better informed so that “risk and responsibility (is) commensurate with function” and responsibility. The Ministerial Insurance Order should be amended to include more ‘specificity’ about the PI risk associated with the roles of the respective building practitioners.
- **Limiting or contracting the scope of cover**  
It is notable that commercial builder cover since its introduction in the mid nineties has only provided indemnification for structural defects rather than general defects. This could be considered on a wider scale. However, the implications of making this a more general requirement on the attractiveness of private certification should be carefully considered. While the 1 July 2002 amendments for residential builders witnessed a profound reduction in risk for insurers, they have increased the pressure on PI for building surveyors.
- **Higher excess and greater opportunity for self-insurance**  
The levels of excess applying to insurance claims set out in the Ministerial Order have not changed in 8 years. Any claims or potential over the level of excess must be notified to insurers who then assume full control of the situation with a consequent impact on their administrative and legal costs.

A review of the levels of excess should be carried out to establish if there is scope for an increase in self insurance by building practitioners to make PI insurance a more viable and useful product for insurer and insured alike.

The failure of the Treasurers and Finance Ministers during November 2002 to agree to a uniform approach to negligence law as recommended by the Ipp Report will continue the legal uncertainty that exists between jurisdictions. This uncertainty, in so far as it relates to negligence causing death or serious injury, has the potential to diminish the benefits of the proposed legislative changes recommended above in so far. The damages awarded in Scolaro's case related to an injury caused through faulty design, approval, construction and inadequate inspection of a handrail to an apartment balcony.

### **Better risk management – a National solution**

The Australian Building Codes Board (ABCB) is the national custodian of the Building Code of Australia and responsible to develop and maintain the code. To protect the industry, consumers and practitioners a national approach is required to address a national problem.

Key to the solution is better risk management. The Building Act is predicated on a level of certainty that is not always supported by the Building Code. The Allen Report - a National Review of Home Builders Warranty Insurance and Consumer Protection - as well as the NSW enquiry on the Quality of Buildings identified the need for the BCA to provide greater certainty. To identify the gaps or weaknesses a compatibility audit on the interface between the Building Act and the BCA is required.

By Victoria taking a lead in addressing the recommendations from the audit it will provide an impetus for reforms to happen on a national basis. Builders, consumers and regulators would benefit from greater clarity and certainty.

### **Building Commission guidance/interpretation service**

There is a need to explore the value of a building legislation advisory service for all practitioners. The Government has produced legislation defining minimum building standards. However, practitioners often encounter problems with the interpretation of requirements on a daily basis (and not just relating to latest amendments to the Act).

The advisory service would help on day-to-day interpretation to all aspects of the industry, which would lead to a more informed construction practice. A more informed practitioner would ultimately provide a more efficient building industry and reduce the level of poor practice. The Building Commission to provide an advisory service on the interpretation of the Building Act 1993 and associated documentation such as the Building Code of Australia 1996.

## **7.4 Recommendations**

- 1) Introduce a package of changes to Court & VCAT rules:
  - Raised barriers to vexatious litigation
  - Increased representation of building experts on Hearing Panels
  - Fairer threshold test for negligence based on peer review
  - Input into cases from a mandatory neutral building expert versus adversarial building expert.
- 2) Lower liability period for approved practitioners to 1 year from completion of their statutory task.

- 3) Lower liability period for design and construction professionals to 6 years from completion.
- 4) Establish immunity from economic loss claims for building surveyors.
- 5) Investigate capping of liability to create a nexus between liability and level of fee.
- 6) Conduct audit of compatibility of the Victorian Building Act 1993 and the Building Code of Australia from a risk management perspective.
- 7) Investigate limiting scope of cover by providing indemnification only for structural defects rather than general defects.
- 8) Explicitly identify in the Ministerial Order the differing accountabilities and risks associated with the various practitioners.
- 9) Change regulations to strengthen mandatory risk management by building surveyors.
- 10) Improve building professionals' understanding and application of the Building Act, regulations and BCA, including a Building Commission advisory service.
- 11) Ensure mediation is a mandatory and effective first step in building dispute resolution.

## 8. Change Driver 4: Redesign of building PI

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### 8.1 Project Summary

**Project Leader:** Ian Blyth

**Background:**

Changes to many aspects of PI are already taking place. Many practitioners report the PI being offered has altered provisions such as national coverage. The process of applying also appears to be changing, either by design or by force of circumstances. Practitioners have noted higher levels of information requirements and much longer time required for review of applications.

Longer term, the redesign of PI for building should include a review of the fundamental rationales for insurance in the building industry. This includes a more responsible and realistic attitude by clients (including Government) to contracts and the engagement of consultants, more equitable sharing of risk through proportional liability. This should also entail a continuing commitment by Federal, State and Territory Governments to ensure that reforms to liability insurance should be implemented on a nationally consistent basis.

#### Key Issues

- The option of runoff cover in question
- Fast track amendments to the Trade Practices act to complement State & territory reforms
- Differing liability laws and legal arrangements across jurisdictions, and sometimes within jurisdictions, creates enormous difficulties for service suppliers.
- Commitment by industry to develop a Standard Risk Management Code of Practice that will establish minimum industry standards
- Adequate competition and prudential regulation of the insurance industry

- Joint and several liability should be replaced with proportionate liability in all contracts
- The taxation and stamp duty issues associated with public liability and professional indemnity insurance premiums should be addressed as part of the responses to the insurance crisis
- The General Insurance Code of Practice should be revised so that it provides remedies for small businesses that are affected by price exploitation in relation to public liability or professional indemnity policies

#### Key Recommendations

Establish a replacement for automatic ten year runoff cover	Adopts a national approach to PI insurance	TPA amendments to include changes to principle of contributory negligence & deceptive and misleading conduct	Cut Government taxes
Higher excess and greater opportunity for self-insurance			

## 8.2 Background

Building professionals, the small business sector and consumers in general are experiencing issues of affordability and accessibility of professional indemnity insurance. Professional indemnity insurance issues impact adversely on the small business sector, the built environment and the general community – these issues cannot be ignored.

This Working Group report proposes a mechanism which firstly, will make it more attractive for service suppliers to carry insurance sufficient to respond to legitimate claims made by a body who feels aggrieved by the results of the service provided and, secondly, promotes procedures which are intended to reduce the incidence of failures in the provision of those services.

These two outcomes can only benefit society in general, along with parties in any contract for services. Practitioners within the building and construction industry work in a large variety of sized businesses ranging from sole practitioners to multi-state practices employing over 100 staff. The majority are at the small end of the scale is either small firms or as sole practitioners.

As a society, we are experiencing worrying changes in the indemnity insurance market. Without a sensible compensation framework, the liability insurance environment will continue to become more hostile to those seeking to properly deal with their moral obligations to consumers. In summary the most pressing issues in the reform of PI Insurance matters include:

- Adverse consequences for the community
- Adverse consequences for the quality of the built environment
- Adverse impact on small business.

The cost of providing infrastructure projects for the community and the safety and quality of these facilities will increase as PI costs impact the tendering and construction process and as industry competition for projects decreases.

Reduced availability of services will result in higher services costs and major delays to projects requiring these services. The limited choice of suppliers for design of buildings and infrastructure will result in a reduced quality of product for community use. Firms who operate either without insurance or without enough insurance will disadvantage clients and consumers.

Consequently, the community will suffer because of the limited choice of suppliers for design of buildings and infrastructure, along with the restriction of services, which will put community health and safety at risk. The choice and availability of service providers for 'higher risk' category projects will become restricted as firms increasingly decline to bid. This will lead to reduced choice for these projects in the marketplace – accompanied by reduced quality and sustainability.

Services may also become unavailable to some development projects where the client has previously demonstrated either a litigious reputation or an unconscionable approach to conditions of contract. There is also a potential for non-compliance with those existing contracts in which commercial conditions require specific levels of PI insurance cover.

Future liabilities on existing contracts may be potentially uninsurable due to high cost or refusal of cover by insurers. Compliance with aspects of Trade Practices legislation may be jeopardised by PI insurance cover being unavailable.

The accessibility and affordability of professional indemnity insurance are leading issues for the construction industry sectors. In the longer term, the community and the economy will also be impacted.

Institutions and associations within the building and construction industry have reported that their members have experienced difficulties in PI insurance matters. These include refusal of PI cover, or rises in PI insurance premiums - in conjunction with increased levels of commercial risk through increased policy excesses or deductibles.

The impact of the accumulated problems is significant and unless remedial action is taken the situation can only worsen. To date:

- Some professional service firms have gone and will go out of business
- Some will diversify into other more commercially viable and 'lower risk' activities or client markets
- Clients including Government will have increasingly limited options for service delivery and costs will increase significantly.

Some critical services will be difficult to obtain – these include community facilities, research, development and building services.

Changes to many aspects of PI are already taking place. Many practitioners report the PI being offered has altered provisions, such as narrowed coverage. The process of applying also appears to be changing, either by design or by force of circumstances. Practitioners have noted higher levels of information requirements and much longer time required for review of applications.

### **8.3 Issues**

Longer term, redesign of PI for building should include a review of the fundamental rationales for insurance in the building industry. This includes a more responsible and realistic attitude by clients (including Government) to contracts and the engagement of consultants. It also includes a more equitable sharing of risk through proportional liability and a continuing commitment by Federal, State and Territory Governments to ensure, as a matter of priority, that reforms to liability insurance should be implemented on a nationally consistent basis.

#### **Redesign of PI**

Subsequent to the signing of a Ministerial Order, the automatic ten-year runoff cover in Victoria has been withdrawn as of 4 December 2002. This leaves the option of runoff cover in question and an alternative needs to be put in place to protect consumers and retired practitioners.

It is important to note that a critical mass incorporating sufficient risk of a like kind is needed for any or all of the following options to be viable. Therefore, consideration should be given to adopting the preferred option on a national basis.

## **Uniformity of legislation and regulation**

The authors of this paper acknowledge the national approach being undertaken by Government through the series of Ministers' Summits being conducted to date.

Since the first meeting in March, the Government has recognised the equal importance of the issue of professional indemnity insurance in the review of the liability insurance sector.

The recent agreement by Ministers on proportionate liability for economic loss and that the majority of jurisdictions are committed to implementing legislation was a positive move. It is also welcomed that the issue of capping liability and risk management via professional standards legislation is to be considered in detail as part of the Ministerial forward work program.

While the Commonwealth has introduced reforms to the Federal Parliament subsequent to the Ipp Report it is vital that action be fast-tracked to achieve Commonwealth amendments to the Trade Practices Act to complement State and Territory law reform.

The Federal, State and Territory Governments must maintain the momentum of reform and bring legislation before their State Parliaments as a matter of urgency in the following areas:

1. Amend Professional Standards Legislation (PSL) to cap professional liability which extends to all States and Territories and which covers Government agencies and private sector clients in relation to engagement of consultants. Amendments should ensure the PSL replaces joint and several liability with proportionate liability and places limitation on the duration of liability.
2. The Trade Practices Act be amended to allow the ACCC to take enforcement action to ensure that any savings or benefits that accrue directly or indirectly from legislative reforms being implemented throughout Australia to minimise insurance premiums are passed on by the insurance companies to consumers.
3. An efficient, strong and competent prudential regulator will go some way to restore public confidence in the insurance industry. Accordingly, the Government should more actively monitor the activities of APRA and ensure that it has adequate powers and resources as well as a commitment to diligently supervise the industry. The Government should also remove the public uncertainty about the roles of the ACCC and ASIC in consumer protection in relation to financial services. In close consultation, the ACCC and ASIC review and report publicly on their respective statutory obligations in regard to consumer protection and market integrity in the insurance industry.
4. Commonwealth agencies (ACCC and ASIC) and their state counterparts should actively promote their roles in consumer protection for all financial products, including general insurance. Clarifying their respective responsibilities, giving particular attention to whether there is any unnecessary overlap; and establishing whether, in their opinion, the legislation provides adequate and appropriate consumer protection in the insurance industry and, if not, identifying the gaps or weaknesses in consumer protection, including the prices and insurance coverage that are being offered to consumers.
5. Ensure application of Trade Practices Legislation to Government such that government agencies are subject to the same legislative requirements in relation to restrictive trade practices as are private sector organisations when letting contracts in the commercial marketplace.

6. A change in Section 68A of the Trade Practices Act in respect of Contributory Negligence in Assessing Loss or Damage to take account of the degree to which each individual party contributes to the loss or damage when determining the amounts of damages for acts of negligence.
7. Redefinition of the law of negligence in relation to the Trade Practices Act where it refers to loss arising from matters of professional judgement, to prevent the interpretation of Section 52 from including loss resulting from errors in professional judgements made in good faith as loss from 'deceptive and misleading' conduct.

### **Limitation of liability**

Differing liability laws and legal arrangements across jurisdictions, and sometimes within jurisdictions, creates enormous difficulties for service suppliers.

The Working Group see a strong and continuing role for the Commonwealth in facilitating the solving of the present problems by bringing together State and Territory governments to develop consistent and complementary measures. The Commonwealth must also ensure that there is adequate competition and prudential regulation of the insurance industry.

There also must a commitment by industry to develop a Standard Risk Management Code of Practice that will establish minimum industry standards. High standards of risk management in building industry firms and a demonstrated high standard of risk management will address legislative, insurance industry and consumer expectations.

Other key issues here include:

- Joint and several liability should be replaced with proportionate liability in all contracts and other relevant legislation, and uniformly is needed at both Federal and State level
- Develop a Risk Management Code of Practice that will be sufficiently rigorous so as to mitigate potential risk for insurers, without imposing unnecessarily high compliance burdens on firms. The Code should encompass risk management programs in firms appropriate to their size and establish contract management programs in firms appropriate to their size
- Government and industry should implement continuing education in contract and risk management and ensure the use of industry standard conditions and contracts, including appropriate short form contracts in small projects and commissions
- Develop fairer models of risk allocation for projects, taking into account the relative capacity of the parties to control, to manage, and to bear risk.
- Review and eliminate current models of Government procurement, which extend liability, and transfer unfair burden of risk to consulting firms. Necessary changes include:
  - Removal of uninsurable indemnities
  - Limiting contractor liability in Deeds or Agreements
  - The use of Consultancy Agreements instead of Deeds for consultancy services
  - The use of qualified rather than unqualified fitness for purpose obligations
  - Removal of liquidated damages clauses in consultancy agreements
  - Qualify indemnity clauses to predicate these on consultant fault or negligence
  - Adoption of reasonable standards of care and retention of owners' risk

- Investigate ways in which Government can review its current models of procurement, which extend liability and transfer burden of risk to consulting firms.
- Recommend actions through which Federal, State and Territory Governments will address anomalies in legislation to restore fairness in matters of liability
- Large clients (including Government) must be accountable if market power is used to dictate untenable conditions of contract and service requirements to smaller suppliers.

### **Taxation via GST and Stamp Duty**

The existence of stamp duty and the GST on public liability and professional indemnity insurance premiums means multiple tax burdens for business. As premiums have escalated so too have the stamp duty revenues of some State Governments. This is a windfall gain for State Governments at the expense of business and consumers. The removal of stamp duty is a priority action for State and Territory Governments.

For example 10% stamp duty applies to all insurance which is calculated after the 10% GST, in effect a tax of 21% is applied to all insurance products (except property insurance which is significantly higher because a fire service levy is applied before GST).

For every \$100 in insurance premiums \$10 GST is added plus \$11 stamp duty = total cost of \$121 (of which \$21 or 17.36% is tax).

The taxation and stamp duty issues associated with public liability and professional indemnity insurance premiums should be addressed as part of the responses to the insurance crisis.

### **Inclusion of PI in the FSR ACT**

The statutory dispute resolution provisions of the *Financial Services Reform Act 2001* (FSR Act) apply only to individuals and small businesses, and only to certain listed classes of insurance, which do not include public liability or professional indemnity insurance (though the list can be enlarged by regulation). These limitations should be removed.

It is vital that ASIC monitors the effectiveness of the dispute resolution provisions and reports on this annually to the Parliament. In addition, ASIC should review, as a matter of urgency, the General Insurance Enquiries and Complaints Scheme and in consultation with the Insurance Council of Australia ensure that it covers adequately public liability and professional indemnity insurance. Further that it re-examine definitions in the terms of reference, such as small business, to ensure that they are consistent with definitions in Commonwealth legislation.

The insurance industry's General Insurance Code of Practice presently excludes small businesses, and effectively excludes public liability and professional indemnity insurance. Accordingly, the General Insurance Code of Practice should be revised so that it provides remedies for small businesses that are affected by price exploitation in relation to public liability or professional indemnity policies.

## **8.4 Recommendations**

### **1) Redesign of PI**

- The Building Commission, on behalf of Government to instigate a mandatory levy on top of registration fees to fund a replacement for automatic runoff in order to allow the practitioner to retire gracefully
- Collection of a levy on a pool basis with the pool being underwritten by an insurer
- Individual scheme – negotiated between parties

### **2) Amend Trade Practices Act and other legislation**

- Amend Professional Standards Legislation to cap professional liability
- Establish a prudential regulator to restore public confidence in the insurance industry
- Active monitoring of the activities of APRA and ensuring that it has adequate powers and resources to diligently supervise the industry
- Commonwealth agencies (ACCC and ASIC) and their state counterparts should actively promote their roles in consumer protection for all financial products, including general insurance
- Ensure application of Trade Practices Legislation to
- A change in Section 68A of the Trade Practices Act in respect of Contributory Negligence in Assessing Loss or Damage
- Redefinition of the law of negligence in relation to the Trade Practices Act
- Allow the ACCC to take enforcement action to ensure that the insurance companies pass on any savings or benefits that accrue from legislative reforms to consumers

### **3) Limitation of Liability**

- Joint and several liability should be replaced with proportionate liability in all contracts and other relevant legislation, uniformly is needed at both Federal and State level
- Develop a Risk Management Code of Practice that will be sufficiently rigorous so as to mitigate potential risk for insurers, without imposing unnecessarily high compliance burdens on firms
- Government and industry should implement continuing education in contract and risk management
- Develop fairer models of risk allocation for projects
- Review and eliminate current models of Government procurement
- Investigate ways in which the Government can review its current models of procurement, which extend liability and transfer burden of risk to consulting firms.
- Recommend actions through which Federal, State and Territory Governments will address anomalies in legislation to restore fairness in matters of liability
- Large clients (including Government) must be accountable if market power is used to dictate untenable conditions of contract and service requirements to smaller suppliers.

#### **4) Taxation via GST and Stamp Duty**

- The taxation and stamp duty issues associated with public liability and professional indemnity insurance premiums
- Government must honour the commitment to remove stamp duty as stated at the introduction of GST
- Review thresholds, caps and structured settlements, along with the imposition of limitations on the duration of liability

#### **5) Inclusion of PI in the FSR ACT**

- Government, by regulation, include public liability insurance and professional indemnity insurance in the classes of insurance covered by the dispute resolution provisions of the FSR Act
- Review the General Insurance Code of Practice so that it provides remedies for small business impacted by price exploitation in relation to public liability or professional indemnity policies

## 9. Change Driver 5: Improved understanding & risk assessment

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### 9.1 Project Summary

**Project Leader:** Tony Arnel

#### **Background:**

The insurance industry and building industry regulators held extensive discussions when the PI insurance elements of the new Victorian Building Act were being negotiated in the mid 1990s. There has been no substantive discussion since, until the recent crisis over the removal of automatic runoff.

The need for discussion now appears evident. The insurance framework established in the mid 1990s has served its purpose well in many respects – the lack of discussion and change since 1996 are evidence of that – but fundamental problems have now arisen for both insurance buyers and insurance suppliers in the Victorian PI market. Multiple problems are also evident from the viewpoint of the Building Commission as an industry regulator.

Not long after the PI major issues began emerging in July, Forum participants identified working relationships with insurers as a critical success factor. This factor was particularly evident to the Building Commission in dealing with the immediately pressing issue of automatic runoff.

#### **Key Issues**

- Do the parties in fact see sufficient value in establishing a dialogue – i.e. communication beyond talking when forced by circumstance? If so, how should the dialogue best be designed?
- Assuming there is in-principle agreement on the value of the proposed dialogue, the issue becomes how best to establish a process.

Key questions to be considered include:

- Should the dialogue arrangements be on a national or State basis?
- Should there be commitment to a fixed schedule of dialogue events?
- Should the dialogue process be per profession or across multiple professions?
- What body or bodies should take on accountability for managing the process?
- How will the process incorporate data adequate for its purpose?

#### **Key Recommendations**

Establish ongoing dialogue process at policy level

Establish ongoing dialogue at operational level

Identify individual organizational vehicles to pursue specific reforms

Investigate establishment of a national taskforce for implementation of PI reforms



## 9.2 Background

The insurance industry and Victorian building industry regulators held extensive discussions when the PI insurance elements of the new Victorian Building Act were being negotiated in the mid 1990s. There has been no substantive discussion since, until the recent crisis over the removal of automatic runoff.

The need for discussion is now evident. The insurance framework established in the mid 1990s has served its purpose well in many respects – the lack of discussion and change since 1996 can be seen as evidence of that – but fundamental problems have now arisen for both insurance buyers and insurance suppliers in the Victorian PI market. Multiple problems are also evident from the viewpoint of the Building Commission as an industry regulator.

Not long after the PI major issues began emerging in July, Forum participants identified working relationships with insurers as a critical success factor. Events over the past few months have confirmed the critical importance of having good working relationships between the insurance industry and the building industry. This factor was especially evident to the Building Commission in dealing with the immediately pressing issue of automatic runoff, but the potential areas needing better communication and understanding spread far beyond that particular issue.

## 9.3 Issues

Two sets of issues apply in the circumstances outlined above: Do all the parties who need to be involved see sufficient value in dialogue? If so, how should the dialogue best be designed?

### Value of dialogue

There is a cost to communication and no one wants to waste time on talkfests. There has to be a net benefit to all of the parties who would need to participate.

The level of benefit will be driven largely by the type of agenda and the type of people involved. As to an agenda, options for items that could be contributed by the individual underwriters include:

- Discussion of the insurer's building professionals claims experience in the prior period, including statistical data where possible
- Identification of specific activities or sub-groups of professionals the insurer sees as currently high-risk
- The insurer's longer term perspective on risks associated with categories of building professionals
- The insurer's views on needed changes in the building professions' self-regulation and in 's regulation of the building professions
- The insurer's thinking on trends and its plans for the subsequent period
- The insurer's requests for assistance at an operational level, such as provision of training information concerning the professions for insurer staff, piloting of new insurance proposal forms, application of underwriting criteria etc.

The contributions to the agenda by building industry participants would in large part be responses, both immediate and subsequent, to the ideas and information put forward by insurers. In addition, building industry participants could contribute on agenda items such as:

- New initiatives by professional associations aimed at reducing and managing risk
- Current results with respect to ongoing performance monitoring and competency assessment of building professionals
- Consultation on plans for industry regulatory changes
- Feedback on the industry's current experiences in the operation of the PI insurance market.

As to the people involved, it is likely that a worthwhile level of benefit will be seen if the key decision-makers for the various parties are the face-to-face participants.

The net benefit derived from an open dialogue process also depends on its cost. It is vital that the time and other costs entailed are kept to an absolute minimum. The dialogue will need to be professionally designed and managed to maximise the productivity of the time invested.

### **Designing a Dialogue**

Assuming there is in-principle agreement on the value of the proposed dialogue, the issue becomes how best to establish a process. Key questions to be considered include:

- Should the dialogue arrangements be on a national or State basis?
- Should there be commitment to a fixed schedule of dialogue events?
- Should the dialogue process be per profession or across multiple professions?
- What body or bodies should take on accountability for managing the process?
- How will the process incorporate data adequate for its purpose?

### **Ongoing Dialogue Process at a Policy Level**

The Working Group recommends establishment of a scheduled, structured dialogue process between the insurance industry and the building industry to address ongoing policy-level matters, with key features that include:

- A multi-jurisdiction, ideally national, approach
- A per-profession structure, except that dialogue involving the smaller professions may be best handled at the one event
- A backbone of a fixed schedule of yearly major dialogue events, supplemented by agreed channels for communication between the events
- Confidential channels for obtaining key detailed data, and a means of aggregating the information to generate a sufficiently detailed picture at the profession level without breaching commercial confidentiality boundaries
- Involvement on the insurance industry side of, at minimum, the key leaders of all underwriters and underwriting agents substantially involved in the building PI market
- Involvement on the building industry side of leaders of the building industry professional and industry associations and of the main building industry regulators
- A primary focus on obtaining a productive interchange between the private sector parties involved, but facilitation by one or several public sector bodies.

Facilitation and logistical support by a public sector body (or more than one body) is aimed at aiding continuity, equity of involvement and appropriate resource support. A single body at the national level would be ideal, although an appropriate organisation is not apparent at this point.

As referred to above, the Working Group thinks the process will only be of sufficient value if the agenda aims at covering the full range of topics key to having a successful PI insurance environment for all parties concerned.

The opportunity of participating will ideally extend to all relevant professional associations and industry organisations that have substantial building professional memberships, including organisations focused on single States.

The process should also engage brokers as much as possible, but it may need to limit their direct participation in the scheduled major events to the brokers with major market shares. Preferably, the number of event participants should be limited to the size of an effective Working Group. If direct involvement of only the major brokers is seen as inequitable, dialogue with the entire broker dimension of the industry will need to take place through other channels.

Involvement of the Insurance Council of Australia at both the national and State levels seems essential.

### **Ongoing Dialogue Process at an Operational Level**

The Commission has already conducted one workshop with representatives from the Australian Institute of Building Surveyors, Royal & Sun Alliance and Aon Professional Risks. The workshop focused on RSA's views on the risks associated with the Victorian building surveyor and building inspector roles and on the practicalities of RSA's and Aon's means of assessing the risks. There was also discussion of key aspects of the roles of building surveyors and inspectors in the Victorian building industry context.

As one practical outcome, AIBS has provided comment on the insurance proposal form, which had been confusing to some practitioners and led to unnecessary problems in the application process. The intention is to provide Aon and RSA with further informative material about the professions and their regulation. The workshop also initiated working relationships between individuals that will assist in future.

Three professional associations, the Association of Consulting Engineers Australia, the Institute of Engineers Australia and the Association of Professional Engineers and Managers Australia, have recently taken an initiative in arranging a seminar with representatives of a number of insurance and broking firms, focused on risk management for the engineering profession.

The subsequent reports on the seminar show that it was very valuable step forward in establishing better risk management by professional engineers and better communication between engineers and insurers involved in building industry PI.

Drawing on the Building Commission's experience in facilitating a workshop and the ACEA-IEAust-APESMA experience with the recent seminar on risk management, the Working Group believes the dialogue process should include provision for regular operational-level communication between the building professions and relevant insurance firm staff.

For instance, the process should include periodic (say yearly) presentations by representatives of the professions as a contribution to the continuing professional development of insurer staff involved day-to-day with building industry professionals. The presentations and accompanying documentation should provide a clear understanding of the work performed by the various professions and the nature of the risks associated with each of the professions and sub-groups within the professions.

This operational-level process should also include scheduled opportunities for interchange about operational, coal-face improvements, such giving feedback on proposal forms and service provision by broker staff.

### **Practical Vehicles for Reform**

Given that many of the needed building industry PI insurance reforms are best approached on a national basis, what body or bodies can best pursue governmental and professional change? No one national body, or one type of body, is apparent as the best vehicle.

The proposed dialogue process at a policy level is expected to form part of the process of reform, as a source of ideas and means of consultation, but it is not intended as the primary vehicle for implementing reforms proposed by the Forum over the coming year.

There are a number of organisations already established that have related goals and are partly focused on this area, but none are clearly appropriate for the overall task of reform. The relevant national organisations include:

- The national level offices of the building-related professional associations
- The national level offices of building and construction industry associations, such as the Housing Industry Association, the Master Builders Association and the Australian Construction Industry Forum
- The construction industry branch within the Department of Industry, Tourism and Resources
- The Australian Building Codes Board
- The network that comprises Builders Licensing Australia
- The Australian Procurement Construction Council.

Given that the professional associations perhaps have the clearest motivation and national basis, and that some at least have strong financial and staffing resources, they may be most practical starting point. As noted above, ACEA, IEAust and APESMA have just provided an illustration of successfully following this approach.

The professional associations have weaknesses as the type of vehicle for the purpose at hand though, such as:

- Their approach will necessarily be on a per-profession basis, whereas a large portion of what needs to be done is above the level of individual professions
- Some professions have State-only associations that represent substantial proportions of the professions
- Rivalries exist between associations within the professions, which may constrain a unified effort
- Some professional associations do not have sufficient national-level resources to pursue these types of initiatives unaided
- Professional associations can only be influencers, not decision-makers, on many of the issues, because they require actions by governments

- Professional associations have the legitimate job of pursuing their members' sectional interests, which limits their ability to be a vehicle for addressing issues from the perspective of the community as a whole.

Given that no current organisation or type of organisation is clearly appropriate for the purpose of pursuing reforms, the options are:

- Create a new body
- Adapt one of the current bodies
- Develop a combined effort by current bodies.

The Working Group's recommendation is that, as a first pragmatic step at least, the vehicles for reform probably need to be identified through a case by case matchup between the main reform initiatives identified by the PI Forum and an appropriate organisation or organization for the particular initiatives.

The Group anticipates a strong representation of the professional associations in these match-ups. Public sector bodies that have a large stake in the outcomes, such as the Building Commission, may be the appropriate vehicle for certain of the initiatives including the combined efforts by several bodies where appropriate.

An alternate possibility is that the relevant branch within the Commonwealth Government could step forward to take on responsibility for supporting the initiatives in this area, but direct Commonwealth involvement will probably only occur if the building and construction industry lobbies to put this in place.

A further possibility is that the various building industry regulatory bodies within all or most States and Territories form a multi-jurisdiction taskforce to pursue the reforms achievable through al changes. Such a taskforce would need to incorporate strong liaison with all professional associations to be effective, perhaps through stakeholder consultation groups per profession. Ideally a taskforce would also include participation by representatives at the Commonwealth Government level.

### **Ad Hoc and One-to-One Meetings**

As a short term, ad hoc initiative over the next few months, the Working Group encourages the Building Commission to facilitate workshops between insurers and the building professional associations on issues of immediate insurance availability and risk assessment. Particularly over the next few months, as many challenges in building industry PI insurance need to be faced, the Working Group urges the Building Commission and insurers to pursue opportunities for meeting face-to-face to work through the issues.

### **Summary**

The Working Group recommends that an ongoing dialogue process between the insurance industry and the building industry be established at both the policy and operational levels and that the associations within each profession should be the main channels for this dialogue, facilitated as needed by Government bodies.

Once the PI Forum is fully clear about its main reform initiatives, it will need to identify which body or bodies can best pursue the recommended reforms. The Working Group anticipates multiple and varying organisations being appropriate for pursuing the multiple and varying objectives. An effective matching up process will be needed.

The Working Group supports investigation into establishing a multi-Government taskforce of building industry regulators to pursue certain of the proposed reforms in consultation with the professional associations.

#### **9.4 Recommendations:**

- 1) Establish an ongoing dialogue process at a policy level
- 2) Establish an ongoing dialogue at an operational level
- 3) Identify individual organisational vehicles for pursuit of particular PI insurance reforms
- 4) Investigate establishment of a national taskforce of building insurance regulators focussed on implementation of PI insurance reforms
- 5) Ad hoc and one-to-one meetings

## **10. Pulling it all together: The next steps**

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The Final PI Forum was held in Melbourne on 10 December 2002. The purpose of the Forum was to present an overview of the evolution of the insurance crises followed by the five chairs of the Working Groups presenting the main issues and recommendations from their reports. The introduction, background and papers that formed the basis of the presentations can be found in Sections 5 to 9 and the presentation is attached as attachment 5.

There was some overlap or common issues in the areas covered by the five Working Groups due to the critical nature and interrelationship of the five key areas particularly when it comes to addressing issues and developing credible recommendations for each area. Examples of overlap include:

- Issues relating to the design of the various elements of the PI product
- The need for major changes to the Trade Practices Act
- The need for greater clarity on each professions areas of responsibility, development of a Code of Practice and a compulsory professional development program linked to registration
- The need to review current models of Government procurement.

The recommendations of the five papers were consolidated to take account of these areas of overlap. Twenty-four recommendations were put to the Forum participants and were asked to identify (but not rank) the top ten 'must do's'. It was pointed out that all the recommendations would be brought to the attention of the appropriate parties for further analysis and action. Appropriate parties to address all the recommendations will need to be identified in the near future.

The process identified the top eight 'must do's' at the Forum. After the Forum further analysis and debriefing showed that there were a further four recommendations of equal importance.

The twelve 'must do' recommendations identified are:

1. Government retain more risk in its building and construction work, and rebalance risk through a Principal Controlled PI scheme for consultants in public construction projects
2. Establish a National Taskforce to formulate a National Risk Allocation Model
3. Obtain systematic data on insurance risk associated with building work, on national basis
4. Each building profession to develop a code of practice in consultation with insurers and other stakeholders
5. Introduce compulsory continuing professional development linked to Building Practitioners Board registration
6. Lower liability periods for 'approval practitioners' and 'design /construct practitioners' to 1 & 6 years respectively
7. Identify accountabilities by profession in the Ministerial Order

8. Ensure mandatory and effective mediation in building contracts
9. PI product design reforms:
  - Nationally consistent features aimed at national-basis market
  - Replacement for runoff cover
  - Enable greater excesses and opportunities for self-insurance
10. Amend the Trade Practices Act, including changes to the contributory negligence and deceptive and misleading conduct provisions
11. Establish ongoing insurer-building dialogue at process and operational levels
12. Investigate establishment of a national taskforce of building industry regulators focused on implementation of PI reforms

These recommendations cover issues that need to be addressed at both a national and/or a Victorian level. For example numbers 2, 3, 10 and 12 are clearly issues that have to be addressed at a national level while recommendations 4, 7, 8 and some elements of 9 will need to be progressed on a State level that may later feed into a national solution.

Other issues raised during the Forum included:

- Concern regarding the fact that the insures, or providers of insurance, have a regulated “gate keeper” role yet the supply of insurance is not regulated but dependent on market forces
- Concern that the momentum for PI reform is not lost. Participants were keen to know how the process would proceed, what the next steps would be and what role the associations and Building Commission would play during the ongoing reform process
- How to manage the complexity of dealing with both operational and policy issues on a profession versus industry basis i.e. how to lead the changes in a co-ordinated national manner while giving appropriate attention to local circumstances.

### **Interim action steps to maintain the PI reform momentum**

The following action steps have been developed in response to the direction set by the participants at the Forum:

1. The PI Forum Paper and outcome from the Final PI Forum to be circulated to the Associations and PI Forum participants
2. The Associations to use the PI Forum Paper to pursue PI reform within their association consistent with their priorities
3. Explore the value of establishing a PI Liaison Group to inform members of insurance issues, explore risk management strategies and establish a dialogue process with insurers
4. The Commission to further facilitate the industry PI reform process including exploring the establishment of a vehicle and funding options for future action.

These interim action steps identify the initial course of action for industry to decide which vehicle and funding options are best suited to bring about the changes required to meet the goals and criteria for PI insurance.

## **PROFESSIONAL INDEMNITY INSURANCE FORUM WORKING PARTIES**

### **Rebalancing of Risk Allocation**

Chairperson:	Robert Squire, Chief Executive, Connell Wagner
Brendan McCarthy	Legal Manager & Company Secretary, Connell Wagner
Dermot Small	Secretary, Association of Consulting Engineers Australia
John Wilson	Chairman, Institute of Engineers Australia
Kim Lovegrove	Victorian Vice-President, Australian Institute of Building
Robert Peck	President, Association of Consulting Architects Australia
Roger Frith	Manager, Building Policy, Building Commission
Ingrid Marx	Consultant, Building Commission

### **Reduction of Underlying Risk**

Chairperson:	Peter Walsh, Victorian President, Australian Institute of Building
Brian Morison	Executive Officer, Building Design Association of Victoria
John Westwood	Registrar, Professional Design and Drafting Group
Glenn Driscoll	Vice President, Australian Institute of Building Surveyors
Ingrid Marx	Consultant Building Commission
Robert Knott	Senior Counsellor, Royal Australian Institute of Architects
Blaire Gardiner	Director, Architeam Co-operative

### **Improved Overall Regulation & Legal Environment**

Chairperson:	Kim Lovegrove, Victorian Vice-President, Australian Institute of Building
Andrew Lyons	Manager, Legal Services, Building Commission
Annie McGuigan	Policy Officer, Consumers Affairs Victoria
Eli Giannini	Victorian President, Royal Australian Institute of Architects
Ingrid Marx	Consultant, Building Commission
Jennifer Cunich	Executive Director, Property Council of Australia
John Kotsopoulos	Policy Team Member, Building Commission
Neil Evans	Manager Technical Services, Master Builders Association Victoria
Ray Martin	Committee Member, Australian Society of Building Consultants
Stuart McLennan	Director, Progressive Building Solutions

### **Redesign of Building PI – Medium to Long term**

Chairperson: Ian Blyth, Executive Officer, Australian Council of Building Design Professionals

Don Hudson Manager, MBA Insurance, Master Builders Association Insurance

Gary Dean President, Australian Institute of Building Surveyors

### **Improved Understanding & Risk Assessment**

Chairperson: Tony Arnel, Commissioner, Building Commission

Andrew Gibson Director, Gardner Group Pty Ltd

Bobbie Novotny Manager Corporate Strategies, Plumbing Industry Commission

John Coghlan Committee Member, Australian Society of Building Consultants

John Westwood Registrar, Professional Design & Drafting Group

Kim Lovegrove Victorian Vice-President, Australian Institute of Building

Haydn Wood Consultant, Building Commission

Attachment 2

**ATTENDEES AT PROFESSIONAL INDEMNITY INSURANCE FORUM  
10 December 2002**

Mr	Tony	Arnel	Commissioner	Building Commission
Mr	Ian	Blyth	Executive Officer	Australian Council of Building Design Professionals
Mr	Wayne	Bretherton		Australian Building Codes Board
Mr	William	Brazenor	Representative	Institute of Engineers Australia
Ms	Therese	Charles	Chief Executive	Association of Consulting Engineers Australia
Mr	Peter	Coatman	Assistant Director, Insurance Policy Branch	Department of Treasury and Finance
Mr	John	Coghlan	Committee Member	Australian Society of Building Consultants
Mr	Gary	Dean	President	Australian Institute of Building Surveyors
Mr	Glenn	Driscoll	Vice President	Australian Institute of Building Surveyors
Mr	Greg	du Chateau	Director	Australian Institute of Building Surveyors
Mr	Glenn	Evans	Director, Practitioner Services	Building Commission
Mr	Roger	Frith	Manager, Building Policy	Building Commission
Mr	Blair	Gardiner	Director	Architeam Co-operative
Ms	Eli	Giannini	Victorian President	Royal Australian Institute of Architects
Mr	Andrew	Gibson	Member	Australian Institute of Building Surveyors
Mr	Moshe	Gilovitz	Director, Compliance & Conciliation	Building Commission
Ms	Lois	Goodes	Manager, Policy Branch	Consumers Affairs Victoria, Department of Justice
Mr	Geoff	Hoare	President	Building Design Association of Victoria
Mr	Don	Hudson	Manager, MBA Insurance	Master Builders Association Insurance
Mrs	Katherine	Iona	Executive Officer	Australian Institute of Building Surveyors - Vic Chapter
Ms	Anne	Keddie	Chair	Building Appeals Board
Mr	Robert	Knott	Senior Counsellor	Royal Australian Institute of Architects
Mr	John	Kotsopoulos	Policy Team Member	Building Commission
Mr	David	Laidlaw	Chairman	Maddocks
Mr	Ari	Loupatatzis	Executive Officer	Building Commission
Mr	Kim	Lovegrove	Victorian Vice-President	Australian Institute of Building Surveyors
Ms	Ingrid	Marx	Consultant	Building Commission
Ms	Sarah	McCann-Bartlett	Director, Business Development & Consumer Services	Building Commission

Mr	Stuart	McLennan	Member	Australian Institute of Building Surveyors
Mr	Ian	McKendry	Policy Team Member	Building Commission
Mr	Brian	Morison	Executive Officer	Building Design Association of Victoria Inc
Mr	Jeff	Norton	Director, Policy Services	Building Commission
Ms	Bobbie	Novotny	Manager Corporate Strategies	Plumbing Industry Commission
Mr	Robert	Peck	President	Association of Consulting Architects Australia
Ms	Jennifer	Pelvin	CEO	Australian Institute of Refrigeration, Air Conditioning & Heating
Mr	Michael	Prickett	Southern Region Manager, Professional Financial Risks	Dexta Corporation Limited
Dr	Darryl	Roberts	General Manager, Rehabilitation & Enforcement	Australian Prudential Regulation Authority
Mr	John	Royce	Manager, Building Advice and Conciliation Victoria	Consumer Affairs Victoria
Mr	Greg	Schofield	Attending on behalf of Past President	Australian Consulting Structural Engineers
Ms	Gwen	Schwarz	Director, Planning & Corporate Affairs	Building Commission
Mr	Dermot	Small	Secretary	Association of Consulting Engineers Australia
Mr	Jason	Smith	Attending on behalf of General Manager	Queensland Building Services Authority
Mr	Robert	Squire	Chief Executive	Connell Wagner
Ms	Kristen	Tomkins	Attending on behalf of Director, Policy & Reform	NSW Planning
Mr	Gideon	van der Westhuizen	Risk Leader	ARUP
Mr	Peter	Walsh	Victorian President	Australian Institute of Building
Mr	Brian	Welch	Executive Director	Master Builders Association Victoria
Dr	John	Wilson	Chairman	Institution of Engineers Australia
Mr	Haydn	Wood	Consultant	Building Commission

**PROFESSIONAL INDEMNITY INSURANCE FORUM  
ASSOCIATION PARTICIPANTS**

Architects Registration Board

Association of Consulting Engineers

Association of Consulting Architects Australia

Australian Consulting Structural Engineers

Australian Institute of Building

Australian Institute of Building Surveyors

Australian Institute of Quantity Surveyors

Australian Institute of Refrigeration Air-conditioning and Heating

Australian Society of Building Consultants

Building Design Association of Victoria

Fire Protection Association of Australia

Housing Industry Association

Institute of Engineers Australia

Master Builders Association Victoria

Professional Design Drafting Group

Royal Australian Institute of Architects

## SUMMARY OF PI INSURANCE FORUM RECOMMENDATIONS

1. Retain more risk in its building and construction work, and rebalance risk through a Principal Controlled PI scheme for consultants in public construction projects.
2. Establish an independent expert Victorian Infrastructure Advisory Council
3. Establish a National Taskforce to formulate a National Risk Allocation Model
4. Review Victorian Code of practice of the Building & Construction Industry
5. Obtain systematic data on insurance risk associated with building work, on national basis
6. Each profession to develop a Code of Practice and Risk Management guidelines for members in consultation with insurers and independent parties.
7. Establish incentives for use of risk management plans
8. Introduce compulsory continuing professional development linked to Building Practitioners Board registration
9. Introduce a package of procedural efficiency and effectiveness gains to Court & VCAT
10. Lower liability periods for 'approval practitioners' and 'design /construct practitioners' to 1 & 6 years respectively
11. Establish immunity for economic loss for building surveyors
12. Conduct audit of compatibility between Victorian *Building Act 1993* and Building Code Australia from risk management perspective
13. Limit scope of cover by providing indemnity for structural defects rather than general defects
14. Identify accountabilities by profession in the Ministerial Order
15. Strengthen regulation to risk management by building surveyors re performance-based building code through changes to *Building Act 1993*
16. Improve professionals understanding and application of *Building Act 1993*, regulations, BCA, and establish a BC advisory service
17. Ensure mandatory and effective mediation in building contracts
18. PI product design reforms:
  - nationally consistent features aimed at national-basis market
  - replacement for runoff cover
  - enable greater excesses and opportunities for self-insurance
19. Amend Professional Standards legislation to cap professional liability
20. Cut taxes on supply of insurance
21. Amend Trade Practices Act including changes to principle of contributory negligence & deceptive and misleading conduct
22. Establish ongoing insurer-building dialogue at process and operational levels
23. Identify organisational vehicle for pursuit of specific reforms
24. Investigate establishment of a national taskforce of building industry regulators focused on implementation of PI reforms