Insurance Council of New Zealand
PO Box 474 Wellington 6140 Level 7, 111-115 Customhouse Quay
Tel 64 4 472 5230 **Fax** 64 4 473 3011 **Email** icnz@icnz.org.nz
www.icnz.org.nz

ICNZ Insurance Council of New Zealand

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Peter McRae
Senior Legal and Policy Adviser
Law Commission
PO Box 2590
WELLINGTON 6011

By email: jsl@lawcom.govt.nz

Dear Peter

NZLC IP32 - REVIEW OF JOINT AND SEVERAL LIABILITY

The Insurance Council of New Zealand ("the Insurance Council") appreciates the opportunity to comment on the Law Commission's Issues Paper on Joint and Several Liability. The matters discussed in the Paper are of significant interest to our members.

1. Insurance Council of New Zealand

The Insurance Council is the industry representation body for fire and general insurance in New Zealand. The Council aims to assist members in key areas affecting their business through effective advocacy and communication.

The Council currently has 26 members who collectively write more than 95 percent of all fire and general insurance in New Zealand. Insurance Council members, both insurers and reinsurers, are a significant part of the New Zealand financial services system. Our members currently protect more than $0.5 trillion of New Zealanders' assets.

The Insurance Council plays an active role in representing the insurance industry. Our members are licensed under the Insurance (Prudential Supervision) Act 2010 and signatories to the Fair Insurance Code that requires insurers to act ethically. We also perform an important role in informing and educating consumers about key insurance issues and risks.

2. Executive Summary

From an insurance perspective, there would be benefits for some insurance customers in moving towards proportionate liability, but not necessarily for all.

Our members are involved, to varying degrees, with both plaintiffs and defendants through the joint and several liability regime. Insurers act for plaintiffs where they have paid a claim and then bring an action in the name of their customer to recover from the party responsible for the loss. They also act for defendants where their customers have liability policies and are being sued. Some members will have different perspectives on the relative benefits of proportionate liability and/or joint and several liability, depending on their particular customer's experience.

Proportionate Liability would be fairer for some insured persons, as defendants would no longer bear the risk of the 'missing defendant'. This system would place more responsibility on the plaintiff (or future plaintiffs) for the risk in selection of professional persons and may make sense in the construction industry for example where the plaintiff will have control over the selection of contractors and the relevant building contract.

However, proportionate liability would essentially transfer that risk to the plaintiff, which would in turn have potential economic consequences for plaintiffs. Also, proportionate liability would not necessarily counter the root causes of issues such as the leaky buildings and finance collapses. While the leaky building crisis may have been fairer for defendants under proportionate liability, without other systems in place to counter the absentee/insolvent defendant issue there would still be a significant financial gap created and placed on the plaintiff. There is also concern amongst some members as to the potential procedural complexities and costs associated with a shift towards proportionate liability.

There are potential strengths and weaknesses with both systems and divergent views amongst our members. Individual members will be making independent submissions on this point and will provide feedback on what they consider to be the most effective and efficient liability regime for New Zealand going forward.

3. Changes since last review

In our meeting with the Law Commission in May 2012, the Commissioner indicated that the liability environment has changed a lot since 1998 (following the leaky homes crisis, finance company collapses and the Australian joint and several review) and that, accordingly, the Law Commission now had a more open-mind towards possibly moving towards proportionate liability.

Some of our members are of the view that joint and several liability was not responsible for the primary issues surrounding leaky homes or finance company collapses and that proportionate liability would not have necessarily fixed the underlying problems associated with these two significant events.

a) Leaky buildings inappropriate driver

The real issue associated with leaky buildings has been the missing defendant and current limitation periods affecting unrecognised weathertightness issues. This would have been a real issue under both liability systems.

As noted at clause 1.7.2 of the Sapere report (26 April 2011):

> *Overall, we consider that many of the problems claimed to arise from joint and several liability are not actually raised by that rule. Rather, they arise from other factors (e.g. the concern over suppliers and certifiers avoiding liability seems to relate to the duty of care, rather than the rule for apportioning liability) or are not actually occurring*.

There remains limited interest from the private insurance sector in participating in a mandatory home warranty scheme, which would be necessary to the introduction of proportionate liability (note the Sapere report recommendation and the Law Commission's acknowledgement at clause 9.20 of the Issues Paper). Some insurers would be reluctant to

engage in such a scheme due to the lack of data on claims history, the long-tail nature of the business, difficulties in obtaining appropriate reinsurance and the high-risk nature of this industry. This is confirmed by the Australian experience for insurers in this market.

Also, with the implications of the *Spencer on Byron* case, there would possibly be a requirement for a warranty scheme to be extended to commercial properties as well. It seems unlikely there would be sufficient political will to entertain extension of a government warranty scheme to commercial properties as well.

The introduction of proportionate liability would not be retrospective, so any change to the current scheme should focus on potential issues going forward. As noted at clause 5.25 of the Issues Paper, "*a "one off" crisis such as leaky buildings does not provide the best context for analysing or adjusting rules of liability generally, given that even such a major event turns on its own facts including the range of contributing causes referred to in this chapter.*"

b) Finance collapses

Again, the primary issues from the finance collapses cannot be effectively attributed to failings with the current joint and several liability scheme. The real issue with finance collapses has been the relaxed regulation of these industries combined again with the missing defendant issue.

There would conceivably be merit in looking at other ways to ensure a well functioning financial services sector, such as the recent introduction of comprehensive financial adviser legislation. There may also be merit in looking at possibly having a capped liability scheme for some industries going forward, which would again counter the need for proportionate liability.

c) Tort Crisis

In the early 2000's, Australia introduced a comprehensive program of tort law reform, including reforms to establishing liability and the extent of damages, as well as procedural reforms to how cases were presented in the courts:

> *The so-called 'tort crisis' arose from a historically peculiar collection of coincidental events on the international and domestic fronts. These events, namely the collapse of the HIH group, the provisional liquidation of United Medical Protection (Australia's largest medical defence organisation), the destruction of the World Trade Centre, underwriting losses on policies written in the 1990s, falling investment returns, and an increasing tendency for the courts to increase awards for general damages, compounded to give rise to the tort crisis.*
>
> *These events impacted directly on the general insurance industry through increased claims costs and uncertainty regarding the outcome of negligence cases, which in turn affected insurer profitability resulting in higher premiums or withdrawals of cover.*[1]

[1] 'Insurance Council of Australia – Looking Back on Tort Reform' - http://www.insurancecouncil.com.au/media/22971/industry%20in%20focus%20tort%20law%20reform%20271109.pdfn

A similar tort crisis does not currently exist in New Zealand and some of our members question whether proportionate liability would have provided a more effective mechanism for dealing with the above issues.

Nevertheless, some of our members have highlighted that proportionate liability could potentially provide some benefits to the New Zealand liability insurance market, in line with pricing and market penetration benefits experienced in Australia following its reform of tort law.

d) Benefits of Proportionate Liability

There are a number of other prospective benefits of proportionate liability.

Some of our members feel that proportionate liability would be much fairer on defendants, as it moves the financial risk of defendants' insolvency or restricting of assets through trusts and corporate structures to the plaintiff rather than the defendant that has deepest pockets and is still trading.

Proportionate liability would place more responsibility on the plaintiff (or future plaintiffs) for the risk in selection of their contractors. For example, in the construction industry the plaintiff is likely to have more control over the selection of contractors and the building contract, so there is arguably benefit in having the plaintiff take responsibility instead of another contractor that has no contractual involvement with the other defendants.

Homeowners are also in a good position to ensure that building contracts fairly allocate risk and that other means of protection are considered - such as warranties from suppliers, insurance of contractors or bonds to secure performance. However, it is important to note that subsequent purchasers may not be in this same position.

Some members are concerned that builders, developers and other contractors have little incentive to ensure they hold appropriate insurance or hold assets to meet any potential claims as they know plaintiffs (and other defendants) will not pursue them if they are insolvent or impecunious. There is concern that it is unfair for the burden of a missing defendant to fall entirely on a solvent defendant.

4. Status of current Australian model/Closer Economic Relations

In order to achieve the ambition of closer economic relations, joint and several liability would need to be changed to proportionate liability. However, there may be some issue with regulatory harmonisation in this respect.

Although all current Australian states maintain some form of proportionate liability, there is certainly not regulatory harmony between all states. Accordingly, this raises a question as to what exactly it is New Zealand would propose to harmonise with. The Law Commission would need to fully consider this before implementing any new liability regime.

Some members also question whether harmonisation would lead to increased efficiencies between New Zealand and Australia. In terms of the insurance industry, each country has distinct markets and products, meaning Australian systems cannot simply be transplanted directly into New Zealand. Clause 6.23 of the Issues Paper suggests that transaction costs should reduce as a result of efficiencies from harmonisation between New Zealand and

Australia on proportionate liability. However, for the reasons noted above (and below at section 5), this would not necessarily be the case for the insurance industry.

The Australian Tort Crisis, which led to the review of joint and several liability, is certainly not comparable to the current insurance environment in New Zealand. Comprehensive professional indemnity insurance is widely available in the New Zealand market, on a competitive basis, and following the Canterbury earthquakes there has been increasing trends towards parties taking up greater amounts of comprehensive professional indemnity and general liability insurance. Nevertheless, as noted above, there could be some potential benefits for the New Zealand liability insurance market.

5. Cost of liability insurance unlikely to decrease in the short-mid term

The issues paper suggests there would likely be decreased costs for consumers, in respect of professional indemnity insurance, if proportionate liability was introduced. This is based on a presumption that there would be a wider spreading of risk amongst a greater number of potential defendants. However, pricing would likely remain the same for such cover, at least until there was sufficient data to evidence a reduction in claims.

The same issue would likely occur with reserving. Some commentators have suggested that insurers would be able to reserve lower amounts if proportionate liability were introduced, because of a greater sharing of risk leading to lower amounts of capital needing to be held for long periods, and subsequent decreases in insurance costs. However, insurers would continue to reserve appropriately until sufficient facts and data evidencing reduced exposure became known, meaning any potential reduction in premium would take many years to come through.

6. Procedural concerns

The Australian experience indicates there could be potential issues under proportionate liability with court processes.

As noted by Hon. Justice Cameron Macaulay:

- *Proportionate liability does make a piece of litigation more complex – particularly getting the pleadings right, as there may have to be several layers to the contribution/apportionment pleadings.*
- *More parties are being joined to proceedings. Interestingly, as many are being joined by defendants as plaintiffs. This adds to the length and costs of proceedings – not only at interlocutory stages, but also at trial. So it is a management issue for the Courts.*
- *These issues have contributed to increased legal costs...*[2]

Further, as noted in a recent NZ Lawyer article:

> *The proportionate liability regime encourages the joinder of all parties who may have liability, as the plaintiff will generally seek to recover all of its loss. The inclusion of*

[2] Clause 77 – 'Proportionate Liability – Is it achieving its aims?' - http://www.austlii.edu.au/au/journals/VicJSchol/2010/35.pdf

> *many more defendants in civil claims is likely to have an effect on court resources and the length, complexity, and cost of the litigation.*[3]

This could be an issue for both the plaintiff and the defendant in New Zealand and is something the Law Commission should be aware of.

However, one member has noted that the increased costs for joining all parties is uncertain as defendants already seek to join other parties to proceedings where available at the moment. Also, the current joint and several liability rule (along with the procedural aspects of joint and several liability) allows and encourages plaintiffs to join insured defendants that are only marginally liable or not liable at all, to protect the plaintiff. This cannot necessarily be said to be a more procedurally efficient or effective outcome.

7. Capped liability

The Issues Paper also discusses the possibility of allowing capped liability for particular professions. While capping would make sense for some industries, such as auditors because of the scope of their liability and the importance of their industry to the economy, this would not necessarily be the case for all professional industries.

There is reluctance from members towards supporting widespread liability caps for all professional industries as there are issues around which professional bodies would be deemed appropriate. Insurance drives behaviour and there is concern that, in some circumstances, capped liability could lead to lower levels of professional care and perception of responsibility.

It would also add complexity, as insurers would need to develop more complicated pricing mechanisms for different professionals.

8. Absentee defendants

At our May meeting, we also discussed the possibility of creating some residual existence for liquidated companies, to counter the missing defendant issue. This would allow creditors to still seek some form of compensation from liquidated companies and would potentially go some way towards alleviating the missing person issue. For some of our members this is one of the biggest issues with joint and several liability, as this exposure is moved to parties other than the plaintiff that selected the company which became insolvent.

This approach may have some merit, however, this would certainly need to be looked at as a separate issue and there is currently no industry consensus on such a proposal at this stage.

9. Conclusion

Thank you again for the opportunity to provide input on the Issues Paper.

As discussed above, there are potential strengths and weaknesses with both systems and divergent views amongst our members. Individual members will be making independent submissions on this point and will provide feedback on what they consider to be the most effective and efficient liability regime for New Zealand going forward.

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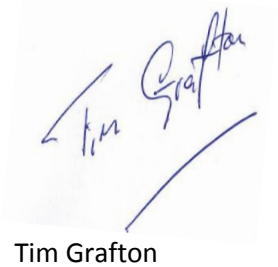
[3] 'Law Commission to reconsider joint and several liability' - http://www.nzlawyermagazine.co.nz/Archives/Issue173/173F8/tabid/3832/Default.aspx

We are happy to discuss our submission in more depth. Please contact Simon Wilson on (04) 472 5230, or at simon@icnz.org.nz, to discuss.

Yours sincerely



Tim Grafton
Chief Executive

Simon Wilson
Regulation and Legal Manager