

11 October 2011

Mr Laurie Glanfield
Secretary, Standing Committee of Attorneys General
Attorney General's Department
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Dear Mr Glanfield,

SCAG - CONSULTATION DRAFT PROPORTIONATE LIABILITY MODEL PROVISIONS

The Australian Property Institute (API) refers to your correspondence of 16 September 2011. It appreciates the opportunity to comment on the Consultation Draft of Proportionate Liability Model Provisions (**Draft Provisions**) and accompanying Regulation Impact Statement (**RIS**).

The API strongly endorses an approach that is nationally consistent. Its preference is for option 1 as detailed in the RIS (pp 15–35).

I attach for your consideration a schedule which summarises the response of the API in relation to each question posed in the RIS.

The API wishes to emphasise three points. They are:

- 1 A proportionate liability scheme is critically important to members of the API. Without it, it is most unlikely our members would be able to obtain affordable professional indemnity insurance. The API therefore strongly endorses the continuation and consolidation of the proportionate liability scheme.
- 2 It is critical for contracting out of the scheme to be prohibited on a national basis.
- 3 The proposed 'carve out' of consumer claims, should not be pursued.

AFFORDABLE INSURANCE FOR MEMBERS OF THE API

- 4 Members of the API that practice valuations act in a high risk profession. For example, over 1,000,000 residential mortgage valuations are done by our members in Australia each year, usually for fees of \$200–\$300 per valuation. The vast majority of these valuations are done for one of the big four banks.
- 5 There has been a consolidation of valuation firms within the last decade, such that most valuation firms operate on a national basis. Even so, the value of an appointment to a bank panel, even on a national basis, is usually around \$2million–\$3million in fees per year. As such, the bargaining power of the valuation firms is very low as compared to the banks. Members of the API continually complain about rates being too low and the risk being too high.

- 6 When there is economic disruption, as there has been, particularly during 2007–2009, a reduction in property values leads to an increase in claims. It is estimated that the available premium for professional indemnity insurance in the Australian market for valuers, is around \$22million–\$24million. As such, insurers hoping to operate on a 70% loss ratio (which is considered to be good practice) are hoping that claims in any year will not be more than \$17million.
- 7 This is not a significant premium pool given the value of the assets about which members of the API are expressing an opinion. An insurer which underwrote 40% of the valuation profession has had to cease underwriting valuers because of losses that are reputed to be as high as 200%.
- 8 Even with these losses, there is still sufficient capacity in the market for valuers, but it is well recognised in the insurance community, that valuers pay an extremely high percentage of their turnover on insurance premiums. Anecdotally, our view is that without the impact of proportionate liability, valuers would likely be uninsurable.

So why is proportionate liability so important?

- 9 The majority of claims against valuers concern a valuation done for mortgage purposes. In each case, the relevant 'players' in the proportionate liability field are:
- the bank
 - the valuer
 - the borrower, and
 - a mortgage broker.
- 10 It is frequently the case in claims that:
- a mortgage broker has manipulated income figures, to get a deal across the line and receive a commission
 - the borrower has either willingly or recklessly been a party to a misrepresentation of their income position; and
 - lending practices within banks (and their mortgage insurers) have not had sufficient checks to pick up these problems.
- 11 In the prior world of joint and several liability, valuers and their insurers frequently ended up wearing the liability for all the wrongdoings of these parties. In addition, the High Court case of *Kenny & Good v Mgica*¹ made a valuer liable for loss caused by falling market values as well.

¹ (1999) 199 CLR 413

- 12 As such, the proportionate liability scheme was a welcome amendment. It reduces a valuer's liability to overcome the most common problem - a frequently insolvent borrower or mortgage broker that was primarily responsible for a bad mortgage deal.
- 13 In the decision of *Kayteal*², a valuer's liability was reduced by 50%, because of the acceding conduct of a now bankrupt borrower. The ability of valuers to apportion responsibility to other concurrent wrongdoers, has had the desired impact, such that our members have endured the last economic downturn - bruised but insurable.
- 14 However, more needs to be done to strike a fairer balance for valuers and clients alike. In the submission of the API, this requires a consistent national scheme that removes the prospect of valuers being pressured to contract out of proportional liability.
- 15 The API therefore strongly endorses option 1 in the RIS and strenuously opposes any approach to remove the proportionate liability scheme or wind it back in any way.

Contracting out

- 16 The API endorses a proposal to prohibit contracting out on a national basis.
- 17 Presently, the Commonwealth Bank of Australia (CBA) released draft terms to its valuation panel, which asked it panel firms to agree as follows:

Proportionate liability

The parties agree and acknowledge to the fullest extent under law, the proportionate liability legislation is expressly excluded.

- 18 As the CBA operates in all States, if a valuation firm agreed to this provision, then the CBA could issue all its claims against that firm in New South Wales, given that contracting out is permitted in New South Wales. This is the case even when the property valued is in another State.
- 19 As such, the legislative reforms of proportionate liability can easily be unwound by such an approach, should valuer members to agree to such a provision. As a number of firms depend very heavily on the Commonwealth Bank for their livelihood, they may have no choice but to accept what is put in front of them.
- 20 This sort of pressure should be made illegal. The only consequence is that a valuation firm (and other professionals), may agree to contractual terms that are going to compromise their insurance coverage should a claim ever be made.
- 21 No doubt the Standing Committee of Attorneys-General is aware that virtually all professional indemnity policies - and certainly those for valuers - include an exclusion clause that is much the same as the following:

² *Kayteal -v- Dignan* [2011] NSWSC 197

[Insurer] will not pay for any amounts insured under the policy for or arising out of ...a liability which the insured has assumed under a contract unless such liability would have attached in the absence of such contract.

- 22 Insurers of valuers will clearly not remove this assumed liability exclusion. As such, pressure to contract out of liability will do no more than force our members to have uninsured liabilities.
- 23 The API therefore strongly submits that a fair allocation of risk for our members, involves endorsing the position in Queensland, which specifically prohibits contracting out of the Proportionate Liability Scheme.

Projects above \$5 million

- 24 The API acknowledges and agrees that for substantial projects, of significant value, that contracting parties may wish to allocate risk on a basis other than proportionate liability.
- 25 The API submits that the wording of any threshold should be carefully stated. For example, the API submits that such a threshold should not apply to the kind of panel appointment that governs valuers. For example, if one bank provides \$5million worth of fees to a national valuation firm each year, then contracting out should still not be permitted. Whilst \$5million may sound like a lot in fees, that is still quite a small business when having regard to the size of the client. Further, introduction of any such threshold, would place larger firms at an unfair competitive advantage which would adversely impact the majority of our members.
- 26 As such, the API considers that each threshold for contracting out of proportionate liability, should be limited to parties involved in large infrastructure projects only.

Consumer claims

- 27 The API submits that a 'carve out' for consumer claims will have an unexpected adverse impact on its members.
- 28 The proposed carve out is for consumer claims that are under \$40,000 and for services acquired by an individual for a domestic purpose.
- 29 The vast majority of valuations done in Australia are provided for less than \$40,000. They are usually for a domestic purpose. Whilst valuations done for individuals are a small percentage of this, consumers are increasingly relying on valuers for advice concerning property acquisitions and also for finance purposes.
- 30 The API submits that there is no logical basis for excluding this work from the proportionate liability regime. It will only introduce great uncertainty concerning the basis on which insurers assess the risk for our members. It is submitted that there is also no logical reason why valuation work done for individuals, should be treated differently to work done for corporations. When claims are made by individuals, they are just as hard fought, contentious and expensive as any other valuation claim.

SUMMARY

- 31 The API is committed to a strong working relationship with the Standing Committees of Attorneys-General. Proportionate liability is critical to the viability of the businesses run by our members.
- 32 We therefore strongly endorse the consolidation of the proportionate liability scheme into one nationally consistent set of rules that provides a fair allocation of risk for our members and clients alike.

If you have any queries, please contact me on 0413 235 432.

Yours sincerely



A.L. McNamara
Professional Standards Manager
Australian Property Institute

Attachment - Schedule responding to specific questions in the RIS

SCHEDULE OF QUESTIONS AND RESPONSES

Question No	Issue	Suggested API response
1	<p>Financial impact</p> <p>What has the financial impact of the proportionate liability provisions been? Have they increased the affordability and availability of insurance?</p>	<p>The provisions have definitely had a financial impact on claims activity and therefore the affordability of professional indemnity insurance. In relation to claims against valuers, this has had a dampening effect on claims activity, although even with this impact, affordable PI insurance for practising valuers is still a real issue, with one underwriter that underwrote 40% of the profession, experiencing significant losses.</p>
2	<p>Inconsistencies between jurisdictions</p> <p>Are practical problems being created by inconsistencies in proportionate liability provisions between jurisdictions? If so, what?</p>	<p>Yes. Different definitions and procedural approaches create too much uncertainty, particularly for national businesses. Model provisions, such as occurred with the <i>Defamation Act</i>, are essential.</p>
3	<p>Is there evidence of 'forum – shopping' and is this causing problems?</p>	<p>Yes. For example, the major banks are pressuring valuation firms to contract out of proportionate liability. This would lead to proceedings being issued in the most favourable jurisdictions. It would undermine the scheme completely, given the inequality of bargaining power between the banks and valuation firms.</p>

Question No	Issue	Suggested API response
4	Is contracting out of proportionate liability provisions occurring and is this causing problems?	Yes. Banks are pressuring valuation firms to contract out of proportionate liability provisions. Given that four banks control the vast majority of the market, there is an inequality of bargaining power. Valuation firms generally sign up to whatever is offered, in the hope that they never get sued. This is undermining the scheme completely for no benefit, as valuers that contract out will not have insurance cover for that liability. The uncertainty should be removed by legislation that outlaws the practice.
5	Is the inability to contract out of proportionate liability provisions causing problems?	No. It is only the ability to contract out in some jurisdictions that is causing problems.
6	<p>Definition of apportionable claim</p> <p>Which is the preferred definition of apportionable claim – the definition in the consultation draft proportionate liability model provisions, or the definition of apportionable claim proposed in the consultation drafting instructions? Why?</p>	The definition in the draft model provisions is far more preferable. That test defines an apportionable claim as a claim that relates to a 'failure to take reasonable care'. This is an easier test to apply. The alternate definition, which limits an apportionable claim to an alleged breach of a 'tortious duty of care' will only create a lot of legal, technical debate about the scope of tortious duty. This is not in the interest of clients and their professional service providers.
7	Do you have any concerns about either of these definitions?	Yes – the definition in the model provisions is to be preferred.

Question No	Issue	Suggested API response
8	<p>Definition of concurrent wrongdoer – same loss or damage?</p> <p>Do you have any concern or comments about the approach taken?</p>	<p>Yes. The API supports the proposed approach in two respects. The inclusion of the requirement that each wrongdoer must be 'legally liable for the loss or damage caused' removes the uncertainty which has pervaded the definition (see <i>Shrimp v Landmark Operations Ltd</i> [2007] FCA 1468). Further, the expansion of the definition to include 'substantially or materially similar loss or damage' addresses the very narrow approach taken by the Victorian Supreme Court of Appeal in <i>St.George Bank Ltd v Quinerts</i> [2009] VSCA 245.</p> <p>Notably, the St.George case involved a valuer. Wrongdoing by a borrower was significantly limited as the bank's right against the borrower was in contract, not for misleading and deceptive conduct or in tort. This is considered to be unduly restrictive. The model provisions remedy this problem.</p>
9	<p>Obligation to notify other concurrent wrongdoers</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>The proposed approach in the model provisions is fine. It is proper that a defendant should notify a person that they are going to blame for the loss in the proceeding. There should be a consistent approach in relation to the information that is to be provided by a defendant to another concurrent wrongdoer, without there being an obligation to join that wrongdoer to join that wrongdoer to the proceeding.</p>

Question No	Issue	Suggested API response
10	<p>Joinder of concurrent wrongdoers required?</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>The API supports the model provisions. Presently, in Victoria, to obtain the benefit of the proportionate liability scheme, a concurrent wrongdoer must be joined. This needlessly adds to the cost, particularly in valuers' claims where this often requires joinder of people that have no money and are often greatly traumatised by recent experience in being "sold up". The approach in other states which does not require joinder, is much more sensible and fair to all, as well as cheaper.</p>
11	<p>Apportioning liability – just and equitable approach</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>The approach suggested in the model provisions is supported. The 'just and equitable' approach works well. Whilst this test can make the range of outcomes extremely uncertain as there are many subjective elements that make up what is 'just and equitable', a more prescriptive approach will create more problems than it resolves.</p>

Question No	Issue	Suggested API response
12	<p>Excluding certain matters – consumer claims</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>Yes. The exclusion of consumer claims, which is essentially excluding the proportionate liability scheme for claims relating to services provided to individuals for less than \$40,000, should be opposed. Virtually all valuation services are provided for less than \$40,000 and usually relate to a domestic purpose - ie finance of property. Whilst claims by individuals against valuers are not common, when they occur they are just as complex and costly as any other claim. It is not logical to exclude them from the proportionate liability scheme. The API also shares the concerns expressed by the Insurance Council of Australia, that the increase in class actions will greatly undermine the purpose of the scheme. Otherwise, the status quo which, most relevantly, does not allow apportionment between principal and agent, is fair and should be maintained.</p>
13	<p>Successive proceedings</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>No concerns. There should be a limited right, for plaintiffs to pursue concurrent wrongdoers for contribution at the conclusion of a proceeding. The alternative, which forces a plaintiff to join a concurrent wrongdoer to a proceeding, generally increases costs and makes cases more difficult to settle.</p>
14	<p>Definition of Court – apply to arbitrations?</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>No concerns. The approach taken in the model provisions, to apply the proportionate liability schemes to alternative dispute resolution methods such as arbitrations, is clearly appropriate. If the law is that the proportionate liability scheme applies, then it should apply whether or not the matter is in Court or part of an alternative dispute resolution mechanism.</p>

Question No	Issue	Suggested API response
15	<p>Post Loss settlements</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>No concerns. The approach taken is to be supported. If a plaintiff settles with one concurrent wrongdoer, then it is clearly a fair approach for the other concurrent wrongdoers to still argue that their apportionment should be greater than the settlement, but there should be no right of contribution against the party that has already settled with the plaintiff. That is a fair approach and gets around the dispute which went through the superior courts in <i>Godfrey Spowers</i>.</p>
16	<p>Binding the Crown</p> <p>Do you have any concerns or comments about the approach taken?</p>	<p>No concerns. Clearly the proportionate liability scheme should apply to bind the Crown.</p>
17	<p>Maintain the status quo</p> <p>Do you have any concerns or comments about maintaining the status quo?</p>	<p>Yes. Changes need to be made so that there is consistency and fairness on a national basis.</p>
18	<p>Wind back proportionate liability altogether?</p> <p>Do you have any concerns or comments about taking this option?</p>	<p>Yes. This should not be done. Proportionate liability has introduced a much fairer and more economical scheme, as shown by the easing in professional indemnity premiums since 2003. Even with these changes, affordability of professional indemnity for valuers is still a significant issue.</p>

Question No	Issue	Suggested API response
19	<p>Contracting out options</p> <p>Comments are invited on:</p> <ul style="list-style-type: none"> • the approach adopted to contracting out in the consultation clause 11 and whether this could create any problems • the practicality of consultation clause 11 • the ways in which consultation clause 11 could be improved • the appropriateness of the proposed amount in clause 11 – is it most appropriate to allow contracting out of proportionate liability where a contract has a total consideration of at least \$5 million or \$10 million or some other amount? 	<p>The API supports a prohibition on contracting out, save for substantial one off projects above at least \$5 million, which is not going to happen for valuation firms. Whilst Bank Panel appointments, might approach that figure in terms of fees nationally in a given 12 month period, contracting out should not be allowed for larger contracts. Even with appointments of this size, \$5M in turnover is still a small business with a huge inequality of bargaining power between the valuation firm and the client. This would undermine the scheme. That is not desirable.</p>
20	<p>Statutory schemes</p> <p>Should the legislation clarify that the proportionate liability provisions do not apply to the statutory warranty and insurance schemes such as the <i>Home Building Act 1989</i> (NSW)?</p>	<p>Yes. Clarity around application to statutory schemes is preferred. However, this has little or no impact on claims against valuers.</p>
21	<p>Are there other similar schemes to which the proportionate liability provisions should not apply?</p>	<p>None that are relevant to the interests of the API.</p>

Question No	Issue	Suggested API response
22	<p>Costs and benefits</p> <p>Comments are invited on the likely costs and benefits associated with:</p> <p>1 General:</p> <ul style="list-style-type: none"> (a) introducing uniform model proportionate liability provisions across the jurisdictions (b) maintaining the status quo (c) repealing proportionate liability provisions. <p>2 Contracting out:</p> <ul style="list-style-type: none"> (a) expressly permitting contracting out (b) expressly prohibiting contracting out (c) omitting contracting out for contracts above a certain value (d) each jurisdiction to determine its own position on contracting out. <p>3 Statutory warranty insurance schemes:</p> <ul style="list-style-type: none"> (a) clarifying proportionate liability provisions do not apply to statutory warranty and insurance schemes (b) clarifying proportionate liability provisions do apply to statutory warranty and insurance schemes (c) leave this issue to be resolve by the Courts. 	<p>The API considers that the introduction of uniform provisions and the express <u>prohibition</u> of contracting out, will have great benefit in terms of certainty. This will contain costs for valuers and their clients alike. As for statutory warranty insurance schemes, these reforms will not have any noticeable impact on members of the API.</p>