



**Professional
Contractors and Consultants
Australia**

GUIDE TO PROFESSIONAL LIABILITY



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INTRODUCTION

This practical guide has been developed as a reference tool to assist independent contractor and consulting members of Professionals Australia.

The guide outlines what constitutes professional negligence and whether contractors will be held liable for their actions.

It also seeks to answer many of the frequently asked questions including:

- what are my liabilities and obligations as a contractor? and
- what types of insurance cover do I need?

The guide also provides practical advice on contract clauses to look out for, and how to establish whether you're an employee or independent contractor.

In Australia, professionals have a legal duty to do their work to the reasonable standard expected of their profession. Where they are engaged as independent contractors and perform work without due care which results in loss/damage, they can be sued and held liable to pay compensation.

In our increasingly litigious society, when people suffer loss they often look to make a claim against a party with sufficient assets to make good that loss. In recent years courts have also expanded the types of persons able to seek damages against professionals for negligence.

This guide is structured across five key areas:

1. the fundamentals;
2. the insurances available and their primary purposes;
3. losses and insurance claims;
4. some common contractual issues; and
5. common traps and 'must do's'.



THE FUNDAMENTALS

1. Who is a professional?

Anyone who gives to another person advice and/or provides a service of a skilful character according to an established discipline is regarded as a 'professional'.

This includes:

- Professional Engineers;
- Architects;
- IT Professionals;
- Professional Scientists;
- Marketing Professionals;
- Advertising Professionals;
- Executive/Management Coaches;
- Translating and Interpreting Professionals; and
- Human Resources Professionals.

2. The employer/employee relationship

Most people work as employees. The employee expects to go to work and not expose themselves personally to a liability that can take their hard-earned money and assets away from them.

However, the reality for any professional person is that they owe their clients a personal duty of care both at common law and under statute.

If this duty of care is not met, the individual can be personally liable for the resulting loss and damage caused. Usually an employer is obliged to cover liabilities caused by their employees' acts of negligence, with employers often seeking to mitigate this risk via an insurance program, although this is not always the case.

Until the 1960s the prevailing view was that a professional person could only be liable in contract, but not in tort. This meant that the retainer of a company to provide professional services would only see the company being held liable. This changed in the case *Hedley Byrne & Co Ltd v Heller Partners Ltd* [1964] AC 465 (1964), where the court determined that professional persons have a duty to take reasonable care to guard against causing pure economic loss. In the case of *Houghton v Arms* [2006] HCA 59 the High Court was unanimous in finding that employees could be personally liable for representations made on company letterhead.

The employee is entitled to an indemnity from the employer, so rest easy...or should you? What if:

- you defame someone?
- someone says you have been dishonest?
- the business of your employer is sold?
- you leave your employer and go to a competitor? or
- you are the subject of disciplinary action by the regulator?

As an employee, what can you do?

Professional employees should insist on their employment contract expressly providing that:

- The employer will indemnify the employee against liability while the employee is acting within the scope of his/her employment;

- The employer will organise professional indemnity insurance to cover liabilities incurred by the professional during the course of their employment; and
- The employer will pay the applicable excess in relation to any claim and will not seek recovery from the employee.

Usually a plaintiff that has suffered a loss only sues the employer. Most litigation involves commercial decisions and generally a plaintiff would rather deal with a solvent and well-resourced employer and their insurers (although it is important to point out that all professionals have a personal exposure to the potential of claims for a breach of professional duty and/or misleading or deceptive conduct under Competition and Consumer Law). It is important to consider the protection available via the employment contract.

3. Employee or contractor and why is the distinction important?

Professionals that work on a contractor or sub-contract basis are considered differently to employees.

The presumption is that they are independent parties who are liable for their own actions and therefore do not enjoy the same protections that an employee would via their employer.

The default position for any contractor is that they should have their own insurance that is of an adequate level and representative of their risks and responsibilities. Contractors should also understand that the party engaging them will have their own insurance and that an insurer can (and is likely to) seek recovery from the contractor in the event of a loss.

4. Principal (client)/contractor relationship

The contractor engagement process/es can make the defence of claims by a contractor difficult. For example, a matter may involve the firm (the principal) being sued, with the firm then seeking to join the contractor as an additional party to the action, thus seeking to transfer the liability to the contractor.

Key issues to be considered for principals and contractors when seeking to engage with each other include:

- Does the principal want to have one insurance policy that covers the contractor as well? If so, the insurance will need to specifically name the contractor as an insured. If not, consideration should be given to which party will have conduct of a claim should a loss occur.
- Principals (clients) can ask the contractor to assume responsibility for and in turn to notify its insurer and assume conduct of a defence, but the circumstances in which this is to be done should be clearly stated and agreed by the contractor's insurer prior to the engagement.
- Any professional doing work on a contract basis, even for the one principal, should not assume that the principal is looking after them.

5. Are you an employee or a contractor? - how to decide

Given that employers are more likely to be liable for the actions of their employees but not the actions of contractors, the distinction is quite important. This can sometimes be confusing when employees on a contract or short term project are sometimes referred to as 'contractors'.

In 2011, a Fair Work Australia Full Bench drew together the relevant case law to provide a summary of the general law approach to deciding employee/contractor status.

The approach to distinguishing between employees and independent contractors is summarised as follows:

1. In determining whether a worker is an employee or an independent contractor the ultimate question is whether the worker is the servant of another in that other's business, or whether the worker carries on a trade or business on his or her own behalf: that is, whether, viewed as a practical matter, the putative worker could be said to be conducting a business of his or her own of which the work in question forms part? This question is concerned with the objective character of the relationship. It is answered by considering the terms of the contract and the totality of the relationship.
2. The nature of the work performed and the manner in which it is performed must always be considered. This will always be relevant to the identification of relevant indicia and the relative weight to be assigned to various indicia and may often be relevant to the construction of ambiguous terms in the contract.
3. The terms and terminology of the contract are always important. However, the parties cannot alter the true nature of their relationship by putting a different label on it. In particular, an express term that the worker is an independent contractor cannot take effect according to its terms if it contradicts the effect of the terms of the contract as a whole: the parties cannot deem the relationship between themselves to be something it is not. Similarly, subsequent conduct of the parties may demonstrate that relationship has a character contrary to the terms of the contract.
4. Consideration should then be given to the various indicia identified in *Stevens v Brodribb Sawmilling Co Pty Ltd* and the other authorities as are relevant in the particular context.

Case reference - Case reference: *Jiang Shen Cai trading as French Accent v Michael Anthony Do Rozario* (C2011/4659) [2011] FWA 8307 Available at <http://www.fwa.gov.au/decisionsigned/html/2011fwafb8307.htm>

Ultimately, if in doubt regarding the employment status (employee v contractor) you should assume the latter in terms of protecting yourself from potential litigation. If there is any doubt, seek clarification first, and secondly purchase an insurance program to cover your professional exposures.

6. Who can sue and to whom do you owe a duty of care?

A professional is only liable to compensate those to whom the professional owes a duty of care.

In general terms, a professional will be held to owe a duty of care to all persons whom the professional should reasonably foresee could be harmed (suffer loss) by a negligent act/omission.

The primary way to mitigate or control the risks faced by a professional person or a professional consultancy, apart from systems and processes to ensure quality is maintained, is to purchase insurance policies to protect against the potential exposures.

7. What sort of act will amount to negligence?

Not all mistakes amount to negligence.

There are three key elements to establishing negligence:

1. first and foremost, there must be a duty of care between the parties;
2. the professional does not exercise the required standard of care, resulting in an error/ omission; and
3. the error/omission causes loss/damages to the other party in order to rectify the error/omission.

Without these three key elements being established, a claim for damage cannot be established.

An act will not be negligent just because a professional with extraordinary skills or the highest professional attainment would not have made such a mistake. It will be negligent however, if the work falls below the level of competence and skill 'usual' amongst those in the profession who do that work.

The amount of care required will depend upon the potential risk of loss and the practicality of the preventative measures that could have been taken.





INSURANCE

1. What is professional liability?

Professional liability is the term used to describe the liability professionals have for any act or omission that is in breach of a duty of care that they owe. It is also known as professional negligence.

The potential liability is to compensate for damage caused by negligence. The damage may be physical injury (for example a broken leg caused by a negligently designed platform collapsing) and/or economic loss (for example, money lost by a person who lent money in reliance of a negligent valuation over the property securing the loan).

2. What is professional indemnity insurance and what does it cover?

Professional indemnity insurance is designed to cover a business for errors and omissions associated with the advice and services provided to clients.

Professional indemnity insurance covers legal liability for claims arising out of an actual or alleged breach of professional duty. The exact parameters of the insurance cover will vary with different insurers and wordings, and it is important to read and review individual insurance wordings.

Professional indemnity policies will, in general, cover a business for errors made whilst advising or servicing clients. It will usually provide cover for not just the damage caused by the mistake, but also the legal costs and expenses of investigating and, if justified, defending the business advice and conduct. Payment of the legal costs associated with defending an allegation of negligence or similar is often the part of the insurance cover most appreciated by an insured business.

Professional indemnity insurance can also include extensions that provide additional protection for:

- reconstituting a client's documents if lost or destroyed ("loss of documents cover");
- loss of money due to dishonesty ("fidelity cover"); or
- the costs of appearing in official investigations by tribunals, ombudsman bodies or even royal commissions ("Inquiries costs cover").

3. What is public liability insurance?

Public liability insurance covers you against legal liability for any unexpected and unintended event that results in damage to property or bodily injury to third parties. The majority of claims arise out of 'negligence' which has been defined as the omission to do something which a reasonable person would do. Whilst the majority of claims arise from negligence they sometimes arise out of nuisance which is the 'interference with the enjoyment of the land'.

4. What is product liability insurance?

If you sell, supply or deliver goods, even in the form of repair or service, you may need cover against claims of goods causing injury or damage. Product liability insurance covers damage or injury caused to another business or person by the failure of your product or the product you are selling.

Businesses insure their product liability risk so that if a member of the public sues them as they feel they have suffered a loss, then they will be insured. For example, if a customer enters a retail shop to inspect goods for sale and slips over on debris on the floor then they may be able to sue the retailer.

For professional consulting firms, 'products' may be limited to tangible elements of reports, stationery, gifts or promotional material provided to clients.

Public and products liability insurance policies often require the 'occurrence' (injury or damage giving rise to a legal liability) to happen during the policy period - this is the opposite of professional indemnity insurance.

Any overlap between professional indemnity and liability insurance is usually avoided by the use of exclusions. Public and products liability policies often having some form of design or advice exclusion. In a similar fashion, a professional indemnity policy often contains exclusions relating to personal injury or property damage matters unless arising out of a breach of professional duty.

5. Workers compensation

The object of workers compensation is to provide income support for injured workers and to facilitate return to work. It operates in conjunction with occupational health and safety legislation to ensure the health, safety and welfare of workers.

Professionals who are starting up a business consultancy may want to clarify their workers' compensation obligations for themselves and, if they employ others, for their employees.

Generally speaking, independent contractors are not defined as workers under the various state workers compensation acts so the legislation does not apply and there is no requirement for contractors to take out workers compensation insurance for themselves.

Contractors who employ staff are required to take out appropriate workers compensation insurance to cover these staff. Where self-employed professionals engage sub-contractors on a regular basis, these sub-contractors may be deemed workers and workers compensation obligations are likely to apply. Where the self-employed professional is him/herself engaged on a regular and systematic basis, it is possible that the principal engaging them may have workers compensation obligations in relation to the contractor.

If independent contractors do not employ staff, they may still have workers compensation obligations depending on the structure of their business. For example, an obligation to carry workers compensation coverage often exists in the case of working company directors in spite of the fact that they don't employ other staff.

Where self-employed professionals do not take out workers compensation insurance, they should arrange their own income protection and/or accident and illness insurance through a private provider. If you're unsure of your workers compensation obligations, you should contact the workers compensation authority in your state.

6. Income protection

Income protection is designed to provide you with continuing monthly income, following an injury/illness that prevents you from working.

As a consequence, income protection insurance (also known as income replacement, disability income or salary continuance) could be your most important form of insurance.

Income protection insurance helps protect you from financial disaster. It's particularly important if you have obligations such as a mortgage or other debts that you would struggle to repay without your income.

It is important for self-employed people who do not have the protection of an employer to provide any sickness benefits (i.e. no workers compensation coverage).

The maximum benefit covered is usually 75% of gross income after business expenses. Everyone who relies on a regular income to live and to pay off life's necessities, particularly the self-employed, need to consider adequate income protection insurance.

7. Management liability

Historically the insurance products forming a management liability insurance program have been known as a Directors and officers liability insurance.

This form of insurance is designed to protect the personal assets of directors and officers by providing indemnity for any loss arising from a claim as a result of a wrongful act committed in the course of them performing their management duties. The insurance coverage has now evolved to cover a whole range of management liability exposures.

The main areas covered under the Management liability policies include:

- Directors and officers liability insurance – protects directors and officers against claims resulting from management decisions. Directors face liabilities under Corporations Law, Trade Practices Act, Environmental legislation and a variety of government bodies and statutes (e.g. ATO and ACCC). Both executive and non-executive directors can be held liable for the actions of the company at a personal level which can put at risk personal assets; and
- Employment practices liability insurance – protects the directors and the company from claims brought by employees for things such as unfair dismissal, harassment, discrimination and/or unfair work practices; *and*
- Statutory liability insurance – protects directors and the company from statutory civil fines and penalties where at law the insurer is able to pay (e.g. OH&S fine following a workplace injury).

Examples of risks that are covered under each section:

THE RISK	MANAGEMENT LIABILITY COVERAGE SECTION:
Investors, customers, clients, government regulators, and competitors can sue a firm's board members and officers over their actions or decisions.	Directors and officers' liability insurance
Employees and former employees can sue a firm, its board members and its officers for discrimination, harassment, and other illegal employment practices.	Employment practice liability insurance
A regulatory/government body may impose a fine upon the company for breach of their statutory requirements.	Statutory liability
A trusted employee can embezzle funds, steal company money, or commit fraud over a long period of time.	Fidelity insurance

8. What is run-off insurance?

Run-off insurance applies to 'claims-based' insurance. If the professional indemnity insurance is allowed to lapse or cease and a claim is made against the insured after the lapse date, the insurer will not be liable to indemnify the insured. Run-off insurance is essentially a continuation of insurance in order to maintain protection against past activities.

An 'occurrence-based' insurance policy (i.e. public liability or workers compensation) covers loss arising from an act that took place at the time the policy was in effect, regardless of when the claim is made. 'Claims-based' insurance (i.e. professional indemnity) covers those claims made while the policy is in force.

For professionals working in areas with long term lags between the work being done and defects becoming noticeable, this can be a problem. For example, structural engineers would need to carefully consider their position to protect themselves from liability for claims made long after they had retired. If the work was done through a company structure, and the company continues to trade (e.g. continued by other principals) and maintains its insurance cover, there might be no need for a retiring principal to maintain his or her own private insurance cover.

Likewise, if a professional sells his/her business the professional should endeavour to ensure that the purchaser takes over the liabilities as well as the assets of the business, and so taking over any potential liability.

For sole traders, however, there may be no choice other than to continue their insurance for many years to ensure that they are adequately protected against claims made long after the work was completed. That does not mean that the insured has to maintain the same level of premium payments for the rest of their life. Run-off cover generally factors in reduced premium costs over time - in line with the amount of time since the work was done.

For those who work on a one-off project, project insurance is available. Again this is claims-based cover and so run-off insurance is advisable for work that may not show any defects for some time.

9. How many years should a professional maintain run-off cover?

There is no 'hard and fast' rule about how long run-off cover should be maintained. Things such as contractual obligations and statutory requirements need to be taken into consideration.

It is generally advisable for run-off insurance to be maintained for at least six years, although in some cases the cover may need to be considerably longer.

For example, the time from which the contractual limitation period commences may be delayed until the discovery of damage where the defect or damage is latent. Asbestosis, brick growth or concrete cancer are all examples of latent defects or damage.

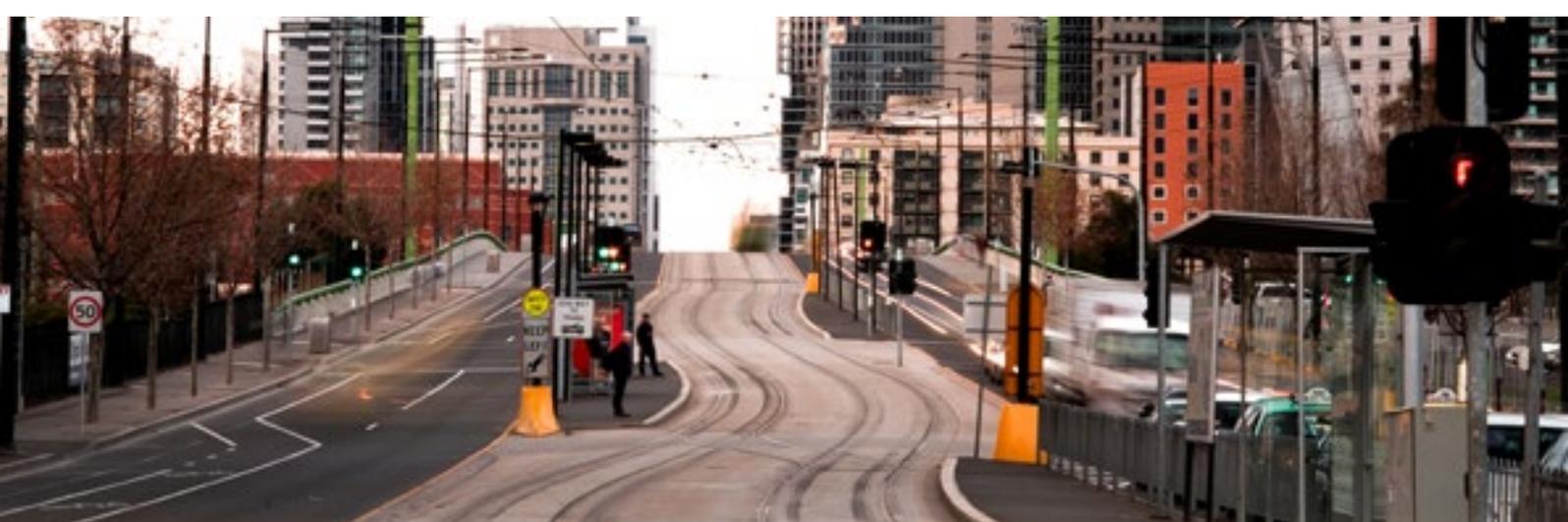
For this reason, construction professionals e.g. engineers and project managers should consider having run-off cover beyond six years because an injury or damage may occur or be discovered many years after their involvement with the construction of a building.

Run-off insurance claim example:

After many successful years as an architect, Mr X, on reaching 60 years of age, decided to retire to a coastal resort where he looked forward to settling into a carefree retirement lifestyle.

At first, Mr X continued to be covered by his former firms professional indemnity insurance policy but after two years the firm folded and no new professional indemnity policy was taken out. Mr X wondered if he should get run-off cover but before he did so, he was served with a writ.

Some 15 years beforehand, Mr X had designed an office building in Tasmania. The building had a ramp leading from street level to a basement carpark and Mr X had incorporated in his design a bridge from street level over the ramp to the front entrance of the office block. Many years later, some youths were skylarking on the entrance bridge. One of them went over the bridge railing and fell to the ramp below suffering severe spinal injuries. The writ alleged that the bridge railing was lower than the applicable Australian Standard. Mr X was left to defend the writ from his own resources as he had no insurance cover when the writ was served upon him.





LOSSES AND INSURANCE CLAIMS

1. Claims made and notified

The vast majority of professional indemnity insurance is written on a “claims made and notified” basis. This means that the insurance in force when a claim is first made against the business and notified to the insurer is the policy that will respond to the insurance.

This differs from “losses occurring” policies where the date of the incident will determine the policy.

This policy structure makes it essential that businesses immediately notify their professional indemnity insurers when a claim is made against them.

2. What is a circumstance?

A circumstance can be broadly viewed as a set of facts that if an average business had been in possession of these facts would then recognise that a claim for loss or damage may later arise against them.

These could include such issues as:

- a business knowing it has given incorrect advice (even if the client does not yet know); or
- if a business knows that a client believes that the advice was incorrect (even if the business disagrees).

If a claim (or allegation thereof) is made against the business at a later date it does not matter if the claim is misconceived and unjustified.

A claim or circumstance should be considered irrespective of the view of the business about its merits or otherwise. This is because the professional indemnity insurance will usually provide cover for the legal costs to defend a matter (including unjustified allegations) against the business and so can be called on even if a claim has no merit.

3. Circumstances that may give rise to a claim

In addition to any claim made against an insured, every business has a right under statute law to notify to their insurers any facts that they think may in future give rise to a claim - usually termed as a “circumstance” (see above). As a result of this obligation, the insurer will, at the beginning of a policy, exclude any circumstances that the business is aware of irrespective of whether the previous insurer has been notified. If you don’t notify claims or circumstances when you first become aware of the matter, the later insurer may not cover them under their policy.

4. What happens when something is notified?

Any set of facts, circumstances or a claim for damages that a business considers may be worth notifying should be immediately discussed with an insurance advisor, broker or the insurer.

It is likely that your insurance advisor will recommend that the matter is notified to the appropriate insurer. On receipt of the notification, the insurer will review the facts and possibly ask for more details. Once the insurer understands the background to the notification they will act accordingly and this may be simply to make a note of the circumstance and allow the business to continue as is (this is especially likely if the notification is purely a notification with no legal action underway).

In other cases the insurer may instruct solicitors or specialist insurance loss adjusters to gain a better understanding of the facts and/or legal issues involved.

Usually the insurer will ask that any further correspondence with the potential claimant is approved by the insurer before it is sent. This is an important precaution as it will ensure that the business does not prejudice the insurer’s position by putting incorrect/inappropriate information in a letter.

Why notify?

There are a number of practical reasons why all circumstances and potential claims should be notified to the insurer as soon as possible. The primary reason is that it will avoid policy problems at a later date.

Any perceived unreasonable delay, can result in the insurance cover being jeopardised if the insurer suffers any prejudice. By way of example, where a business has a clear and reasonable opportunity to prevent or resolve a claim that insurers are unaware of, but the business fails to take this opportunity without good reason resulting in additional costs and potential increases in the size of the claim, the risk to the insured party is that the insurer may deny indemnity under the insurance.

If the insurer is aware of the claim and has an opportunity to resolve the matter but allows the business to miss the opportunity, then the insurance cover would not be affected, and the risk of escalation of the matter is a cost to the insurer, and not the insured party.

From a legal perspective the prompt notification of circumstances will provide a business with statutory protection that is not available after expiry of the policy. This is invaluable if a circumstance later escalates into a serious/large scale claim.

Common reasons why not to notify?

What harm does a precautionary notification to the insurer do?

A number of the common misconceptions that have led to late notifications are:

1. "It was under the excess"

Even if a claim is under the excess it should be notified to the insurer. In the case of a circumstance only (no actual demand or legal documents) it is difficult to assess if the matter is definitely under the excess. If a claim is to be defended then it is possible the insurance will provide for the costs of doing so without having to pay the excess (known as a "a costs exclusive excess") so the value of the claim itself is irrelevant. If the claim is a justified claim then the matter can easily exceed the excess once the claimant's costs and interest are added in.

It may be that the claim/circumstance will disappear or be resolved under the excess and if this occurs, the insurer will generally close their file. If the matter escalates and costs more than the excess and the matter has not been notified to the insurer, the insured could be left with an uninsured claim – the risks and downside of not notifying are far greater than the potential benefits.

2. "I thought it would go away"

Circumstances/claims often do go away with little or no effort. They also often do not. If a circumstance is notified and it never becomes a claim then insurers will simply close their file. However, conversely if the matter doesn't go away and escalates into legal proceedings you do not want to be without your insurance protection because you failed to notify the issue when you first became aware of it.

3. "I had done nothing wrong, the claim was unjustified"

Each year a significant proportion of the funds spent by insurers are on defence costs. It can cost hundreds of thousands of dollars to run the defence of a claim and it is only after a favourable judgment that any claim can really be said to be unjustified.

It is essential that even those complaints and circumstances that a business considers have no merit are promptly notified to the insurer. The longevity of a claim is dependent on whether the claimant views it as merited not on the view of the insured business.

4. "I did not want to have my premium increased"

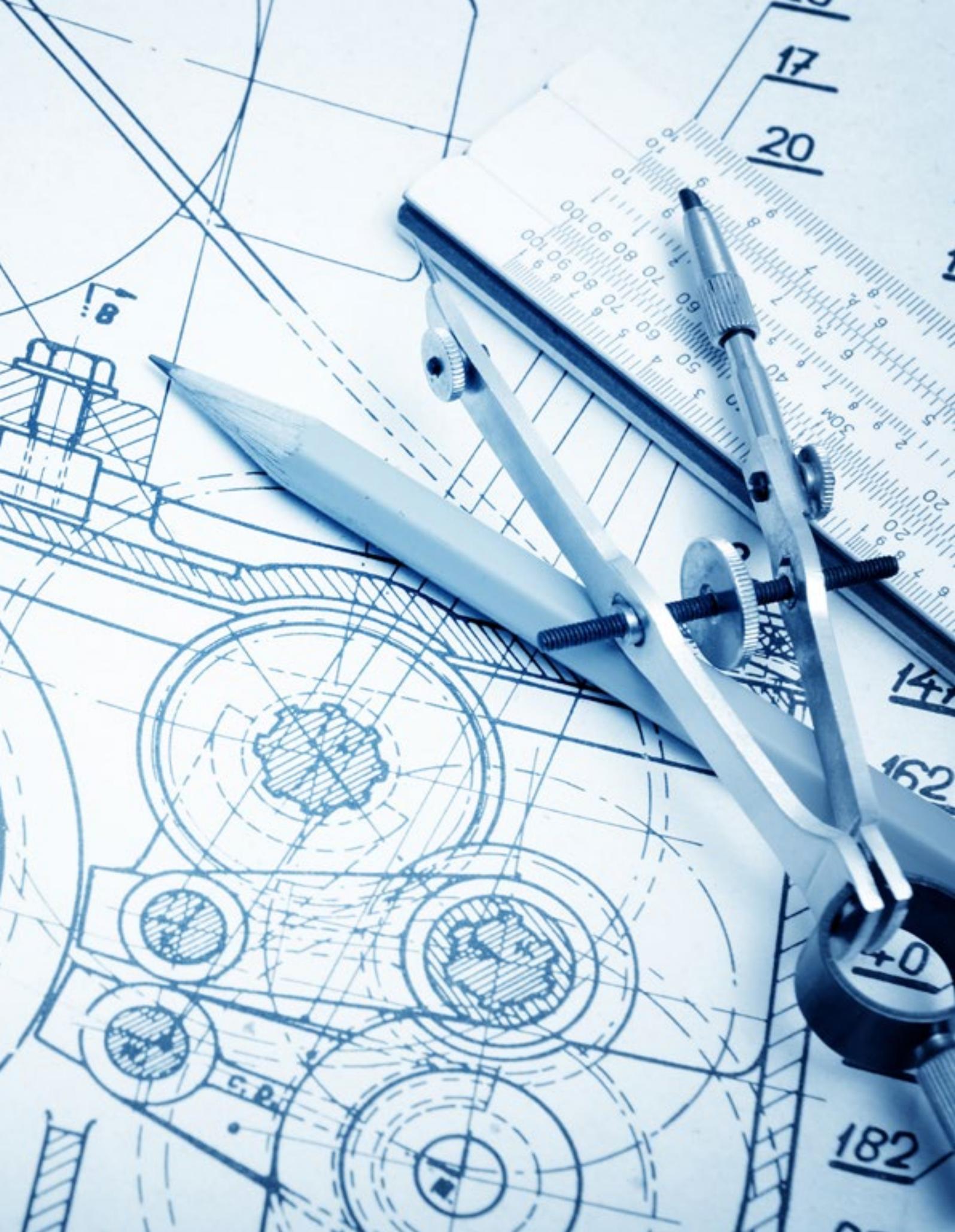
Claims history is an important aspect of the rating process that insurers undertake on renewal. However, insurers are also aware that a proportion of notified circumstances do not develop into claims, with most insurers able to consider the position on each notification and obtain the views of their claims staff prior to imposing financial cost penalties to the insurance cover. Precautionary notifications are not likely to significantly affect premiums. Even if they do, generally increased premiums are less than the potential financial impact of being without insurance protection.

In summary, you should notify every circumstance to the insurer. Though you should carefully read and review the terms of your insurance program, you are unlikely to be criticised or suffer from the prompt notification of any issue that you consider could later develop into a claim against you.

Whether the claim is justified or not, your insurer will assist in mitigating and resolving the dispute, and if necessary provide the best legal team to back you and this is to your advantage.

5. Professional indemnity claims checklist

- If in doubt refer any issue to insurance advisor, broker or in their absence your professional indemnity insurer.
- Notify your insurance advisor or broker of all claims/circumstances.
- Notify your professional indemnity insurer of all claims/circumstances.
- In discussions or correspondence with the claimant never disclose information about your professional indemnity insurers, solicitors or any legal advice you have received.
- Once a circumstance or claim is notified, forward draft correspondence relating to it to insurers for their approval before sending it off.
- Inform professional indemnity insurers of any offer to resolve the complaint.
- Immediately notify insurers if proceedings, or any similar legal document is served, send them a copy and store the original safely.
- Never make an admission of liability or culpability for any loss.
- Never make any deals or enter into any agreement to resolve the complaint without your insurer's consent unless you are content to have no insurance involvement.
- Before renewal, ask all staff/offices/authorised representatives to confirm by return email that they are not aware of any circumstances or claims against them. Encourage openness and not a culture of fear regarding notifications to professional indemnity insurers.





KEY CONTRACTUAL ISSUES

1. Contractual liabilities faced by the professional

Now you have the correct insurance program in place covering your consultancy business. What do you need to be aware of in terms of risk management strategies to ensure you're not prejudicing your insurer or running the risk of your insurance policy not working correctly come claim time.

A significant area when addressing this issue is the signing of contracts.

Professional indemnity policies typically exclude a straight contractual liability claim. What does this mean?

As previously discussed, a professional has a common law professional duty of care to any third parties to not cause them bodily injury, property damage or financial loss during the course of offering their professional services. A typical professional indemnity policy will cover claims alleging negligence against that professional person.

The relevant professional indemnity policy, however, will generally have an exclusion along the lines of:

There is no cover for claims alleging a liability under a contractual warranty, guarantee or undertaking (unless liability would have existed regardless of the contractual warranty, guarantee or undertaking).

So what does this mean? It means effectively that you should endeavour to enter into contracts which reflect your common law duty. The professional person should be held liable for his or her negligent acts and each other party to the contract will also be equally responsible for their own negligent acts.

2. Proportionate liability

In all states and territories in Australia, legislation now replaces the common law doctrine of joint and several liability with the principle of proportionate liability.

Under this principle, the liability of each wrongdoer is limited to the portion for which he or she is directly responsible. That portion corresponds to the wrongdoer's percentage of comparative responsibility.

Essentially, a defendant is liable to pay the loss apportioned by a court against it for its part in contributing to the plaintiff's loss. The risk of seeking a claim against a defendant who cannot pay the amount apportioned against it by judgment now lies with the plaintiff.

It is notable that in all Australian states and territories, proportionate liability applies only to claims (whether in tort, contract or under statute) for economic loss or property damage arising from a failure to take reasonable care. It does not apply to personal injuries claims - the doctrine of joint and several liability still applies in those circumstances.

3. Joint and several liability

In the United Kingdom and other common law jurisdictions such as Hong Kong and Singapore, the doctrine of joint and several liability continues to apply.

This doctrine operates when one or more person has tortiously contributed to a plaintiff's loss. The plaintiff is able to recover the full amount of that loss arising from the wrong from any one defendant or any combination of the defendants who caused the loss. If the plaintiff recovers the whole amount from a single defendant, that defendant is then permitted at law to seek recovery from the other defendants for their share of responsibility in causing that loss.

From a practical standpoint, plaintiffs are unlikely to choose to bring a claim against an insolvent defendant. Instead, they are likely to claim against defendants with "deep pockets" such as professional service providers who typically carry professional liability indemnity insurance. It is then up to the "deep pocket" defendant, and their insurers, to seek contributions from the other wrongdoers in order to reduce their liability. The risk of a futile contribution claim against an insolvent wrongdoer lies with the defendant and their insurers.

4. What is a hold harmless clause?

Like an indemnity clause, a hold harmless clause is a risk transfer mechanism.

A hold harmless indemnity clause within a contract is a condition that requires one contracting party to hold harmless/indemnify the other contracting party.

An indemnity is sometimes distinguished from a hold harmless clause by saying the indemnity relates only to reimbursement of an actual loss and that the hold harmless obligation requires the grantor of that benefit to hold harmless the recipient from risks of potential loss as well as actual loss.

An example of a hold harmless clause is:

The contractor holds the principal harmless from any action, claims, liability or loss in respect of the performance of the services.

Under this clause, the contractor is not only prevented from bringing any claim against the principal (even if the principal has contributed to the loss or liability in the first place), the contractor is also required to “hold the principal harmless” by ensuring that the principal does not suffer any loss or liability as a result of the performance of the services which may include claims by a third party.

The reality is that the precise operation and application of the clauses depend on the actual wording of the clauses and a court's interpretation of them. At a simplistic level, however, the practical effects of both types of clauses are similar - they are both about risk allocation and the extent of risks that each party is prepared to assume. Careful drafting of the clauses determines the extent of the protection that is given to the recipient of the hold harmless obligation.

5. Waiver of subrogation rights

If an insured agrees in a contract to hold harmless another party without any right to adjust their respective liabilities according to each party's contribution to the loss or liability, this may jeopardise a company's insurance for financial liability risks.

First, a hold harmless clause involves an assumption of contractual liability which is typically excluded by contractual liability exclusions in insurance policies. Whilst an extension may be provided in a policy to cover liability assumed under contracts, insured's must read the wording of the extension carefully to ensure that they understand the precise ambit of the cover. For instance, if the contractual liability extension covers only the loss that results from an act, error or omission of the insured in the provision of the relevant services or supply, then a loss that falls within the hold harmless provision but did not in fact result from an act, error or omission of the insured would not be covered by the policy.

Furthermore, a hold harmless clause, like an indemnity clause, also involves a waiver of the insurer's right of subrogation which is an issue often overlooked when parties agree to accept risks under such clauses.

Insurers have a right of subrogation, both as a matter of law and under the insurance contract, to “step into the shoes” of the insured and bring a claim against other parties who have some responsibility for the loss or damage. This right is a key element of an insurance contract because it allows insurers to recoup some of what they have paid to the insured by way of the insurance claim. But, in subrogating “into the shoes of the insured”, the insurer can only exercise those rights that an insured has.

Having said that, some insurers in the marketplace acknowledge the fact that indemnity and hold harmless clauses are common negotiating tools in commercial contracts and so, notwithstanding the fact that such clauses have the effect of waiving some or all of the insurer's subrogation rights, specifically provide by way of an extension that such clauses will not prejudice the insured's claim under the policy.

Independent contractors and consultants are advised to read their contract for service in conjunction with their professional indemnity policy carefully, and to discuss this issue with their insurance broker.

6. Contractual risk allocation and proportionate liability

Risk allocation between contracting parties is an integral part of contractual negotiations. In order to clinch a deal, some insureds are often under commercial pressure to contract out of the effects of proportionate liability legislation.

For instance, contractors to a major project may agree that each will be jointly and severally liable to the principal which means that the principal could recover 100 per cent of their loss from any one of the defendant contractors, even if each of those contractors caused only a part of the principal's total loss. Furthermore, the contractors themselves may also include appropriate indemnities in their agreement so as to share liabilities as between themselves in proportions that may differ from the proportions that may be determined by a court.

Some proportionate liability legislation expressly permits the "contracting out" of the application of the legislation. Most proportionate liability laws are silent on the issue whilst some (e.g. in Queensland) specifically prohibit the practice of "contracting out".

7. Insurance implications of contracting out

Most insurance policies contain contractual liability exclusions that exclude any contractual liability assumed by the insured. Some policies include "write-backs" to the effect that the exclusion would not apply to liability that would have attached to the insured in the absence of the contractual agreement.

By "contracting out" of a proportionate liability regime, whether expressly or by implication, a party agrees to assume liability that may be greater than the liability which would have been imposed on it at law under the proportionate liability regime. An insured may therefore be assuming liability that "would not have attached in the absence of the contractual agreement".

Policies that contain the usual contractual liability exclusion with the usual write-back would only cover an insured for the portion of the loss that a court, under the relevant proportionate liability regime, attributes to it because that would be the liability that would have "attached in the absence of the contractual agreement".

Any additional liability a party voluntarily assumes by virtue of having "contracted out" of the proportionate liability regime would be excluded from the insurance policy coverage. Such a party may therefore have a "gap" in coverage. Insurance policies should be reviewed carefully to identify any such financial risk exposures.

Beware of clauses in contracts which allow clients to contract out of their proportionate liability obligations under the Professional Standards Act or any other relevant statute. Consult your professional insurance broker on the implications of signing such contracts.

8. Can I limit my liabilities within a contract? – capped liability schemes

Capped liability schemes started in NSW in 1994, when NSW enacted the Professional Standards Act. The concept is quite simple. Limitation of civil liability should create a stable market for professional indemnity premiums, which will benefit professionals and clients alike.

A key objective is the improvement of professional standards. Capped liability is obviously only relevant when a professional receives a claim that exceeds the amount of available insurance. That professional is required to plead in its defence that they have the benefit of a capped liability scheme. They need to have complied with the disclosure requirements of the scheme (that clients were aware of its existence).

Even where a contract may attempt to limit the liability between the contractor and the named client, it cannot limit the liability you may owe to a third party (such as the final end user of the material you create for the client). For this reason it is highly advisable that contractors maintain adequate insurance professional indemnity cover, even where the client's professional indemnity cover is extended to the contractor. There is often no harm in trying to limit the amount of your liability within a contract, just be aware it is just a further risk management strategy, however, it is not the 'be all and end all' in terms of the dollar amount of liabilities that you may face.

9. Indemnities within contracts – what is appropriate?

Beware clauses which hold the contractor to a higher level of liability than is due at common law, where the contractual liability exceeds professional liability, or where the contractor is liable for losses of the principal whether or not the contractor's performance of the contract was defective.

An appropriate clause:

The contractor shall indemnify the principal against all loss, damages, claims, liability, expenses, payments or outgoings incurred by or awarded against the principal arising directly or indirectly from:

- (a) *any breach by the contractor of this agreement; and*
- (b) *any act or omission (including any negligence, unlawful conduct or wilful conduct) by contractor relating to this agreement or arising as a consequence of the performance or non-performance of the services.*

The liability of the contractor is reduced to the extent that the client or other person(s) caused or contributed to the loss or occurrence which gives rise to a claim.

Under this clause, the professional would not be liable for any loss, damage, injury or death caused or contributed to by the act, omission, direction or negligence of the principal, its servants or agents, or any third party over which the professional does not have direct control. This in turn is much more closely aligned to a professional's own professional liability and does not represent liabilities above and beyond what they may face under common law.





COMMON TRAPS AND THE 'MUST DO'S'

1. Contractual terms to avoid

The following table contains some examples of contractual terms which should be avoided and clauses which would be preferable in their place:

EXAMPLE	RECOMMENDATION
The professional will perform his/her services in accordance with the highest/best/excellent standards of the profession.	The correct standard to be applied is that of a reasonable and competent professional
The professional will prepare complete drawings and specifications and all documents that will enable the contractor to construct the works	Do not allow the Contract to be greater than what is reasonable/standard
The professional will certify that the works have been performed and the materials used and installed, comply with the approved plans and specification	An Architect or Engineer can never be at the site all the time and see everything constructed/installed/built
Indemnity provisions are unlimited/uncapped	Apply a cap to the indemnity provisions of the contract so that the cap is linked to the value of insurance protection in place.

2. Contractual review checklist

- If your potential client is attempting to cap their liability make sure it is reciprocal, otherwise you are prejudicing your Insurer (and possibly your insurance cover).
- Do not agree to hold harmless clauses in contracts.
- Be careful of the 'contracting out' of relevant proportionate liability legislation as you may be jeopardising your insurance cover.
- Be careful with 'limited retainers'. Limitations must be confirmed in writing and state the reasons for the limitations, what you are doing and what you are not doing. (Alternatively, don't be afraid to say 'No' to limited retainers).
- Be sure the contract does not assign you a responsibility you don't want, are not being paid for and do not have the expertise to carry out.
- Be aware of terms in a contract like supervise, guarantee, ensure, indemnify/hold harmless.

3. Common traps which can lead to professional indemnity claims

- Inspection and certification
- You need to clearly state frequency and purpose, be careful about what you are required to certify, only certify matters within your knowledge and avoid language such as "all" and "every".
- Cost estimates
- Avoid them or where appropriate refer either to a Quantity Surveyor or Builder early. Provide a reasonable basis for costing (e.g. per square metre); and watch your language – 'probable cost or 'likely cost'.
- Use of sub-contractors
- If you can have the client retain sub-contractors, ensure your insurance covers you for work done by sub-contractors, ensure the sub-contractor has their own insurance and arrange back to back agreements.
- Outstanding fees

Make sure clients are paid up and ensure your contract gives you rights in respect of non-payment of fees.

4. Things to do:

1. Remember you are the professional adviser – you advise, the client decides.
2. Take time to get to know your client.
3. Communication is the key
4. Get it in writing – keep an organised file, keep clear, accurate and contemporaneous file notes. Get the client to sign off on important instructions, otherwise confirm in writing. Print off emails! To win cases alleging negligence – you need three things – documents/documents/documents!
5. Get organised – keep a diary, not just for appointments. Proper resourcing – you cannot do it all yourself. If you are not organised, hire someone to help get you organised.
6. Get help – if you feel uncomfortable or if you are out of your depth. Get a second opinion on tricky matters, stick with your strengths and develop a referral network. Don't be all things to all people.
7. Checklists – keep a checklist and use it.
8. Keep up to date – clients are entitled to current and informed advice.
9. Things will go wrong – don't panic, get help (don't investigate yourself), notify your insurance broker, gather materials and investigate quickly. Know your rights and look for an early solution.





**Professional
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Australia**

Disclaimer

The subject of legal liability is complex. The information within this Guide is of a general nature only and is not intended for any particular individual.

No consideration has been given to the individual financial situation or particular needs of any person and readers of this Guide should independently assess whether the advice is appropriate to their own circumstances.

Any member who is faced with any of the circumstances noted within this Guide should seek and only act upon advice they obtain that is specific to their circumstances.

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