



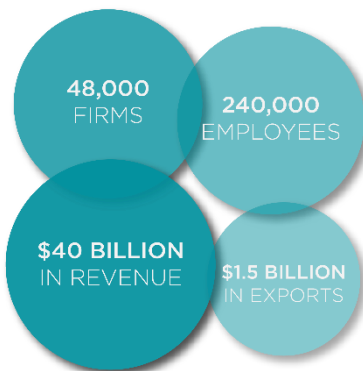
LCSC/TWT 40

Inquiry into TasWater

SUBMISSION TO LEGISLATIVE COUNCIL SELECT COMMITTEE

JULY 2021

ABOUT US



Consult Australia is the industry association representing consulting businesses in design, advisory and engineering. Our industry comprises some 48,000 businesses across Australia, ranging from sole practitioners through to some of Australia's top 500 companies, providing solutions for individual consumers through to major companies in the private sector and across all tiers of government. Our industry is a job creator for the Australian economy, directly employing 240,000 people. The services we provide unlock many more jobs across the construction industry and the broader community.

Our members include:



A full membership list is available at: <https://www.consultaustralia.com.au/home/about-us/members>

EXECUTIVE SUMMARY

Consult Australia welcomes the opportunity to make a submission to the Legislative Council Select Committee Inquiry into TasWater. While we have previously raised the issues contained in this submission directly with TasWater, we provide them to the Committee for its information and consideration.

TasWater released several draft contracts for comment in February/March 2021. While these contracts had some improved conditions, we remained concerned about many onerous terms. In March 2021, Consult Australia met with TasWater to discuss these issues and while the engagement was positive there has been minimal movement since. While the promise to shift smaller works back to TasWater proper is supported, more change is needed.

We have significant concerns with the procurement model used for TasWater work, which essentially outsources procurement to the CPB/UGC JV via the Capital Delivery Office (CDO). The current model sees reduced transparency and accountability of the JV's procurement practices back to the Tasmanian government and the Tasmanian people. TasWater is owned by local councils and with the state government as a shareholder, however the contracting behaviour of the CDO is far removed from what industry expects from local and state governments.

We understand that our concerns are echoed by other industry associations – which demonstrates that industry is aligned that change needs to happen. Our industry needs a healthy ecosystem of consultants and contractors to sustain itself and deliver great project outcomes for the people of Tasmania. Collaboration, capacity, and insurance are the driving factors making action vital now.

There is an urgent need to create a more collaborative procurement and contracting framework, with balanced commercial structures, that will improve the culture across the industry, which will result in greater productivity. There is no build without design.

Capacity issues have always been a policy driver for Tasmania, but at the current time we are seeing capacity as a leading business-critical issues for consulting businesses across Australia – making it even harder to get and keep workers in Tasmania. Consult Australia's latest [Industry Health Check Pulse Survey of April 2021](#) called this out. More than half (56%) of our members are concerned about pressures on workforce capacity to deliver the expected volume of work over the next six months. Skill shortages, exacerbated by limited access to skilled migration and a 'hot' market, is impacting the industry's confidence to deliver a growing pipeline of infrastructure and related projects, which in turn may impact Australia's COVID-19 recovery efforts.

The availability and affordability of insurance is also a leading business-critical issue for consulting businesses. Our latest [Industry Health Check Pulse Survey of April 2021](#) demonstrates that around 90% of businesses have experienced significant premium increases to their professional indemnity (PI) insurance, with 11% reporting that they have experienced increases of over 100% in the last 12 months. This is impacting Tasmanian businesses, not just those working on high-rise buildings in other states. With the current issues in the insurance market, both globally and for Australia across a range of products but most particularly PI insurance, it is essential that action is taken to de-risk the industry – by procurement practices that promote healthy, well-balanced, and sustainable contractual relationships.

In this submission we will highlight where the current TasWater procurement practices are hurting rather than helping the industry in Tasmania as well as the people of Tasmania.

MORE ON INSURANCE

Before we set out our concerns on the TasWater procurement approach, we would like to provide further detail on the current state of the PI insurance market.

PI insurance is business insurance that a consulting business can fall back on in the unlikely event that they have made an error, act, or omission that has given rise to a claim for loss in the provision of their services. It provides businesses with the ability to settle a claim without jeopardising the entire business (depending on the size of the claim and the sum of insurance held). An insurance policy is generally not obtained to cover the liabilities of a business under one contract but covers all relevant liabilities across all their contracts to provide business services to their clients. As a client is not a party to the insurance policy, it generally has no rights to claim on the consultant's insurance because the insurance policy is a contract between the insurance underwriter and the consulting business.

Client organisations (public and private sector) are increasingly expecting the consulting business' policy of insurance to cover them and their project in the face of any losses or issues, often regardless of the fault of the consulting business. In some cases, this is due to a lack of understanding regarding the role of the consultant and their insurance.

We see increasing commentary from the insurance market about the issues that arise in the procurement and delivery of projects which is feeding the decline in availability and affordability of PI insurance across consulting businesses of all sizes. These issues relate to risk being transferred to consulting businesses via contractual warranties, indemnities, high levels of (or unlimited) liability, and cross-liabilities for matters that are unlikely to be in the full control of the consultant. For example, the global insurance broker AON said this of the Australian market:

Australian insurers are focused on cost over-runs, loss mitigation, warranties and cross liability, with related exclusions and sub-limits commonplace. As the Australian government tries to kick start the economy with infrastructure investments, capacity may become an issue.¹

Our members report to us that capacity is already an issue across businesses of all sizes (as evidenced in our Health Check Survey noted earlier). In the infrastructure sector we see significantly diminished access to project specific PI insurance, because Australia's building and construction sector is now considered one of the highest risk industries in the world for PI insurance.

The financial impact of legal disputation against consultants has a dramatic impact, but often gets little attention as the value of claims is only a small percentage of the total construction costs of projects. Consult Australia has observed a disproportionate number of claims against consultants generally occur where there is noticeable back-to-back pass-through of risk from the head client. A significant proportion of claims against consultants seek to redress commercial loss or inappropriate contingency allocations and not *actual loss* caused by defect rectification in the end-product. The industry accepts that defects may occur, and those matters should be addressed with the responsible party (who would likely rely on their relevant insurance), but claims should not be made to redress unrelated issues, such as narrow profit margins.

¹ See AON's Global Insurance Market Conditions Q2 2020.

It is the level of risk transfer that breeds the culture of disputation rather than collaboration. A different way of working is needed – where the contract is used to engender a collaborative approach that incentivises problem solving, and the value and role of each party delivering the project is understood and respected.

The legal disputation in the Australian market is resulting in insurers significantly reducing capacity and availability. Insurers prepared to continue underwriting PI insurance policies are placing far greater scrutiny on their underwriting assessment, rates, and the liability exposure for consultants through their contractual terms and conditions with clients.

Declining profitability

Prior to 2017, the PI market was in a relative 'soft' cycle, meaning that there was broad availability and business were able to access various extensions to their policy cover (typically not on offer previously).

An insurance agency needs to earn approximately \$1.00 for every 70 cents of claims incurred to break even. In Australia, gross claims incurred was \$1.25 billion at the end of 2017. This value was 86% of total premiums earned in the Australian market. This means that the average insurer *lost* 16 cents for every \$1.00 earned. As a result of this declining profitability, the market has tightened in the years following 2017 and has continued to do so at a rapid rate, with some underwriters withdrawing entirely. Looking at the experience of consultancy businesses across Australia throughout 2020 and 2021, it is difficult to say that we are experiencing a periodic 'hard' cycle – it is more critical than that and we are at risk of long-term lack of capacity in the insurance market.

Unfortunately, the commercial nature of insurance is not readily appreciated, even by experienced clients. Insurance underwriters are making commercial decisions based on the risk of claims in the market and the potential (or lack thereof) of profitability – as would any commercial operator. In contracts, procurement guidance, and even in regulation, we see an underlying assumption that a private entity's insurance policy is there for the client or the community as a safeguard. Further, there is an expectation that a consulting business has full control over the terms on which it can obtain and maintain insurance coverage, which is in stark contrast to any other consumer of any other commercial product. Imagine requiring a consumer to guarantee they would source the same product, with the same specifications for every year for the next five to ten years.

Insurance impacts small businesses to global businesses

The insurance issues are hitting businesses of all sizes, with global businesses struggling to get appropriate coverage for their Australian operations. We have set out below some case studies from across our sector to demonstrate this point.

However, our small business members advise that PI insurance premiums are their largest business expense and year on year premiums are increasing while coverage amounts decrease – irrespective of claim history.

The number of underwriters providing any sort of coverage has become extremely limited. Small companies providing specialised design, advisory, or engineering services will struggle to survive unless action is taken.

While affordability is a key issue, we are now seeing small businesses and sole traders face forced business closures and early retirement based solely on the fact they can no longer get insurance at any price (let alone at an affordable premium).

We are increasingly hearing stories from consultants that multiple brokers specialising in engineering and professional services cover are advising that there is no cover from any insurers, underwriters, or other markets (at any price). Various options have been explored for these businesses including:

- a renewal or new policy at a lower sum insured and with the retroactive date intact
- a renewal or new policy at any sum insured with a reduced retroactive date
- a renewal or new policy with no retroactive cover
- a renewal or new policy with cover for personal injury excluded
- a renewal or a new policy with a high level of deductible
- a combination of all the above.

This is an untenable position for these consulting businesses that have successfully operated and could still contribute to the Australian economy, but for the current state of the PI insurance market. The worsening PI insurance market combined with the economic downturn caused by COVID-19, is significantly impacting the ongoing sustainability of our industry and that is why it is time to look at potential solutions.

Case study 1 – Premium increase of less than 25% for a small business

A small structural and civil engineering business that provides services across Australia renewed their PI insurance with a 7% increase in fees and a 23% increase in the premium (which the broker stated was 'a good result in the current market' and the only other main option had pricing at least \$50,000 more). While they were seeking a \$20million coverage, no insurer was able to offer that. The business therefore has primary layer cover of \$10million.

Case study 2 – Premium increase of over 400% for a small business

A small structural engineering business that provides services across Australia previously paid a \$60,000 premium for \$3million PI insurance cover. The renewed policy in 2020 has a premium of \$250,000.

Case study 3 – Potential premium savings for a global business

Large global consulting businesses in the built environment have advised that they could save 40% on their premium if they carved out Australian operations.

Case study 4 – No cover at any price for a sole trading structural engineer

A sole trading structural engineer has been forced into early retirement because they cannot secure PI insurance. This is despite having a long-term client of over 20 years, a steady stream of work and income and no claims in over 15 years.

Without PI insurance, this sole trader cannot operate, even as a verifier of other's work, as insurance is a legislative requirement. Further, they are unable to secure run-off insurance, to cover any claims that may arise during retirement for past work. Essentially, this engineer is self-insuring, putting at risk savings and property holding/s.

The cover required by this engineer to continue working with their long-time client is only \$2-3 million. In past years the premium for the PI insurance was \$6,500 this increased to \$22,000 in 2019. Multiple brokers specialising in engineering and professional services cover have advised this member that there is no cover 'from any insurers, underwriters, or other markets (at any price)'.

Case study 5 – No cover at any price for a small fire engineering business

A small fire engineering business has recently sought renewal of its PI insurance. The previous policy had a limitation excluding all cladding related work and was obtained at a substantial increase in premium. In 2021, there is no offer of insurance with brokers advising that due to the nature of the business activity there is no insurance available.

Without insurance this business cannot continue to operate. If other fire engineering businesses face the same situation this will have a significant impact on the broader construction industry as the Building Code of Australia requires fire engineers to complete the verification method and any cladding product that passes the large-scale testing needs a fire engineer to complete the verification report.

To alleviate the current issues in the insurance market we need urgent action to prioritise de-risking projects through procurement and contracting behaviours.

TASWATER CONTRACT TERMS THAT NEED ATTENTION

We have significant concerns about the TasWater contract conditions released in February/March 2021 – however this is not an exhaustive list. We provide this feedback in the spirit of assisting in positive actions to realise an increase in productivity and improved project outcomes. Model procurement practices reduce the amount of time and expense for both clients and industry in contract negotiations on every project, especially in respect of conditions that are unsuitable for consultants.

Unbalanced rights and obligations

We have found several provisions in the template contract conditions that give more rights to TasWater and/or CPB/UGL JV and places more obligations on the consultant. One example is CPB/UGL JV's unilateral right to determine the amount payable and to demand such payment in the short form agreement. We recommend more balanced language, for example as used in AS4122-2010.

Failure to distinguish between contractor and consultant and goods and services

As we point out in our [*Model Client Policy*](#) (see pages 8-9) many contractual issues arise from the failure to recognise the different role and responsibilities of a contractor and a consultant. These issues can be compounded when a combined goods and services contract is used. We recommend that both short form contracts relevant to consultants be services-only contracts and make clear that the other signatory is the consultant.

Absence of liability cap in the short form contracts

It is curious that the major works contracts include a liability cap, but the short form contracts do not, given the risk assessment should be simpler for less complex/smaller projects. As we point out in our [*Model Client Policy*](#) (see page 12) a contractual limit on liability set with reference to a thorough risk assessment allows business to properly insure their work and provide certainty for themselves and their clients. We recommend that all TasWater contracts include a cap on liability to be determined at the outset of every project.

No exclusion of consequential loss

The contract conditions have no exclusion of consequential loss, which as pointed out in the [*Model Client Policy*](#) (see page 13) is problematic as it makes consultants responsible for eventualities that are beyond their control. We recommend that all TasWater contracts include an exclusion of consequential loss.

Inappropriate insurance obligations

The insurance obligations are onerous in many respects, including the evidence of insurance, notification requirements, coverage, and the set insurance amounts. We recommend that the insurance obligations be redrafted to be less prescriptive and onerous (see for example the insurance obligations in AS4122-2010). Further, the insurance amounts should be set as maximums rather than predetermined amounts. The amount of insurance required should be the last step in a risk assessment and management process.

Unreasonable defect rectification time

A lengthy defect rectification period might be appropriate on a contractor to cover the construction of the dam/water facility etc. but not where the contract is for consultancy services. We recommend that the defect rectification time be shortened to an appropriate timeframe.

Inappropriate requirement for a security deposit

Security deposits and bank guarantees can be relevant to contractors but are inappropriate for consultants. Undertakings should not be used as a tool to mitigate risk generally but instead should be used for its proper purpose, as a backstop for the performance of contractual obligations to mitigate potential losses. Security in construction projects is not unusual but should be applied to the relevant party. The potential financial loss from non-performance of a contractor versus a consultant is significantly different:

- **Contractors** often seek client payment for goods or materials that have not yet been incorporated into the project works. The client's financial loss if a contractor fails to complete performance could, for example, be a pile of steel that has not yet been constructed into a stadium/railway etc. There would be significant financial costs for the client in finding a new contractor to complete the build.
- **Consultants** rarely seek client payment for services before delivering the services. The client's financial loss if a consultant fails to complete performance could, for example, be the absence of a soil analysis or heritage report. The financial cost for the client to get re-work of that professional service is relatively inexpensive.

The client's loss arising from consultant's non-performance can be secured under the general liability cap and therefore no undertaking for security/bank guarantee is needed.

In appropriate fitness for purpose provision in the major works contract

Including fitness for purpose obligations in consultancy agreements fails to recognise the roles of each party, particularly the difference between consultants and contractors. While a fitness for purpose obligation is a suitable requirement for contractors, it is not an appropriate requirement for consultants. These provisions are typically uninsurable for consultants. Including them in agreements with consultants drives up professional indemnity (PI) insurance premiums and influences future available cover which impacts the whole PI market.

Clients can ensure that the consultant is liable for the work they do by relying on the standard duty of care for professional services.

In a contract, a fitness for purpose obligation is a guarantee of an outcome, that is, that the final product is well equipped or well suited for its designated role or purpose. It is an absolute obligation and is not fault-based. Fitness for purpose provisions are not unusual in construction projects where the final build is guaranteed. However, it should only apply to the relevant parties. A consultant cannot guarantee the final build because there are too many factors beyond the consultant's control. Modifying the provision to guarantee the consultant's services/deliverables is sometimes attempted in consultant contracts. That is also problematic because it is almost impossible to define the purpose of a professional service with the same certainty as the purpose of a finished build.

In addition, consultants often rely on data provided by other parties to provide their services. Insurers recognise this and therefore typically do not provide cover under a consultant's PI insurance policy for this contractually assumed risk.

CONCLUSION AND CONTACT

Consult Australia is keen to work with TasWater to address the issues raised above, however a significant change would need to be made by TasWater, particularly in the Capital Delivery Office to embed a more collaborative contracting environment. Without change, Consult Australia and other industry associations are concerned not only about the impact on members (the consultants and contractors needed to deliver TasWater projects) but also the impact on the Tasmanian economy and people.

We would welcome any opportunity to further discuss the issues raised in this submission.

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