

**Available and affordable**

**Improvements in liability  
insurance following tort law  
reform in Australia**

December 2006

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## FOREWORD



During 2002, Australia experienced a crisis regarding the availability and affordability of insurance. In particular, public liability and professional indemnity insurance became increasingly harder to find and purchase. Many community groups, volunteers, professionals and small business operators faced the prospect of having to limit their activities due to the lack of insurance cover.

Thankfully, those days are behind us and the availability and affordability of insurance in Australia has improved markedly in recent years.

This report describes the tort law reforms that have been implemented across Australia by the Commonwealth and State and Territory governments to address the factors that led to the crisis in insurance. The report also outlines the positive impact the reforms are having on the availability and affordability of insurance.

For reasons outlined in this report, we will not see the full impact of the reforms for several years. It is essential that governments across Australia remain committed to the spirit and intent of these reforms if we are to reap the long-term benefits from the changes made.

Australia's insurance sector is now well placed to meet the important task of reallocating risk across the economy. The implementation of both the tort law reforms as well as recent prudential reforms by the Australian Government now mean that the settings are right for business, community groups and individuals to carry on day-to-day activities with confidence that we have a robust insurance and consumer protection regime.

I would like to acknowledge the assistance of my State, Territory and Federal Ministerial colleagues for their work in implementing these reforms both swiftly and effectively.

A handwritten signature in black ink, which appears to read 'Peter Dutton'.

Peter Dutton MP  
Minister for Revenue and Assistant Treasurer



# BACKGROUND TO THE TORT LAW REFORMS

## CRISIS IN THE LIABILITY INSURANCE MARKET IN AUSTRALIA

By early 2002, a number of international and domestic, cyclical and structural forces came together to cause a crisis in the liability insurance market in Australia. These included:

- the collapse of the HHH group of companies in March 2001;
- the destruction of the World Trade Center on 11 September 2001;
- the provisional liquidation of Australia's largest medical defence organisation, United Medical Protection, in April 2002;
- recognition of heavy underwriting losses on policies issued in the previous decade;
- falling investment returns due to a downturn in financial markets;
- increasing compensation payments for bodily injury;
- increasingly litigious community attitudes; and
- the increased tendency of courts to extend liability for negligence.

Insurers felt the effect of these forces in:

- the increasing cost of claims;
- increased uncertainty in the way courts were deciding negligence cases, and therefore increased risk in setting premiums; and
- reduced profitability as a result of both underwriting losses and falling investment returns.

These factors affected the availability and affordability of liability insurance.

For a risk to be insurable, it must be measurable, well understood and bounded. The insurer needs to be able to set premiums that are acceptable to both the insurer and consumers. To do so, the insurer also has to be able to determine the chances of the insured event occurring and the extent of the losses for which it will be liable.

Insurers saw claims increasing in frequency and damages increasing in quantity in the lead up to the crisis. While public liability premiums had been flat or falling in the 1990s, claims costs had been increasing well in excess of the rate of inflation.<sup>1</sup>

Premiums provide an insurer with revenue to cover the development, marketing, operating and claims-processing costs of the insurance and some profit. Premiums reflect not only the cost of claims, but also a range of other costs. Overwhelmingly, however, the most significant cost of insurance is the cost of meeting claims.

HIH Insurance Limited was a major public liability insurer and its market share had grown to around 40 per cent by the time it collapsed. The HIH Royal Commission concluded that the primary reason for HIH failing was 'under-reserving'; that is, a failure to properly price risk to adequately provide for future claims.<sup>2</sup>

When such a significant player in the general insurance market collapsed, remaining insurers were unable to instantly fill the void. Insurers that had the capacity to take on some of HIH's market share inevitably had to raise premiums, given that HIH had been underpricing its premiums at the time of its collapse.

A stark lesson for Australian insurers arising out of the failure of HIH was that insufficient attention to pricing risk and the full and relative costs of capital can be catastrophic to the long-term fortunes of an insurer.

## INCREASING COST OF CLAIMS

Factors affecting the price of insurance are many and varied. They include international conditions in insurance and reinsurance markets. Other factors are domestic in nature. One obvious domestic factor which impacts on premiums is the cost of claims. Because governments are responsible for the legislative framework that impacts on tort law, claims costs is one area where government policy can influence insurance affordability.

It is apparent that claims costs and, in particular, the cost of personal injury claims, had escalated in the years leading up to the insurance crisis. The enormity of these increases can be demonstrated in simple terms by comparing the increase in consumer prices with the increase in court awards over the same period. In the ten years to 2002, inflation in Australia averaged 2.5 per cent per annum. In contrast, a study commissioned by the Australian, State and Territory governments found that awards for personal injury had increased at an average rate of 10 per cent per annum.

When looking at large claims, the comparison is even more telling. Between 1979 and 2001, the consumer price index increased by 212 per cent. Over the same period the

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1 Sam Maitra et al, 'Public liability tort reform – assessing the impacts' (Paper presented to the Institute of Actuaries XVth general insurance seminar 16-19 October 2005) 8.

2 The HIH Royal Commission, *The failure of HIH Insurance Volume I A corporate collapse and its lessons* (2003) xvii.



highest award for personal injury in Australia increased from \$270,000 to \$14.2 million, an increase of over 5,000 per cent.

## INCREASED UNCERTAINTY AND RISKS

In the period leading up to and during the time of the insurance crisis, a number of high profile court awards for negligence were resolved with multi-million dollar verdicts awarded to plaintiffs. In some circumstances, courts awarded verdicts where the community perceived that the plaintiff had significantly contributed to his or her own injury. Some sections of the public became increasingly concerned that court verdicts were unreasonable and were being financed by increasingly burdensome insurance premiums.

Some members of the community expressed concern that Australia was adopting an increasingly litigious culture, where individuals were reluctant to take responsibility for their actions.

## UNDERWRITING LOSSES

A combination of increasing claims costs and relatively low premium pricing brought about some noticeable underwriting losses in the insurance industry in the late 1990s.

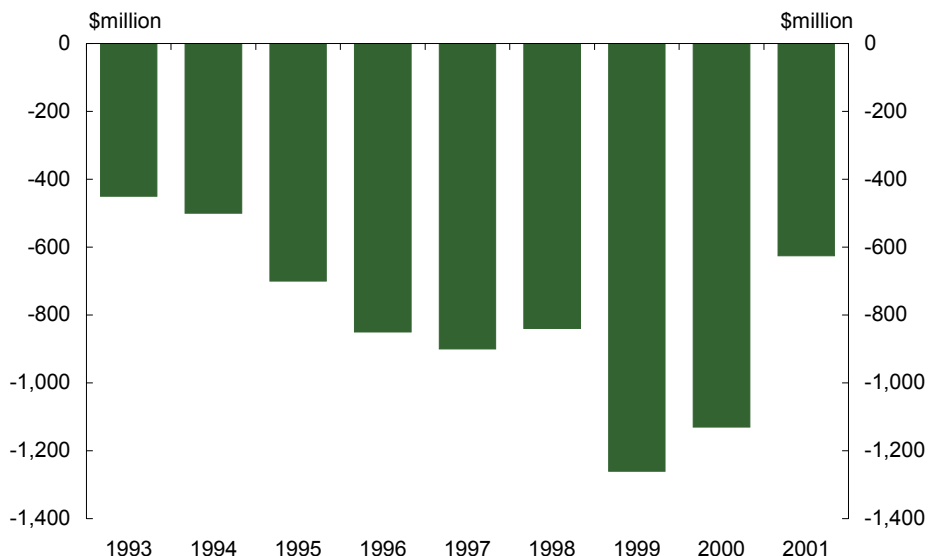
On its face, it would appear that unhealthy underwriting profit coincides with having an unhealthy insurance industry. However, it is not uncommon for underwriting operations to run at a loss, especially for long-tail risks. Underwriting results do not take into account the substantial investment earnings expected on reserves for outstanding claims liability.<sup>3</sup>

Although it may not be unusual for insurers to face underwriting losses, losses were gradually increasing from the early to mid nineties, before peaking at a level in excess of \$1 billion in 1998-99 (*see chart 1*). Notwithstanding the fact that underwriting losses should not be viewed in isolation, these larger than normal losses adversely affected the overall profitability of the sector.

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3 Australian Competition and Consumer Commission, *Insurance Industry Market Pricing Review* (March 2002) 18  
<<http://www.accc.gov.au/content/item.php?itemId=321817&nodeId=3f4c53cf03615e54d002d94a18dc4a72&fn=Insurance%20Industry%20Market%20Pricing%20March%202002%20part%201.pdf>> at 23 November 2006.

**Chart 1: Underwriting losses: year ending 30 June<sup>4</sup>**



## FALL IN INVESTMENT RETURNS

While underwriting is an obvious core business of insurers, investment income forms a critical part of insurance profit and the overall return on equity. During the 1990s, because the insurance industry was experiencing underwriting losses, it had to rely on investment income and/or the running down of capital reserves to maintain cash-flows.

In long-tail classes of insurance such as public liability and medical indemnity, insurers typically earn substantial income on premiums invested before paying out claims. However, claims costs also tend to rise over time because of inflation.<sup>5</sup>

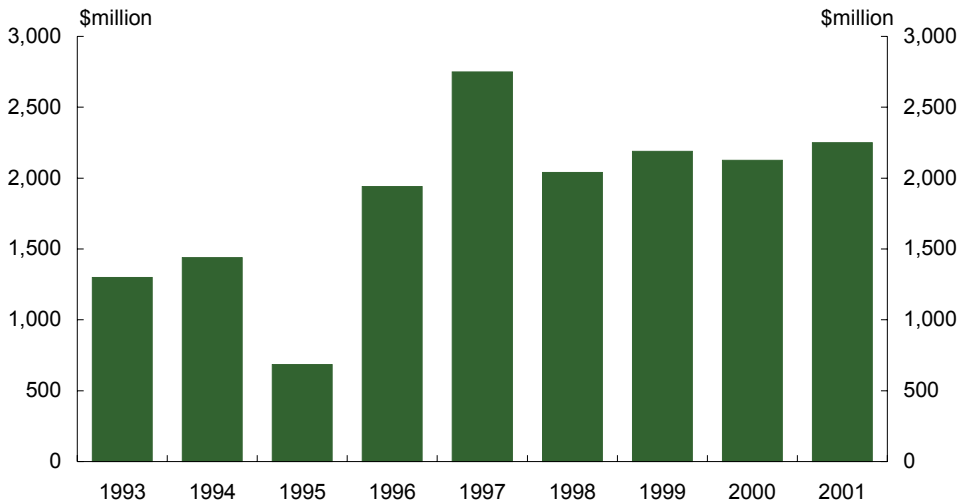
Investment income generated by insurers is largely dependent on the fortunes of the Australian and international stock markets.<sup>6</sup> Investment income for the industry reached its peak in 1997, at \$2,746 million. Returns in subsequent years up until 2001 were not as high due to falls in stock market returns, despite there being more funds invested by the industry (*see chart 2*).

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4 *ibid.*

5 Australian Competition and Consumer Commission *Public liability and professional indemnity insurance: Monitoring report* (July 2003) 18  
<<http://www.accc.gov.au/content/index.phtml/itemId/346591>> at 23 November 2006.

6 Australian Competition and Consumer Commission, above n 3, 21.

**Chart 2: Investment returns: year ending 30 June<sup>7</sup>**

## IMPACT OF THE INSURANCE CRISIS

The insurance crisis manifested through insurers no longer being willing to write insurance for certain activities because it was unprofitable, or insurers only being willing to write insurance at unaffordable prices. After the demise of HIH the remaining competitors in the domestic general insurance market did not have the capacity to fully absorb an additional 40 per cent market share. As a result, many individuals and businesses found it difficult to obtain affordable insurance.

While there was a crisis in the availability and affordability of insurance, the subsequent rise in previously under priced premiums for public liability and professional indemnity insurance was partly a result of the market correcting itself.

A more focused approach to underwriting and a fall in investment returns, combined with the sharp hardening of international insurance markets, had dramatic flow-on effects for Australian consumers.

During the initial stages of the insurance crisis, the Australian media regularly reported on the cancellation of sporting and recreational events. The reason given for their cancellation was that insurance premiums were significantly higher than what had been paid in the past and, in some cases, accounted for the entire budget of the event.

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<sup>7</sup> *ibid.*

There were numerous reports of community groups, businesses and professionals threatening to cease their activity. There were also accounts of well-known recreational and tourist attractions either closing or operating without insurance.

Society relies on insurance to pool and transfer risk to those best placed to manage it. Without a reliable risk management mechanism, considerable economic and social activity would not take place.

Businesses often view liability insurance as a cost of carrying on day to day operations, while not-for-profit entities may see liability insurance as a necessary measure to limit their exposure.

Some activities are required by law to have appropriate insurance coverage, while for others insurance is merely a financial necessity.

Because of its importance, a well-functioning insurance market is critical for the Australian economy.

## **PUBLIC LIABILITY INSURANCE**

Public liability insurance protects individuals, businesses and organisations against the financial risk of being found liable to a third party for injury or loss resulting from negligence by the insured.<sup>8</sup>

Public liability insurance policies tend to be broad in scope. This is because entities that choose to purchase public liability cover tend to do so with the broad objective of minimising their civil liability to the public.

For example, in the case of local councils, the public liability cover they might purchase is designed to cover personal injuries incurred within a defined local government area. Such policies are broadly defined and, to the extent that they are within the public domain, may include:

- public facilities, such as community halls and sports grounds;
- general infrastructure such as roads and footpaths; and
- landed areas, such as public parks, reserves and watercourses.

Often, councils will require organisers of community events to hold separate cover that relates to a specific event or facility. Such a requirement may exist where the event relates to the weekly use of a public facility, such as community hall for karate classes, or for the once-off use of a council car park for a local fair.

A public liability insurance market that can satisfy the demand from community groups as well as the broader community is therefore vitally important.

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8 Australian Competition and Consumer Commission, above n 5, vii.

The average size of public liability claims increased in real terms between 1997 and 2002 (*see table 1*).

**Table 1: Changing size of public liability claims<sup>9</sup>**

	Average size of claims settled in real terms each year (\$)					
	National	NSW	VIC	QLD	SA	WA
1997	10,237	11,434	11,934	8,234	9,315	6,782
1998	10,346	13,723	9,010	8,607	6,859	8,522
1999	12,186	16,706	10,312	10,935	7,515	9,230
2000	12,979	14,650	12,808	15,469	8,547	7,354
2001	12,256	16,954	10,685	9,788	9,644	8,065
2002	17,906	26,688	15,130	12,807	11,780	10,771
Per cent change between 1997 and 2002	75%	133%	27%	56%	26%	59%
Average annual per cent change	13%	21%	8%	13%	6%	11%

## Effect on the community

The rapid increase in public liability premiums in 2001 and 2002 seriously diminished the capacity of certain groups to carry on frequent activities or one-off events.

Sporting, tourism, community and not-for-profit groups found it difficult to obtain affordable public liability insurance. This affected school fetes, regattas and a broad range of recreational events.

One annual Tasmanian sporting event experienced an increase in public liability insurance premiums of 2,261 per cent between 2001-02 and 2002-03, while a Tasmanian tourist attraction experienced a 572 per cent increase in the same period.

In October 2003, the Western Australian State Government paid a \$45,000 grant to the Surf Life Saving Association of Western Australia to help it overcome a \$90,000 shortfall in its public liability insurance premium.

Indoor rock climbing operators found it very difficult to obtain insurance, and many ceased operating as the price of public liability insurance made business unviable. One Victorian indoor rock climbing gym reported a one-year premium increase of over 1,500 per cent.

Another activity that suffered due to the reduced availability of public liability insurance was adventure tourism. As with many other activities, a number of operations ceased as increased public liability premiums made business unviable.

<sup>9</sup> *ibid*, 112. The average size of claims settled on a national basis includes data from all States and Territories. Derived from responses provided by seven insurers.

Other operators wrote to the government detailing that, while they could manage to obtain insurance, new limitation clauses in the contracts forced operators to significantly scale back operations, resulting in job and revenue losses.

Governments and the community at large were concerned that such rapid increases in premiums would effectively make many of these events and organisations unviable.

### **Case study: public liability insurance**

At the peak of the insurance crisis in 2002-03, six key tourism and heritage rail and tram societies in South Australia were faced with increases in public liability insurance premiums ranging from 55 to 900 per cent on the previous financial year.

Given the nature of these societies, the immediate viability of their operations relied on contributions from local government, community organisations and private donors.

One rail activity ceased its operations in June 2002, while two were able to negotiate old rates for a further twelve months. In 2003-04, State and local governments provided assistance to these organisations to help with rising public liability costs.

## **PROFESSIONAL INDEMNITY INSURANCE**

Professional indemnity insurance is a product that indemnifies professional people such as accountants, architects, lawyers and others, for their legal liability to their clients and others who relied on their advice or services. It provides indemnity cover if a client suffers a loss, material, financial or physical, that is directly attributed to negligent acts of the professional.<sup>10</sup>

Professional indemnity generally has a narrower scope than public liability insurance, as well as a different focus. Professional indemnity effectively insures individuals or businesses for the professional services they carry out. The definition of 'professional' for the purposes of professional indemnity insurance is sufficiently broad to include any person or entity that provides advice or services in which they use acquired skill or knowledge. Public liability insurance generally has a much broader coverage in terms of the liability it seeks to cover.

Professional indemnity insurance acts as an important risk management mechanism to limit exposure for professional negligence. Depending on the profession and the jurisdiction, some individuals are not allowed to practice their profession unless they can show evidence of sufficient professional indemnity cover.

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10 *ibid*, vii.

A well functioning professional indemnity market that can cater to demand is highly desirable, both for the professionals who may be obliged by their professional associations or governments to take out professional indemnity cover, and for the consumers who rely on their services.

Although professional indemnity has generally been one of the smaller classes of insurance, representing approximately 3 per cent of the total gross written premium and less than 1 per cent of policies written at the time of the insurance crisis, it represented 8 per cent of the outstanding claims liability in 2000-01.<sup>11</sup>

In addition to professional indemnity representing a disproportionately high percentage of outstanding claims liability in the Australian market, in the years leading up to the insurance crisis the average size of professional indemnity claims was increasing (*see table 2*).

**Table 2: Changing size of professional indemnity claims<sup>12</sup>**

	Average size of claims settled in real terms each year (\$)			
	National	NSW	VIC	QLD
1997	6,399	7,195	6,264	5,453
1998	9,098	7,679	12,408	5,822
1999	10,072	15,197	7,668	7,253
2000	12,501	16,602	12,551	10,526
2001	12,395	17,355	15,253	6,275
2002	18,885	22,372	24,593	8,914
Per cent change between 1997 and 2002	195%	211%	293%	63%
Average annual per cent change	26%	29%	41%	16%

The average size of all claims settled in the largest jurisdictions of New South Wales and Victoria had a significant role in driving the national figure.

The overall increase in the size of professional indemnity claims is consistent with the premium increases that followed across Australia.

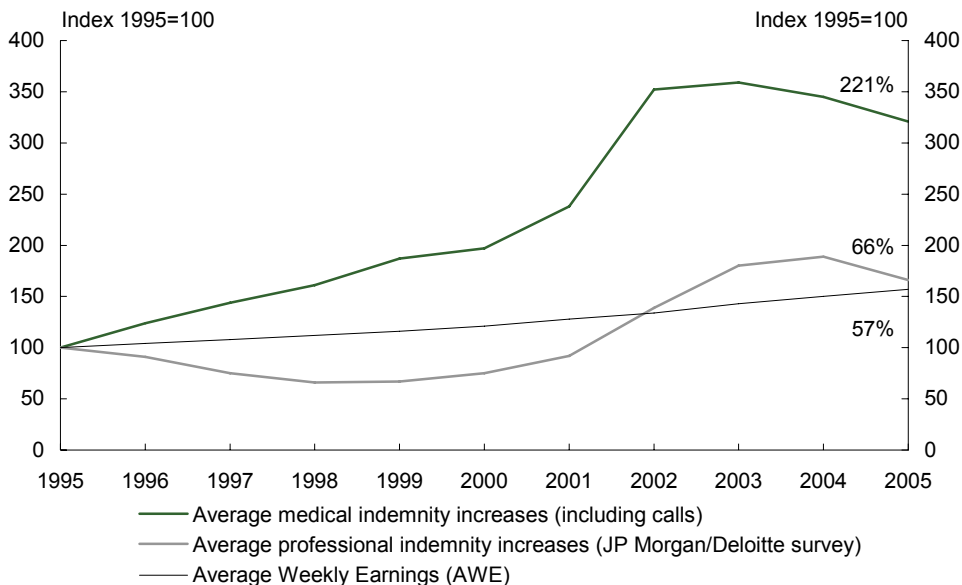
Some professions saw greater increases in premiums than others. Average medical indemnity premiums increased by 221 per cent between 1995 and 2005 (at an average rate of 13 per cent per annum). The largest annual increase was in 2002, when the average premium rose nearly 50 per cent. By way of comparison, Australian average

11 Australian Competition and Consumer Commission, above n 3, 46.

12 Australian Competition and Consumer Commission, above n 5, 114. The average size of claims settled on a national basis includes data from all states and territories. Derived by the ACCC from responses provided by six insurers.

weekly earnings increased by 57 per cent (or an average of 4.6 per cent per annum) over the same period (see chart 3).<sup>13</sup>

**Chart 3: Average increases in cost of indemnity cover<sup>14</sup>**



### Effect on the community

In 2002, most public attention initially focused on increases in the cost of public liability insurance and the subsequent impact on small businesses, community and sporting groups. The high and unpredictable cost of claims also had a major impact on the cost of professional indemnity insurance in the Australian market.

The increased cost of professional indemnity insurance had a greater impact on some professions than others. In the case of medical indemnity insurance, health care professionals and health care service providers expressed concern about the rapid increases in the cost of medical indemnity premiums up to the period of 2002-03, and the potential for health care professionals to cease practising in a particular field or altogether.

During this time, Australia’s largest medical defence organisation, United Medical Protection (United), went into provisional liquidation, with substantial incurred but not reported liabilities. Because United indemnified many health care professionals in

13 Medical Indemnity Industry Association of Australia *Medical indemnity report: an analysis of premium and claim trends in Australia from 1995 to 2005* (21 August 2006) 5 <<http://www.miaa.com.au/reports.php>> at 23 November 2006. Prepared by Insurance Statistics Australia Limited.

14 *ibid.* The medical indemnity premium includes calls made on members of the medical defence organisations for additional subscriptions.



Australia, the Australian Government took on its incurred-but-not-reported liabilities in order to prevent it from being wound up.

The near collapse of United did nothing to help the rising cost of medical indemnity insurance. In fact, it demonstrated that some medical defence organisations had under priced the premiums they had charged members in the past (*as seen later in chart 11*). The rise in medical indemnity premiums in 2002 was partly a result of the market correcting itself.

Most parts of Australia felt the pressure of the potential reduction of specialist medical services, due to specialists such as obstetricians claiming that affordable cover was becoming more difficult to obtain. Most Australian jurisdictions faced the risk of doctors leaving their specialty or the area of health care altogether.

Professional indemnity premiums for other professions also rose in this period. For example, the Victorian State Government received representations from accountants highlighting how the low availability of professional indemnity insurance had forced premiums to increase by as much as 1,000 per cent in a year. Consequently, many businesses were under threat of becoming unviable due to the increasing costs of professional indemnity cover.

If professional indemnity insurance is available but expensive to purchase, it is highly likely that professionals would pass on their increased costs to the consumers of their services.

### **Case study: professional indemnity insurance**

In 2002, a consulting engineer from NSW practising as a sole trader sought to renew his professional indemnity insurance policy. His current policy at the time had cost just under \$1,700 per year. In 40 years of practising as an engineer, he had never had a claim made against him.

To renew his insurance the engineer's insurance broker of 25 years quoted him for a similar policy, for just over \$60,000 per year. Because he was unable to obtain affordable cover, the engineer saw his only options as being to go uncovered or to retire early.

## **GOVERNMENT RESPONSE TO THE INSURANCE CRISIS**

The Australian, State and Territory governments recognised the important role that insurance plays in the transfer of risk across the economy.

The lack of available and affordable insurance made it expensive for some entities to purchase appropriate levels of insurance cover. It also forced some, particularly small

entities, to either cease operations altogether or to 'run bare', without the protection of insurance.

During 2002 and 2003, community stakeholders made representations to all levels of government seeking action to address the insurance crisis.

Submissions calling for action came mainly from community groups, individual consumers and small businesses struggling to obtain affordable public liability or professional indemnity insurance. Local governments, insurers' representatives and local members of parliament also called for government action.

Other submissions came from plaintiff lawyers and injured persons' representatives asserting that the insurance market was cyclical and that premium problems were temporary, due to insurer profiteering, or were necessary as an incentive to manage risks.

The Victorian Government estimates that, at the peak of the public liability and professional indemnity insurance crisis, the volume of correspondence it received from individuals, community groups, small businesses and other organisations increased by approximately 20 fold.

That businesses or community groups were discontinuing their services due to the rising cost of insurance was a critical issue for governments. Just as critical was the prospect of a significant number of businesses or community groups operating without adequate cover. There are inherent problems for entities, small entities in particular, that carry on their activities without appropriate liability insurance cover. Arguably, the possible eventuality of a claim outweighs any savings from not buying insurance. Furthermore, it is not in the interests of consumers or the public generally for entities to go uncovered, particularly those entities too small to self-insure and fully absorb any civil action.

Given this situation, arguably a market failure existed. The benefits of more insurance being provided included the activities of businesses and community groups continuing and entities being adequately insured. Governments were therefore looking for ways to facilitate the provision of additional insurance at affordable prices.

While most of the correspondence from the community did not suggest specific solutions to the insurance crisis, many put the onus on the government to resolve the crisis. There was a firm belief that there was genuine urgency in finding a solution and that any action by government had to be swift and effected immediately.

## **THE REVIEW OF THE LAW OF NEGLIGENCE**

Commencing in March 2002, ministers representing the Australian, State and Territory governments and a representative from local government (the ministers), met frequently to discuss the insurance crisis. The meetings assisted all governments to

exchange information about the various courses of action being considered and the legislative reforms being proposed to improve the availability of insurance.

Through these meetings, all jurisdictions reached a non-partisan accord to implement major reforms to Australian law in a consistent manner.

At the second ministerial meeting in May 2002, the ministers agreed to convene an expert panel, chaired by the Honourable Justice David Ipp, to review the law of negligence (the Ipp review), in light of the concern by all jurisdictions that unpredictability in the interpretation of the law of negligence was a factor driving up insurance premiums.<sup>15</sup>

Ministers commissioned the Ipp review to inquire into the law of negligence and to develop a series of proposals to provide a principled approach to reforming the law of negligence. Specifically, the panel's task was '... to examine a method for the reform of the common law with the objective of limiting liability and quantum of damages arising from personal injury and death.' The review was intended to assist governments in developing consistent national approaches to tackle rising insurance premiums and the reduced availability of public liability insurance.

The Ipp review made 61 recommendations to governments on a principled approach to reforming the law of negligence.

The then Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan, released the Ipp review report in October 2002.

## REFORMS TO TORT LAW

At the ministerial meeting on insurance issues in October 2002, ministers agreed in principle to the development of nationally consistent legislation for provisions relating to liability for personal injury or death resulting from negligence.<sup>16</sup>

In November 2002, ministers formally agreed on a package of reforms implementing key recommendations of the Ipp review. All states and territories agreed to implement the key Ipp recommendations that went to establishing liability on a nationally

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15 Joint communiqué: ministerial meeting on public liability Melbourne (30 May 2002) 3 <<http://www.treasurer.gov.au/atr/content/publications/2002/20020530.asp>> at 23 November 2006.

16 Joint communiqué: ministerial meeting on public liability Sydney (2 October 2002) 1 <<http://www.treasurer.gov.au/atr/content/publications/2002/20021002.asp>> at 23 November 2006.

consistent basis. Each jurisdiction agreed to introduce the necessary legislation as a matter of priority.<sup>17</sup>

While civil liability legislation differs between jurisdictions, states and territories have largely implemented comparable reforms in their respective jurisdictions that were broadly consistent with the findings of the Ipp review.

The Australian Government also agreed to amend the *Trade Practices Act 1974* to complement state and territory tort law reform, to avoid possible avenues for plaintiffs and their lawyers to circumvent reforms in other jurisdictions.

The Australian Government expected that the tort law reforms would reduce premiums and improve the availability of insurance.<sup>18</sup>

### ACCC monitoring

Because governments were making such significant changes to tort law, they wanted to ensure that insurers would pass any cost savings onto the consumers of insurance products. In this regard, ministers at the ministerial meeting on insurance issues in May 2002 agreed that monitoring market developments and premium pricing was crucial in ensuring the effectiveness of the tort law reforms. Specifically, ministers agreed to the Australian Competition and Consumer Commission (ACCC) monitoring the domestic insurance market.<sup>19</sup>

In July 2002, the then Parliamentary Secretary to the Treasurer, Senator Ian Campbell, asked the ACCC to monitor costs and premiums in public liability and professional indemnity insurance markets every six months in the following years. The ACCC was to consider the impact on insurance premiums of measures taken by governments to reduce or curb claims and to improve the data available to insurers to evaluate and price risk.<sup>20</sup>

The ACCC subsequently produced five monitoring reports on public liability and professional indemnity insurance. The Australian Government released the last of these reports in August 2005.

In 2006, the Minister for Revenue and Assistant Treasurer, the Hon Peter Dutton MP, agreed that the ACCC should suspend its monitoring of public liability and

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17 Joint communiqué: ministerial meeting on public liability insurance Brisbane (15 November 2002) 1.

<[http://www.engineersaustralia.org.au/shadomx/apps/fms/fmsdownload.cfm?file\\_uuid=1952E65A-D23A-8353-4D1E-2DC454D29418&siteName=ieaust](http://www.engineersaustralia.org.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=1952E65A-D23A-8353-4D1E-2DC454D29418&siteName=ieaust)> at 23 November 2006.

18 Minister for Revenue and Assistant Treasurer's press release C119/02 (15 November 2002) <<http://assistant.treasurer.gov.au/atr/content/pressreleases/2002/119.asp>> at 23 November 2006.

19 Joint communiqué: ministerial meeting on public liability Melbourne (30 May 2002), above n 15.

20 Australian Competition and Consumer Commission, above n 5, 1.

professional indemnity insurance, in light of the more comprehensive data now available from the National Claims and Policy Database (NCPD).

As part of the Australian Government's medical indemnity assistance package, the Prime Minister announced on 23 October 2002 that the ACCC would monitor medical indemnity premiums to determine whether they are actuarially and commercially justified.<sup>21</sup>

The Treasurer, the Hon Peter Costello MP, asked the ACCC to report on an annual basis for a period of three years, with a final report in 2005. In 2006, the Minister for Revenue and Assistant Treasurer, the Hon Peter Dutton MP, extended the ACCC's monitoring role for a further three years to 2008.

The Australian Government released the ACCC's third monitoring report of medical indemnity insurance in February 2006 which found that the premiums charged for the 2005-06 underwriting period were actuarially and commercially justified.

### **APRA data collection**

At the time of the insurance crisis, the insurance industry argued that a lack of comprehensive data was a significant constraint on appropriate pricing and premium setting and limited the development of appropriate insurance products.

In June 2002, the then Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan, asked the Australian Prudential Regulation Authority (APRA) to use its powers to collect data on public liability and professional indemnity insurance.

APRA established the NCPD to provide more detailed information to the insurance industry to improve the availability and affordability of public liability and professional indemnity insurance. This is expected to be achieved through:

- better assessment of risk;
- more appropriate determination of premiums and reserves;
- the development of products for public and product liability and professional indemnity insurance; and
- establishing industry-wide benchmarks and facilitating greater market transparency and informed commercial decision-making by insurers.

The database is also designed to give the Australian Government access to comprehensive data, which will assist in understanding issues affecting the insurance market and, specifically, to assist in policy-making. APRA will also be able to use the

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21 Prime Minister's press release (23 October 2002)  
<[http://www.pm.gov.au/news/media\\_releases/2002/media\\_release1937.htm](http://www.pm.gov.au/news/media_releases/2002/media_release1937.htm)>  
at 23 November 2006.

## Background to the tort law reforms

information received to assist in the prudential regulation of authorised insurers writing these classes of business.

Like the role previously played by the ACCC reports, the NCPD has become a mechanism to ensure that insurers pass the benefits of tort law reform onto consumers.

The insurance industry funds the NCPD. A levy introduced in 2006 recovers the costs of the NCPD from general insurers who contribute to and make use of the database.

# THE TORT LAW REFORMS

Since 2002, governments across Australia have undertaken a comprehensive programme of law reform to improve the cost and availability of the liability classes of insurance.<sup>1</sup>

Jurisdictions introduced reforms progressively from 2002 to 2006, with each jurisdiction taking into account its own circumstances. However, these reforms were broadly consistent with the recommendations of the *Review of the Law of Negligence* (the Ipp review).<sup>2</sup>

The law reforms fall into three categories, dealing with:

- Establishing liability – changes to the law governing decisions on liability, including contributory negligence and proportionate liability.
- Damages – changes to the amount of damages paid to an injured person for personal injury or for a claim for economic loss against a professional.
- Procedural reforms – time limits and methods for making and resolving claims, including court procedures, legal conduct and legal costs.

The sections below refer, where appropriate, to two previous publications: the *Review of the Law of Negligence* and a subsequent survey of the tort law reforms, *Reform of liability insurance law in Australia*.<sup>3</sup>

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1 Do not rely on the information in this chapter as a statement of the law. Instead, refer to the Australian legislation in force from time to time and seek appropriate legal advice.

2 Minter Ellison *Special report: Tort law reform throughout Australia: a brief review of recent amendments* (Sixth edition, December 2005) 1  
<[http://www.minterellison.com/public/resources/file/eb1bac0d59b7755/RG-TortLawReform\\_0512.pdf](http://www.minterellison.com/public/resources/file/eb1bac0d59b7755/RG-TortLawReform_0512.pdf)> at 23 November 2006.

3 *Review of the Law of Negligence: final report* (September 2002)  
<<http://revofneg.treasury.gov.au/content/reports.asp>> at 23 November 2006. *Reform of liability insurance law in Australia* (February 2004)  
<<http://www.treasury.gov.au/contentitem.asp?ContentID=799&NavID=>>  
at 23 November 2006.

## ESTABLISHING LIABILITY

Reforms to liability	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>Foreseeability</b>									
A person is not negligent by reason only of failing to take precautions against a foreseeable risk of harm	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
A person is not negligent for failing to take precautions against a risk of harm unless that risk is 'not insignificant'	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
A person is not negligent for failing to take precautions against a not insignificant risk unless a reasonable person would have taken such precautions	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
Negligence calculus	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
<b>Causation and remoteness of damage</b>									
Plaintiff bears the onus of proof in relation to issues associated with causation	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
Principles of the two elements of causation and guidance in application	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
Principles for determining when the 'evidentiary gap' should be bridged in circumstances of material contribution by the defendant to risk or harm	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
Principles for determining what the plaintiff would have done had the negligent conduct not occurred	n/a	✓	✓	✓	✓	—	✓	—	u/c



Reforms to liability	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>Standard of care for professionals</b>									
Modified <i>Bolam</i> rule	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
Restatement of duty to inform for medical practitioners to give greater clarity and address hindsight bias	n/a	—	—	✓	✓	—	✓	—	u/c
<b>Non-delegable duties</b>									
Existence and extent of liability for breach of a non-delegable duty is determined on the basis of principles applicable to vicarious liability	n/a	✓	✓	✓	—	—	—	—	u/c
Civil liability legislation applies to a non-delegable duty	n/a	—	—	✓	—	—	✓	✓	u/c
<b>Fair trading laws</b>									
Action prohibited for personal injury and death under Division 1 of Part V of the <i>Trade Practices Act 1974</i> and similar provisions under state and territory fair trading law	✓	✓	—	✓	—	u/c	✓	—	u/c
<b>Mental harm</b>									
Pure mental harm and economic loss for consequential mental harm must be a recognised psychiatric illness and harm must be foreseeable to a person of normal fortitude	n/a	✓	✓	—	✓	✓	✓	✓	u/c
Restatement of factors relevant to assessing mental harm	n/a	✓	✓	—	✓	✓	✓	—	u/c
Restrict the circumstances in which pure mental harm can be awarded as a result of another being imperilled, injured or killed to a specified list of family relationships	n/a	✓	✓	—	✓	✓	✓	✓	u/c

Reforms to liability	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>Apologies</b>									
An apology cannot be taken as an admission of liability	n/a	✓	✓	✓	✓	✓	✓	✓	✓
<b>Contributory negligence and the assumption of risk</b>									
Negligence calculus for contributory negligence	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
100 per cent reduction of available damages for contributory negligence	n/a	✓	✓	✓	—	—	✓	✓	u/c
Special provisions for contributory negligence of a plaintiff under the influence of drugs or alcohol and engaged in criminal activities	n/a	✓	✓	✓	✓	✓	✓	✓	✓
Reform of the defence of voluntary assumption of risk	n/a	✓	✓	✓	✓	✓	✓	✓	u/c
<b>Proportionate liability for economic claims</b>									
Proportionate liability for claims of economic loss	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Recreational activities and waivers</b>									
No liability for harm resulting from an obvious risk of a dangerous recreational activity	n/a	✓	✓	✓	✓	—	✓	✓	✓
Providers of dangerous recreations can enter into contracts limiting their liability	✓	✓	✓	✓	✓	✓	—	✓	✓
<b>Good Samaritans</b>									
A 'good Samaritan' is not liable in any civil proceedings for any acts or omissions done in good faith	n/a	✓	✓	—	✓	✓	—	✓	✓

Reforms to liability	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>Volunteers</b>									
Protect volunteers doing work for community organisations from civil liability for acts or omissions in good faith	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Public authorities</b>									
Policy defence if an authority is sued for negligence in the exercise or non-exercise of a public function	n/a	✓	✓	✓	✓	—	✓	✓	u/c
Restore highway immunity rule	n/a	✓	—	✓	✓	✓	✓	✓	u/c

## DAMAGES

Reforms to damages	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>General damages</b>									
Set threshold before general damages apply	✓	✓	✓	—	✓	✓	✓	✓	✓
Assessment procedure for general damages	n/a	—	—	✓	—	✓	—	—	✓
Cap on general damages	✓	✓	✓	✓	—	✓	—	—	✓
<b>Earnings loss cap</b>									
Limit compensation for loss of future earnings or loss of earning capacity	✓	✓	✓	✓	✓	✓	✓	✓	✓

Reforms to damages	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>Gratuitous care</b>									
Threshold for damages to apply	✓	✓	✓	✓	✓	—	✓	—	✓
Cap on rate of payment	✓	✓	✓	—	✓	✓	✓	—	✓
<b>Discount rate</b>									
Align discount rate used in civil liability matters at 5 per cent	✓	✓	✓	✓	n/a	✓	✓	—	n/a
<b>Structured settlements</b>									
Remove tax impediment to structured settlements and facilitate court ordered structured settlements	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Punitive damages</b>									
No punitive damages in personal injury cases	n/a	✓	—	✓	—	—	—	✓	✓
<b>Caps on professional liability</b>									
Professional standards schemes	✓	✓	✓	✓	✓	✓	✓	✓	✓

## PROCEDURAL REFORMS

Procedural reforms	Cth	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
[ ✓ ] legislated [ a ] announced but not yet legislated [ u/c ] under consideration [ n/a ] no jurisdictional responsibilities [ — ] not agreed									
<b>Limitation periods</b>									
Commencement period defined as date of discovery	✓	✓	✓	—	—	—	✓	✓	u/c
Limitation period 3 years	✓	✓	✓	✓	✓	✓	✓	✓	u/c
12-year long stop	✓	✓	✓	—	—	—	✓	✓	u/c
Court discretion to extend long stop	✓	✓	✓	—	—	—	✓	—	u/c
Protection for persons under a disability and minors	✓	✓	✓	✓	✓	✓	✓	✓	u/c
<b>Pre-litigation procedures</b>									
Improve pre-litigation procedures including notice of claims	—	✓	✓	✓	—	✓	—	✓	✓
<b>Legal advertising</b>									
Restrictions on advertising of personal injury legal services and touting	—	✓	—	✓	✓	—	—	—	✓
<b>Legal costs</b>									
Limits on legal costs awarded for small claims	—	✓	—	✓	✓	—	—	✓	✓
<b>Claims-made policies</b>									
Clarify the operation of section 54 of the <i>Insurance Contracts Act 1984</i>	a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

## ESTABLISHING LIABILITY

### FORESEEABILITY

*Review of the Law of Negligence recommendation 28*

*Reform of liability insurance law in Australia section C1*

In tort, a person owes another person a duty of care if the first person could reasonably have foreseen that if they did not take care the other would suffer either physical injury or death or economic loss.

The concept of negligence has two components under Australian law: foreseeability of the risk of harm and a calculation of the degree of negligence, the 'negligence calculus'.

A person will not be liable for failing to take precautions against an unforeseeable risk. For a risk to be foreseeable, it must not be so improbable that a reasonable person would ignore it.

Once foreseeability is established, the negligence calculus helps to decide what precautions a reasonable person would have taken to avoid the harm that occurred and what precautions it would have been reasonable to expect the defendant to take. The calculus considers:

- the probability that the harm would occur if care was not taken;
- the likely seriousness of that harm;
- the burden of taking precautions to avoid the harm; and
- the social utility of the activity creating the risk (that is, it is more worthwhile to take risks for some activities than for others – for example, if life is at stake).

Case law in Australia had evolved so that events with a very low probability of occurring could still be held to be foreseeable. In *Wyong Shire Council v Shirt* (1980) 146 CLR 40, the court found that persons could be held liable for any foreseeable risks other than risks that were far-fetched or fanciful. This may have required a person to take precautions against a risk with a very low probability of occurring, simply because it was foreseeable. However, determining whether a foreseeable risk was not far-fetched or fanciful does not help determine whether precautions to prevent the risk occurring would be reasonable. That is the role of the negligence calculus.

The reforms to tort law replaced the test of foreseeability established by *Wyong Shire Council v Shirt* with a test that persons can only be held liable for risks that are 'not insignificant'.

The reforms also clarified that foreseeability is a necessary but not sufficient condition for a finding of negligence. A person is not liable just because the risk was foreseeable.

In addition, the reforms set out the negligence calculus in legislation, to prescribe what the court should take into account when determining negligence.

## CAUSATION AND REMOTENESS OF DAMAGE

*Review of the Law of Negligence* recommendation 29

*Reform of liability insurance law in Australia* section C2

In tort, a person cannot be liable for damages for failure to take care to prevent injury or death unless negligent conduct on his or her part (whether by act or omission) caused the harm and unless that harm was not too remote from the negligent conduct.

In determining whether negligent conduct caused the harm, the court considers whether the negligent conduct played a part in bringing about the harm. That is, whether the harm would have occurred without the conduct.

The court also considers whether to hold the defendant liable to pay damages for the harm caused.

It was possible that a court would impose liability where the defendant's conduct was only remotely responsible for the loss. Where it is not possible to prove, on the balance of probabilities, that there was a causal link between the conduct and the harm, it may be necessary to address this 'evidentiary gap' by allowing proof that negligent conduct materially contributed to harm or risk of harm. In these circumstances, a defendant might be liable for the total injury suffered by a plaintiff, despite being only partially responsible.

The major problem was in establishing when to relax the normal requirements of proof of causation.

Another difficulty lay in determining what the plaintiff would have done if the defendant had not been negligent. For example, where a doctor failed to give appropriate warnings before an operation, the question is whether the patient would have continued had the doctor given the warnings. There is an inherent difficulty in determining the state of mind of the plaintiff prior to harm occurring, without the influence of hindsight bias.

The reforms to tort law improved understanding of this area of the law by providing legislative guidance on the principles underlying causation.

In addition, to address the 'evidentiary gap', the reforms made it clear that the onus of proof in relation to causation always rests with the plaintiff.

The reforms also clarified the way in which a court should consider what the plaintiff would have done had the negligent conduct not occurred.

## STANDARD OF CARE FOR PROFESSIONALS

There are two aspects to the standard of care required of professionals:

- negligence related to the duty to disclose relevant information before undertaking treatment; and
- negligent treatment.

### Duty to disclose relevant information

*Review of the Law of Negligence* recommendations 5-7

*Reform of liability insurance law in Australia* section C3

A doctor has an obligation to advise a patient contemplating treatment of the material risks inherent in that treatment and of risks about which the doctor ought to appreciate that the patient would wish to be aware. A doctor who negligently fails to warn of a risk, which eventuates in circumstances where the patient would not have undergone the treatment if the doctor had advised them of the relevant risk, will be held liable.

Doctors have a proactive and a reactive duty to inform.

The proactive duty to inform requires a doctor to take reasonable care to give a patient such information as a reasonable person in the patient's position would, in the circumstances, want to be given before deciding whether to undergo treatment.

The reactive duty to inform requires a doctor to take reasonable care to give a patient such information as the doctor knows or ought to know that the patient wants to be given before deciding whether to undergo treatment.

Some statements concerning the duty of doctors to provide information did not refer to the obligation as being a duty of reasonable care. This required consideration of the circumstances of the doctor.

Professions and occupations other than doctors may also have a duty to give particular categories of information in particular circumstances. However, the law is still evolving in this area. Given this, the reforms to this area of tort law related only to doctors.



A doctor only has a duty to exercise reasonable care in giving information and does not have a duty to give whatever information is obtainable. However, some doctors were uncertain as to their duties. In addition, there was also concern among doctors that hindsight bias increased the risk of their being found liable.

The reforms to the tort law made it clear that a doctor's obligations to give information are only to take reasonable care. In addition, the reforms made it clear that the assessment of whether there had been a breach of the duty to inform should be set at the time the decision to undergo treatment was made by the patient and not at some later time.

## Treatment

*Review of the Law of Negligence* recommendations 3-4

*Reform of liability insurance law in Australia* section C3

Until 1992, it was widely thought that a rule derived from the English case of *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582, the 'Bolam rule', applied to cases of professional negligence in Australia. The Bolam rule was that a professional was not guilty of negligence if he or she had acted in accordance with a practice considered proper by a body of professional practice skilled in that particular art.

Strictly applied, the Bolam rule could allow small pockets of medical opinion to be arbiters of the requisite standard of medical treatment, even where a substantial majority of medical opinion would take a different view.

In 1992, the judgment in *Rogers v Whitaker* (1992) 175 CLR 479 found that a court was entitled to consider the entirety of the expert evidence to determine whether, in its view, the professional had acted negligently.

The basic rule is that the standard of care is determined by reference to what could reasonably be expected of a person exercising the skill that the defendant professed to have. However, there was considerable fear and uncertainty about the risk of being sued. Professionals thought that a court would find them negligent for an act that accorded with generally accepted practice at the time they carried out the procedure.

The reforms to the tort law introduced a modified version of the Bolam rule. In most circumstances, they require a court to take into account views current at the time the event that gave rise to a loss took place. The modified test ensures that the view had to be widely held – to avoid the drawbacks of the original test – and allows a court to intervene where the view was irrational.

The effect of these reforms is that the standard of care is determined by what could reasonably be expected of a person professing the skill and the relevant circumstances at the date of the alleged negligence.

## NON-DELEGABLE DUTIES

*Review of the Law of Negligence* recommendation 43

*Reform of liability insurance law in Australia* section C4

Vicarious liability is liability for the negligence or other wrong of another. It is also strict liability – that is, liability without proof of fault. A person can be vicariously liable for the negligence of another no matter how careful the person was in all relevant matters, such as choosing and supervising that person.

The general rule of vicarious liability is that an employer is vicariously liable for the negligence of an employee, provided the employee was acting in the course of their employment.

Vicarious liability does not apply where independent contractors, as opposed to employees, performed a task. While an employer is not vicariously liable for the negligence of an independent contractor, there are a number of exceptions to this rule. The concept of a non-delegable duty allowed such exceptions.

A non-delegable duty imposes liability on one person for the negligence of another to whom the former has entrusted or delegated the performance of some task on their behalf. However, the precise nature of a non-delegable duty was uncertain. Given this, the Ipp review expressed the concern that, if governments accepted all its recommendations, it would be possible to avoid the reforms by pleading that the incident was the result of breach of a non-delegable duty. Accordingly, the Ipp review recommended that the tort law reforms should treat liability for a breach of a non-delegable duty as though it were equivalent to vicarious liability.

States and territories agreed that it was important to deal with a breach of a non-delegable duty in the same way as a breach of any other duty.

The reforms to tort law either treat a breach of a non-delegable duty as being equivalent in all respects to vicarious liability (in line with the findings of the Ipp review) or include it within the terms of application of the tort law reform legislation.

## **FAIR TRADING LAWS — MISLEADING AND DECEPTIVE CONDUCT AND SIMILAR PROVISIONS**

*Review of the Law of Negligence* recommendations 17-22

*Reform of liability insurance law in Australia* section C5

Division 1 of Part V of the Commonwealth *Trade Practices Act 1974* and similar provisions under state and territory fair trading law prohibit unfair practices in trade and commerce, including misleading and deceptive conduct.

These have rarely been used to seek damages for personal injuries or death. However, this remained a possibility and potential loophole allowing the circumvention of the tort law reforms.

This is so even though section 52 of the Trade Practices Act (a key provision in Division 1 of Part V) is limited to conduct in the course of activities that are ‘in trade or commerce’. There are various areas of everyday life that might give rise to claims for damages for personal injuries or death, such as claims arising out of the provision of professional services or the occupation of land. For example, suppose a surgeon informed a patient that a certain operation would improve the patient’s health. In the course of the operation, the surgeon decides — because of unforeseeable circumstances — that the operation was not, in effect, necessary and should not continue. The patient may be able to claim damages on the ground that the surgeon was guilty of misleading conduct in advising that the operation should occur.

Plaintiffs rarely relied on the trade and commerce provisions of the Trade Practices Act to claim damages for personal injury or death because the common law was seen as an adequate source of compensation.

This would have changed once state and territory reforms blocked or made less attractive avenues for plaintiffs under the law of negligence (by the reform of rules on quantum of damages and other limitations of liability). Cases would have shifted to Commonwealth law, effectively undermining the state and territory civil liability reforms.

To avoid this, the tort law reforms prevented actions for personal injury and death under Division 1 of Part V of the Trade Practices Act and similar provisions of state and territory fair trading laws.

## MENTAL HARM

*Review of the Law of Negligence* recommendations 33–38

*Reform of liability insurance law in Australia* section C6

Personal injury may be either physical or mental. Mental harm may be a consequence of physical injury (for instance where depression is suffered because of a bodily injury), or it may stand alone (for example, where a person suffers anxiety from witnessing traumatic events).

It is harder for people to recover damages for negligently caused pure mental harm than for negligently caused physical harm and consequential mental harm. Reasons for this include the difficulty of diagnosing pure mental harm objectively and proving pure mental harm for legal purposes. In addition, the risk of causing pure mental harm may be more difficult to foresee.

Reasonable foreseeability of mental harm is the only precondition of the existence of a duty of care. However, a duty of care will only be owed if it was foreseeable that a person of normal fortitude might suffer mental harm in the circumstances of the case if care was not taken. That is, a plaintiff's abnormal vulnerability is not taken into account when determining the standard of care to be applied. The exception to this rule is where the defendant knew or ought to have known of this vulnerability.

The circumstances of the case include matters such as whether or not the mental harm was suffered as the result of a sudden shock, whether the plaintiff witnessed the event or the aftermath, what the relationship was between the plaintiff and defendant and the nature of the relationship between the plaintiff and anyone killed or injured.

There was a difference between the law's treatment of consequential mental harm on the one hand and pure mental harm on the other. Pure mental harm only attracted compensation if the plaintiff had suffered a 'recognised psychiatric illness'. This had the effect that expert evidence was normally required to establish whether damages were recoverable for pure mental harm. By contrast, consequential mental harm did not have to constitute a 'recognised psychiatric illness'.

The reforms to tort law applied the same evidentiary requirements to both pure mental harm and to economic loss associated with consequential mental harm. That is, in order to be compensated for these a plaintiff must have suffered a 'recognised psychiatric illness' and the defendant ought to have foreseen that a person of normal fortitude might, in the circumstances, suffer a 'recognised psychiatric illness' if reasonable care was not taken.

In addition, the reforms restated the relevant factors in assessing mental harm.

The reforms also restricted the circumstances in which pure mental harm can be awarded — because of another being imperilled, injured or killed — to a specified list of family relationships.

## APOLOGIES

*Reform of liability insurance law in Australia section C7*

In many cases, defendants were reluctant to communicate with injured persons in any sympathetic or cooperative way for fear any comments might be taken as an admission of liability.

Advice from insurers (including in policy wordings) and lawyers instructing policyholders against admissions of liability reinforced this reluctance.

Research showed that plaintiffs — particularly medical patients — are less likely to seek recovery of damages where the doctor or potential defendant explained the cause of the loss or apologised for the loss.

The reforms to tort law made it possible for certain apologies or expressions of regret not to be taken as an admission of liability.

## CONTRIBUTORY NEGLIGENCE AND THE ASSUMPTION OF RISK

*Review of the Law of Negligence recommendations 30-32*

*Reform of liability insurance law in Australia section C8*

Contributory negligence is failure by a person (usually the plaintiff) to take reasonable care for his or her own safety, which contributes to the harm the person suffers.

Legislation in all Australian jurisdictions provides for the apportionment of damages. Apportionment reduces the damages to which the plaintiff is entitled because of contributory negligence. The court has very wide discretion to reduce the plaintiff's damages to the extent the court considers just and equitable having regard to the plaintiff's share of responsibility of the harm suffered.

The basic principle underlying the defence of contributory negligence is that people should take reasonable care for their own safety as well as for that of others. Contributory negligence is an objective concept that refers to the care that a reasonable person in the plaintiff's position would have taken for his or her own safety.

The onus of proving that a plaintiff was guilty of contributory negligence traditionally rested on the defendant.

There was a perception that, on occasion, lower courts accepted a lower standard of care from the plaintiff in contributory negligence and were more indulgent to plaintiffs than to defendants. In some cases, judges expressly applied a lower standard of care.

Apportionment legislation provided that the reduction of damages for contributory negligence should be 'just and equitable'. The High Court held that a reduction of 100 per cent was not permissible, on the basis that a finding of 100 per cent contributory negligence would be incompatible with the finding that the defendant was negligent. Contributory negligence allowed some recovery to the plaintiff, even where the plaintiff bore a significant share of responsibility for the harm suffered.

There may be circumstances in which the plaintiff's relative responsibility for the injuries suffered is so great that it seems fair to deny the plaintiff any damages at all. For example, where the risk created by the defendant was patently obvious and could have been avoided by the plaintiff exercising reasonable care.

The reforms to tort law ensured that the standard of care applied to the determination of contributory negligence was the same as that applied to negligence. The reforms also allowed the court to reduce the damages of a plaintiff by 100 per cent where it considered it just and equitable to do so.

In theory, the standard of care that applied to the actions a person should take to protect themselves is equivalent to the actions required of others to take care of that person.

For that reason, the negligence calculus (described above in the discussion of foreseeability) provides a framework for deciding what precautions it is reasonable to expect a plaintiff to have taken for his or her own safety.

The defence of voluntary assumption of risk is a complete defence in the sense that it provides the basis for denying the plaintiff any damages at all. A person will be held to have voluntarily assumed a risk only if they were actually aware of the precise risk in question and freely accepted that risk.

Following the introduction of the defence of contributory negligence, the defence of the voluntary assumption of risk fell into disuse. This was because any conduct that could amount to voluntary assumption of risk would also amount to contributory negligence.

The reforms to tort law made it easier to establish the defence of the assumption of risk, by reversing the burden of proof on the issue of awareness of risk in relation to obvious risks. That is, there is a presumption that a person against whom the defence is pleaded was aware of an obvious risk unless that person can prove, on the balance of probabilities, that he or she was not aware of the risk. The question is whether the person was aware of the type or kind of risk, not of its precise nature, extent or manner of occurrence.

## PROPORTIONATE LIABILITY FOR ECONOMIC CLAIMS

*Review of the Law of Negligence* recommendation 44

*Reform of liability insurance law in Australia* section C9

The common law applying to all tort claims, for personal injury and economic losses, involved joint and several liability.

Professionals, such as accountants, with ‘deep pockets’ and adequate insurance, expressed concern that they could be liable for the full amount of a loss even though they had made only a small contribution to the loss.

The reforms to tort law applied proportionate liability to claims for economic loss.

The Australian Government’s *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* introduced proportionate liability for economic loss and property damage claims made under the *Australian Securities and Investments Commission Act 2001*, the *Corporations Act 2001* and the *Trade Practices Act 1974* arising from misleading or deceptive conduct.

Western Australia’s proportionate liability rules, which apply to economic loss claims under common law, contract or statute (except personal injury claims) commenced on 1 December 2004. Tasmania’s proportionate liability legislation (Part 9A of its *Civil Liability Act 2002*) came into force on 1 June 2005. South Australia’s *Professional Standards Act 2004* came into force on 1 October 2006.

In Queensland, the *Professional Standards Act 2004* amended the *Civil Liability Act 2003* to introduce proportionate liability of concurrent wrongdoers in claims for damages for economic loss or damages to property.

In July 2006, the Standing Committee of Attorneys-General approved the formation of a working group to review the current national legislative framework on proportionate liability, to make recommendations to achieve greater national consistency in proportionate liability legislation and to consider issues with contracting out of proportionate liability.

## RECREATIONAL ACTIVITIES AND WAIVERS

*Review of the Law of Negligence* sections 5.48-5.67

*Reform of liability insurance law in Australia* section C10

Section 74 of the *Trade Practices Act 1974* implies into certain contracts statutory warranties that the parties cannot waive. These statutory warranties include a requirement to provide services with due care and skill.

Similar provisions apply in state and territory fair trading acts.

Providers of recreational services, and in particular those with a high degree of inherent risk, argued that the existence of these statutory warranties prevented the effective use of waivers.

The law reforms allow recreational service providers to enter into effective waivers overriding the statutory warranties of section 74 and similar provisions in state and territory law.

## GOOD SAMARITANS

*Review of the Law of Negligence* sections 7.20-7.24

*Reform of liability insurance law in Australia* section C11

In South Australia, the *Wrongs Act 1936* provides that a 'good Samaritan' is immune from civil liability for any act or omission done in good faith and without recklessness in assisting a person in apparent need of emergency assistance.

Other jurisdictions did not have such an exemption from liability prior to the tort law reforms. Good Samaritans could incur personal civil liability actions against them in certain circumstances.

In most jurisdictions, the tort law reforms protect a Good Samaritan who comes to the assistance of a person in danger from all civil liability for acts or omissions done in good faith.



## VOLUNTEERS

*Review of the Law of Negligence* sections 11.20-11.23

*Reform of liability insurance law in Australia* section C12

A plaintiff may sue a volunteer for harm they inflicted during the course of their volunteering activities.

While the number of claims against volunteers is not significant, fear of incurring negligence liability could have discouraged people from doing voluntary work.

Legislation protected emergency service providers from civil liability arising out of incidents that arise in the course of performing a rescue in good faith.

The reforms to tort law excluded volunteers doing work for community organisations from civil liability for acts or omissions done in good faith in most circumstances and made the organisation for which they provided services liable for any negligence of the volunteers.

Some jurisdictions have continued to reform this area of law.

In New South Wales, the *Civil Liability Amendment (Food Donations) Act 2005* protects people making food donations from civil liability.

In Queensland, the *Justice and Other Legislation Amendments Act 2004* amended the *Civil Liability Act 2003* to alter the definitions of 'community work' and 'volunteer' and to protect from civil liability people who donate food in good faith and without reward to community organisations.

The Western Australian Parliament is considering the *Volunteers (Protection from Liability) Amendment Bill 2006*, which would amend its volunteers legislation to protect food donors from liability.

## PUBLIC AUTHORITIES

*Review of the Law of Negligence* recommendations 39-42

*Reform of liability insurance law in Australia* section C13

In 2001, in *Brodie v Singleton Shire Council* (2001) 206 CLR 512, the High Court abolished the rule that a highway authority is not liable for injury or damage resulting from 'non feausance' in the performance of its functions as a highway authority. This affected the liability of all public authorities.

The High Court found that, where the state of a highway poses a foreseeable risk of harm to road users, the public authority with power to remove the danger is obliged to take reasonable steps to do so. The duty to take care arises when the authority knows of the danger, or when it would have known of the danger if it had taken reasonable care to inspect the highway.

In determining whether the public authority took reasonable steps to remove the risk, regard is had to 'competing or conflicting responsibilities or commitments of the authority'.

Because of this decision, increasing amounts of time were spent in the course of a trial considering whether the authority's conduct in relation to a risk was reasonable given the other demands on the resources available to the authority.

The reforms to tort law provide public authorities with a 'policy defence'; recognition that the variety of responsibilities they face may limit their resources. Some jurisdictions also reintroduced the rule that an authority is not liable for injury or damage resulting from 'non feaseance' in the performance of its function.

## DAMAGES

### GENERAL DAMAGES

*Review of the Law of Negligence* recommendations 47-48

*Reform of liability insurance law in Australia* section C14

General damages are damages for non-economic loss, including pain, suffering, loss of amenities and loss of expectation of life.

Pain and suffering are matters of subjective experience. Loss of amenities refers to the inability of an injured person to enjoy life as they did before the injury. This may relate to the ability to work, play sport, engage in hobbies, marry, have children, realise ambition or achieve sexual satisfaction. Damages for loss of expectation of life are awarded for the loss of prospective happiness resulting from the reduction in an injured person's life expectancy.

Underlying the award of damages for non-economic loss is the idea that money can provide the plaintiff with some consolation for their injury.

The subjective nature of general damages leads to uncertainty for insurers in their premium setting and reserving.

For claims between \$20,000 and \$100,000, 45 per cent of the cost was in general damages. Therefore, the reforms to tort law imposed a threshold on general damages, to reduce the number and cost of smaller claims.

The reforms also capped general damages. These caps improved stability and assisted the consistent calculation of general damages amounts below the cap.

In making these reforms, each jurisdiction took into account its own circumstances.

The Australian Government amended the *Trade Practices Act 1974* through the *Trade Practices Amendment (Personal Injuries and Death) Act (No 2) 2004*. The amendments limited recovery for personal injury or death arising out of a contravention of the Act. This ensured that damages limits under the state or territory law of the tort would apply and that access to the *Trade Practices Act 1974* for the same cause of action would not undermine the state or territory tort law reforms.

Western Australia imposed thresholds in the same manner as its *Motor Vehicle (Third Party Insurance) Act 1943*. However, it chose not to impose a cap on general damages as it considered that this had the potential to operate unfairly in relation to the most seriously injured claimants.

Queensland introduced a cap on general damages of \$250,000 as appropriate for the jurisdiction, having regard to the more conservative approach historically adopted by the Queensland courts in the assessment of general damages.

Rather than introduce thresholds for general damages in personal injuries actions, Queensland instead introduced a system of graduated general damages. It uses 'injury scale values' that describes different types of injuries and allocates them a point value as a guide to courts in assessment. Corresponding dollar values for different ranges of point values provide more compensation for the more seriously injured. Queensland considers that this system provides clarity and transparency and is fairer than eliminating general damages for smaller claims altogether. Queensland is currently reviewing this scheme and expects to report on the outcome of consultation soon.

In contrast with this approach, Victoria uses guides to assess injuries for awarding damages, including in relation to workers' compensation and transport accidents.<sup>4</sup> Victoria argues that the guides have a proven record of measuring the extent and nature of injury.

Victoria has set permanent impairment thresholds to access general damages at 5 per cent for physical injury impairment and 10 per cent for psychiatric injury impairment, whereas New South Wales uses a 15 per cent threshold for extreme cases.

Tasmania did not set a cap on general damages. Traditionally, general damages awarded in Tasmania were modest so it saw no need for a cap. Also, because of the

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4 American Medical Association *Guides to the evaluation of permanent impairment* (Fourth edition, 1995).

## The tort law reforms

modest damages awarded in Tasmania, the threshold set for general damages is low and indexed to the consumer price index.

The Northern Territory's *Personal Injuries (Liabilities and Damages) Act 2003* provides thresholds that relate to percentages of permanent impairment. This reflects the approach taken in the Territory for the statutory, no fault schemes in place in respect of workers' compensation and motor vehicle accidents.

## EARNINGS LOSS CAP

*Review of the Law of Negligence* recommendation 49

*Reform of liability insurance law in Australia* section C15

Damages for loss of earning capacity were limited only by the earning potential of the injured person.

While cases involving very high-income earners are rare, insurers found the uncertainty in their risk profile difficult to manage.

Insurance premiums funded income protection for very high earners who could instead arrange their own insurance protection.

The reforms to tort law set a limit on compensation for loss of future earnings or loss of earning capacity. The maximum award is based on a multiple of average weekly earnings for the expected duration of the plaintiff's loss, except in South Australia, where the cap is set as a dollar amount.

## GRATUITOUS CARE

*Review of the Law of Negligence* recommendation 51–52

*Reform of liability insurance law in Australia* section C16

In 1977, in *Griffiths v Kerkemeyer* (1977) 139 CLR 161, the High Court decided that compensation could be awarded in respect of the injured person's need for care and assistance even if that need was met gratuitously by relatives or friends at no cost to the plaintiff. The compensation was for the loss of the capacity to care for oneself and the consequent need to be cared for by others, which existed regardless of whether the person who actually met the need did so gratuitously. The quantum of damages was the market value of the services required to meet the need.

The rule in *Griffiths v Kerkemeyer* was criticised on the basis that it allowed compensation for plaintiffs for care provided free of charge. A plaintiff might never have to pay for the services.

Another criticism was that claims by plaintiffs about the nature and extent of their need for gratuitous services are easy to make and difficult to refute. The needs of a plaintiff are partly subjective, dependent on the level of injury and the plaintiff's age, general state of health, personality and state of mind.

The reforms to tort law limited gratuitous care claims to circumstances where the plaintiff will require care for a significant period and where the amount of gratuitous care is significant.

The reforms also provided guidance for the calculation of gratuitous care.

In subsequent developments in New South Wales, the *Civil Liability Amendment Act 2006 No 56* partially reinstated *Sullivan v Gordon* (1999) 47 NSWLR 319 damages; that is, the ability to claim damages for the loss of capacity to provide gratuitous domestic services to dependants.

Tasmania had abolished claims for gratuitous services provided to plaintiffs in 1986. It reinstated damages for gratuitous care to a person following the Ipp review, except for claims to which Part III of the *Motor Accidents (Liabilities and Compensation) Act 1973* applies.

## DISCOUNT RATE

*Review of the Law of Negligence* recommendation 53

*Reform of liability insurance law in Australia* section C17

In awarding compensation for future economic loss or future expenses that will be suffered or incurred periodically as a lump sum, courts assume the plaintiff will invest the lump sum and receive a stream of income from it. To calculate the present value of this lump sum, the court uses a discount rate to ensure that the plaintiff does not receive too much. The discount rate is a way of arriving at the present value of compensation for future losses and expenses.

In 1981, the High Court set the discount rate for personal injury and death claims at a default rate of 3 per cent, a rate that continued to apply in the absence of any statutory provision to the contrary. A number of jurisdictions set discount rates higher than the default rate.

The reforms to tort law saw most jurisdictions align the discount rate used in civil liability matters with those in their respective compulsory third party motor vehicle and workers' compensation statutory schemes. The common discount rate is 5 per cent, although there are variations.

## The tort law reforms

The Australian Capital Territory did not prescribe a discount rate, so it therefore remains at the default rate of 3 per cent. In 2005, Tasmania reduced its discount rate, which was 7 per cent, to 5 per cent.

Western Australia calculates lump sum award payments using a discount rate of 6 per cent, under the *Law Reform (Miscellaneous Provisions) Act 1941*.

In Victoria, a discount rate of 5 per cent applies to assessments for future economic loss, under section 28I of the *Wrongs Act 1958*. However, legislation for the Transport Accident Commission and the Victorian WorkCover Authority mandate a discount rate of 6 per cent. Reducing this rate would have a significant impact on liabilities of these schemes and substantially increase the cost of major awards.

A New South Wales parliamentary report into personal injury compensation legislation recommended that New South Wales reduce the discount rate on damages for future economic loss paid as a lump sum to 3 per cent. The report noted that the Ipp review had recommended the lower rate and that the higher rate was likely to affect most the severely injured in the greatest need of assistance.<sup>5</sup>

The New South Wales Government did not support this recommendation. It argued that its *Motor Accidents (Lifetime Care and Support) Act 2006*, establishing the Lifetime Care and Support Authority, would provide medical treatment, care and support services for life to all people catastrophically injured in motor vehicle accidents.<sup>6</sup>

## STRUCTURED SETTLEMENTS

*Review of the Law of Negligence* recommendation 57

*Reform of liability insurance law in Australia* section C18

Typically, a court in Australia awarded compensation for future economic loss or future expenses that the plaintiff will suffer or incur periodically as a lump sum.

Lump sum compensation was more tax advantageous than an income stream and courts could not always make structured settlement awards for periodic payments.

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5 New South Wales Parliament Legislative Council General Purpose Standing Committee No.1 *Report on personal injury compensation legislation* (2005) 146-8, <<http://www.parliament.nsw.gov.au/prod/PARLMENT/Committee.nsf/0/6DEB694C553E0DB8CA2570D100000C9A>> at 23 November 2006.

6 New South Wales Government *Response to the Legislative Council General Purpose Standing Committee No. 1 report on personal injury compensation legislation* (2005) 16-8, <<http://www.parliament.nsw.gov.au/prod/PARLMENT/Committee.nsf/0/6DEB694C553E0DB8CA2570D100000C9A>> at 23 November 2006.

While there was an assumption that the plaintiff would invest the lump sum and receive a stream of income from the investment, a plaintiff who did not know how to manage a large sum of money could dissipate it within their lifetime.

The reforms to tort law removed the tax impediment to structured settlements and facilitated court ordered structured settlements.

The Treasurer, the Hon Peter Costello MP, is due to appoint a person to review by the end of 2007 the operation of the structured settlements and orders provisions of Division 54 of the *Income Tax Assessment Act 1997*.

## PUNITIVE DAMAGES

*Review of the law of negligence* recommendation 60

*Reform of liability insurance law in Australia* section C19

Punitive damages include both exemplary and aggravated damages.

Exemplary damages are damages awarded over and above the amount of damages necessary to compensate the plaintiff. Their purpose is to punish the defendant, to act as a deterrent to the defendant and others who might behave in a similar way, and to demonstrate the court's disapproval of the defendant's conduct.

Aggravated damages are damages awarded to compensate the plaintiff for increased mental suffering caused by the manner in which the defendant behaved in committing the tort.

Various arguments have been used to support abolition of exemplary damages:

- exemplary damages confuse the punishment function of the criminal law with the compensation function of the civil law;
- exemplary damages constitute an undeserved windfall for the plaintiff;
- awards of exemplary damages are unpredictable, especially in jury trials; and
- awards for exemplary damages are often too high.

The main argument for abolishing aggravated damages is that, if they are truly compensatory, they are unnecessary because compensation for mental distress can be given on other grounds.

The status of insurance coverage for punitive damages was unclear, with insurers sometimes using exclusion clauses and insureds expressing concern about unprotected exposures.

The reforms to tort law specifically abolished punitive damages in personal injury cases.

## CAPS ON PROFESSIONAL LIABILITY

### *Reform of liability insurance law in Australia section C20*

Professional standards schemes help to minimise economic loss and property damage claims against professionals through improved professional standards. Schemes gazetted under the relevant state or territory professional standards law require risk management strategies, compulsory insurance cover, professional education and appropriate complaints and disciplinary mechanisms, in return for caps on the liability of the professionals covered by the schemes. This is intended to facilitate the ongoing affordability of professional indemnity insurance.

New South Wales was the first jurisdiction to facilitate professional standards schemes, prior to the tort law reforms, with the introduction of its *Professional Standards Act 1994*.

While New South Wales had gazetted professional standards schemes under its legislation, the *Trade Practices Act 1974* and other Commonwealth law had the potential to limit the effectiveness of these schemes by providing an alternative, unlimited, cause of action against professionals.

As part of the tort law reforms, the Australian Government enacted the *Treasury Legislation Amendment (Professional Standards) Act 2004* to amend the *Australian Securities and Investments Commission Act 2001*, the *Corporations Act 2001* and the *Trade Practices Act 1974* to provide for capped liability. These amendments supported the implementation of professional standards schemes legislation across the states and territories.

All states and territories are now implementing or amending existing arrangements to facilitate these schemes. For example, Western Australia's *Professional Standards Amendment Act 2004*, which amended its *Professional Standards Act 1997*, commenced on 26 January 2005.

Schemes generally cap the upper limit of liability for a profession. However, Tasmania's *Professional Standards Act 2005*, which commenced on 1 August 2005, provides that an occupational association must approve a higher maximum liability than would otherwise apply, if its member wishes to hold a higher liability. Tasmania considered that the level of indemnity was a matter for agreement between two contracting parties on a purely commercial basis and that there was not a sufficiently strong public interest case to intervene in such an arrangement.



## PROCEDURAL REFORMS

### LIMITATION PERIODS

*Review of the Law of Negligence recommendations 23–27*

*Reform of liability insurance law in Australia section C21*

Limitation periods limit the time within which a potential plaintiff can bring an action to court.

Limitation periods are generally defined in terms of:

- the date of commencement;
- the length of the limitation period;
- whether there should be an ultimate bar to commencing proceedings (a ‘long stop period’, which prevents an action from being taken more than a set period after the events on which the claim is based took place);
- whether the court should have the discretion to extend the limitation period and, if so, on what basis; and
- whether the limitation period should be suspended, particularly for minors and incapacitated persons.

Prior to the reforms to tort law, the rules applying to these criteria varied between states and territories and by claim type. The most common limitation period was six years, although courts could generally extend this period on a case-by-case basis. In most cases, the limitation period did not commence for minors until the age of 18.

More generous limitation periods meant that defendants were subject to long periods of uncertainty regarding whether a claim was to be brought. A claim could be brought against an obstetrician up to 25 years after the date of the date of an injury sustained by a child during birth.

Defendants were likely to be disadvantaged and less well prepared for defence, due to the passage of time. This had the ability to prejudice the fair trial of a claim. Evidence is likely to diminish, be lost or be affected by additional influences over time. As time passes, it becomes more difficult to verify the accuracy of information regarding the nature of the loss and the conduct of the defendant.

Except in certain special circumstances, settling claims within a short period is generally likely to reduce the costs associated with the claim and court proceedings, increase the quality and accuracy of the evidence and information presented and provide certainty for both plaintiffs and defendants.

In general, the reforms:

- defined the commencement of the limitation period as the 'date of discoverability';
- set the limitation period as three years from the date of commencement;
- inserted a 12-year long stop period;
- provided the court with discretion to extend the long stop period to the expiry of three years from the date of discoverability;
- provided guidance to the court on matters it must have regard to before extending the long stop provision; and
- provided special protection to persons operating under a disability.

Western Australia's reforms to its limitations laws, in the *Limitations Act 2005*, included reducing the base limitation period for personal injuries claims from six years to three years. A detailed scheme for suspension and extension of limitations period in circumstances of undiscovered disease or injury or of undiscovered facts material to a claim provides flexibility and fairness that was not available under the generally fixed limitations periods of its *Limitations Act 1935*.

Tasmania's *Limitation Amendment Act 2004* commenced on 1 January 2005. This amended its *Limitation Act 1974* to adopt the above reforms and to ameliorate the effect of restrictive limitation periods (three years from the date the cause of action arose) particularly in relation to persons suffering a latent disease.

## PRE-LITIGATION PROCEDURES

*Review of the Law of Negligence* recommendation 9

*Reform of liability insurance law in Australia* section C22

The laws, regulations and court rules in each jurisdiction dealing with civil actions govern court procedures for liability claims.

Prior to the tort law reforms, only a couple of jurisdictions had rules aimed at liability claims. However, most jurisdictions had modified the normal court procedures for claims in the statutory schemes: motor accidents and workers' compensation. There was a wide variety of provisions involving a variety of pre-litigation procedures.

Insurers believed that court procedures in a few jurisdictions had disadvantaged them, through:

- tactical delays in notifying claims;
- not notifying the insurer of a claim before commencing proceedings; and
- a reluctance to reveal details of a claim and evidence until court, thus reducing settlement opportunities and increasing costs.

The reforms to tort law improved pre-litigation procedures.

## LEGAL ADVERTISING

*Reform of liability insurance law in Australia section C23*

States and territories, in conjunction with the relevant professional bodies, regulate the activities of the legal profession.

Some commentators argued that aggressive advertising by law firms contributed to a more litigious culture and an increase in claims.

In effecting the tort law reforms, some jurisdictions restricted advertising and touting by law firms. These were mainly jurisdictions that had previously introduced similar rules for motor accidents or workers' compensation claims.

Restrictions on advertising of personal injury legal services and touting are consistent across New South Wales, Western Australia, Queensland and the Northern Territory.

In Queensland, the *Personal Injuries (Legal Advertising) and Other Acts Amendment Act 2006* amended the *Personal Injuries Proceedings Act 2002* to extend the advertising restrictions for personal injury legal services to non-lawyers. Previously the restrictions caught only lawyers or persons acting on behalf of lawyers.

## LEGAL COSTS

*Review of the Law of Negligence recommendation 45*

*Reform of liability insurance law in Australia section C24*

Australia experienced a substantial increase in the number of small to medium sized claims before 2002. Legal expenses were a major component of the cost of the smaller personal injury claims.

The reforms to tort law limited the amount of legal costs that a court could award for small claims.

Western Australia did not fix limits on legal costs for personal injuries claims as it already had a system for fixing maximum legal fees, by way of scales set by an independent Legal Costs Committee.

## CLAIMS-MADE POLICIES

### *Reform of liability insurance law in Australia section C25*

Section 54 of the *Insurance Contracts Act 1984* seeks to balance the interests of the insurer, the insured and third parties in response to some act of the insured, provided that the act could not reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract. The section allows an insurer to reduce its liability under the contract to an amount representing the extent to which the act prejudiced its interests.

A 'claims-made and notified' policy covers an insured if, during the policy period, a claim is made against them and they notify their insurer of the claim. Late notification of a claim or circumstance that may give rise to a claim by an insured may breach the terms of a claims made and notified policy. However, judicial interpretation of section 54 has prevented an insurer from relying on this non-compliance to avoid a claim by an insured, provided the non-compliance did not cause or contribute to the loss.

This interpretation may increase the costs of, and reduce the breadth of coverage of, claims-made insurance. This is because it may require insurers to have higher ongoing claims reserves than they would otherwise have to allow for such claims.

In response to concerns raised by the insurance industry at the judicial interpretation of section 54, the Australian Government established an independent panel to review and make recommendations on section 54, together with the remainder of the Act, in November 2003.

The review panel concluded that legislative reform of section 54 and associated provisions was necessary. The panel made further recommendations to revise draft amendments released for public consultation in 2004, in response to submissions and stakeholder consultations.

The Government expects to consult soon on draft legislation to amend the operation of the *Insurance Contracts Act 1984*.

## FURTHER REFORMS

Since 2002, jurisdictions across Australia have taken account of their individual circumstances and made alterations to their legislative regimes additional to the comprehensive programme of tort law reform described in the previous chapter.

This chapter notes, where appropriate, further legislative reforms by the Commonwealth and each State or Territory jurisdiction.

## COMMONWEALTH

### PRUDENTIAL REFORM

In Australia, the *Insurance Act 1973* established prudential regulation of the general insurance industry. The Act sets out standards that authorised general insurers must meet. It imposes strict entry requirements and provides enforcement powers for the regulator.

Prudential supervision promotes the stability of financial institutions and the financial system. It encourages and promotes prudent behaviour in financial institutions, focussing on resource adequacy and the quality of an institution's systems for identifying, measuring and managing the various risks to its business. Proactive prudential supervision also helps prevent problems in one institution from spreading more widely through the financial system.

This level of prudential certainty is essential for Australian consumers. Insurance cover is of little value, regardless of the price paid, if the insurer lacks sufficient resources to pay claims.

Over time, the prudential framework for general insurance established in 1973 was increasingly seen as being blunt and unresponsive in the face of significant market and regulatory developments that transformed the financial sector. Following the collapse of HIIH Insurance Limited, the Australian Government significantly enhanced the prudential regime for general insurance with the *General Insurance Reform Act 2001* and subsequent reforms.

Most notably, the general insurance reforms introduced higher risk-based capital requirements for authorised general insurers and the power for the Australian Prudential Regulation Authority (APRA) to make prudential standards governing key aspects of the operation of general insurers.

The subsequent reforms primarily concern corporate governance, 'fit and proper' requirements, risk and financial management, outsourcing and prudential supervision of corporate groups involving authorised general insurers.

## Further reforms

New prudential standards on fit and proper requirements, risk and financial management and corporate governance arrangements came into effect on 1 October 2006. New prudential standards on outsourcing arrangements will commence on 1 April 2007.

APRA is also currently consulting with industry on proposals concerning the prudential supervision of corporate groups involving authorised general insurers.

Collectively, these reforms have strengthened the safety and financial soundness requirements for general insurers significantly, through a more risk-based prudential regime that is consistent with international best practice. The reforms have helped protect policyholders' interests and enhanced public confidence in the insurance industry.

The insurance industry widely praised the reforms implemented through the *General Insurance Reform Act 2001* as having significantly enhanced the safety of, and helped restore public confidence in, the general insurance industry.

Prudential standards introduced or expanded by APRA were developed in consultation with the industry.

Coinciding with the implementation of these reforms, the general insurance industry has adopted a more disciplined approach to underwriting. These changes, combined with well performing investment markets and a relatively benign claims environment, have led to the Australian general insurance industry performing very strongly over the last three years.

Net after tax profits for the years ending 31 December 2005 and 31 December 2004 were \$5.3 billion and \$4.9 billion respectively, compared with an after-tax profit of \$861 million in 2001.

Insurers have also strengthened reserves. The capital position of the general insurance industry has strengthened by at least 50 per cent since the 2002 reforms. At December 2005, the absolute level of capital held by the industry was more than twice the minimum required by APRA.

## **MEDICAL INDEMNITY**

After a long period of relatively low premiums, medical defence organisations significantly increased the cost of medical indemnity insurance over a relatively short period, in response to deteriorating claims performance. Between 1995 and 2005, average medical indemnity premiums increased by 221 per cent (averaging 13 per cent

per annum), with the largest average premium increase of approximately 50 per cent in 2002.<sup>1</sup>

Medical defence organisations also began to move away from the principle of mutuality (all members paying the same premium) to charging higher premiums to members with a higher risk. Premiums therefore increased at different rates for different groups of doctors.

Following the provisional liquidation of United Medical Protection in April 2002, the Australian Government announced a medical indemnity assistance package on 23 October 2002 and refinements to it on 17 December 2003. This package allowed only insurers subject to prudential supervision by the Australian Prudential Regulation Authority to indemnify health care professionals and required them to offer doctors a minimum level of cover and cover for past incidents.

Other elements of the Government's medical indemnity package include:

- the premium support scheme for doctors, which helps meet the costs of premiums greater than 7.5 per cent of gross private medical income;
- the high cost claims scheme, which meets half of the cost of a payout over \$300,000, up to the limit of the doctor's cover;
- the exceptional claims scheme, which protects doctors against personal liability for claims greater than \$20 million;
- the run-off cover scheme for claims against retired doctors; and
- the incurred-but-not-reported indemnity scheme and the United Medical Protection support payment scheme.

A key element of the medical indemnity assistance package was direct financial support for groups of doctors facing higher premiums due to the higher risks of their specialty, previously called the medical indemnity subsidy scheme but now referred to as the premium support scheme. High-risk groups included obstetricians, neurosurgeons and general practitioners performing procedures.

In late 2005, the Government convened a second medical indemnity policy review panel, chaired by the Minister for Health and Ageing and the Minister for Revenue and Assistant Treasurer, to review the effectiveness of the Government's package of medical indemnity measures and developments since December 2003. The panel is to report later this year or early in 2007.

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1 Medical Indemnity Industry Association of Australia *Medical indemnity report: an analysis of premium and claim trends in Australia from 1995 to 2005* (21 August 2006) 5 <<http://www.miaa.com.au/reports.php>> at 23 November 2006. Prepared by Insurance Statistics Australia Limited.

## AUSTRALIAN CAPITAL TERRITORY

There have not been any associated developments in the Australian Capital Territory. This is consistent with the fact that the initial legislative response of the Australian Capital Territory differed from that of other jurisdictions. For example, it did not introduce caps on general damages and only introduced thresholds before general damages apply with respect to medical practitioners. This is because it considered that it did not face a claims explosion and that minimal reforms were necessary.

## NEW SOUTH WALES

The New South Wales *Motor Accidents (Lifetime Care and Support) Act 2006* established the Lifetime Care and Support Authority to provide lifetime care and support for catastrophically injured victims of motor accidents. This is a no fault scheme funded through a levy on compulsory third party insurance premiums.

The New South Wales Department of Health has also introduced an 'open disclosure policy' for all medical procedures undertaken in public hospitals. This provides a process where staff can advise patients whenever there is an adverse incident. It expects that open disclosure will improve the claims process and provide better outcomes for hospitals, staff and patients.

The *Civil Liability Amendment (Offender Damages) Act 2004* defines when damages can be paid to an offender in custody, when the offender is injured or killed due to the negligence of a protected defendant. No damages are payable unless there is a permanent impairment of greater than 15 per cent. The *Civil Liability Amendment (Offender Damages) Act 2005* included the authority to deduct from offender damages restitutions payable under the *Victims Support and Rehabilitation Act 1996*. On a similar theme, the *Civil Liability Amendment (Offender Damages Trust Fund) Act 2005* provided for the satisfaction of personal injury damages claims by victims of crime from certain damages awarded to offenders. This included the ability to access offenders funds held in trust to pay to victims of crime.

## NORTHERN TERRITORY

The Northern Territory awaits the final report from the Tort Law Reform Committee established by its Attorney-General in 2004. It intends to consider legislation along the lines of the civil liability legislation enacted elsewhere in Australia.



## QUEENSLAND

In Queensland, the *Civil Liability (Dust Diseases) and Other Legislation Amendment Act 2005* amended the *Succession Act 1981* and the *Limitation of Actions Act 1974* to:

- allow for awards of general damages to be made where the plaintiff dies prior to final determination of the claim; and
- clarify the point in time at which knowledge of the nature and extent of a personal injury will constitute a material fact of a decisive character for the purposes of extending a limitation period for the claim.

## SOUTH AUSTRALIA

South Australia's *Dust Diseases Act 2005* has the object of ensuring that residents of South Australia who claim rights of action for, or in relation to, dust diseases have access to procedures that are expeditious and unencumbered by unnecessary formalities of an evidentiary or procedural kind.

The South Australian Parliament Economic and Finance Committee reviewed the impact of the legislative reforms in the *Recreational Services (Limitation of Liability) Act 2002* and the *Wrongs (Liability and Damages for Personal Injury) Amendment Act 2002*. The review was to assess the impact of these reforms on the availability and cost of public liability insurance.

The committee tabled its report on 1 December 2005. One of its recommendations was for the South Australian Treasurer to work with a number of government departments to review the approach to insurance arrangements imposed on community organisations. This review is currently underway.

The *Law Reform (Ipp Recommendations) Act 2004* requires the South Australian Parliament Economic and Finance Committee to review the tort law reforms three years after the commencement of the Act.

## TASMANIA

The Tasmanian *Administration and Probate Amendment Act 2005*, which commenced on 15 December 2005, amended the *Administration and Probate Act 1935* to allow for the survival of general damages where the plaintiff dies of a dust-related condition after commencing legal action based on that condition, but prior to the legal resolution of the claim.

## VICTORIA

The Victorian Government worked closely with the Municipal Association of Victoria, Our Community and Jardine Lloyd Thompson to develop the Community Insurance Scheme. This scheme provided affordable and effective public liability insurance to the majority of Victorian not-for-profit community organisations, and provided premium reductions to close to 1,000 community groups (*see the section on public liability insurance for not-for-profit organisations in the next chapter*).

The Victorian Department of Treasury and Finance provided public liability insurance information and support to over 800 organisations and individuals to assist them with obtaining commercial insurance while Victoria implemented the legislative reforms.

The Victorian Government, through the Community Support Fund, provided funding to a consortium of peak groups to develop risk mitigation initiatives targeting public liability insurance premiums. This included developing information such as fact sheets and education packages and establishing an insurance hotline and assistance service.

Victoria's *Wrongs (Part VB) (Dust and Tobacco-Related Claims) Regulations 2006* excluded awards of damages for dust and tobacco-related disease from the operation of Part VB of its *Wrongs Act 1958*.

## WESTERN AUSTRALIA

Western Australia amended the *Insurance Commission of Western Australia Act 1986* to allow the commission to offer insurance cover to not-for-profit community groups, due to the commission's status as a government body with expertise in the insurance industry. In addition, the Western Australian Local Government Association made public liability insurance available to community groups through its Local Government Insurance Services operations.

In May 2006, Western Australia passed legislation to align the economic loss caps applicable under motor vehicle third party insurance laws with those in its *Civil Liability Act 2002* – that is, three times the average weekly earnings at date of award – for all motor vehicle personal injury claims arising under the *Motor Vehicle (Third Party Insurance) Act 1943*.

Western Australia set a new, lower, threshold on the professional indemnity insurance cover required to tender for government contracts, in August 2006. Suppliers were required to have professional indemnity insurance cover of not less than \$5 million for any one occurrence. Because of the difficulty and cost to small business of getting this level of cover, Western Australia reduced this requirement. It now requires that suppliers have at least \$1 million worth of professional indemnity insurance cover, where appropriate.

The Insurance Commission of Western Australia has made a risk management programme available to small businesses and community groups to help them to better identify and manage risks associated with their activities.<sup>2</sup>

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2 Available from the Insurance Commission of Western Australia at <[http://www.icwa.wa.gov.au/cifund/cif\\_risk\\_mgt.shtml](http://www.icwa.wa.gov.au/cifund/cif_risk_mgt.shtml)> at 23 November 2006.



## EFFECTS OF THE TORT LAW REFORMS

The tort law reforms undertaken by the Australian, State and Territory governments in recent years have effected a significant, yet carefully balanced, change to the common law rights to compensation.

Governments carried out these reforms to assure the availability and affordability of public liability and professional indemnity insurance.

Despite the recency of the tort law reforms, there is early analytical evidence of their success in limiting liability and quantum of damages arising from personal injury and death.

This chapter examines the limits on assessing the impact of the tort law reforms before examining their outcomes.

## LIMITS ON ASSESSING THE IMPACT OF THE TORT LAW REFORMS

The terms of reference for the Review of the Law of Negligence (the Ipp review) gave it the ‘... objective of limiting liability and quantum of damages arising from personal injury and death.’<sup>1</sup>

At its simplest, limiting liability reduces the occurrence of claims, while limiting the quantum of damages reduces the cost of claims.

While changes in these factors are measurable, it is not yet possible to be definitive about the impact of the tort law reforms. The reforms are too recent and untested in court and the data needs time to mature, to show long-term trends.<sup>2</sup>

It will only be possible to estimate the full impact of the tort law reforms when other variables in the market settle, given the long-tail nature of indemnity insurance.

Public liability and professional indemnity insurance are long-tail classes of business. That is, they form a class of policy where insurance claims may not be made, or reported, until several years after the policy period.

In this class, claims made in current policy period are likely to be only part of the total claims made, with subsequent claims made in following years.

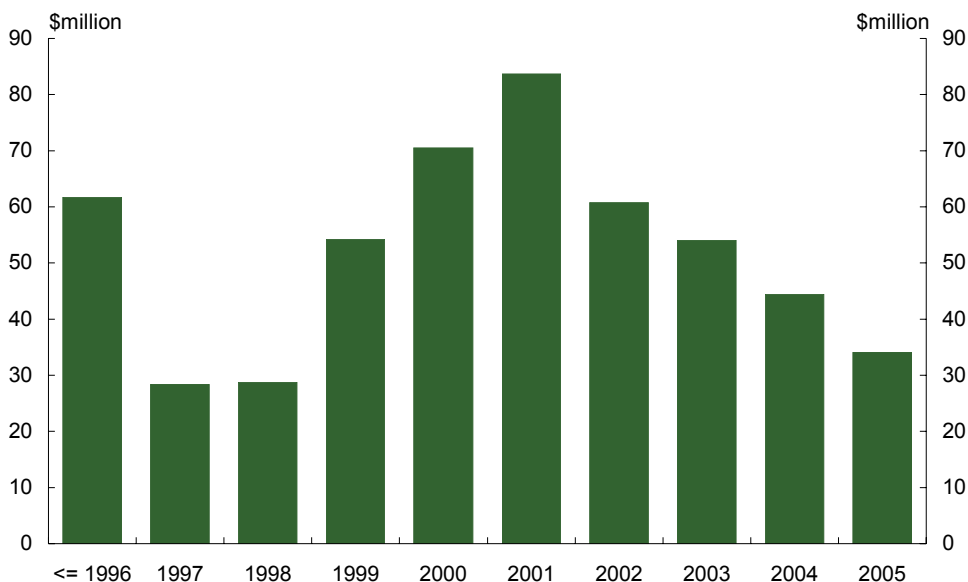
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1 Minister for Revenue and Assistant Treasurer’s press release C76/02 (2 July 2002) <<http://assistant.treasurer.gov.au/atr/content/pressreleases/2002/076.asp>> at 23 November 2006.

2 Sam Maitra et al, ‘Public liability tort reform – assessing the impacts’ (Paper presented to the Institute of Actuaries XVth general insurance seminar 16-19 October 2005) 1.

There is, for example, a significant length of time between the occurrence of an accident and the payment of a public liability claim (*see chart 4*). Most payments relate to incidents that occurred between two and seven years earlier.

**Chart 4: Incident year of public liability claim payments in 2005<sup>3</sup>**



Insurers write most public liability business on a loss-incurred basis. This means that claims are made against the policy in place at the time the event occurred. Consequently, it can take many years for claims experience to develop for a particular underwriting year.

Only limited analysis is possible when the majority of current public liability claims costs that are borne by insurers relate to accidents that occurred before the reforms to tort law. Full analysis of the impact of the reforms will be possible once a full history of claims subsequent to the reforms is available.

The reforms made by different jurisdictions took effect at different times. Also, some reforms applied from the occurrence of an incident and some from the notification of a claim. Given this, it will take many years for the data to reflect fully the consequences for claims arising in the new environment.

The impact of the tort law reforms on the average cost of claims will become clearer as the courts and insurers process the significant increase in claims made in New South

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3 Australian Prudential Regulation Authority, *National Claims and Policies Database Overview of professional indemnity and public and product liability insurance for the period 1 January 2003 to 31 December 2005* (20 July 2006) 22  
 <<http://www.apra.gov.au/General/National-Claims-and-Policies-Database.cfm>> at 23 November 2003.

Wales in 2001-02 – a ‘spike’ attributed to claims being brought forward before the introduction of the tort law reforms.<sup>4</sup> However, even once variables in the market settle, analysis of the impact of the reforms to tort law on the occurrence and cost of claims will be complicated.

Changes in practices and changes over time in the terms and conditions of the insurance on offer affect the number and cost of claims and complicate comparisons.

Insurance policies are not a homogeneous product. The terms and conditions of policies vary. This determines the quality of the insurance product.

For example, during the last decade most medical indemnity insurers have moved from offering claims or loss incurred policies (which are typically more expensive) to claims-made policies (which are typically cheaper than claims-incurred policies or mature claims-made policies).

Claims-made policies are cheaper, especially in early years, because the period the insurer is ‘on risk’ is limited. Under a claims-made policy, the insurer will indemnify all claims arising from incidents notified during the policy period, if the incident occurred during the policy period or during previous policy periods in which the policyholder held continuous claims-made cover with the insurer. It is likely to take at least four or five years for a claims-made policy to mature.

Insurers tend to offer a standard insurance policy, available to all sectors in which the insurer writes business. While most insurers write most of their business under their standard policy, the variations that can occur complicate direct comparisons.

The size of the average cover limit and the average level of excess are examples of these variations. These can vary significantly between insurers and policyholders. In 2004, the average public liability cover limit ranged from slightly over \$7 million to approximately \$20 million. The average level of excess ranged from \$250 to slightly under \$50,000.<sup>5</sup>

Competition is another factor that influences increases or reductions in premiums. Tort law reform has itself been an important driver of increased competition. It has made the Australian public liability market more attractive for local and overseas insurers.<sup>6</sup>

Changes in risk management practices also affect the number and cost of claims and complicate comparisons over time.

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4 AM Actuaries, *2005 actuarial assessment of the impact of tort law reforms on medical indemnity premiums* (November 2005) (Commercial-in-confidence report to the medical indemnity policy review panel) 34.

5 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance: Fifth monitoring report* (July 2005) 17  
<<http://www.accc.gov.au/content/index.php/html/itemId/703613>> at 23 November 2006.

6 Maitra et al, above n 2, 12.

There is evidence that both insurers and policyholders, such as not-for-profit organisations, are practicing risk management to a greater extent than occurred prior to the tort law reforms (*see the discussion of public liability insurance for not-for-profit organisations below*). For example, the Government's medical indemnity assistance package supported additional industry measures that focused on quality and safety improvement for doctors, such as improving clinical risk management, reducing adverse events and improving patient safety. The Government intended these measures to benefit the provision of health services and expected them to have flow-on effects to medical indemnity insurance in the long-term.<sup>7</sup>

With these qualifications, the next sections consider the impact of the tort law reforms on the occurrence and cost of claims and the effects for the availability and affordability of insurance.

## REDUCTION IN THE OCCURRENCE OF CLAIMS

A report commissioned by the Law Council of Australia shows a significant decline in the average annual injury claims following the tort law reforms for most jurisdictions (*see chart 5*).<sup>8</sup>

As this analysis is based on the number of court commencements, it does not measure claims settled outside the court system.

South Australia is the only jurisdiction shown to have a higher incidence of claims after tort reform. However, the numbers involved are small relative to other jurisdictions and, as the report notes, it does not include South Australian Supreme Court data because that data includes claims other than for personal injury.

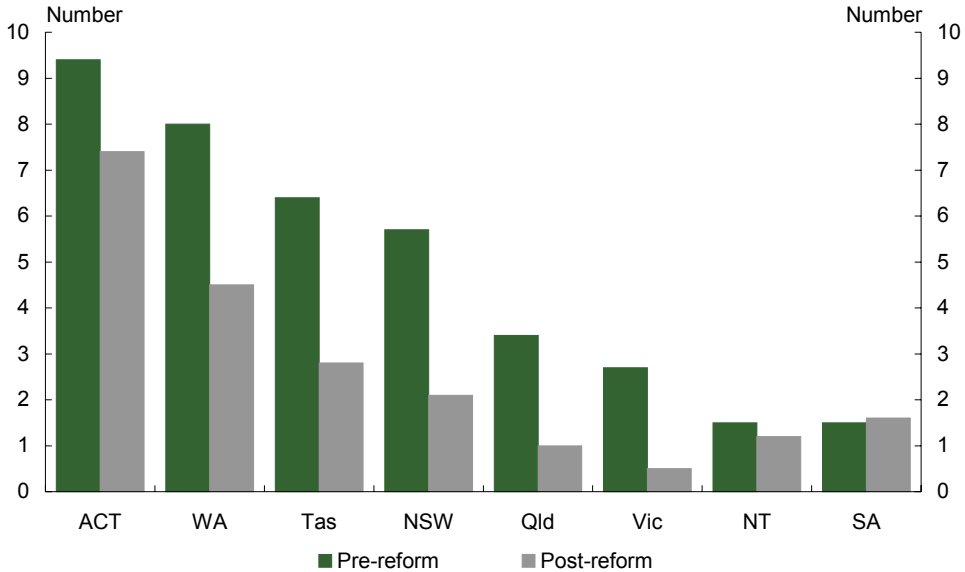
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7 Australian Competition and Consumer Commission, *Medical indemnity insurance: Third monitoring report* (December 2005) 63  
<[http://www.accc.gov.au/content/item.phtml?itemId=724656&nodeId=ee29bb83a3d946be73aa0cc9a9cfd568&fn=MedicalIndemnityInsurance\\_Dec2005.pdf](http://www.accc.gov.au/content/item.phtml?itemId=724656&nodeId=ee29bb83a3d946be73aa0cc9a9cfd568&fn=MedicalIndemnityInsurance_Dec2005.pdf)> at 23 November 2006.

8 Professor E W Wright, *National trends in personal injury litigation: before and after 'Ipp'* (26 May 2006) 13  
<[http://72.14.209.104/search?q=cache:5oXMx3ztW\\_kj:www.lawcouncil.asn.au/get/media/2424209592.pdf](http://72.14.209.104/search?q=cache:5oXMx3ztW_kj:www.lawcouncil.asn.au/get/media/2424209592.pdf)> at 23 November 2006. The figures for New South Wales and Queensland are based on estimates of year to year state totals. The data also excludes tort law reform claim spikes.



**Chart 5: Average annual injury claims per 10,000 population before and after tort law reform by jurisdiction<sup>9</sup>**



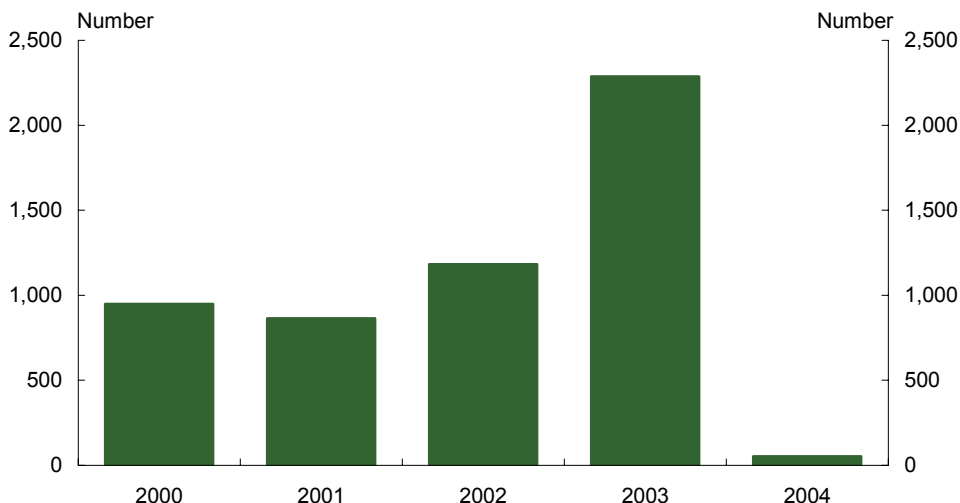
There are different factors in this decline in different jurisdictions. In Western Australia, District Court civil claim lodgments declined by about 20 per cent between 2002 and 2003. (The District Court deals with virtually all public liability and personal injuries claims.) In 2004, the number of lodgments increased in all categories. In 2005, lodgments also grew marginally. Western Australia believes this suggests that there was a decline in civil claims following the tort law reforms, with claims later stabilising.

In Victoria, the number of personal injury writs identified as 'public liability' or 'slipping' lodged in the Victorian County Court between 1 October 1999 and 30 September 2004 reflect this trend. Between 1999 and 2002, writs averaged around 1,000 claims a year. These jumped to 2,300 in 2003 before dropping to less than 100 (*see chart 6*).

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<sup>9</sup> *ibid.*

**Chart 6: Number of personal injury writs served in the Victorian County Court — public liability and slipping<sup>10</sup>**



While this Victorian experience may appear dramatic, regulations telling plaintiffs how to make a claim under the reformed tort law were not issued until June 2005. This may have resulted in a backlog of claims.<sup>11</sup> Also, while there was a ‘spike’ in writs lodged in Victoria in 2003, a number of these writs will have been intended to avoid the tort law reforms and may not result in actual claims.

Medical indemnity insurers have also identified a reduction in the reporting of claims. The number of medical indemnity claims that the five medical defence organisation insurers expect to meet for each notification year between 1999–2000 and 2004–05 has declined. The ultimate number of claims increased by 33 per cent between 1999–2000 and 2001–02, before falling by 36 per cent over the following three years (*see chart 7: ultimate claim numbers*).<sup>12</sup>

Claims frequency has followed a similar trend. Claims frequency increased from 3.4 per cent in 1999–2000 to 4 per cent in 2001–02, before decreasing over the following three years to 2.5 per cent in 2004–05 (*see chart 7: claims frequency*).<sup>13</sup>

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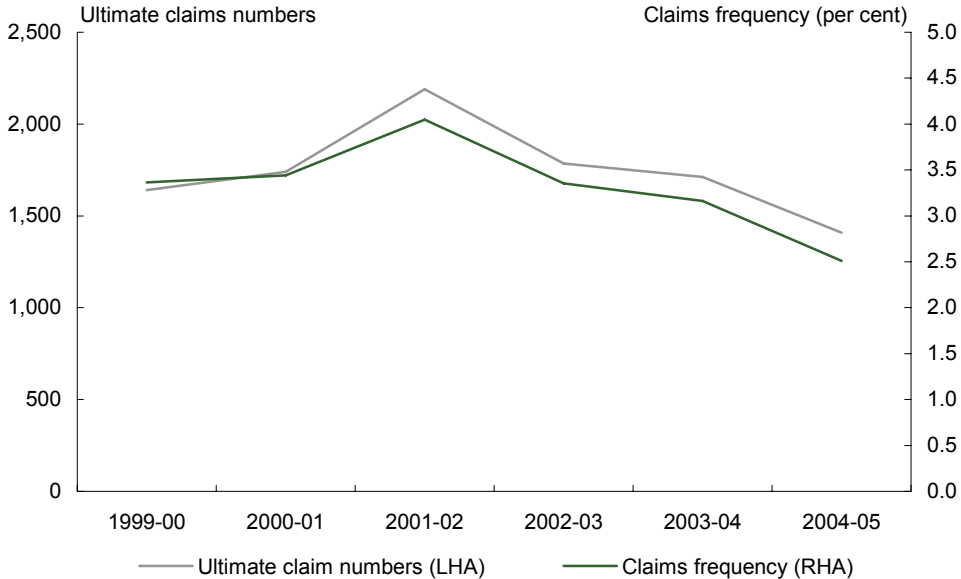
10 Australian Competition and Consumer Commission, *Public liability and professional indemnity insurance: Fourth monitoring report* (January 2005) 43  
[http://www.accc.gov.au/content/item.phtml?itemId=648433&nodeId=6d1d8f146b103d7ded0987608163eae2&fn=Public%20liability%20insurance\\_Jan2005.pdf](http://www.accc.gov.au/content/item.phtml?itemId=648433&nodeId=6d1d8f146b103d7ded0987608163eae2&fn=Public%20liability%20insurance_Jan2005.pdf) at 23 November 2006.

11 Maitra et al, above n 2, 2.

12 Australian Competition and Consumer Commission, above n 7, 23.

13 *ibid.*

**Chart 7: Medical indemnity claim numbers and claim frequency by year of notification<sup>14</sup>**



The Australian Competition and Consumer Commission (ACCC) speculated that the significant increase, or 'spike', in claims frequency might be attributable to claims being 'brought forward' before the introduction of the tort law reforms. That is, the introduction of tort law reform perhaps resulted in many claims being lodged sooner, that might otherwise have been lodged several years later, to ensure that the pre-reform legislation applied. This would create the sharp increase seen in the number of claims lodged in 2001-02.<sup>15</sup>

It is possible that there is a backlog of claims accruing while lawyers work on those claims already lodged. One effect of bringing future claims forward is a short-term reduction in claims, seen, for example, in the reduction in medical indemnity claims frequency (see chart 7: claims frequency) from a peak of 4 per cent in 2001-02 to 2.5 per cent in 2004-05. However, medical indemnity claims frequency is likely to increase once lawyers address the backlog of claims in the 'spike' and begin to focus on post tort law reform claims.<sup>16</sup>

<sup>14</sup> *ibid.*

<sup>15</sup> *ibid.*

<sup>16</sup> AM Actuaries, above n 4, i.

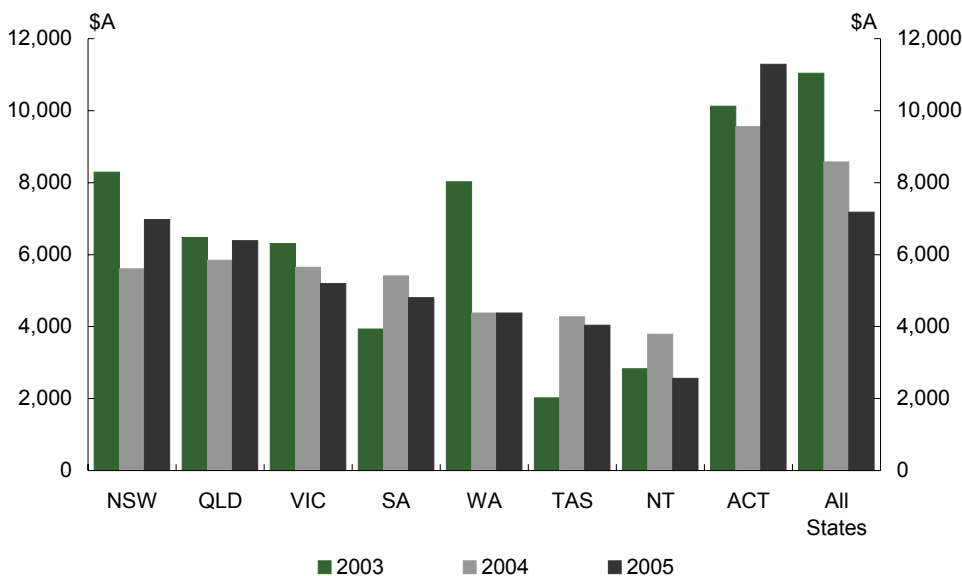
## REDUCTION IN THE COST OF CLAIMS

### PUBLIC LIABILITY AND PROFESSIONAL INDEMNITY

The National Claims and Policies Database indicates that the average cost of public liability claims fell by 16.3 per cent and the average cost of professional indemnity claims fell by 23.9 per cent from the 2004 to 2005 underwriting year. In its analysis of the claims data, the Australian Prudential Regulation Authority notes that it is difficult to draw conclusions about changes in claims costs from the few years of data submitted, given the inherent volatility of claims data.<sup>17</sup>

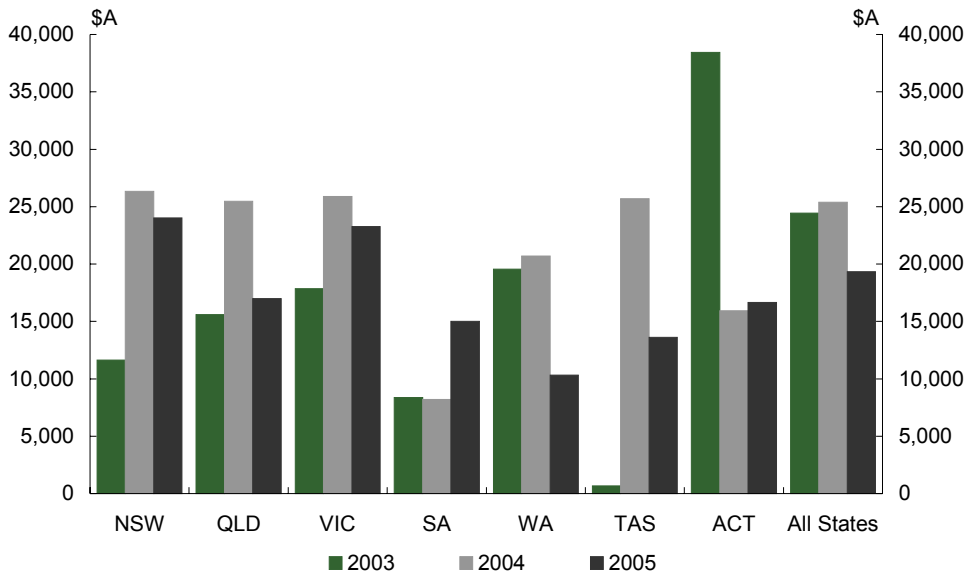
The average cost of public liability and professional indemnity insurance claims has fallen between 2003 and 2005, although there has been considerable variability across jurisdictions (see charts 8 and 9).

**Chart 8: Average public and product liability insurance claim cost<sup>18</sup>**



<sup>17</sup> Australian Prudential Regulation Authority, above n 3, 9.

<sup>18</sup> *ibid*, 10. The 'all states' average includes claims for which no jurisdiction has been provided.

**Chart 9: Average professional indemnity insurance claim cost<sup>19</sup>**

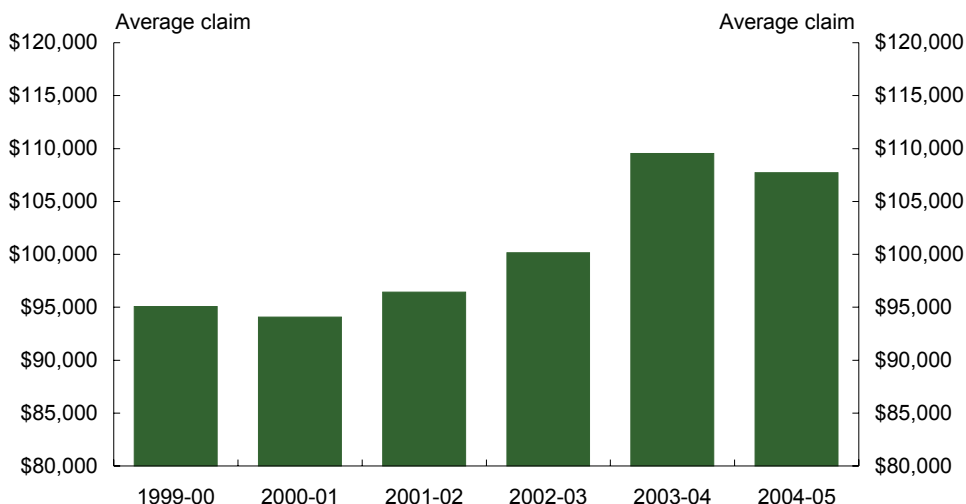
## MEDICAL INDEMNITY

Medical indemnity insurer estimates of the average cost of claims generally increased from 1999-2000 and peaked in 2003-04 at around \$110,000. The impact of tort law reform on the average cost of claims began to emerge in 2004-05, with the average reducing slightly to \$108,000 (*see chart 10*).

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<sup>19</sup> *ibid.*

**Chart 10: Estimated average cost of medical indemnity claims<sup>20</sup>**



The spike in claims, discussed previously, would normally reduce the expected average cost of claims significantly, because claims without merit are resolved with little cost. However, the advance lodgement of large claims meant that there was a significant increase in the average cost for several insurers accompanying the increase in claims. The impact of the tort law reforms on the average cost of claims will become more apparent once the courts and insurers process the claims involved in the spike, by around 2008.<sup>21</sup>

## IMPROVEMENTS IN THE AVAILABILITY AND AFFORDABILITY OF INSURANCE

The Australian Government expected that the tort law reforms would improve the availability and affordability of insurance. There is analytical and anecdotal evidence that the reforms limiting liability and quantum of damages are achieving this goal.

As noted earlier, it is not possible to be definitive about the impact of the tort law reforms on the availability and affordability of public liability and professional

<sup>20</sup> AM Actuaries, above n 4, 34:

- The average cost of claims is calculated as the total expected settlement cost (actual paid plus projected future payments) divided by the ultimate number of claims.
- While the definition of a claim differs between medical indemnity insurers, the trend is based on consistent definitions over time.
- AMIL/UMP data relates to calendar years, so 2004-05 is equivalent to 2004 for AMIL/UMP.
- The average cost for each year may change with subsequent actuarial estimates.

<sup>21</sup> *ibid.*

indemnity insurance. It is too soon to tell if insurers are passing on all the benefit of tort law reform in reduced premiums because:

- the adequacy of premiums before the tort law reforms has not been reported;
- the reduction in claim costs due to tort law reform is not known and the full impact of tort law reform is still emerging;
- insurers have reduced premiums as a result of the reforms to tort law, but the extent of the reductions and their impact on profitability are unclear; and
- competitive pressure will align premiums with costs in the medium term, but the extent to which this has occurred to date is not clear.<sup>22</sup>

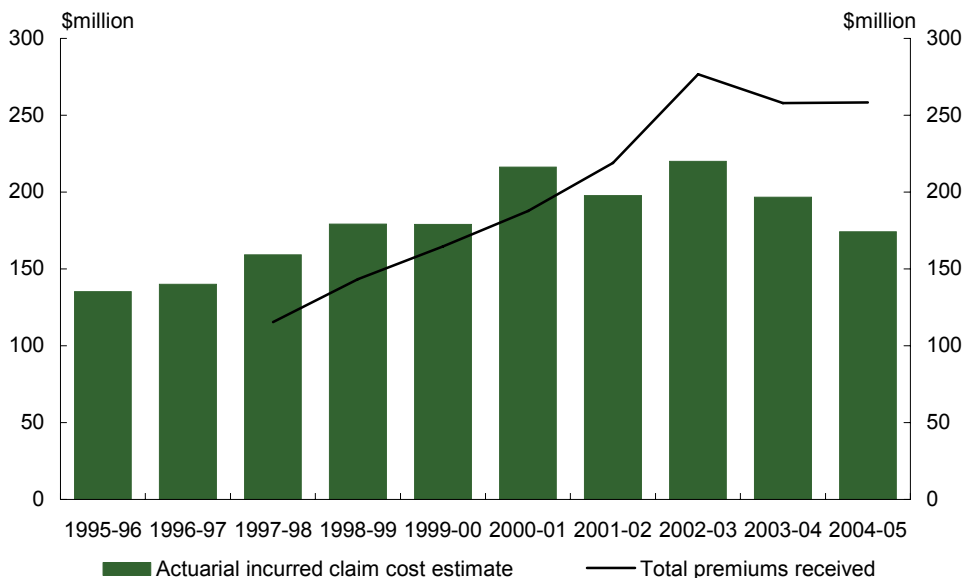
By way of example of the first point, prior to the insurance crisis, the premiums of some medical defence organisations were insufficient to meet claims costs, let alone the other costs of doing business (*see chart 11*). It is likely that, as a group, they were eating into capital rather than building it up. Years since 2001-02 show claim costs below the level of premiums. This should produce a better financial outcome – after allowing for expenses and investment income – although the insurers have had to build capital to meet the solvency requirements of the Australian Prudential Regulation Authority.<sup>23</sup>

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22 Maitra et al, above n 2, 4.

23 Medical Indemnity Industry Association of Australia *Medical indemnity report: an analysis of premium and claim trends in Australia from 1995 to 2005* (21 August 2006) 6-7 <<http://www.miaa.com.au/reports.php>> at 23 November 2006. Prepared by Insurance Statistics Australia Limited.

**Chart 11: Comparison of premium income with actuarial claim cost estimates<sup>24</sup>**



In relation to the third point, the impact of price reductions on profitability is not well understood outside the insurance industry. People equate a 10 per cent premium reduction with a 10 per cent profit reduction, when (see table 3) the effect of a 10 per cent price reduction where the starting level of the profit margin is 20 per cent is to reduce profit by 50 per cent.<sup>25</sup>

**Table 3: Effect of a premium reduction on profit<sup>26</sup>**

Premium reduction	Starting profit amount		
	10	20	30
5%	50%	25%	17%
10%	100%	50%	33%
15%	150%	75%	50%

The Insurance Council of Australia notes that, while insurers announced profits in 2006, public and product liability insurance classes represent less than 10 per cent of the insurers’ total revenue. Many insurers do not provide public liability insurance, or only provide it to a limited degree. Still, premiums in these classes have been trending downward. The Insurance Council argues that linking the profitability of insurers with the tort law reforms is misleading.

24 *ibid* 7. While this ignores the effect of future investment earnings on premiums, it provides a consistent basis for considering relative performance by financial and notification years.

25 Maitra et al, above n 2, 3.

26 *ibid*, 4.



Insurers operate in markets that have regular and rapid changes in risks and returns. An insurer's profits over time depend on its ability to trade-off risk and return, in both the insurance and investment markets. An insurer's sales growth is not always profitable. It can take years for bad business to show up in the insurer's reported results. For example, what first appears as good returns may over time be seen to be due either to peak pricing conditions or low claims experience.<sup>27</sup> An insurer's reported profit at the end of a year is really an estimate. The actual profit can only be known with the benefit of hindsight.

## **PUBLIC LIABILITY AND PROFESSIONAL INDEMNITY PREMIUMS**

The report from the National Claims and Policies Database in July 2006 showed that public liability and professional indemnity (including medical indemnity) insurance premiums fell significantly in 2005.

During 2005, public liability insurance premiums fell on average by 13.4 per cent and professional indemnity insurance premiums fell on average by 6 per cent. This followed from falls of 6.9 per cent for public liability and 1.2 per cent for professional indemnity insurance in 2004.<sup>28</sup>

These findings are consistent with those reported by the ACCC. The average public liability insurance premium in real terms fell by 4 per cent in the 12 months to December 2004. The same report also found that the average professional indemnity insurance premium decreased by 4 per cent in 2004.<sup>29</sup>

The Insurance Council of Australia notes the insurance market is cyclical, fluctuating between hard (increasing) premiums and soft (decreasing) premiums. It suggests that the insurance market is in a soft phase and that increased competition should see premiums continue to fall.

The Insurance Council also suggests that premium reductions should be seen in perspective. To deal with inflation, premiums in many classes of business would have been likely to rise by as much as 4 per cent, rather than fall as they have.

The New South Wales Government's self-indemnity scheme (Treasury Managed Fund) experienced liability portfolio premium renewal increases in 2001-02 of 21 per cent and in 2002-03 of 44 per cent. Claims have fallen in frequency and severity since the introduction of the tort law reforms. For the renewal years 2004-05, 2005-06 and 2006-07, the liability portfolio premium reduced by 2 per cent, 12 per cent and 5 per cent respectively. The actuarially assessed provision for outstanding claims has also reduced since the introduction of its tort law reform legislation.

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27 D & D Tolhurst 'Identifying tomorrow's insurers' 10(5) Professional update (October 1998) <[http://www.apesma.asn.au/newsviews/professional\\_update/1998/october/identifying\\_tomorrow.htm](http://www.apesma.asn.au/newsviews/professional_update/1998/october/identifying_tomorrow.htm)> at 23 November 2006.

28 Australian Prudential Regulation Authority, above n 3, 6.

29 Australian Competition and Consumer Commission, above n 5, 14-5, 29.

There is also anecdotal evidence of the success of the tort law reforms in limiting liability and quantum of damages arising from personal injury and death.

For example, the New South Wales Government received hundreds of representations from community and not-for-profit groups before its tort law reform package began to make an impact. These groups could not afford their higher premiums or were unable to purchase any insurance protection. Now the government receives almost no correspondence from third parties unable to obtain or afford insurance.

A number of specialised schemes now service the not-for-profit and community sectors of the market (*see the section below on Public liability insurance for not-for-profit organisations*). These include NCOSS (Council of Social Service of New South Wales) Community Cover and the Community Related Insurance and Superannuation Program. These services were unavailable prior to the tort law reforms.

New South Wales considers that these specialist providers have helped to improve the affordability and availability of insurance in New South Wales, by lowering premiums and increasing the availability of insurance for not-for-profit organisations.

Also, the Insurance Council argues that insurers now offer lower deductibles because the tort law reforms provided predictability to the civil liability environment. It suggests that these lower deductibles assist community groups and small business by allowing them to better control their risk and by reducing the financial uncertainty of a liability claim.

New South Wales suggests that it is possible that the improvements in availability and affordability will peak within the next two years. However, as noted above, the insurance market moves in cycles. If no adverse events (either natural or man-made) impact on the insurance market, then it is likely that the tort law reforms will continue to have a flow on effect for some years to come.

Victoria also sees the benefits of tort law reforms passing through to not-for-profit community groups. It suggests that excessive insurance charges and poor or restrictive cover no longer inhibit these community groups.

Victoria considers that its tort law reforms strike a reasonable balance between access to compensation for those suffering serious injury or loss through another's negligence, and access to affordable insurance for not-for-profit community groups. Anecdotal reports from umbrella bodies for community groups in Victoria indicate that the not-for-profit sector is obtaining these benefits.

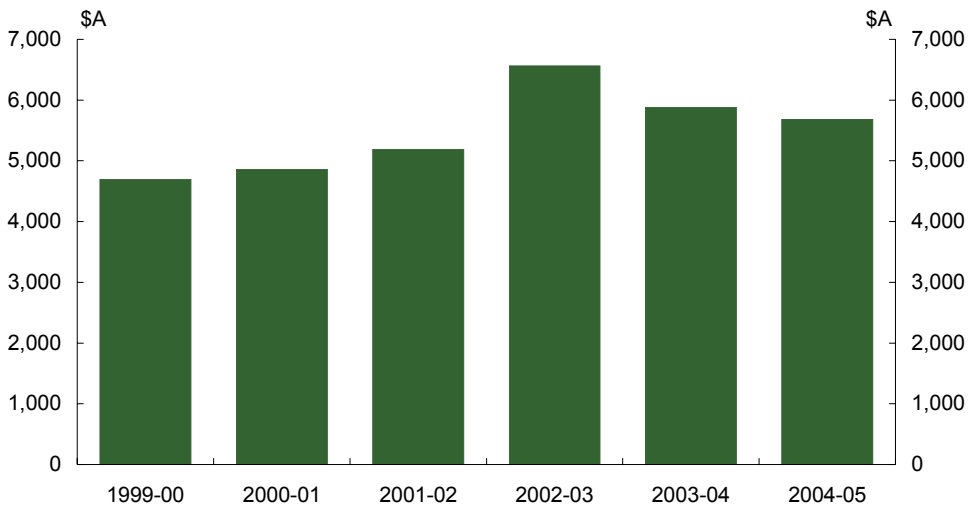
## **MEDICAL INDEMNITY PREMIUMS**

The ACCC assesses the actuarial and commercial justification of medical indemnity premiums. The Minister for Revenue and Assistant Treasurer, the Hon Peter Dutton MP, released the latest ACCC report in February 2006. The report found the premiums of the five insurers monitored to be actuarially and commercially justified.

Minister Dutton said the report was further evidence that the reforms have had a positive impact on the availability and affordability of medical indemnity insurance. The average medical indemnity premium fell by 3 per cent in 2004-05, to \$5,690 (see chart 12). The cost, frequency and average size of claims each fell in 2004-05.

Average medical indemnity premiums for the five insurers monitored by the ACCC have declined in real terms in the last two years (see chart 12).

**Chart 12: Average medical indemnity premium<sup>30</sup>**



While the tort law reforms appear to have halted the increase in the cost of claims experienced by the medical indemnity insurers monitored by the ACCC, a recent actuarial assessment suggests this hiatus will not continue and costs will increase. Typically, medical indemnity claims costs increase at around 7 per cent per annum, with a consequent impact on premiums. However, relatively moderate or flat growth in premiums may be expected in the short term.<sup>31</sup>

The Insurance Council of Australia notes that, after the collapse of the HIH Insurance Limited, there was a limited medical indemnity market for health care service providers (that is, for hospitals and clinics, rather than for individual doctors). The departure of St Paul and Gerling Insurance from the Australian market exacerbated this problem. Most of the larger health care service providers sought insurance offshore. Only a few local insurers were willing to offer limited coverage to small providers. However, following the tort law reforms, Assetinsure entered the medical indemnity market in 2005, bringing in additional capacity.

<sup>30</sup> Australian Competition and Consumer Commission, above n 7, 27.

<sup>31</sup> AM Actuaries, above n 4, 24.

## **PUBLIC LIABILITY INSURANCE FOR NOT-FOR-PROFIT ORGANISATIONS**

The not-for-profit sector encompasses a wide range of organisations, including religious organisations, professional bodies and community and sporting groups.

Organisations in the not-for-profit sector are particularly sensitive to increases in their insurance premiums. Their funding does not increase as their costs increase. Cost increases can result in them reducing the level of services they provide. It is also difficult for insurers to quantify the high levels of exposure these groups face. These groups face premiums that they see as being inexplicably high. The importance insurers give to risk management can place an additional burden on smaller organisations with limited resources and infrastructure.<sup>32</sup>

There were a range of insurance arrangements for the not-for-profit sector before the crisis in the affordability and availability of insurance. Additional arrangements developed in the wake of the crisis.

### **Availability of public liability insurance for the not-for-profit sector**

A number of measures now address the insurance needs of not-for-profit organisations, from specialised commercial arrangements to local initiatives. For example:

- Jardine Lloyd Thompson developed national club insurance schemes with organisations such as Cricket Australia and the Australian Football League; and
- a South Australian council resolved to provide and pay for the cost of blanket public liability insurance cover for all community based groups using council-owned facilities.

### **Special risk facilitation scheme**

The Insurance Council of Australia formed the special risk facilitation scheme in 2002, to seek out public liability cover for those entities or activities that could not find or afford cover.

### **Community Care Underwriting Agency**

Three Australian insurers, QBE, IAG and Allianz, formed the Community Care Underwriting Agency to help not-for-profit organisations access public liability insurance.

A key feature of the agency's approach is to encourage organisations seeking insurance to undertake risk management. That is, to attempt to identify and describe the risks

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32 Maitra et al, above n 2, 12.

that the organisation faces and how it will deal with them. It involves asking four questions:

- What can go wrong?
- What can we do to prevent it happening?
- What will we do in the event that something happens?
- If something happens, how will we pay for it?

The Australian Capital Territory considers that it benefited from the Community Care Underwriting Agency providing cheaper cover from 16 December 2002, before the enactment of its first tranche of reforms, on the basis that its community was the best informed and had the best access to risk awareness facilities.<sup>33</sup>

The Insurance Council of Australia advises that the agency has issued more than 1,800 policies to not-for-profit organisations around Australia since its launch. More than 100 of these provided cover to one-day only events, such as fetes and associated community events.

Initially, Community Care Underwriting Agency policies excluded personal injury claims brought against a community organisation by its members or volunteers. Policies the agency has issued since 15 March 2005 no longer contain this exclusion. This provides broader cover for community organisations.

An authorisation from the ACCC made the agency's operation possible. One of the ACCC's functions is to consider whether to allow anti-competitive practices that would otherwise breach the *Trade Practices Act 1974*, where it is satisfied that the practice will deliver a net public benefit.

The ACCC originally provided interim authorisation for the agency's co-insurance pool arrangements in November 2002, during the crisis seen in the public liability insurance market.

With more insurers offering public liability insurance to the not-for-profit sector and premiums becoming more affordable, the ACCC, in its recent review of the authorisation, observed that there had been a 'softening' of the market. It suggested that those not-for-profit organisations with current policies with the agency would be able to obtain public liability insurance elsewhere, from one of the individual agency members or another insurer.

The ACCC also considered that the softening conditions reduced the public detriment and public benefits associated with the arrangements. The ACCC was not satisfied that

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33 The Australian Capital Territory has a public liability insurance advisory website for business, sport and recreation or community groups at <<http://www.insuranceriskadvice.act.gov.au>> at 23 November 2006.

on-going authorisation generated a net public benefit. However, it renewed the agency's authorisation in July 2006 for a transition period, to allow the agency to give effect to any policies until the end of 2007.<sup>34</sup>

### **Councils of Social Service measures**

Aon Risk Services developed a range of policies for the community sector, in partnership with organisations including the Councils of Social Service.

The Council of Social Service of New South Wales Insurance Program provides community cover for organisations providing social services in New South Wales.

### **Civic Mutual Plus — Victoria**

The Municipal Association of Victoria operates Civic Mutual Plus, formed in May 2002, to offer public liability insurance to not-for-profit organisations in Victoria. It has around 130 members.

### **Local Government Risk Services — South Australia**

In South Australia, Local Government Risk Services had been operating an insurance scheme for clubs and community groups for a number of years. This provided public liability cover to a large number of community and sporting clubs that used council facilities. This scheme was extended to provide cover to community groups, events and not-for-profit organisations not associated with councils.

Local Government Risk Services also developed a specific scheme to provide cover for low risk groups such as resident groups, book clubs and services clubs that regularly hire council facilities.

### **Affordability of the public liability insurance for the not-for-profit sector**

Seven organisations provided the ACCC with data on public liability premium revenue and policy numbers. These provide, or help to provide, around 17,000 public liability policies for the not-for-profit sector.

Three of the seven organisations saw increases in the average premium between 2003 and 2004. However, between 2004 and 2005, six of the seven saw decreases in the average premium (*see table 4*).<sup>35</sup>

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34 Australian Competition and Consumer Commission press release 'ACCC allows transition period for insurance pool' (7 July 2006)  
<<http://www.accc.gov.au/content/index.php/html/itemId/751772/fromItemId/621589>> at 23 November 2006.

35 Australian Competition and Consumer Commission, 'Public liability insurance for not-for-profit sector' [Unpublished report] (2006).

**Table 4: Changes in the average public liability premium for the not-for-profit sector<sup>36</sup>**

Percentage change	Number of organisations	
	2003 to 2004	2004 to 2005
Increase greater than 20%	1	
Increase between 10 and 20%	1	
Increase between 0 and 10%	1	1
Decrease between 0 and 10%	3	5
Decrease between 10 and 20%		1
Decrease greater than 20%	1	

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36 *ibid.* Includes some data on a financial year basis, derived by the ACCC from responses provided by Aon Risk Services, Catholic Church Insurance Limited, Civic Mutual Plus, Community Care Underwriting Agency, Community Insurance Fund, Community Related Insurance and Superannuation Program, Council of Social Services of New South Wales, EIG-Ansvar Limited Australia, Local Government Insurance Services of Western Australia and Suncorp Metway Insurance Limited.





## CONCLUSION

Australians experienced a crisis in the availability and affordability of insurance during 2001 and 2002. Many community, volunteer, sporting and recreational groups found it difficult to obtain affordable public liability insurance. Many small businesses and individual professionals experienced rising professional indemnity premiums. Some of these considered ceasing professional practice or operating uninsured.

The Australian, State and Territory governments acted to address this crisis. With the Review of the Law of Negligence report as a blueprint, all jurisdictions agreed to a series of legislative reforms aimed at restoring predictability to the law of negligence. They also addressed community concern about the tendency of some plaintiffs to fail to take personal responsibility for their actions to the extent that they contribute to their own injury.

State and territory civil liability legislation and amendments to the *Trade Practices Act 1974* by the Australian Government reformed tort law in relation to personal injury and death and the liability of professionals. For the most part, these reforms are complete.

Australians have already experienced improvements in the availability and affordability of liability insurance. Premiums have eased; the National Claims and Policies Database report of July 2006 shows that average premiums for both public liability and professional indemnity insurance have decreased.

While this provides good news for the community, the Australian Government does not expect that the community will see the full effects of the tort law reforms for several years. The passage of time will provide a much clearer picture of how the reforms have influenced the affordability of insurance. In the interim, the reforms will require sufficient time to mature, to determine their long term impact on the liability insurance industry.

