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CONSULT AUSTRALIA

Driving business success for consulting firms in the built and natural environment

3 December 2018

The Honourable Steven Marshall MP
Premier of South Australia
GPO Box 2343,
ADELAIDE SA 5001

Dear Premier,

RE: South Australian Productivity Commission – Government Procurement Inquiry

Consult Australia is the industry association representing consulting firms operating in the built and natural environment sector. These services include design, engineering, architecture, technology, surveying, and project management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments. We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $42 billion a year.

Consult Australia strongly supports standardisation of procurement practices and documents, alongside simplified, fair liability and insurance requirements – with the inclusion of contractual limits to liability as a measure to provide certainty to industry contracting with government, and one that also will drive efficiency and result in better project outcomes for public sector clients.

In September 2016, the then South Australian Government implemented a major procurement reform strategy aimed at reducing red tape and costs to suppliers by adopting a less complex, more agile procurement framework.

The State Procurement Board played a significant role in developing the policy framework that underpinned the reform strategy, which increased the standardisation of procurement practices and documents across government and simplified the liability and insurance requirements. However, under the current South Australian State Procurement Regulations 2005 (under the State Procurement Act 2004) there is an exemption of building and construction projects above $165K. This means those procurement reforms adopted by the State Procurement Board do not affect those agencies/authorities predominately focused on building and construction projects. This situation sees businesses having to factor in disproportionate levels of project risk, purchase additional insurance and waste time and cost on protected contract negotiations. This benefits neither the health of our sector nor the project objectives of clients and Government.

The exemption of capital projects from the current Government Procurement Inquiry once again denies our sector opportunity to access:

- Collaborative-based approaches to procurement, project management and risk allocation;
- Promotion of safer and more productive delivery;
- best practice on bidding, contracting and procurement streamlined processes and;
- reduced costs.

Consult Australia's recent Model Client Policy calls on all political parties to ensure the governments they lead, or support, will behave ethically, fairly, and honestly in their dealings with the private sector. That is, for them to adopt a Model Client Policy, in line with governments' Model Litigant Policy.

A 'Model Client' works collaboratively with industry to achieve mutually beneficial outcomes and does not use their market power to the disadvantage of local businesses and their employees.

The Model Client Proposal sets out a number of principals including:

Appropriate Risk Allocation

Some public and private sector clients are using their market power to adopt a position that presents systemic risks to the economy and business confidence. When acting as a purchaser, government entities hold significant market power, therefore it is important that their conduct demonstrates Model Client behaviour. This is particularly important given the application of the Competition and Consumer Act to government procurement remains unresolved. A similar position is often adopted by the financial institutions and contractors, reinforcing a culture of inappropriate risk allocation where the burden is placed on professional services firms.

It is important here to highlight that technical capability and risk (e.g. is something designed correctly) is different from project risk. A firm's commercial capacity to cover that risk (e.g. having sufficient assets or capital) is driven by the extent to which the firm has control of the risk.

This culture can make a wide range of consultants liable for the entirety of the losses associated with the project, including in some instances, economic loss which a court may not normally ascribe to professional liability. This may have been a reluctantly tolerated business practice in the past when insurance costs were moderate and availability relatively unrestricted.

Today, and particularly in tougher insurance environments, this inappropriate transfer of risk drives the cost and availability of professional indemnity insurance beyond the capacity of some consulting firms to afford, obtain, and retain cover over the often long-life of the liability exposure. As a result, some professional services firms now choose to avoid government and public sector work where a poor procurement culture persists (such as the contracting out of proportionate liability legislation).

Fairness in Contracting

Onerous contracting is more likely to lead to disputation, as well as lengthier negotiations in the initial phase. Should a risk be realised and liability eventuate, an onerous contract means there will be less incentive for the parties to settle instead of pursuing costly litigation.

The cost of lengthy negotiations and managing onerous contracts, or indeed the cost of disputation and litigation is significant. A 2009 study by the Cooperative Research Centre for Construction Innovation[1] found the cost of disputation to be worth around $7 billion in that year in Australia, adding around 6 per cent to the overall cost of work done. In addition, delays to project delivery could be reduced by 7 per cent through better procurement, according to The Economic Benefits of Better Procurement report.

Onerous and unfair terms such as these should be prohibited from use in government contracts. Governments should adopt a more appropriate approach to risk allocation and liability management. Setting an appropriate limit of liability allows business to properly insure themselves, and makes government a more attractive client to do business with.

This Principle, within the Model, would prohibit the use of such clauses in contracts for consulting services, and prohibit government agencies from using their market power to introduce such terms.

Accessibility and Affordability of Professional Indemnity Insurance

Affordability and accessibility of professional indemnity insurance is critical because unlike other parties involved in infrastructure development, professional service firms are generally an asset poor class of business, with a majority being small and medium enterprises.

Like other professional groups, they provide intellectual services (as opposed to a tangible good), they depend on professional indemnity insurance to cover their common law liability. Indeed, consulting firms generally take

[1] Cooperative Research Centre for Construction Innovation, Guide to Leading Practice for Dispute Avoidance and Resolution, www.construction-innovation.info, 2009, p8

out broad ranging and often expensive insurance policies to cover liabilities arising from their work, and to protect their business and personal assets. For professional services firms, the professional indemnity insurance premium is one of their largest expenses.

In recent contracts, requirements for professional indemnity insurance and public liability insurance amounts are unreasonably high and bear little relationship to the risk profile of the project. This has the effect of increasing costs for consultants when bidding for projects in order to increase the amount of insurance they hold. This again reduces competition because few consultants are able to absorb the cost given that attempts to pass on the additional cost to the potential client renders their bid unattractive.

Adoption of Standard Contracts

The use of standard contracts fairly negotiated between industry and government, with input from relevant stakeholders, reduces the need for costly legal review or negotiations. Such contracts give all parties the comfort of knowing that risk and reward is allocated fairly to avoid many of the negative outcomes described above.

This was the driver behind the development of the Australian Standard Conditions for Consultants AS4122-2010. The negotiation of AS4122-2010 was developed by government and industry representatives who invested significant resources. The objective was to negotiate and agree a fair and balanced contract that would reduce the need for bespoke contracts, and achieve significant cost savings by reducing the need for protracted contract negotiations.

AS4122-2010 has been adopted to some extent, but has yet to achieve its full potential. Regrettably an issue frequently encountered with the use of standard contracts, like AS4122-2010 is the attachment of special conditions. Where agencies do attach special conditions, they need to be aware that they are undermining the benefits of using a standard contract. This is because it re-introduces the need for extended negotiation of the new terms.

While we acknowledge that standard contracts will not be appropriate on all projects (such as, for example, unique major infrastructure projects), we strongly recommend that government agencies use standard contracts on an 'if not, why not' basis, whereby the public service is required to use them unless there is an appropriate reason not to do so that is explained to their industry partners and recorded publicly.

Adoption of Proportionate Liability

In response to the insurance crisis of 2001, a package of reforms including Proportionate Liability Legislation was enacted to replace the doctrine of 'joint and several' liability. Under this old regime, multiple parties may have contributed to the loss suffered by a plaintiff, but any one of them could have be held liable for the total loss, and be required to bear the full cost irrespective of their individual contribution to the loss. Proportionate liability was introduced on the principle that any loss is divided among the parties according to their share of responsibility, as determined by a court. Ensuring that all the parties retain their rights under the Proportionate Liability Legislation will keep the cost of insurance down and maintain stability of access to professional indemnity insurance for professionals.

The persistence of contracting out of proportionate liability creates a significant systemic risk to the procurement of the professional services required to deliver government infrastructure. It also perpetuates a culture of poor risk management resulting in governments:

- Paying higher fees for professional services
- Forcing many businesses to pay expensive additional insurance premiums, if available
- Reducing competition from firms unable to obtain or afford insurance
- Creating an situation where some firms proceed without insurance, often unknowingly
- Reinforcing a culture of poor risk and contractor management, and of inappropriate offloading of risk
- Unnecessarily exposing the economy to future tightening in local and global insurance markets

A copy of the full Model Client Policy is attached to this submission and available for download HERE

Consult Australia would argue that the scope of the South Australian Productivity Commission – Government Procurement Inquiry be expanded to include capital projects as the issues raised in the paper are as relevant in capital works projects as they are general goods and services.

Consult Australia would welcome the opportunity to further discuss any issue raised within this letter, and to discuss how South Australian procurement can be generally improved. Should you wish to contact me, my contact points are below.

Yours sincerely,

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