PROFESSIONAL LIABILITY - PROPOSALS FOR REFORM

- **The Honourable John Dowd M.P., Attorney General for New South Wales**

At a recent seminar on professional liability sponsored by the Association of Consulting Engineers Australia, the Royal Australian Institute of Architects and the University of Technology, Sydney, the Honourable Mr John Dowd M.P., Attorney General for New South Wales, delivered the address set out below on reform proposals to address the problem of professional liability in the industry. Most interesting are the Attorney General's comments that it is insufficient and improper to respond to the problems faced by professionals merely by limiting liability, other than as part of a scheme which includes provisions for professional indemnity insurance and risk management procedures, and the sympathy expressed for a ten year limitation period coupled with project insurance.

Thank you for the invitation to attend this seminar to discuss some of the issues of concern in relation to professional liability in the building industry.

It is just over 15 months since representatives of the Institute of Architects came to my office to discuss some of the problems they were experiencing with an increasing number of claims for professional negligence and rising insurance premiums.

They struck at a most appropriate time because I had been considering many of the problems of what may be described as a litigation explosion and how to avoid what, pejoratively, may be referred to as the American experience.

The public face of this problem is twofold. First, there is the withdrawal of public services because insurance is unobtainable. This is most noticeable with local councils which often find they can no longer obtain or afford insurance against the risk of a claim arising from the services they provide.

The other issue is the problems facing the court system. As Attorney General, I am only too well aware of the demands placed upon the court system. The court infrastructure is a cost borne by the community and it is in the public interest to introduce systems which encourages attention to reducing risk, and thus the number of claims, and the early settlement of claims.

In response to such problems I initiated a review of tort liability, including professional liability. Issue papers were released on those topics in September and I hope that most of you have now had the chance to consider those papers.

Further discussion papers will be released in the very near future.

Before considering the particular issues of concern to the building and construction industry I believe it is appropriate to consider why there has been an increase in claims and litigation against professionals, and in the liability area generally. It is trite to attribute this merely to a growing litigiousness in the community. This is as much a product of the problem as a cause.

The increase in the number and quantum of claims is to some extent due to the much greater complexity of our society, and the impact of technological development.

For professionals, it is also partly due to the much greater size and complexity of the work undertaken and thus continually rising potential liabilities.

However, the litigation explosion can also be attributed to developments in the law, in particular, the expansion of tort liability.

I believe it is timely to offer two responses to this development. First, there is a need to reassert the fundamental common law principle that the basis for compensation is restoration of loss rather than satisfaction of an expectation.

Second, there is a need to highlight the fact that the payment of liability claims is in the long run a cost borne by the community.

The determination of the standard of care rests ultimately in the hands of the community itself. Underlying standards, statutory requirements and other relevant considerations are shaped by community attitudes. In simple terms it can be said that the level of the standard of care at any one time is a product of the communities' willingness or otherwise to accept the repercussions of either raising or lowering the standard.

This is an issue which will be addressed as part of the tort reform process.

Turning to the more specific issues I recall that the submission I received from the architects proposed 3 reforms to the law.

1) Limitation of liability by introduction of monetary caps;
2) Amendment of the law for limitation periods; and
3) Abolition of the doctrine of joint and several liability.

Today I will deal with the first two of these.

Professional Liability

My consideration of proposals to limit professional liability stems from increasing interest among a number of professions and the representations and suggestions which they have put forward.

Through meetings with various professional bodies both myself and officers of my Department were able to gain a better appreciation of the issues involved.

In examining this area I take as my starting point the claim by a number of professional bodies that their members are experiencing a substantial increase in tort claims and serious and growing problems in obtaining affordable professional indemnity insurance. This impacts upon the manner of professional practise which, in turn, has consequences for the client, third parties and the community generally.

I will say at the outset, and I am sure you will agree, that no matter how valid the problems of professionals it would

be wrong to view them in isolation. This is why I am considering the issue of professional liability in tandem with that of wider tort law reform.

Similarly, it would be improper to see a solution only in terms of protecting professionals from liability. There is a need to have regard to the interest of clients, third parties and the community generally.

My aims in this exercise are threefold:

1) To ensure the availability of affordable tort liability insurance.
2) To ensure the availability of reasonable levels of compensation for injured plaintiffs; and
3) To encourage risk minimisation and effective risk management.

While it would misinterpret the consideration of the issue of professional liability to see limitation of liability only as a response to the problem for professionals of obtaining adequate insurance, this has brought the issue to a head.

Traditionally, professionals have regarded it as almost axiomatic that they should accept the consequences of their own default. The professional was able to insure against such default, although such insurance was by no means universal. The situation was not unsatisfactory so long as the scale of claims was, in general, modest.

This is no longer the case and, as I have noted, in recent years there has been a substantial increase in the number and quantum of claims which impacts upon the determination of premiums for professional liability insurance.

This is not necessarily a direct result but is also a matter of perception. Thus, while there is little statistical evidence to show a correlation between professional indemnity insurance premiums and the claims history of each profession, the perception that there is an expansion in potential liability impacts upon the determination of premiums.

This is clearly an issue which cannot be neglected. As is indicated in the issues paper the extent of the problem may at times be disguised by fluctuations in insurance premiums as a result of investment returns and re-insurance costs. However, the underlying problems of unpredictability and the difficulty of pricing unlimited liability remains.

It is appropriate to ask why professional liability should be limited. After all if it costs professionals a bit more to insure they will just pass it on to their clients in increased fees.

This view sees the problem only in terms of the cost of insurance and not the consequences.

The statistics available from overseas suggests that one of the most notable consequences of increased insurance premiums is the number of professionals who "go bare".

It is clearly of no consolation to the aggreived client if they can be awarded unlimited damages but have no real prospect of recovery.

I am also concerned, on the basis of annecdotal evidence from the professional bodies, as to the effect it may have on practise.

In my opinion it is in the interest of the public that members of professions should conduct their practices in a forthright manner. Undue exposure to financial risk may well lead the professionals to conduct the practice in an over-cautious way, to the client's detriment.

Any scheme to limit liability should take into account these wider considerations.

In my view the key feature of any scheme must be that the limitation or limitations prescribed should be reasonable. The requirement of reasonableness is easy to state but difficult to apply. The main object should be to ensure that the level of any likely claim from the substantial majority of the clients of the profession in question should be within the limitation at any given time. This will ensure that the great majority of valid claims will be met.

From the responses received to the issues paper and the issues examined it has become clear to me that given the diversity of both the nature and extent of a professional's exposure to liability it would seem that the most workable scheme involves the establishment of a statutory procedure for individual professions to prepare schemes by which their members exposure to liability may be limited.

What particular option or options would be appropriate may be determined having regard to the nature of the profession in terms of work performed, role undertaken and the extent of professional indemnity insurance.

I therefore have in mind inviting the professional bodies to bring forward detailed submissions in relation to schemes for their profession.

I would envisage that scheme would include details of the form of the limitation, insurance arrangements, risk management plans, and appropriate complaints and disciplinary procedures.

The risk management component is, I believe, the essential public benefit factor in any scheme.

Clearly the best way of avoiding liability problems is to avoid negligence in the first place. Matters which go to minimising the risk of a claim include improving professional standards, education and quality control. It is my belief that any scheme to limit professional liability should be based on a positive requirement for the profession to engage in risk minimisation procedures.

In saying this I do recognise that however high a profession's standards, and however well monitored and developed, it is not possible to eliminate genuine mistakes which may amount to negligence. Indeed throughout the time that claims have been increasing in size and number, improved standards have been imposed by most professions. It must also be recognised that there is an economic cost in avoiding mistakes and there comes a point where the costs outweigh the benefit. Nevertheless it is reasonable to hope that over a period a sustained effort in this area might reduce valid claims.

It has been pleasing to see the manner in which professions have adopted risk management procedures and the open manner in which they have considered alternative means of claims resolution.

It must be said that no matter how far reaching the

reforms may be, the key to reduced litigation is greater co-operation between parties in avoiding claims and in settling problems before the matter ends up in court. Even further, I would hope the professional bodies and the government can act to properly educate and inform clients and the community generally as to acceptable standards of care, taking into account the risks that arise by inevitable consequence of activity in a highly industrialised and complex society.

The essential point which I wish to emphasise is that it is insufficient and improper to respond to the problems faced by professionals merely by limiting liability.

I consider a limitation of liability to be acceptable only as part of a scheme which includes provisions for professional indemnity insurance and risk management procedures.

Such schemes should meet the needs of individual professions and be developed as part of wider reforms to resolve disputes, reduce litigation, and introduce greater balance into the tort liability system.

Limitation Periods

I turn now to the question of limitation periods and the particular problems for the building and construction industry from latent damage.

Many of you will be aware that in November I commissioned a consultative committee to examine this issue. Indeed some of you have served on that committee and will be aware that a Discussion Paper is currently being finalised by my Department.

I do not wish to pre-empt that Paper but I can say that the problem is clearly identified and solutions proposed.

Essentially the problem is that of the application of the Limitations Act to claims in negligence arising from damage to buildings.

A limitation period is the period of time within which legal proceedings should be commenced. If the proceedings are not commenced within that time, the defendant is able to make use of the limitation defence, which may, but need not, be pleaded.

The NSW Limitation Act sets a limitation period of six years for actions based on contract or tort.

Limitation statutes reflect a concern for both the defendant's interest in litigation and for the public interest. By limiting the time within which a plaintiff may make a claim, the defendant's potential liability is made finite and can be predicted with certainty. This is an important element in obtaining insurance against damages for liability.

It is desirable, if not essential, that insurers be made aware reasonably quickly of potential claims, and that they be in a position to determine the possible size of claims. This is necessary to allow insurers to determine their future liabilities with some degree of accuracy, and on occasion, to satisfy their needs to inform reinsurers. Current arrangements make those financial assessments extremely difficult.

The essential problem is determining when the limitation period for actions in tort commences. Judicial consideration of this issue has led to different, and changing, conclusion. The issue came to the fore in a line of cases commencing in the mid seventies.

Initially it was held that the damage was done when the building was badly constructed and consequently the limitation period began to run from time of construction. This was later overturned and it was held that the limitation period began to run from the time the owner discovered or ought to have discovered the damaged state of the property. This in turn has been surpassed by the decision in *Pirelli's* case in which the House of Lords held that the period runs from when the damage occurred regardless of whether this is discoverable.

I do not wish to go further into this case other than to say that *Pirelli* is considered to be the applicable law in Australia at the moment.

One of the main problems with the test in *Pirelli* is determining when the damage has occurred and when the cause of action therefore accrues. It is by no means an easy matter to assess and is subject to disagreement among experts as to just when a latent defect becomes latent damage, given that the damage is not necessarily discoverable, at least without extensive technical testing.

There is a further problem in that the damage may not occur until many years after the building is erected. parties involved in the construction of a building therefore remain liable for an indefinite and virtually unlimited time. This presents a particular problem in obtaining insurance against a claim arising out of the construction and to a great extent retains the problems that limitation periods are designed to overcome. Where claims are brought a considerable period of time after completion of construction it becomes difficult to mount a defence within a reasonable cost constraint because invariably document have long since been destroyed and the people involved have no recollection of the events or are not available.

The present law is unsatisfactory to all parties. For the victim of a negligent act or omission the starting date for reckoning the period of limitation is the date when the damage actually occurs, and time will start to run even if the damage is not discoverable.

The result is that potential plaintiffs may find themselves barred from action before they know or could even be in a position to know, they had suffered damage.

Potential defendants, too, are handicapped because they have no way of telling in advance how long they may be at risk of legal proceedings. When damage does not occur until long after the events giving rise to it, they are likely to be faced with grave practical difficulties in contesting a stale claim.

As I have noted I do not wish to pre-empt the Paper I will be releasing on this issue in the near future, however I will say that I have considerable sympathy for a limitation period running from time of construction. I also recognise that should that period be, say, ten years, then it would encourage the introduction of project insurance.

Thank you for your attention. I am sure you will keenly await the further papers to be published and I encourage you to respond to them.