CONSULT AUSTRALIA

AUSTRALIAN CONSUMER LAW REVIEW

SUBMISSION

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Australian Consumer Law Review

Submission

CONSULT AUSTRALIA

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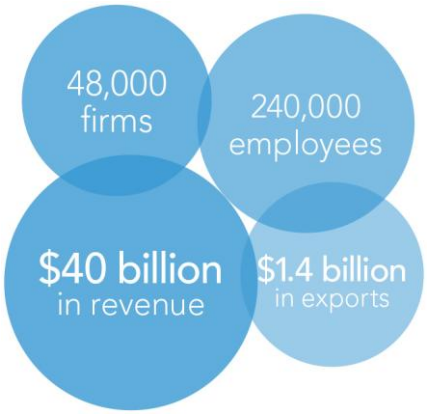

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sectors. These services include design, engineering, architecture, technology, survey, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments. We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $40 billion a year.

Some of our member firms include:

EXECUTIVE SUMMARY

Consult Australia welcomes the opportunity to comment on the issues paper and the review of the Australian Consumer Law (ACL). Consult Australia is the leading not-for-profit association that represents the business interests of consulting firms operating in the built and natural environment. Consult Australia member firms' services include, but are not limited to architecture and engineering..

Consult Australia represents an industry comprising roughly 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms. Over 95% of firms in our industry are smaller firms. Collectively, our industry is estimated to employ over 240,000 people, and generate combined revenue exceeding $40 billion a year.

Of greatest interest to Consult Australia, and the subject of this submission, is the question as to whether the consumer guarantees should be extended to goods and services currently excluded, in particular those services provided by architects and engineers. These services are currently excluded from the consumer guarantee relating to fitness for a particular purpose.

It would be easy to overlook the importance of this clause in the legislation and its significance as it is currently written in delivering the objectives of the Act for our industry. While this clause appears relatively minor, it reflects an acknowledgement of the need to tailor the Act to prevent unintended consequences where, due to the very nature of the services provided, a guarantee of fitness for purpose is not possible nor desirable to meet the objectives of the Act. Where this issue has been previously and extensively examined, the avoidance of a one-size-fits-all approach to fitness for purpose has been essential to respond to the operational realities of our industry which is dominated by small businesses operating in an economically significant sector of the economy.

As a result Consult Australia is strongly opposed to any proposal to remove the exemption for engineers and architects from the fitness for purpose guarantee provision currently contained in the ACL.

This guarantee is not possible due to the very nature of the services provided and the unique characteristics of the supply chain in which engineers and architects provide these services. Building and construction projects involve multiple parties in the delivery of a project. It is the builder or contractor that delivers the end product. To require the architect or engineer to warrant the performance of other parties, particularly where they have no control over the other parties or the quality of their work, is plainly unreasonable, reflects poor risk management, and creates new risks for all those involved in the supply chain. The introduction of an implied fitness for purpose warranty introduces substantial risk for engineers, architects and their insurers because it exposes them to the risks associated with the performance and behaviour of other participants involved in delivery of the project.

Engineering and architecture services are unique when it comes to professional service firms. This is perhaps best articulated by Senator Haines who in explaining this exemption in 1986 said;

> *"The issue with regard to architects and engineers is we believe that they fall into a special category as far as their relationship to their client is concerned; that is that, while they come up with designs, specifications and so on in accordance with whatever a particular client wishes, in the implementation of those specifications, designs, contracts and so on a fairly significant third party intervenes".*[1]
>
> *"To imply that the architects or engineers are absolutely responsible and that if a building or whatever turns out to be unfit in some way for the purpose they are wholly responsible is to place a far more onerous provision on them, I would have thought, than is placed in any other dealings between another group of professionals and their clients or patients, or whatever they want to call them".*[2]

The removal of this exemption would run counter to the very objectives of the ACL and this Review.

[1] Senator Haines, *Senate Hansard,* 30 April 1986

[2] Ibid

NEGATIVE IMPACTS

Engineering and Architectural Firms

Project delivery in building and construction involves multiple parties, the transaction is not solely between the consultant and the consumer ('the client'). This makes engineering and architectural services different from services provided by other professionals (e.g. a lawyer or accountant).

Consult Australia maintains that the arguments put forward by Senator Haines remain as relevant today as they did in 1986. In fact there is evidence that the commercial environment in which consultants operate has deteriorated further; increasing the importance of this exemption to support appropriate risk management through construction supply chains.

Engineering and architectural consultants provide professional services, they do not deliver the end product. The professional consultant has a duty of care to the consumer that they will render their services with reasonable skill and care, it is then for the builder or contractor that constructs the end product, to provide the fitness for purpose warranty in respect of the physical work that they have carried out.

Removing the exemption for architects and engineers will not provide any added benefit to consumers, who are already well protected from the consequences of negligent advice by an architect or engineer through the common law; their contract with that professional consultant; and the guarantee as to care and skill. Faulty workmanship is covered by the fitness for purpose warranty given by the builder.

Conversely the removal of the exemption will result in substantial detriment to engineering and architectural professionals because it will significantly increase the risk of litigation against consultants. Clients will be able to sue a consultant regardless of whether or not there has been any fault on the part of the consultant and regardless of the fact that it is the builder that has control over delivery of the final project and not the engineer or architect.

Insurance Markets

Professional Indemnity (PI) insurance is a contract between a professional and an insurance company, where the insurer indemnifies losses arising from the conduct of that professional and only that professional. The insurer does not allow potential claims to be made through the conduct of an unknown third party. So for this reason any warranties, guarantees or other such agreements (e.g. indemnities) are excluded because such terms make the professional responsible for final project outcomes even though a third party may be at fault.

The insurance industry recognises that the professional engineer or architect is only one party involved in a building and construction project, therefore this exclusion is included in PI policies to protect the insurer against claims arising from the conduct of parties other than the engineer or architect. A fitness for purpose warranty expressly contained in the terms of a contract between a consumer and a professional engineer or architect understandably falls squarely within the insurer's exclusion.

If the exemption from an implied fitness for purpose warranty is removed, the insurance industry would then be exposed to indemnifying claims that are not exclusive to the engineer or architect, but to a number of project participants.

This would change the entire risk profile of professional indemnity insurance policies in Australia. At best it would substantially increase professional indemnity insurance premiums and at worst it could make professional indemnity insurance for engineers and architects so unmanageable (as the insurer would not be able to accurately analyse and rate its risk exposure) that insurers would simply cease to provide cover.

This has happened in Australia before when in 2001/02 Australia suffered a major insurance crisis and the cost of PI insurance premiums escalated by up to 1000 per cent and some insurers withdrew from this line of business. Consult Australia surveyed its members over that period (2002-2005) and the table below highlights the severity of the impact.

Date	Average Policy Increases	Highest Policy Increases	Average Deductible Increases	Highest Deductible Increases
Feb 2002	115%	300%	80%	203%
Aug 2002	205%	1000%	247%	1000%
Jan 2003	114%	1000%	207%	1200%
Feb 2004	36%	400%	32%	1200%
May 2004	47%	500%	46%	400%
Jan 2005	11%	108%	8%	100%
Total increases: 2002-2005	**528%**		**620%**	

Source: Consult Australia – Professional Indemnity Insurance Surveys 2002-2005

All clients in Australia require, through their contracts with the engineer or architect, evidence that they hold a current certificate of insurance. Without Professional Indemnity Insurance an engineer or architect cannot practice. In any event very few engineering or architectural firms in Australia would have the asset base which would allow them to self-insure against the risks that are potentially involved in the provision of their services.

Consult Australia is of the view that should the exemption be removed then the industry would likely incur similar increases to insurance costs that they experienced during the major insurance crisis in 2001/02.

Macro Economic

The Federal Government has highlighted the challenges of an economy in transition and the impact of this transition on the Budget.

The Productivity Commission in its 2014 Report – Public Infrastructure (May 2014) found that:

> *"Investment in public infrastructure is substantial. Engineering work done for the public sector has been equivalent to more than 2 per cent of GDP since 2008."* [3]

In addition to the significant role of engineering on the Australian economy the Office of the Chief Economist in the 2015 Australian Industry Report found:

> *"Engineering construction activity generated by the resources boom has driven much of the growth in the sector over the last 10 years. However, as the investment phase of the resources boom has wound down, so has engineering construction activity. Engineering construction activity fell by 14.2 per cent in 2014–15, the largest decline since the start of the statistical series."* [4]

At a time when the sector is experiencing significant economic challenges any changes to fitness for purpose warranties that pose greater liability risk will likely lead to engineers and architects further contracting.

Changes will also have the potential to drive up professional service fees, as the engineer and architect, in an attempt to minimise their risk exposure, 'over-design' as they try to meet every conceivable 'purpose' in the mind of the client.

Furthermore Professional Indemnity Insurance, which provides insurance for professionals in the event that they are negligent, excludes cover for such warranties. This means the cost of engineering and architecture will increase because of the increased risk exposure for engineers, architects and insurers.

These costs will be passed on to the consumer, which is not in the best interests of individual consumers or the community in general. Increased litigation is also not in the economic interests of consumers or the broader economy of Australia. The number of engineering and architectural business failures will also increase in the event of growing litigation and cost (or loss) of insurance.

The risk of increasing costs that may ultimately be passed onto the consumer has broader economic impacts. At a time when housing affordability is a serious economic issue across Australia removing the exemption that will in turn force engineers and architects to increase costs will only add to the already considerable cost of housing. Engineers are architects are heavily involved in the residential housing sector and often those engineers and architects that work in this market are predominately small business. Any change to the current exemption would be a 'double-whammy' on these companies, both increasing costs for the small businesses and in turn increasing the costs to the consumer.

[3] Productivity Commission Inquiry Report Public Infrastructure Volume 1, No. 71, 27 May 2014, page 5.

[4] Australian Government, Department of Industry, Innovation and Science, Office of the Chief Economist, Australian Industry report 2015, page 45

Small Business

The small business data card, published by Treasury shows that the number of Professional, scientific and technical services small business makes up almost 12 per cent of small business in Australia[5].

Any changes to fitness for purpose that increases exposure to these businesses will likely see this sector contracting as the risk profile for these firms increases.

Removal of the exemption will mean that consultants will carry liability for inadequate project briefs and consequent project failure in the eyes of their clients, despite there being no fault on the part of the consultant in carrying out their professional duties.

Problems with project definition and scope are emphasised in the domestic sector, because the client is far less informed than a client involved in commercial projects. In addition builders and developers in the domestic market are more susceptible to changing market conditions and are more vulnerable to commercial failure. This means that the effect of removing the exemption will make claims against engineers and architects increase because there is more likelihood of recovering any financial loss from the engineer or architect than the builder.

[5] http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/sml-bus-data Small businesses by industry sector, June 2013

CONCLUSION

Consult Australia submits that there is no robust policy basis for the removal of the exemption that applies to engineers and architects. Further, the Act already adequately protects consumers and there appears to be no market failure to justify the removal of the exemption.

Rather any removal of the exemption will go against the overall objectives of the Act by:

- Increasing risk of litigation;
- The contraction of designers (and competition) in the marketplace because of the reduction in the availability of insurance;
- Increasing the cost of engineering/architectural fees due to higher insurance premiums;
- The reduction in design innovation;

Consult Australia submits that Australian Consumer Law retain the exemption for architects and engineers that exists in Section 61 (4) of the Act. Consult Australia recommends this for the following key reasons.

1) This guarantee is not possible due to the very nature of the services provided and the unique characteristics of the supply chain in which engineers and architects provide these services. Building and construction projects involve multiple parties in the delivery of a project. It is the builder or contractor that delivers the end product. To require the architect or engineer to warrant the performance of other parties, particularly where they have no control over the other parties or the quality of their work, is plainly unreasonable, reflects poor risk management, and creates new risks for all those involved in the supply chain.

2) The introduction of an implied fitness for purpose warranty introduces substantial risk for engineers, architects and their insurers because it exposes them to the risks associated with the performance and behaviour of other participants involved in delivery of the project. These additional risks will drive up the cost of services and Professional Indemnity insurance and ultimately increase costs for consumers and government.

3) Consumers, when they engage the services of a professional engineer or architect, are already well protected by the Act. In the case of negligence on the part of an engineer or architect, protections for the consumer exist within the Act. The addition of a fitness for purpose warranty provides no meaningful additional protection to a consumer in the context of professional services but it does significantly open up the extent of risk faced by the supplier.

4) Absolute fitness for purpose warranties that pose greater liability risk will lead to engineers and architects adopting more conservative approaches in their designs thus increasing project outturn costs and acting to reduce innovation.

5) Removal for the exemption will particularly impact small businesses working in the residential sector because of increased risk, costs and disputation. This has broader implications for housing affordability if the cost of professional services increases and competition is reduced in the small business sector. These outcomes are contrary to the intention of the Act.

Consult Australia requests that the review of the Australian Consumer Law (ACL) retain the exemption for engineers and architects in Section 61 (4) of the Competition and Consumer Act 2010 – Schedule 2, The Australian Consumer Law.

61 Guarantees as to fitness for a particular purpose etc.

(4) This section does not apply to a supply of services of a professional nature by a qualified architect or engineer.

We would welcome any opportunity to further discuss the issues raised in this submission. To do so, please contact Ryan Bondar, Senior Advisor – Policy and Government Relations on ryan@consultaustralia.com.au or phone: 02 8252 6707.