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Public Liability

by

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CONTENTS

EXECUTIVE SUMMARY

BACKGROUND 1

PUBLIC LIABILITY – WHAT IS IT? 4

COMMON LAW -TORT LAW OF NEGLIGENCE	4
PUBLIC LIABILITY AND SPORT	4
PUBLIC LIABILITY AND LOCAL COUNCILS.....	7
PUBLIC LIABILITY AND COMMUNITY ORGANISATIONS.....	8
LIMITATION ON NEGLIGENCE ACTIONS	8

PUBLIC LIABILITY INSURANCE..... 8

GENERAL INSURANCE INDUSTRY	9
PROFITABILITY OF PUBLIC AND PRODUCT LIABILITY.....	10
INCREASE IN PREMIUMS	12
FACTORS CONTRIBUTING TO AN INCREASE IN PREMIUMS	12
<i>The Insurance Council of Australia view</i>	12
<i>The Australian Plaintiff Lawyers Association view</i>	13
<i>The view resulting from the Ministerial Meeting on Public Liability – 27 March 2002</i>	14
<i>Increase in number and size of claims</i>	14
<i>A litigation explosion?</i>	17
<i>September 11</i>	21
<i>Underpricing premiums</i>	22
EXACERBATING FACTORS	22
<i>Tax on premiums</i>	22
<i>Conditional costs agreements (‘no win/no pay’ litigation) and advertising</i>	22
<i>Collapse of HIH</i>	26

REFORM POSSIBILITIES 26

EXAMPLES FROM OVERSEAS JURISDICTIONS	26
<i>National no-fault compensation schemes</i>	26
<i>Statutory immunity for local councils</i>	26
STAKEHOLDER PROPOSALS	27
<i>ICA</i>	27
<i>Association of Plaintiff Lawyers</i>	27
<i>Federal Government</i>	28
<i>NSW Government</i>	28
<i>Local Government Association</i>	29
OUTCOME OF NATIONAL MINISTERIAL MEETING 27 MARCH 2002	29

APPENDIX A - Joint Communique Ministerial Meeting on Public Liability, 27 March 2002, Canberra

APPENDIX B - ICA Submission to National Ministerial Meeting, pp8-11

APPENDIX C - APLA Submission to National Ministerial Meeting, pp7-14

APPENDIX D - Appendix 2 of Kehl’s paper: Liability Insurance Premium Increases: Causes and Possible Government Responses

EXECUTIVE SUMMARY

There has been a high level of concern expressed over public liability insurance premiums in the past few months. It has been reported that there have been premium rises of up to 400% and higher in some areas, with sporting and community groups, and businesses which offer adventure tourism, being particularly affected. It has also been reported that the flow on effects of such increases have been disastrous for such groups who have curtailed activities or ceased operating altogether.

There have been numerous calls for reform, from Members of Parliament, community groups and media commentators.

The result of the increasing pressure to put in place reforms to alleviate spiralling premiums has been: a national ministerial meeting, convened by the Federal Minister for Revenue and Assistant Treasurer Senator Helen Coonan, which was held on 27 March 2002 to investigate causes and possible solutions to the present situation; an agreement to meet again in May 2002; an announcement of a Senate *Inquiry into the Impact of Public Liability and Professional Indemnity Insurance Cost Increases*. The NSW Premier, Bob Carr, has also announced a range of measures to tackle the problem.

Following the national ministerial meeting on 27 March 2002, there has been a strengthening of the debate by key stakeholders about the precise causes of the premium increases. Whilst there is agreement that premium increases have occurred and this is impacting heavily on the community, particularly sporting groups and not-for-profit community organisations, there is considerable disagreement by the key stakeholders over the exact causes of premium increases and therefore a difference of opinion over what form reform should take.

The debate has centred on whether or not insurers have been ‘unfairly’ raising premiums due to poor investment returns coupled with underpricing of premiums or whether in fact there has been a rise in claims, or rise in the cost of claims, and a litigation explosion which has led to the current crisis.

There are many complex factors given as causes to the current situation. Key stakeholders disagree or emphasise certain factors as being more significant or central than others.

A key concern that has emerged in the debate is that any proposals for reform should bear in mind that the key causes have yet to be explored in full or are hotly contested. In particular, it has been argued that major changes to the tort law system, including changes to the definition of negligence, should not be made without exploring such causes in full.

Section 1 outlines what public liability is and looks at the common law of negligence. It also looks at negligence in the context of sport, local councils and community organisations. (pp 4-8)

Section 2 briefly explains public liability insurance, what it is, what it covers. It also gives

a brief overview of the general insurance industry and its profitability and factors which will effect or impact on the profitability of insurance companies, such as reinsurance costs. It more also looks at the factors which have contributed to the increase in public liability insurance premiums and outlines the competing views of key stakeholders in this area. It then explores in more detail the competing arguments with respect to the key factors raised by the stakeholders. (pp 8-26)

Section 3 looks at reform possibilities. (pp 26-29)

BACKGROUND

There has been a significant level of concern expressed recently in the community and in the media over escalating public liability insurance premiums. In particular, sporting organisations and clubs, and small businesses who specialise in high risk sporting activities have claimed that their business activities are being adversely affected by significant premium increases.¹ The rise in premiums has led to such groups limiting (or not offering) certain activities and events (sporting or otherwise). Many examples have been reported in the media.² These range from fetes to a recent report that some Anzac Day events may have been threatened.³

The precise factors which are responsible for premium increases are disputed. Different stakeholders have differing views. The Insurance Council of Australia (ICA) refers to a combination of factors as being responsible for the increase in premiums, with the main cost driver being an increase in the number and size of claims over recent years - from 55,000 claims in 1998 to 88,000 claims in 2000, an increase of 33,000 claims.⁴ The ICA and others also point to further external cost drivers such as: rising costs of reinsurance which is associated with global catastrophic events such as September 11; the collapse of HIH; increase in litigation and associated legal costs; as well as exacerbating factors such as 'no win/no pay' advertising by lawyers.

However, a community group support network disputes the ICA's contention that claims have increased.⁵ A survey conducted by them found that out of 700 groups surveyed 96%

¹ Many examples have been reported in the media. A recent example reported by Sport Industry Australia is that Gymnastics South Australia has had a premium increase from \$12,000 in 2000 to \$36,000 in 2001: Sport Industry Australia, "Spiralling insurance premiums spells danger for sport participation", <http://www.sportforall.com.au/latestedition/latest8.html> (accessed 1/2/02). Another example is that Scouts NSW is facing increases of between 85 per cent and 165 per cent this year. It is reported that the "2000 premium is expected to cost between \$383,000 and \$507,000...[whilst]...in 2000 it was \$93,000": "Insurance costs crippling us, say sport groups", *Sydney Morning Herald*, 19/12/01, p 4.

² "NSW: Public liability industry in crisis: Debus", *AAP*, 15/3/02; "Liability lawyers earn Howard's wrath", *Sydney Morning Herald*, 15/3/02; "Sheer volume of claims pushing up insurance costs - Carr", *AAP*, 12/3/02; "Insurance likely to produce more pain", *Sydney Morning Herald*, 26/2/02, p 24; "Risky business", *Sydney Morning Herald*, 26/1/02, p 23; see also the *Australian Financial Review* on 24/1/02 and 25/1/02 for several articles on this issue; "Insurance costs crippling us, say sport groups", *Sydney Morning Herald*, 19/12/01, p 4; "Insurance premiums to soar by \$1 billion", *Sydney Morning Herald*, 11/12/01, p 1.

Due to the topicality of this issue, there is a large amount of material (particularly media) being generated daily. For the purposes of this briefing paper, only media coverage to 4 April 2002 is referred to.

³ "NSW: Carr to convene insurance meeting over liability crisis", *AAP*, 18/3/02.

⁴ ICA, "ICA raises public liability options", *Briefings*, December 2001. See also *Ourcommunity.com.au*.

⁵ "Survey finds no evidence for rising premiums", *AAP*, 25/3/02.

had not lodged a claim in the past 5 years.

Further, key legal stakeholders such as the Australian Plaintiff Lawyers Association (APLA) dispute the contention that there has been an increase in litigation, and also question whether there has, in fact, been an increase in claims.

The competing arguments and views will be explored further below. (pp 14-21)

Whilst the precise causes of premium increases are yet to be explored in full, the impact of such increases is being strongly felt by the community. There have been virtually daily reports in the media about event cancellations and business closures. These include community run events such as street fairs, country fairs, other celebrations, and sporting activities. For example.⁶

- Cancellation of Australia Day celebrations in Victoria Park, Dubbo – due to 5 fold increase in public liability costs.
- Sale of 27 bed backpacker hostel in Katoomba – due to premium increases of 300 per cent.
- Cancellation of the bridge to bridge race on the Hawkesbury river.⁷
- Cancellation of King St Fair in Newcastle – due to high public liability insurance premium quotes for the event which were between \$8500 and \$20000.⁸

Members of both the federal and NSW Parliament have increasingly called for this issue to be addressed⁹, and many proposals have been put forward.

Earlier in the year, the federal Minister for Small Business, Joe Hockey MP initially called for a national compensation scheme similar to that which operates in New Zealand.¹⁰ He stated that “There is a systemic crisis in public liability insurance right across Australia, and the only solution is to look at rebuilding the common law litigation system.”

⁶ For a comprehensive list of recent cancellations or threatened activities see Death of Fun: As politicians plan another talkfest, community spirit is dying before our eyes; *The Daily Telegraph*, 8/3/02, p 1. This article lists 50 such activities which have either been cancelled or are under threat of cancellation.

⁷ op. cit. n 2

⁸ Public liability cover kills fair; *The Newcastle Herald*, 2/11/01, p 2.

⁹ See, for example, the following media releases and NSW parliamentary debates and articles: M Egan MLC, Treasurer, Public Liability Insurance; *Media Release*, 26/3/02; B Carr MP, Premier, Public Liability Insurance; *Media Release*, 20/3/02; M Egan MLC, Treasurer, Public Liability Insurance; *Media Release*, 21/2/02; D Gay MLC, Time for State Government to move on Public Liability, *Media Release*, 22/1/02; *NSWPD (LA)*, 21/3/02, p 961; *NSWPD (LA)*, 20/3/02, p 828; *NSWPD (LA)*, 19/3/02, pp 683, 689; *NSWPD (LA)*, 27/2/02, pp 54, 82, 85; *NSWPD (LA)*, 15/11/01, p 18705; *NSWPD (LA)*, 25/10/01, p 18053; *NSWPD (LA)*, 23/10/01, p 17762; *NSWPD (LC)* 14/3/02, p 485; *NSWPD (LC)* 13/3/02, p 294; *NSWPD (LC)* 14/11/01, p 18510; *NSWPD (LC)* 28/11/01, p 18947; *NSWPD (LC)* 13/11/01, p 18422; Ministers at odds over liability insurance plan; *The Australian*, 23/1/02, p 2; Hockey puts premium on risky business; *The Australian*, 22/1/02, p 14.

¹⁰ Crackdown on injury payouts; *Australian Financial Review*, 21/1/02,

On 27 February 2002 the NSW Premier, Bob Carr, announced reform (effective from 1 April 2002) which would restrict lawyers advertising for personal injury cases:

...today I can announce that the Government is introducing restrictions on lawyers advertising for personal injury matters to take effect from 1 April...The rules that we propose will stop lawyers advertising personal injury services on television, on radio and in hospitals.¹¹

At the same time, the Premier stated that the insurance industry also needed to review its own practices:

The industry should ensure that current prices are not an overreaction to the collapse of HIH and to what happened on 11 September. The industry should give rational quotes for public liability insurance, based on the risk involved. At the very least, insurers should explain clearly to customers why their individual risk circumstances may not be relevant.¹²

The Premier more recently announced a package of proposed further measures as follows:

- capping general damages – possibly at \$350,000 (which is the level that applies to health care claims)
- capping damages for loss of earnings – possibly at \$2,712 (which is the level that applies to motor accidents and health care claims)
- making lawyers liable for costs in “speculative unmeritorious claims”
- a review of contingency fee arrangements
- introduction of thresholds so as to preclude small claims
- modifying the common law test for negligence in certain areas¹³

As has been noted by the Premier and others, reform in this area needs to be addressed on a national and uniform basis in order to have an impact on premium increases.

The federal Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, called for a national meeting to take place to deal with the public liability insurance issue. The meeting was held 27 March 2002 and investigated accessibility and affordability of public liability insurance as well as canvassing options for reform. Outcomes of the meeting will be explored further below. The Ministers have agreed to meet again in May 2002.¹⁴

On 20 March 2002, the Commonwealth Senate referred an *Inquiry into the impact of public liability and professional indemnity insurance cost increases* to the Senate Economics

¹¹ NSWPD (LA), 27/2/02, p7.

¹² NSWPD (LA), 27/2/02, p7.

¹³ B Carr MP, Premier, Public Liability Insurance,” *Media Release*, 20/3/02; “States study plan to cap public liability payouts,” *Australian Financial Review*, 21/3/02, p43.

¹⁴ Ministerial Meeting on Public Liability *Joint Communique*, 27/3/02, Canberra.

References Committee. The Committee is due to report by 27 August 2002 and has called for submissions. The closing date for submissions is Monday 13 May 2002.¹⁵

PUBLIC LIABILITY –WHAT IS IT?

Common law –tort law of negligence

Public liability falls within the common law area of tort law. Under the tort law of negligence an individual, business or organisation can be sued for negligent acts or omissions which result in the injury or death of a person or damage to their property. Sporting participants, groups, organisations and businesses can be liable on a number of fronts within tort law (or other areas of the common law such as criminal law) but the common area concerned is that of negligence. In addition occupiers or owners of sporting premises or other recreational facilities can be liable under the area of occupier's liability.¹⁶

In order to be liable for an action in negligence, 3 elements must be established:

- that the plaintiff owed the defendant a duty of care;
- that the duty was breached; and
- and that there was ensuing damage or injury as a result of the breach.

In order to obtain relief under the common law, a plaintiff must establish: first, that the defendant owed the plaintiff a *duty of care*; second, that they did in fact *breach* that duty by some *act or omission*; and finally, that this breach resulted in *injury* to the plaintiff and that there is sufficient *proximity* to establish the *foreseeability* of the damage or injury.¹⁷ Even though actions for negligence must pass a 'reasonably foreseeable' test which will rule out damage that is too remote, in past cases it is evident that the test can be applied narrowly or widely. In an action for negligence the *kind* of damage suffered by the plaintiff must be foreseeable, not the actual damage (or its extent).¹⁸

Public liability and sport

Historically, negligence actions were not always open to athletes or other participants in sport with respect to injury caused through their sporting activities. This was in recognition of the fact that sport contained certain inherent risks. However, this is no longer the case following the High Court decision in *Rootes v Shelton*¹⁹. The High Court held that just

¹⁵ CPD (Senate), 20/3/02, p 1111.

¹⁶ Occupier's liability falls within the mainstream law of negligence: *Australian Safeway Stores Pty Ltd v Zaluzna* (1987) 162 CLR 479. For a detailed discussion on Occupier's liability, Participants and Volunteer's liability, liability of sporting organisation, coach's and supervisor's liability, liability for equipment and liability for first aid and emergency services see the following looseleaf service: *Laws of Australia*, LBC, title 32 Sport & Leisure, 32.4 Liability.

¹⁷ per Deane J., *Jaensch v Coffey* (1984) 155 CLR 549

¹⁸ *Hughes v Lord Advocate* (1963) AC 837

¹⁹ (1967) 116 CLR 383.

because an injury occurred in the context of sport or a game this was not sufficient to exclude it from the operation of the laws of negligence; and that simply because an activity contained certain inherent risks this did not eliminate a duty of care.

The case of *Rootes v Shelton* concerned a water skier who was severely injured following a collision with a stationary boat. He sued the driver of the towing boat for failing to take due care in the control of the boat and for failure to warn him of the presence of the stationary boat (which is apparently usual practice). In this decision the High Court overturned the decision of the Supreme Court (Court of Appeal Division) which held that the driver of the boat owed no duty to the plaintiff as they were both participants in a sport who accepted the risks of injury which might be involved in taking part in it. Chief Justice Barwick stated that this decision was in error and that:

By engaging in a sport or pastime the participants may be held to have accepted risks which are inherent in that sport or pastime: the tribunal of fact can make its own assessment of what the accepted risks are: but this does not eliminate all duty of care of the one participant to the other. Whether or not such a duty arises, and, if it does, its extent, must necessarily depend in each case upon its own circumstances. In this connexion, the rules of the sport or game may constitute one of those circumstances: but, in my opinion, they are neither definitive of the existence nor of the extent of the duty...²⁰

Chief Justice Barwick further stated:

No doubt there are risks inherent in the nature of water skiing, which because they are inherent may be regarded as accepted by those who engage in the sport. The risk of a skier running into an obstruction, which, because submerged or partially submerged or for some other reason, is unlikely to be seen by the driver or observer of the towing boat, may well be regarded as inherent in the pastime...But neither the possibility that the driver may fail to avoid, if practicable, or, if not, to signal the presence of an observed or observable obstruction nor that the driver will tow the skier dangerously close to such an obstruction is, in my opinion, a risk inherent in the nature of the sport.... There was, in my opinion, no evidence that any of the risks to which I have referred were inherent in the sport.²¹

Duty of care in the context of sporting events

A duty of care can be owed by:

- athletes or other participants in the sport
- volunteers
- coaches

²⁰ op. cit. para 6.

²¹ op. cit. para 7

- trainers
- sporting organisations (directly or vicariously)²²

A duty of care can be owed to many, including: other athletes or participants (be they amateur or professional); volunteers; coaches; trainers; spectators or anyone who is injured as a result of the sporting activity.²³

Occupiers' liability and sport

In addition, occupiers and owners of sports premises can be liable through occupier's liability.

What kind of considerations are encompassed by a duty of care? What kind of duty is owed?

With respect to occupiers and owners of land a duty extends to:

- maintaining safe premises (eg on playing fields²⁴ or surrounding areas near playing fields²⁵)
- providing adequate warnings²⁶ - it should be noted that warning signs do not necessarily exempt an occupier from their duty to provide safe premises²⁷ - an adequate warning sign is one which refers to the specific risk
- protecting spectators from injury from either a sporting participant or other spectators.²⁸ (this would require the organisation of appropriate security relevant to the risk).

What kinds of injury have been held to be reasonably foreseeable?

²² *Rootes v Shelton* (1967) 116 CLR 383. Note: a recent High Court case has stated that the duty does not necessarily extend to rule making bodies who are responsible for making rules for sport - Undertaking the function of participating in a process of making and altering the rules according to which adult people, for their own enjoyment, may choose to engage in a hazardous sporting contest, does not, of itself, carry with it potential legal liability for injury sustained in such a contest.²³ *Agar v Hyde* [2000] HCA 41 (3 August 2000).

²³ Note: this duty has been held to extend to a developing foetus. The case of *Lynch v Lynch* (1991) 25 NSWLR 411 held that a duty of care extends to an unborn, and may be breached by a mother who engages in conduct that results in injury. Whilst this case did not specifically deal with the question of injuries arising through sport the NSW Supreme Court stated "it is possible that a foetus may sustain injury as a consequence if the mother is engaging in competitive sports or in dangerous activities such as abseiling" (Clark JA at 414)

²⁴ *Nowak v Waverley Municipal council* [1984] Australian Torts Reports 80-200

²⁵ *Staines v Commonwealth* [1991] Aust Torts Reports 68,974 (¶ 81-106)

²⁶ For example warning of deep or shallow water. In the case of *Wyong Shire Council v Shirt* (1980) 146 CLR 40, a Council was found to be in breach of its duty of care because it did not provide a clear enough sign. A sign reading "deep water" was erected and this was found to liable to misinterpretation by the water skier in question. The plaintiff suffered serious head injuries as a result of falling into shallow water.

²⁷ *Mutual Life & Citizens' Assurance v Evatt* (1968) 122 CLR 556

²⁸ *Hackshaw v Shaw* (1984) 155 CLR 614

Although the kinds of injury which will be found to be reasonably foreseeable depend on the particular facts of each individual case, in the past the kinds and scope of injury which have been found to be foreseeable are quite wide: for example injuries to spectators - eg a spectator who was hit by a car at a motor race when it lost control and went through a barrier.²⁹

Public liability and local councils

Local councils are faced with a great degree of exposure to negligence actions and public liability claims. This is because of the wide range of services and facilities provided by councils which the general public comes into contact with or uses on a daily basis.³⁰

The facilities provided to the public also generally include a high proportion of recreational and sporting facilities, including: playgrounds, swimming centres, sporting grounds, child care facilities, community centres and libraries. These sporting facilities can carry a greater degree of exposure because sporting activities contain more risks than other types of activities.

In addition to the above services and facilities, local councils are usually responsible for maintaining infrastructure which is continually used by the public such as footpaths and roads. The responsibility for maintaining such infrastructure further increases councils' potential exposure, particularly in light of the recent High Court case of *Brodie v Singleton Shire Council* which abolished the immunity of highway authorities from legal action. Prior to this decision, highway authorities were not required to exercise statutory power to maintain roads, or associated, works.³¹

²⁹ *Australian Racing Drivers' Club Ltd v Metcalf* (1961) 106 CLR 177 at 184

³⁰ For a detailed treatment on the issue of public liability and local councils see: Parliament of New South Wales, Report of the Public Bodies Review Committee *Public Liability Issues Facing Local Councils*, November 2000. See also the seminar papers in Legal and Accounting Management Seminars (LAAMS), *Liability of councils and statutory authorities*, 2001, especially: Hyde C, Non Feasance –The High Court Overturns 50 Years of Settled Law; Concannon T, Ghantous –A Plaintiffs Perspective; Jamieson R, Impact of Recent Cases; Connell D, Risk Management for Local Authorities & Statutory Instrumentalities"

³¹ See: *Hughes v Hunters Hill Municipal Council* (1992) 29 NSWLR 232; and *Brodie v Singleton Shire Council* [2001] HCA 29 (31 May 2001). In the case of *Brodie v Singleton Shire Council* the High Court abolished the long established principle of immunity for highway authorities against negligence actions (the highway rule) and replaced it with the ordinary principles of negligence. The High Court refers to the definition by Dixon J in the case of *Buckle v Gorringe* (1936) 57 CLR 259 at 281, in which:

The "highway rule" is said to be that, "by reason of any neglect on its part to construct, repair or maintain a road or other highway", a "road authority" incurs "no civil liability".

The majority noted that the principle, as developed in cases, has many exceptions and qualifications which so favour plaintiffs as almost to engulf the primary operation of the immunity"thus rendering it ineffective. [para 67] They also criticised the rule in that it had developed in such a way that gave rise to "illusory distinctions"such as, an authority could escape liability if it had never attempted to repair a road or structure in question (non-feasance) but if it was repaired and the repair was problematic then they could be held liable (misfeasance) [para 86]. This distinction provided no incentive for authorities to take positive

Whilst local councils perform a variety of statutory functions³², the main areas which increase councils' exposure from a public liability point of view are those functions outlined above which relate to the councils "...role as a landowner, occupier of land or provider of services and facilities". Indeed the "...cost of claims against councils arises predominantly from bodily injury to members of the public involved in accidents on footpaths, roads, beaches, rivers, cliffs, in parks, playgrounds, community halls, swimming pools and other sporting and leisure facilities."³³

Local councils have been affected by high premium increases. It has been reported that some local council premium increases have more than doubled in cost in the past three years, including Wollongong City Council which had a premium rise from \$400,000 in 1999 to \$1,132,000 in 2002.³⁴

Public liability and community organisations

Community organisations can face exposure to public liability claims when undertaking or organising events which involve public participation. Like sporting groups, local councils, businesses or others, community organisations need public liability insurance to indemnify themselves from exposure to claims.

Limitation on negligence actions

In Australia there is no statutory scheme which limits damages payouts for general negligence actions, although the Premier has recently announced a reform package which includes a proposed cap on damages.

PUBLIC LIABILITY INSURANCE

Public liability insurance covers those insured from damages payouts relating to tortious acts committed against third parties which result in injury, death or damage to property. Public liability insurance is referred to as 'long tail' business which means that there can be a considerable gap in time between when a policy is written (ie when a policy is taken out) and the time in which the financial outcome of a claim is fully known. It also implies that the nature of compensable loss may not be fully known for a significant period.

It is useful to briefly survey the general insurance industry in Australia (as opposed to life insurance) and its profitability before looking at the precise causes of public liability premium increases specifically.³⁵

action"to repair dangers. Note: the Premier, Bob Carr MP, has announced that the NSW Government will revisit this decision to remove immunity for highway authorities. *NSWPD (LA)*, 20/3/02, p 32.

³² These statutory functions are enumerated in many pieces of legislation.

³³ *ibid.* n 30, p 13.

³⁴ "Some NSW activities hit by public liability insurance problems", *AAP*, 22/3/02.

³⁵ For a thorough profile of the insurance industry see: ACCC, *Insurance Industry Market Pricing Review*, March 2002. It is available at <http://www.accc.gov.au>.

General Insurance Industry

As noted by Kehl in his paper *Liability Insurance Premium Increases: Causes and Possible Government Responses*,³⁶ general insurance companies' revenue can come from a variety of sources - from operating activities (insurance premiums and claims on reinsurance contracts) and from investment activities. Expenses can include (among other things) claims, reinsurance premiums and administrative costs.

The profitability or performance of general insurance companies can be measured in a variety of ways. It is usually measured by the underwriting result (which is premiums minus the cost of reinsurance, claims and other expenses).³⁷ The underwriting result can then be offset by any investment income to get a clearer picture of the overall profitability of general insurers.

Reinsurance is a key component of insurance as it affects the underwriting result of a company and hence its profitability. Reinsurance refers to the act of ceding or sharing risk with insurance providers for a cost.³⁸ It is common practice for insurers to share/spread their risk by entering into contracts with reinsurers - who are often international companies.³⁹ This is because the act of retaining all of the risk for the insurance they sell could have a detrimental impact on their profitability and also impact on their ability to pay claims.⁴⁰

³⁶ Kehl D, 'Liability Insurance Premium Increases: Causes and Possible Government Responses', *Current Issues Brief No. 10 2001-02*, Commonwealth Department of the Parliamentary Library, p 2.

³⁷ The underwriting result is a 'traditional measure for determining the profitability of a general insurer. This is the surplus or the deficit that emerges after reinsurance cost, unearned premiums, claims expenses and underwriting expenses applicable to a period are deducted from premium revenue, net of reinsurance recoveries' HIH Royal Commission, 'Glossary of common insurance and reinsurance terms, concepts and acronyms', *Background Paper No 5*, November 2001, p 17.

³⁸ The *Butterworths Australian Legal Dictionary* defines reinsurance as 'A contract of insurance taken out by the original insurer (the reinsured) with another insurer (the reinsurer) to indemnify the reinsured against liability or payments under the original or underlying contract of insurance. Reinsurance may be taken out against the risk of having to pay a particular claim (facultative reinsurance) or claims related to a particular class of business (treaty insurance).'*[Butterworths Australian Legal Dictionary, 1997, p 1003]*

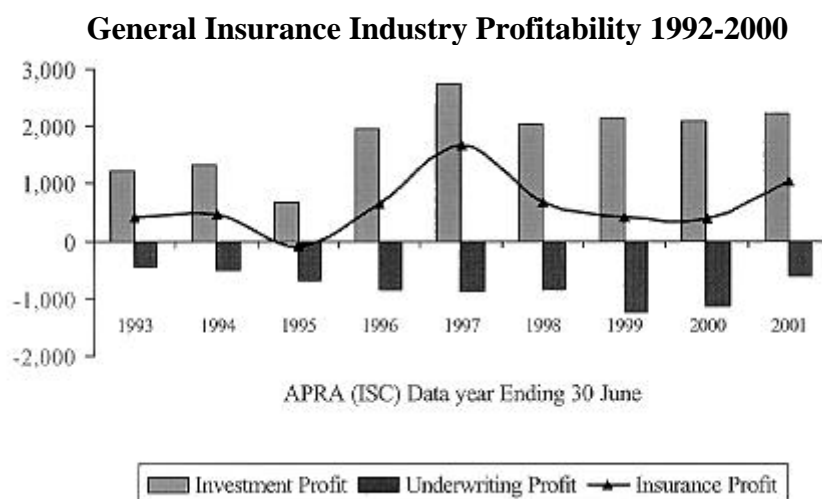
³⁹ The reinsurance market accordingly, is an international market: Australian Competition and Consumer Commission, *Insurance Industry Market Pricing Review*, March 2002, p 31. This is the reason why international catastrophic events can have an impact on the Australian domestic insurance market.

⁴⁰ As noted by Stenhouse R "...the economic incentive to use reinsurance to mitigate risk is basically one of capital efficient management of the loss exposures. The capital required by a reinsurer (or panel of reinsurers) to adequately cater for the risks of a combined reinsured risk pool is commensurately lower than the collective capital requirements of the primary insurers if, in the alternative, they retained the gross risk to their own account" Stenhouse R with the ICA, 'Background Paper -Reinsurance', *Submission prepared for the HIH Royal Commission*, January 2002.

As noted by Kehl, over the past decade:

The Australian general insurance industry made underwriting losses throughout the 1990s. For every dollar it received in premiums, it paid out more than a dollar in claims and expenses. Australian general insurers, like the rest of the world insurance industry, offset underwriting losses with investment income...hence industry profitability is driven by investment returns. During the 1990s, underwriting losses have been more than offset by investment income, enabling insurers to return overall profits while losing money on insurance business. Overall profits are sensitive to fluctuations in investment income such that industry has been generally dependent over the past 5 years on investment returns for profitability.⁴¹

The following table⁴² shows the general insurance industry profitability for the past 9 years.



Source: ACCC, *Insurance Industry Market Pricing Review*, March 2002, p 23.

Profitability of Public and Product Liability

The ACCC outlined the profitability of public and product liability insurance in their report, *Insurance Industry Market Pricing Review*, released in March 2002. Public and product liability figures are grouped together as there are no separate figures listed either by the ACCC or APRA. The following chart, from the ACCC report, shows the overall profitability of public and product liability in the past 9 years. A table contained in the ACCC report indicates that the overall performance for public and product liability is low, and its recent performance and its outlook are very low. They note that very low "...indicates that the return on capital invested may be at an unsustainable level suggesting intervention to either increase premiums (perhaps selectively) or exit from the market".⁴³

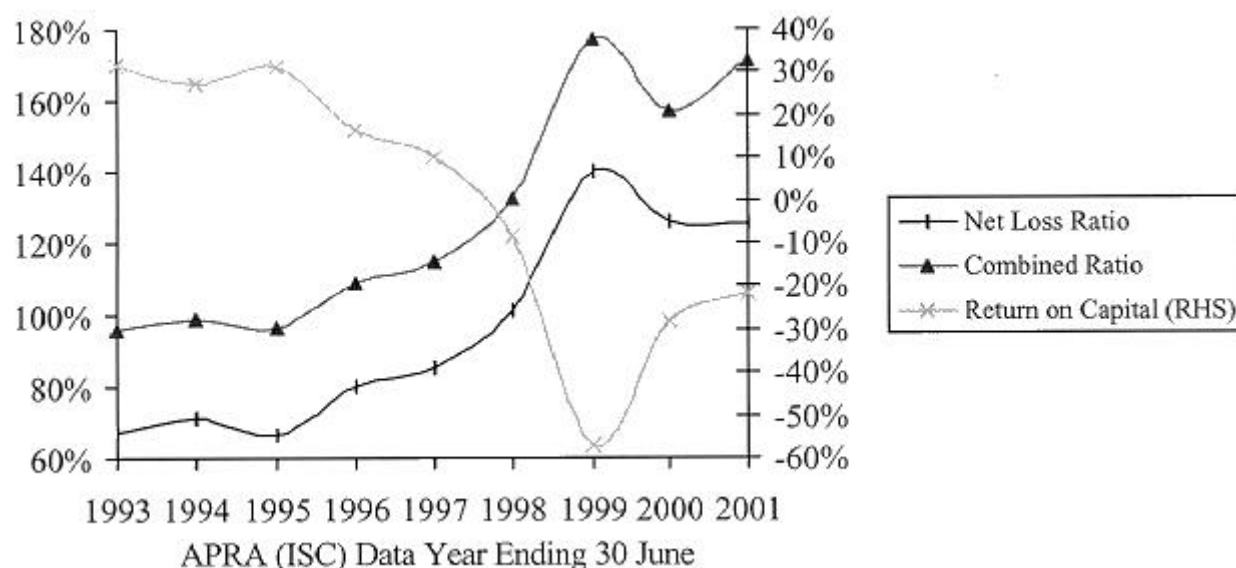
⁴¹ *ibid.* n 36, p 2.

⁴² Reproduced from the ACCC report on *Insurance Industry Market Pricing Review*, March 2002, p 3.

⁴³ ACCC, *Insurance Industry Market Pricing Review*, March 2002, p 55.

They also note that if businesses wish to increase profits by increasing premiums that the pressure to increase premiums will be greatest in several classes of insurance, including public and product liability.⁴⁴

Profitability of Public and Product Liability⁴⁵



Net Loss ratio refers to the claims expense for the year divided by net earned premium. The ACCC note that "...target loss ratios vary according to the class of business but are generally expected to range from 50 percent to 80 percent."⁴⁶ A loss ratio over 100% means that there has been a negative underwriting result. From the above chart, we can see that the net loss ratio for public and product liability has steadily increased above 80% since 1996 and peaked in 1999 at close to 140%. In the same year, the return on capital was the lowest.

Combined ratio refers to the loss ratio plus expense ratio (expense ratio being operating costs divided by net earned premium). The ACCC note that "It is not uncommon for combined ratios to exceed 100 percent for some classes. These may still be profitable after investment income is taken into account...[and further that]...Combined ratios in excess of 100 percent indicate that the industry relies on investment income on the technical reserves to generate profits."⁴⁷

As noted elsewhere, the ICA states that (based on APRA figures) the number of public

⁴⁴ ACCC, op. cit. n 43, p 56.

⁴⁵ ACCC, op. cit. n 43, p 48.

⁴⁶ ACCC, op. cit. n 43, p 18.

⁴⁷ ACCC, op. cit. n 43, p 20.

liability claims increased from 55,000 in 1998 to 88,000 in 2000 and the insurance industry subsequently incurred a loss ratio of 134% - ie a negative underwriting result.⁴⁸

Increase in premiums

Some reports suggest that there have been significant premium increases for public liability insurance recently. There have been various reports in the media of up to 400% rises in premiums in some areas. Those groups or businesses engaging in or offering high risk sporting activities have been particularly affected.

A national forum was held on 27 March 2002 to discuss increasing public liability premiums, contributing factors and proposals for reform. This forum attempted to shed some light on the scope of the problem as well as pinpoint the main causes of the current situation. A *Joint Communique* issued as a result of the forum is attached at Appendix A. The Australian Consumer and Competition Commission has also released their report on *Insurance Industry Market Pricing Review – March 2002*.⁴⁹

Factors contributing to an increase in premiums

Many factors are thought to be responsible for escalating public liability insurance premiums. To encapsulate the main arguments, they are: increase in number and size of claims; increase in litigation; rise in reinsurance costs associated with international catastrophic events such as September 11; and underpricing premiums. In addition, some arguments suggest that there are many exacerbating factors such as stamp duty on premiums (in NSW), collapse of HIH, and the use of conditional costs agreements (otherwise known as ‘no win/no pay’ agreements) which have reportedly contributed to the rise in litigation.

Whilst stakeholders disagree on the main cost driver/s for premium increases, and indeed emphasise different factors as being primarily responsible for such increases, it is evident that many factors have contributed to the rising costs. Two of the key stakeholders views are outlined below.

The Insurance Council of Australia view

As noted earlier, the Insurance Council of Australia (‘ICA’) argues that the causes of premium increases are varied and include other factors besides HIH and September 11 and the latter’s associated increase in reinsurance costs. The other factors include:

- an increase in number and size of claims
- a change in the attitude of society in making a claim. The ICA states that societal expectations have changed to one where “if something happens, someone pays”. This is an environment which encourages claims. This change in attitude has been a result of the population being better educated about their rights to recover damages.

⁴⁸ ICA, ‘ICA raises public liability options’, *Briefings*, December 2001.

⁴⁹ This report is available at <http://www.accc.gov.au>. See also the following publications for more information on public liability insurance: Kehl D, ‘Liability Insurance Premium Increases: Causes and Possible Government Responses’, *Current Issues Brief No. 10 2001-02*, Commonwealth Department of the Parliamentary Library; Dixon N, ‘Public Liability Insurance’, *Research Brief No 2002/07*, Queensland Parliamentary Library.

- a trend towards courts upholding strict liability for damage caused by defective products (But note that this relates to product liability, not public liability per se)
- changes to regulations covering lawyers which have led to a more active pursuit of class actions.
- advertising by lawyers and the promotion of a “no win – no pay” system which has encouraged claims “where in the past they may not have been pursued”.
- legal expenses involved in assessing claims
- proliferation of higher risk recreational activities
- collapse of HIH
- September 11
- reinsurance costs
- insurance taxes⁵⁰

Details are included in full at Appendix B.

The Australian Plaintiff Lawyers Association view

The Australian Plaintiff Lawyers Association (‘APLA’) on the other hand argue that the causes of the increases are the result of market forces which include:

- aggressive competition between domestic insurers in the 1990s which resulted in a reduction of premiums to unsustainable levels
- HIH collapse and industry mergers
- increased reinsurance costs
- changes in the international risk environment
- reduction in investment earnings
- renewed focus on profitability
- increased costs associated with prudential regulation
- industry cycle of insurance profitability. The concept of an industry cycle of profitability which drives premiums has been raised in a report by Trowbridge Consulting and Deloitte Touche Tohmatsu. As noted in a media article, the report “...claims premium rates are influenced by the investment returns insurance companies earn in the stock market when they invest premium income. When interest rates are low premiums rise, and when they are high premiums fall...”.⁵¹
- impact of taxes and levies⁵²

⁵⁰ ICA, *Submission to the National Ministerial Summit into Public Liability Insurance*, March 2002, pp 8-11; Alan Mason, Executive Director ICA, *Speech presented to the Insurance Council of Australia NSW Conference*, 8 March 2002, pp 2-4.

⁵¹ Accordingly, The Deloitte report reinforces an earlier study by a lawyer-backed US consumer group that examined public liability problems in the US in the 1970s and 80s following steep rises in insurance premiums” See: ‘Premium rises part of an industry cycle’, *The Australian*, 28/3/02, p 2. According to the article, the report also shows that premiums for public liability insurance are 10 per cent lower on average than in 1993 (after adjustments for inflation are made).

⁵² APLA, *Submission to the National Ministerial Summit into Public Liability Insurance*, 20/3/02, pp 8-13; ‘Public Liability: The Plaintiff Lawyers’ Perspective’, *CCH Bulletin*, 21/3/02.

Details are included in full at Appendix C.

APLA have also rejected the following as purported causes of premium increases:

- increasing litigation
- increasing claims
- ‘no win-no fee’ costs arrangements
- lawyer advertising
- legal costs

These are discussed in more detail below (at pp 14-21)

The view resulting from the Ministerial Meeting on Public Liability – 27 March 2002

As outlined in the *Joint Communique* (reproduced in full at Appendix A) from the Ministerial Meeting on Public Liability on 27 March 2002, the major factors behind rising premiums are said to be:

- changing community attitudes to litigation
- change in what constitutes negligence
- increased damages payouts for bodily injury claims
- past under-pricing and poor profitability of the insurance industry
- the collapse of HIH
- insurance companies becoming more selective about the risks they cover.

The Commonwealth Treasury commissioned a report by Trowbridge Consulting and Deloitte Touche Tohmatsu for the purpose of assisting the ministerial meeting.⁵³

Some of the key factors will be explored in detail below.

Increase in number and size of claims

As noted earlier, the ICA has stated there has been an increase in the number, and size, of claims and this has contributed to the rise in premiums. The ICA note that the latest Australian Prudential Regulation Authority (APRA) figures show that “...between 1998 and 2000 the number of public liability claims jumped by 33,000, from 55,000 to 88,000.” Further that “...the cost of public liability premiums rose by about 14 percent...[between 1998 and 2000]...while the overall cost of claims increased by 52.5 percent.” Alan Mason, ICA Executive Director, stated that the cost of claims did not “...necessarily reflect an increase in the number of claims made, rather an increase in the average cost of each claim...In other words, court awards are becoming more generous.”⁵⁴

⁵³ The report can be obtained via: http://www.deloitte.com.au/downloads/publicliability_apr02.pdf . A summary of the report is available at <http://www.deloitte.com.au>.

⁵⁴ ICA, *Media Release*, ‘Insurers Lose on Public Liability and Professional Indemnity Claims’; 2/8/01. The ICA have flagged possible areas of reform including risk management, increased mediation and tort reform: ICA, *Media Release*, ‘ICA raises public liability options’; 19/12/01.

The ICA also suggest why claims have risen. As noted above, the ICA argue that the rise in claims is due to a change in societal attitudes coupled with greater awareness of rights to recover damages and willingness to exercise those rights (due to in part media focus on damages payouts, and advertising of ‘no win-no pay’ schemes).

APLA, however, express concerns about the accuracy of the APRA data. They state that “The data on claims does not identify clear parameters about how a claim should be defined. As such, some insurers classify as claims the mere knowledge of circumstances that may result in a claim, for example, notification to the insurer that an injury has been sustained even though a damages claim may never be brought by the injured person.” They note that an APRA representative has stated before a Senate Estimates Committee that “there are a number of factors that make interpretation of the claims data difficult, and considerable caution is required”. APLA go on to describe those factors as being the “...the way the data is collected and the type of data collected, particularly the ‘less scientific’ reporting by some

⁵⁵

APLA further suggests claim numbers cannot be looked at in isolation, and indeed it is misleading to do so. The number of claims made “...bears a proportionate relationship to the number of policies written.” They suggest that:

When insurers assert that claims have increased, they quote gross claims figures, and do not mention the ratio of claims to policies. However, this ratio is the only reliable indicator as to whether claims have risen or declined.

In the year to December 1996, there were 2.64 claims per 100 policies. In the year to June 2001, there were 2.71 claims per 100 hundred policies.

Based on these figures, the real increase in claims since 1996 is therefore only 2.63%. This is hardly an explosion. This is hardly the explosion in claims that has been referred to in the press.⁵⁶

They argue that any increase in the overall number of claims is due to an increase in the number of policies that are issued, which is particularly the case in the past decade of aggressive competitiveness coupled with poorly assessed risk, as “...policies for poor risk carry a much higher probability of a claim.”⁵⁷

Not only does APLA dispute the contention there has been an explosion in claims, so do some small community groups. As noted earlier there are community groups who have been

⁵⁵ APLA, op. cit. n 52, p 15, citing the *Hansard* of the Senate Superannuation and Financial Services Committee, 13/3/02, E341.

⁵⁶ APLA, op. cit. n 52, p 16, quoting from: APRA, *Selected Statistics on the General Insurance Industry for the Year Ended December 1996*, Table 1.5, Table 1.8; and APRA, *Selected Statistics on the General Insurance Industry for the Year Ended June 2001*, pp 22-23.

⁵⁷ APLA, op. cit. n 52, p 16; *CCH Bulletin*, ‘Public Liability: The Plaintiff Lawyers’ Perspective’

adversely affected by increases but who do not have any claims history/ experience.⁵⁸ For example, as mentioned earlier, a group called *ourcommunity.com.au* stated that “There was no evidence to justify community groups being slugged with massive public liability insurance rises”. A survey of 700 organisations by the group found that 96 per cent of the groups who took part in the survey had not claimed on their public liability insurance in the past 5 years. They claim community groups are being subjected to increases irrespective of their good (or non-existent) claims history.

The CEO of the group, Rhonda Galbally, stated “All we have heard about from the insurance industry is about how community groups are high risk and how more people are making claims against community groups but the response to the survey just doesn’t bear that out.” She added “The industry has never provided a breakdown of the claims against community groups and you now have to ask whether the community sector – the sector that provides the social fabric of our nation – is paying for the sins of others”.⁵⁹

APLA concurs with the view that industry specific data needs to be produced for public liability insurance:

...in light of the fact that the problem of public liability relates primarily to not-for-profit, adventure tourism and community-based sectors, a need exists for industry specific data to be produced. This would enable a more detailed analysis of how the current problems have impacted on these sectors. Hopefully, this would then ensure that the solutions developed would directly relate to the sectors affected by unaffordable premium levels.

...

One of the notable consistencies that comes out of the widespread media reports is that the organisations and businesses worst affected by the rising insurance premiums are the very policyholders that have never made a claim.⁶⁰

With respect to the issue of the size of claims being a key factor in premium increases, commentators seem to be referring to an increase in the size of damages payouts awarded by courts as well as size of claims in general.

The ICA says that there have been more generous court awards and that these ‘leapfrog each other faster than inflation’.⁶¹ In addition, the ICA also refer to sample data from insurers which (whilst they note it is ‘necessarily imperfect’) also shows that the ‘average claim size has doubled from 1996 to 2001’.

⁵⁸ <http://www.ourcommunity.com.au> accessed on 25/3/02.

⁵⁹ ‘Are community groups getting ripped off on public liability insurance?’ 25/3/02, available at *ourcommunity.com.au*.

⁶⁰ APLA, op. cit. n 52, p 16.

⁶¹ Alan Mason, op. cit. n . *Speech presented to the NSW conference, 8/3/02*, p 3; ICA, op. cit. n 50, p 8

Others dispute the contention that there has been an increase in size of damages awarded by courts. Peter Cashman, from the plaintiff law firm Maurice Blackburn Cashman, has been reported as stating that the quantum or size 'of damages in NSW had not changed for a decade'. Cashman disagreed with the view that there had been an increase in compensation payments for bodily injury claims.⁶²

Some, such as the Victorian and Queensland Attorneys' General, have expressed some reservation/concern about broad based tort reform taking place before the full details and causes of the blowout in public liability insurance premiums are fully known. It has been reported that they believe the current debate has been "skewed to focus on the legal system instead of any shortcomings by insurers..." and that insurance companies should "open their books" before changes to the tort system are made. The Victorian Attorney General, R Hulls, was reported to have said:

...the insurance companies had produced no evidence to show a connection between increased premiums and increase court payouts, and until they did "Victoria won't be conned by insurance

⁶³

A litigation explosion?

A common assumption is that there has been a litigation boom or explosion, particularly in the area of negligence, over the past decade or so. Key cases highlighted in the media for extraordinary or massive lump sum payouts have perhaps contributed to this assumption. So too have reported cases from the US. So widespread is this assumption that it is rarely challenged.

Arguments refuting the contention that there has been a rise in litigation

In the face of these unchallenged assumptions and lack of data, the Australian Plaintiff Lawyers Association ('APLA') recently undertook research to ascertain the actual state of play.

⁶² 'Lawyers dispute negligence report,' *Australian Financial Review*, 28/3/02, p 8.

⁶³ 'Lawyers bid to axe insurance plan,' *Australian Financial Review*, 4/4/02, p 1.

It found that overall litigation levels were not increasing.⁶⁴

This research is supported by Productivity Commission data, published in the APLA submission to the March 27 Ministerial Meeting, which shows overall litigation levels have been declining in recent years (see further below at p 21).

APLA President, Rob Davis states that "...The assertion that litigation is 'out of control' and 'exploding' is an important premise in the argument made by insurers, corporate defendants, and professional groups that lobby to curtail the individual's right to compensation for injury". Further that it is "...vital that governments in this country do not fall into the same trap...[as the US]...of accepting anecdote as truth and responding with unfair restrictions on compensation, which both hurt the injured and do nothing to solve the underlying problem of premium increases"..⁶⁵

Other commentators also question or disagree with the argument that Australia has become more litigious. Tony Abbott, President of the Law Council of Australia, said of Minister for Small Business and Tourism Joe Hockey's National Accident Compensation Scheme Proposal:

He was right to raise the legitimate concern of the affordability of public liability insurance, but in the Law Council's view he was wrong to lose sight of:

- The obvious reasons for the huge recent increases in insurance premiums. The reasons, and the increases, may be "one-off". These reasons are unrelated to the legal profession and to the court system. For example, the collapse of HIH Insurance which had been offering competitive rates, increased reinsurance premiums due to the tragic events of 11 September 2001 and natural disasters have been major factors in premium increases. Furthermore, the Law Council believes that insurance companies should do more to explain the justification for individual increases.
- The need to carefully examine alternative proposals to ensure that they are not considerably more expensive than the current system and that they do not involve merely shifting costs to the social security system or some other section of society.
- The expectation of injured persons to be adequately compensated for their injuries.

Abbott also said:

⁶⁴ Davis R, APLA National President, "Exploring the litigation explosion myth", *Plaintiff*, Issue 49, February 2002, pp 4-5. APLA data was obtained from Court Registries in SA, Tas, ACT, QLD and NSW. Data from VIC and NT was not available at the time of publication. All registries except NSW were able to provide information as to the number of personal injury court filings in the last decade. They note that the NSW Supreme Court however "does not track or publish statistics due to lack of funds for that purpose[and that the NSW District Courts data]does not discriminate between personal injury and non-personal injury actions."

⁶⁵ *Ibid.*, p 5.

It is not constructive for the Minister to criticise “greedy lawyers” and “out of control courts”, or to isolate this as the sole reason for the blow-out in insurance premiums. The criticism is misconceived.

Lawyers do not manufacture claims for compensation. It is not greedy for lawyers to inform their client what their client’s rights and options are, nor to act without fee to enable injured persons to receive compensation. To label courts as “out of control” is simply abuse masquerading as argument.

For its part, the legal profession wants to engage in a constructive and co-operative examination of the causes of the current situation and a range of possible solutions.⁶⁶

Ian Dunn, former CEO of the Law Institute of Victoria, has stated: “To attribute the present crisis, in the face of these disasters...[the driving down of premiums by HIH, the collapse of HIH, and September 11]...to one, simplistic cause is extraordinary”⁶⁷:

The Insurance Council of Australia attributes premium increases, sometimes between 500 and 800 per cent, to a huge surge in litigation. It is alleged that this has led to the need for the insurers to charge these extraordinary premiums.

The Australian Prudential Regulation Authority, which has responsibility for regulation of insurers, has published the relevant statistics as to public liability insurance over the past three years.

It shows that the cost of claims is about 140 per cent of total premium revenue. In other words, if premiums were increased by 50 per cent the balance would be more than restored, particularly when one takes into consideration the investment value of premium income earned in respect to claims which are not paid out for many years...

Dunn also points out:

...that a 1999 study conducted by the Productivity Commission has shown that the amount of civil litigation is reducing rather than increasing. The so-called explosion in litigation just hasn’t occurred.⁶⁸

APLA state that studies have shown there is a lack of credible quantitative and qualitative evidence to support the contention that the level of litigation has increased and point to the 2000/01 Annual Report of the Productivity Commission which shows that the level of litigation has in fact decreased at an average rate of 4% per annum over the past three

⁶⁶ Letter to the *Law Institute Journal*, March 2002, pp 8-9.

⁶⁷ Ian Dunn, former CEO of the Law Institute of Victoria, *Law Institute Journal*, March 2002, p 4.

⁶⁸ Ian Dunn, *Law Institute Journal*, February 2002, p 4.

years.⁶⁹ They also question the motives of the insurance industry in perpetuating the fallacy of an ever increasing litigious society:

If there is a belief that there is an increased willingness to sue, would this not lead to more people taking out insurance cover in order to protect themselves against possible litigation? Essentially then, the claim about Australia's growing litigiousness is in itself a good marketing tool for insurance providers. The insurance industry has a vested interest in promoting this idea.⁷⁰

Arguments supporting the contention that there has been a rise in litigation

The assumption/argument that litigation has increased has been often repeated and rarely challenged. Of late there has been a shift in the statements made by some of the key stakeholders - whilst they have not explicitly referred to a rise in litigation, they have implied or inferred that this is the case. An oft repeated statement is not that there has been a rise in litigation but that there has been 'a change in society attitudes towards litigation' or a 'pot of gold mentality'. Arguably this means the same thing. (ie a 'change in societal attitudes' towards litigation infers that there is an increase in people willing to take court action).

Examples of such statements include the following:

From the Federal Minister for Revenue and Assistant Treasurer Senator Coonan:

It's not only people that are catastrophically injured who are having the very large claims that are driving up the premiums, because there's not as many of those...

It's the number of small claims and the fact that we've become such a litigious community where somebody might normally...just dust themselves off if they've got a bruised backside.⁷¹

In their submission to the ministerial meeting, the ICA does not actually say there is a rise in litigation, but infer that there is a climate generally which encourages claims and talk of "the attitude of society to making a claim". The ICA states:

Plaintiff lawyers have argued that litigation is not increasing therefore the legal system cannot be a contributor. This ignores the fact that very few claims reach court, so statistics on litigation alone do not give a true indication of the trends. It only needs an injury to be reported or a letter of demand to be received for insurers to begin costly investigations to assess the extent of liability.⁷²

⁶⁹ APLA, op. cit. n 52, p 14, sourcing the Australian Productivity Commission, *Annual Report 2000-2001*, p 409 and Table 9A.1.

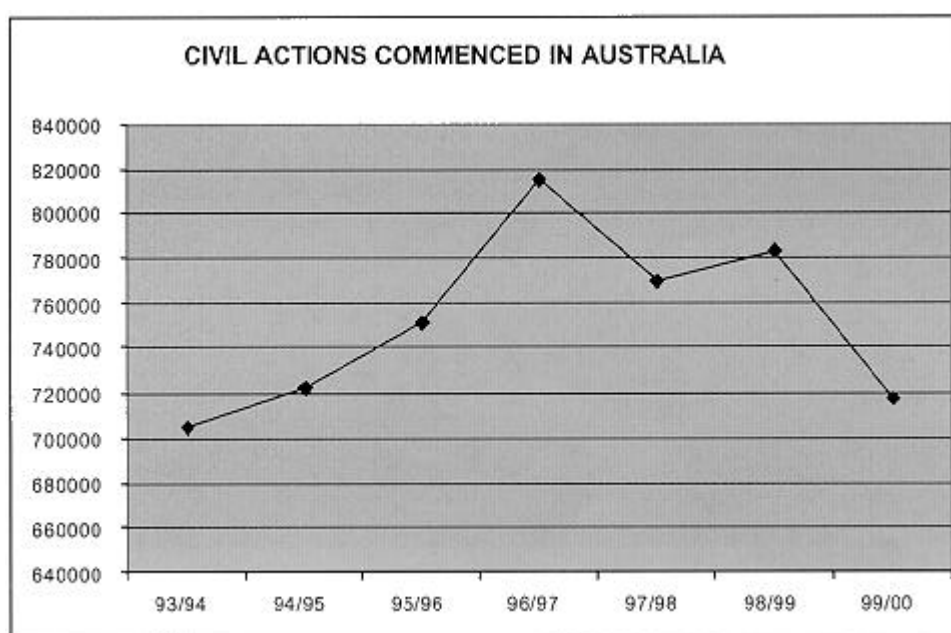
⁷⁰ APLA, op. cit. n 52, p 15.

⁷¹ AAP Monday 4/2/02, 1:20 pm. Coonan says small liability claims drive up costs"

⁷² Alan Mason, Executive Director ICA, *Speech presented to the Insurance Council of Australia NSW Conference*, 8 March 2002, p 4.

Conclusion

As noted earlier, data from the Australian Productivity Commission shows that there is an overall (albeit slight) decline in the level of litigation since 1994/95. The following chart illustrates civil actions commenced in Australia since 1993/94. Litigation levels rose from 93/94 to a peak in 96/97 and have declined since 96/97.



Source: APLA, *Submission to the National Ministerial Summit into Public Liability Insurance*, p 15.⁷³

Based on the above reported data on litigation levels in Australia, it is perhaps incorrect to state that there has been a litigation explosion. As APLA and the ICA note, the majority of personal injury claims never reach court and in fact are settled out of court. It may alternatively be more accurate to say that whilst there may have been a rise in the overall (gross) number of claims (and a marginal increase in the ratio of claims to policies), this has not necessarily translated into a rise in litigation.

September 11

Global catastrophic events such as September 11 can have a significant impact on the domestic insurance market. This is due to reinsurance costs increasing.⁷⁴

The way in which reinsurance impacts on prices has been explained earlier. All stakeholders seem to agree that September 11, and the associated rise in reinsurance costs, has had an impact on premium pricing. The extent to which it has been emphasised as a contributing factor to current premium increases varies. It is more often characterised as a factor that will impact on future premiums, given that premium increases were already being felt prior

⁷³ The APLA table is based on data from Table 9A.1 of the Australian Productivity Commission Report *Annual Report 2000-2001*.

⁷⁴ Insurance and the balance of payments; *Australian Financial Review*, 25/1/02, p10.

to September 11.

The ICA⁷⁵ and APLA⁷⁶ in their separate submissions to the Ministerial Meeting, refer to it briefly as a contributing factor. See Appendix B and C for further detail on their view.

Underpricing premiums

It has been said that insurers have in the past decade been cutting premium prices to gain a competitive edge in the market place. Instead of pricing premiums to reflect risk, they have been pricing premiums to be competitive (what has been referred to as “slack”⁷⁷ This has been described as a significant factor. APLA says that the insurance market throughout the late 1990s was aggressively competitive and insurers lowered their premiums to levels which have proved to be unsustainable.⁷⁸

The ICA, however, point out that:

Critics of insurers have suggested that this is just a matter of insurers not charging enough for the risk they were covering, losing money and therefore increasing premiums...However, that is an effect, not a cause. It does not help identify why claims costs have been increasing.⁷⁹

Exacerbating factors

tax on premiums

The stamp duty levied on premiums (in NSW and other states), coupled with the GST, has been cited as putting an additional pressure on premiums. As noted by the ICA and others, insurance taxes are high in Australia by world standards.⁸⁰

Conditional costs agreements (‘no win/no pay’ litigation) and advertising

There has also been criticism of conditional costs agreements⁸¹, generally referred to as ‘no win/no pay’ litigation, as being a contributing or exacerbating factor to the purported increase in litigation and subsequent flow-on costs to public liability insurance. There is a large degree of confusion about the system that operates in Australia, with many mistakenly believing it is similar to the contingency fee system which operates in the United States. Criticism of the system also becomes intermingled with criticism of lawyers advertising in

⁷⁵ ICA, op. cit. n 50, p 10.

⁷⁶ APLA, op. cit. n 52, p 10.

⁷⁷ “Insurance and the balance of payments”, *Australian Financial Review*, 25/1/02, p 10.

⁷⁸ APLA, op. cit. n 52, p 8.

⁷⁹ Alan Mason, Executive Director ICA, *Speech presented to the Insurance Council of Australia NSW Conference*, 8 March 2002, p 2.

⁸⁰ APLA, op. cit. n 52, p 8; ICA, op. cit. n 50, p 11, The ICA cite Deloitte, Touche Tohmatsu 2001.

⁸¹ Which have mistakenly been called contingency fee agreements.

general, and particularly advertising of “no-win, no-pay” agreements. It should be noted, in the context of the debate over conditional costs agreements, that in Australia Legal Aid is not available to pursue civil claims.

*What is a conditional cost agreement?*⁸²

Under section 186 (1) of the *Legal Profession Act 1987* (NSW) a barrister or solicitor (‘legal practitioner’ or ‘practitioner’) can make a costs agreement under which all of the practitioners’ costs are contingent on the successful outcome of the matter for which the legal service is provided. As per section 186(3) a conditional costs agreement cannot be used for criminal proceedings. A conditional costs agreement must set out the circumstances constituting the successful outcome of the matter (s186(4)) and it may exclude disbursements from the costs that are payable.⁸³ Under section 188 costs must not be calculated on the amount recovered in proceedings. Therefore, unlike in the US, a practitioner is prohibited from calculating costs as a proportion of, or that varies according to, the amount recovered in proceedings.

A practitioner, can however, charge a premium on top of the costs otherwise payable under the agreement subject to the successful outcome of the matter (s187(1)). However the premium must be clearly identified in the agreement and must be a specified percentage of the costs but not exceeding 25% of the costs payable (s187(2),(3)).⁸⁴ This is different to the US contingency system where a practitioner can charge a proportion (say 30 or 40%) of the amount recovered in proceedings.

With respect to costs in general, a practitioner is obligated to disclose either the basis of costs⁸⁵ or an estimate of the likely amount of the costs⁸⁶. The disclosure must be made before the practitioner is retained to provide the legal service concerned or, if it is not

⁸² This section will refer to the relevant legislation and rules in NSW.

⁸³ Disbursements refer to any moneys paid to third parties on behalf of the client. An example of a disbursement could be a filing fee for lodgement of a statement of claim in the relevant court. Note also, as well as solicitor/client costs, there are party/party costs: Whilst solicitor/client costs refer to the costs which a client has agreed to pay their lawyer for their services, party/ party costs are costs which a court orders one party to pay to the other party in the litigation. Party/party costs are usually outside the scope of conditional costs agreements and therefore if there are any such costs, these will be required to be paid by the unsuccessful party in the litigation irrespective of any conditional costs agreement they may have. This is why advertising for ho-win/ no-pay’ actions must be carefully worded so as to inform potential clients of the possibility of having to be liable, not only for disbursements but for possible party/party costs. So that ho-win/no-pay’ is not misleading the client.

⁸⁴ The maximum can be varied by the regulations (s187(4)).

⁸⁵ s 175

⁸⁶ Although there are circumstances in which a disclosure is not required to be made, which include for example when the total costs, excluding disbursements, to be charged are or estimated to be no more than \$750 for an individual or private company: as per s 57B of the *Legal Profession Act 1987* and Solicitor Rules 1.2.2(i).

practicable to do so, as soon as practicable after the practitioner is retained.⁸⁷ As costs agreements (including conditional costs agreements) must be in writing⁸⁸, expressed in clear plain language⁸⁹, and be disclosed/ given to a client prior to or soon after the practitioner is retained, it is evident that it would be difficult for a practitioner to guess (should the matter be successful) the likely amount recovered from proceedings, so as to charge/or estimate costs according to the perceived likelihood.

Advertising by lawyers of 'no-win/ no-pay'

Advertising by lawyers in NSW is regulated by the *Legal Profession Act 1987* (NSW) as well as other relevant legislation (such as the *Trade Practices Act 1974* (CTH) or the *Fair Trading Act 1987* (NSW)).

There has been debate as to whether there may be problems with slogans such as 'no-win/ no-pay'. This is because clients, even in the event of a win, can be charged disbursement costs, and in the event of a loss may be ordered to pay party/party costs. So the litigation may not be entirely free from cost in the event of a win or loss. Advertisements must be carefully worded to advise of any possible liability because of the potential to mislead.⁹⁰

Criticisms of advertising of conditional costs agreement/ support for restriction of advertising

The ICA have stated that "Advertising by lawyers and promotion of a "no win – no pay" system of remuneration have...encouraged claims where in the past they may not have been pursued".⁹¹

Others have concurred with this view such as the Minister for Gaming and Racing, Richard Face, who is reported as saying:

...the insurance crisis was the biggest problem facing local communities and lawyers' advertising was partly to blame.... 'I have got to say my personal view is that it is what has led to a lot of what is going on'.⁹²

It was reported that the Federal Minister for Small Business:

⁸⁷ s 177

⁸⁸ A cost agreement is void if it is not in writing or evidence in writing as per s184(4).

⁸⁹ s 179

⁹⁰ For more information see: s 38J of the *Legal Profession Act 1987* (NSW) and relevant provisions relating to misleading and deceptive conduct in the *Trade Practices Act 1974* (Cth) and the *Fair Trading Act 1987* (NSW); Dal Pont, G. E. *Lawyer's Professional Responsibility in Australia and New Zealand*, 2nd ed., Sydney, 2001; Law Society, Professional Conduct: Advertising guidelines set to become rules," (1998) 36 (7) *LSJ* 70; Knowsley, No-pay advertising wins for some," (1996) 34 (9) *LSJ* 8.

⁹¹ Alan Mason, op. cit. n 79, p 3.

⁹² ABC Monday 25/2/02, 9:02 AEDT. Inquiry focus on lawyer advertising!

...blamed greedy lawyers using “no win, no fee” promises for the spiralling insurance costs...[The Minister said]...“you know there is something wrong with our legal system when, if you fall off your chair at home, it’s an accident, but if you fall off your chair in the shopping mall, it’s an opportunity to sue somebody”.⁹³

The NSW Law Society president, Kim Cull supported the restriction of advertising of ‘no-win/ no-pay’ agreements. The president said “The Law Society doesn’t want the public to be misled or offended by the content of advertisements” and further that “Advertisements must not be published which could bring lawyers or the administration of justice into disrepute or which encourage a party to engage in unmeritorious legal proceedings”.⁹⁴

Support for conditional costs agreements and advertising of conditional costs agreements
APLA states, with respect to the system of conditional costs agreements:

...As law firms that advertise ‘no-win, no-fee’ do not get paid for cases that do not succeed, it follows that they will not encourage people to make claims that are unlikely to win...

The use of ‘no-win, no-fee’ arrangements simply enables people to get initial advice that they otherwise may not be able to afford. The challenge to ‘no-win, no-fee’ agreements comes at a time when Legal Aid has been effectively removed for civil claims. If ‘no-win, no-fee’ agreements are banned or otherwise restricted, the ability of disadvantaged people to access the legal system will be significantly reduced.

If ‘no-win, no-fee’ agreements were removed, the government would have to re-establish Legal Aid for civil claims to create equity of access to the legal system.⁹⁵

APLA further states, with respect to advertising:

Advertising on the basis of ‘no-win, no-fee’ generates enquiries about legal entitlements. It does not, however create litigation opportunities where rights to litigation did not already exist.

There is no evidence that lawyer advertising is in any way responsible for increasing premiums.⁹⁶

The president of the NSW Bar Association, Bret Walker, stated that the new regulations banning advertising of ‘no-win, no-pay’ arrangements would have an adverse impact on poorer injured victims’ and their ability to access justice. He further said:

Our profession should never be ashamed of the long tradition of counsel arranging to be paid their ordinary fee only if and when

⁹³ Crackdown on injury payouts,” *Australian Financial Review*, 21/1/02.

⁹⁴ Bar president slams Carr and Hockey over advertising ban,” *Lawyers Weekly*, 8/3/02, p8.

⁹⁵ APLA, op. cit. n 52, p 17.

⁹⁶ APLA, op. cit. n 52, p 18.

their client succeeds in obtaining monetary remedy. This is not some sort of recent American decadence, but lies at the heart of the traditional Australian/English legal calculus...⁹⁷

Collapse of HIH

The collapse of HIH has had an impact on premium prices due to the reduction in availability in obtaining cover⁹⁸, as well as flow on costs. As ICA note, HIH covered a large proportion of the liability market, so its collapse resulted in a reduction in industry capacity to provide cover.

REFORM POSSIBILITIES

Examples from overseas jurisdictions

In other jurisdictions, there are a variety of schemes which either confer an immunity on local government for negligence actions or attempt to limit or cap damages payouts in general.

National no-fault compensation schemes

New Zealand has a national no-fault accident compensation scheme which insures all citizens on a no-fault basis for all non-work related injury⁹⁹. This system effectively replaces tort law remedies. The scheme appears to operate in a similar fashion to other types of no-fault schemes (such as motor accidents or workers compensation schemes) in that the amounts awarded for certain injuries are capped. For more information on the New Zealand scheme see Appendix D which is a reproduction of Appendix 2 of Kehl's paper on *Liability Insurance Premium Increases: Causes and Possible Government Responses*.¹⁰⁰

Statutory immunity for local councils

Local governments can have statutory immunity from being sued for negligence. The immunity conferred can be quite extensive or limited. For example, certain states within the United States such as Texas and California have statutory immunity schemes. As it implies, the immunity exempts the municipal councils within the jurisdiction from liability for either inherently dangerous recreational activities (eg water skiing and skateboarding) prescribed under the statute, or injuries that occur in natural environments which have not been modified by the councils (eg rivers, beaches).¹⁰¹

⁹⁷ Bar president slams Carr and Hockey over advertising ban," *Lawyers Weekly*, 8/3/02, pp 1 and 8.

⁹⁸ Some sporting organisations have reported difficulty or an inability in obtaining cover due to the HIH collapse, as HIH wrote a substantial number of sports insurance." Sport Industry Australia, "Spiralling insurance premiums spells danger for sport participation," www.sportforall.com.au/latestedition/latest8.html, accessed 1/2/02.

⁹⁹ op. cit. p 29.

¹⁰⁰ Kehl, op. cit. n 36, p 13. See also <http://www.acc.co.nz>.

¹⁰¹ For a detailed discussion on statutory immunity for local governments in overseas jurisdictions see: NSW Parliament, Legislative Assembly, Report of the Public Bodies Review Committee on *Public Liability Issues Facing Local Councils* (M Orkopoulos MP Chairman),

Stakeholder proposals

Various reform proposals have been touted as possible ways to reduce pressure on increasing premiums. These proposals range from the introduction of a national no-fault compensation scheme, similar to that which exists in New Zealand, to reducing damages payouts by placing a limit or cap on the minimum and maximum amounts claimed.

A useful summary of what the key stakeholders want was published in *The Australian*¹⁰². It is reproduced in full below, with additions in some parts where there is further information. The additions are footnoted.

*ICA*¹⁰³

- A national scheme of risk management to reduce injuries
- Change in focus of legal system from financial compensation to rehabilitation
- Medical treatment to be delivered through Medicare
- Elimination of “joint and several” liability that makes all defendants liable for whole bill
- End to no-win no-pay lawyers fees

Association of Plaintiff Lawyers

- Risk management scheme
- Community-based insurance solutions
- An excess in public liability insurance contracts

Federal Government

- Insurance pooling arrangements
- ‘A ban on drunks suing after doing things they would not do sober’
- Elimination of tax disadvantages from taking structured settlements instead of lump sums (this was originally announced in September 2001¹⁰⁴ and again on 28 March

November 2000, pp 28-30

¹⁰² 28/3/02

¹⁰³ It has been noted elsewhere that the insurance industry viewpoint was largely accommodated during months ministerial meeting and there has subsequently been some controversy over what has been felt to be a disproportionate level of influence that the insurance industry has had over government decision making in this area. The Law Council of Australia has attempted to correct what they believed was a mistaken assessment of the concept of contributory negligence in the Trowbridge Consulting report which, they believe, was heavily relied on by the government in the summit and which subsequently has led to proposals to reform the tort law of negligence: CCH, Negligence definition up for debate,” *Compensation Week*, 9/4/02, p 1 & 2; Lawyers bid to axe insurance plan,” *Australian Financial Review*, 4/4/02, p 1; Lawyers challenge insurance report,” *Australian Financial Review*, 3/4/02, p 5; Lawyers dispute negligence report,” *Australian Financial Review*, 28/3/02, p 8. Note: the CCH article notes that the Democrats Senator John Sherry has called for the Australian Law Reform Commission to inquire into the operation of the law of negligence. The article also notes that the Democrats have been critical of the level influence the insurance industry has had with respect to government decision making on this issue.

¹⁰⁴ For more information on structured settlements see:
<http://www.structuredsettlements.com.au>

2002¹⁰⁵ - the legislation is yet to be passed)

- Altering the definition of negligence¹⁰⁶

NSW Government

- Statutory limit to damages¹⁰⁷
- Limit on the right to sue for small injuries
- An end to no-win no-pay lawyers fees (conditional costs agreements)¹⁰⁸
- Requirement for lawyers to pay for speculative claims that lose in court
- Test for negligence to be made more difficult

Other tort reform measures announced by the NSW Premier include:¹⁰⁹

- Protection of good samaritans who help in emergencies.
- Revisiting the High Court's decision on local councils and the removal of their immunity from liability.
- A proposal to abolish reliance by plaintiffs on their intoxication.
- Prevention of people making public liability claims where the injury arises through the course of them committing a crime.
- Increasing the discount rate that courts apply in relation to damages for economic loss.
- Removal of the courts power to award punitive damages.

Local Government Association

- Grouped conventional insurance
- Federal and state governments to underwrite public liability risk for community groups
- Mandatory pre-trial mediation

Other reform possibilities include:

- Reduction/ removal of stamp duty on insurance premiums
- Establishment of a bulk-buying scheme for community organisations¹¹⁰

¹⁰⁵ H Coonan, Senator, "Structured Settlements a Win-Win," *Media Release*, 28/3/02.

¹⁰⁶ "Negligence definition up for debate," *Compensation Week*, 9/4/02.

¹⁰⁷ Note: there has been some argument as to whether capping damages would have any impact on curtailing premium increases. It has been argued that US experience has shown this not to be the case. For more information on the US experience see: "Shakedown: How the insurance industry exploits a nation in times of crisis," *Media Release*, Center for Justice and Democracy, 8/4/02; *Premium Deceit – The failure of Tort Reform to Cut Insurance Prices*, the report is co-authored by actuary J. Robert Hunter, Director of Insurance for the Consumer Federation of America (CFA), former Commissioner of Insurance for the State of Texas. For information on these publications see the Center of Justice and Democracy website at: www.centerjd.org; See also an article by the *Wall Street Journal*, "Why firms pay more for insurance," 11/4/02, at www.online.wsj.com.

¹⁰⁸ For arguments against removing conditional costs agreements see also: "Carr heading down the wrong road to insurance solution," *Lawyers Weekly*, 29/3/02, p 1.

¹⁰⁹ B Carr MP, Premier, "Public Liability Insurance," *Media Release*, 20/3/02; *NSWPD (LA)*, 20/3/02, pp 32-34.

- Government insurance of funded non-government organisations

As noted earlier, reform which has already taken place in NSW includes a restriction of lawyers' advertising for 'no-win/no-pay' agreements.

Outcome of national ministerial meeting 27 march 2002

The *Joint Communiqué* from the Ministerial meeting held on 27 March 2002 is attached at Appendix A.¹¹¹

As outlined earlier, according to the *Joint Communiqué*, the major factors behind rising premiums (as identified in the Trowbridge report) are:

- changing community attitudes to litigation
- change in what constitutes negligence
- increased damages payouts for bodily injury claims
- past under-pricing and poor profitability of the insurance industry
- the collapse of HIH
- insurance companies becoming more selective about the risks they cover.

The Ministers agreed to either investigate or implement several areas of reform including: introduction of legislation to allow structured settlements; reform to claims costs (by examining tort reform and legal system costs and practices); examining changes to *Trade Practices Act/ Fair Trading Acts*; encouraging group insurance buying; requesting more detailed information from the insurance industry on claims experience; consideration of widening data collection; and investigation and implementation of effective risk management practices.

The Ministers have agreed to meet again in May.

¹¹⁰ Public liability insurance: what solutions will work for non-government organisations?" *NCOSS News*, vol 29, number 3, April 2002, p 3.

¹¹¹ For more detailed information about the stakeholders views see the following websites and the briefings and relevant submissions contained within: <http://assistant.treasurer.gov.au> <http://www.ica.com.au> <http://www.apla.com> <http://lawcouncil.asn.au> <http://www.accc.gov.au> <http://www.deloitte.com.au> http://www.deloitte.com.au/downloads/publicliability_apr02.pdf

APPENDIX A
Joint Communique Ministerial Meeting on Public Liability, 27 March
2002, Canberra

JOINT COMMUNIQUE
MINISTERIAL MEETING ON PUBLIC LIABILITY
27 March 2002, Canberra

The Commonwealth, State and Territory Ministers and the President of the Australian Local Government Association (the Ministers) restated their shared determination to tackle the problems of rising premiums and reduced availability of public liability insurance.

The Ministers agreed that many of the issues are complex and cross-jurisdictional, requiring collective action from governments and industry in the immediate and long term. The problems being confronted in the public liability area are not unique and are also evident in other insurance classes.

The Ministers received an expert report identifying the major factors behind rising premiums and reduced availability of public liability insurance as being:

- changing community attitudes to litigation;
- change in the courts' view of what constitutes negligence;
- increased compensation payments for bodily injury claims;
- past under-pricing and poor profitability of the insurance industry;
- the collapse of HIH, a major player in the public liability market; and
- a decision by insurance companies to be more selective about the risks that they cover.

The Ministers noted that a number of jurisdictions had already undertaken a range of initiatives including facilitating group insurance for not-for-profit organisations, tort law reform and development of risk management guidelines.

Ministers agreed that:

Structured Settlements

1. The Commonwealth will introduce legislation to make tax changes to encourage the use of structured settlements for personal injury compensation.
2. The States and Territories will make such legislative changes as are necessary to remove the barriers to structured settlements as an alternative to lump sum payouts.

Reform to Claims Costs

3. Subject to evidence that changes will increase affordability and availability of cover, the States and Territories will examine:
 - targeted claims cost reduction by, for example, protecting volunteers, community and appropriate sporting organisations from actions;
 - broadly based tort reform; and
 - legal system costs and practices, such as legal advertising.

Trade Practices Act/Fair Trading Acts

4. The Commonwealth, the States and Territories will examine relevant sections of the Trade Practices Act and comparable State and Territory legislation to consider the extent to which individuals can legally and confidently assume personal responsibility for high risk activities.

Group Buying

5. State Governments would encourage group insurance buying where appropriate.

Role of Insurance Industry

6. The insurance industry will be asked to collect more detailed information on claims experience through a co-operative industry arrangement.
7. A representative of the Insurance Council of Australia will be invited to address the next meeting of Ministers.

8. Ministers encouraged the insurance industry to be more innovative and responsive in product development and communications with consumers.

Data

9. The Commonwealth will consider widening data collection on the insurance industry by APRA and will report to a subsequent meeting on the impact of the new prudential requirements for general insurers.

10. The States and Territories will collect data on claims and costs and provide it to Heads of Treasuries.

Risk Management

11. States and Territories will provide advice to Heads of Treasuries on risk management practices introduced in their jurisdictions that have assisted in making insurance more available and more affordable.

12. The insurance industry will be asked to advise Heads of Treasuries on other effective risk management procedures.

There was also agreement that the problem needed to be tackled against two frameworks - one of addressing rising claims costs and the second of addressing the availability of insurance cover. Ministers recognised that there were no easy solutions but that work will commence immediately on the above.

Given the multiplicity of the functions in governments impacted by the problem in public liability markets, the meeting agreed to request that the Council of Australian Governments (COAG) on 5 April 2002 endorse the outcomes of today's meeting.

Recognising the complexity, urgency and technical nature of many of the issues, Ministers agreed that the Heads of Treasuries Group, which will include the Commonwealth and Local Government, was best placed to develop practical measures for consideration by each Government by 30 April 2002.

Ministers noted that the Commonwealth had asked the Australian Competition and Consumer Commission to update its recently released report on Insurance Industry Market Pricing by July 2002. The report will analyse the competitiveness of the public liability and professional indemnity markets and the Australian Securities and Investments Commission will be asked to provide advice on improving the information to consumers in insurance policies.

Ministers acknowledged the significant contribution from stakeholders and thanked those who made submissions for the meeting. These submissions will be further considered by the Heads of Treasuries Group.

Ministers agreed to meet again in May.

APPENDIX B
ICA Submission to National Ministerial Meeting, pp8-11

Public Liability Submission to Ministerial Forum

Insurance Council of Australia Limited
Level 3, 56 Pitt Street
SYDNEY NSW 2000

March 2002

Section Two

Liability Insurance – What are the Pressures?

Public liability insurance has been effected by many developments in recent times and this section describes the major pressures on liability insurance.

- (a) **The attitude of society** to making a claim for injury has changed in recent years. The population is well educated and the media and other sources have helped people to become more aware of their rights to recover damages from third parties. Record awards receive wide media coverage and there is an increased expectation that "if something happens, someone pays."

There have been recent court cases which suitably demonstrate a trend in the community to seek compensation for injuries that in the past, would not have been compensable or perhaps not have been pursued. One example was an inebriated plaintiff in Queensland who injured himself after leaving a hotel and successfully sued the proprietor (*Chevron Hotels v. Johns*).

- (b) **Changes to regulations covering lawyers** have led to more active pursuit of legal recourse. For example contingency fees, where solicitors promote a "no win – no pay" system of remuneration, have also encouraged claims which in the past may not have been pursued. Contingency fees in Australia are also known as conditional costs agreements. Solicitors may charge a premium conditional on success. Advertising by lawyers has also contributed to this situation.

Specialist legal firms have actively pursued class actions since 1992.

- (c) **The courts and legislation** protecting the consumer have generally resulted in more damages for more people in more circumstances than past decades. There has been a trend towards courts upholding strict liability for damage caused by defective products. In many cases there are very limited grounds for raising a defence against litigation.

Some examples of legal developments are as follows:

(i) **Joint and Several Liability**

There are incidents where an individual is only peripherally connected with an incident but can be drawn into a case. They may be remotely involved in an incident. An example of this is a newly completed hospital which had developed structural cracking. An architect engaged by the finance company who had no direct involvement in the building work was brought into the case. It cost the insurer \$750,000 to defend the architect (*St. Mary's Private Hospital v FJ Mercer Building Company P/L*).

In many instances joint and several liability has resulted in defendants who only partially contributed to the loss being found liable for the whole loss. A party need only be 1% liable to incur 100% of the verdict and cost if the co-defendant is not insured or unable to meet a verdict.

(ii) **Astley v. Austrust (Law of Negligence)**

In this case a defendant in contract was found 100% liable for the plaintiff's claim, despite having a small degree of negligence.

The High Court of Australia's decision was that there was no contributory negligence in contract, which set a precedent.

All states and territories with the exception of Western Australia have introduced legislation to redress the High Court decision.

(iii) **FAI v. Australian Hospital Care (Section 54 of Insurance Contracts Act 1984)**

This High Court case has implications for "Claims Made and Notified Policies". Most professional indemnity/directors and officers insurance is only available with this form of wording. If the insured did not advise of a claim or potential claim in the period of cover, they would not be able to make a claim. The High Court has now ruled by this decision that late notification of a claim under these policies is acceptable. The decision undermines the operative intent of these wordings and threatens the availability of insurances normally written under this form of policy wording.

(iv) **Trade Practices Act, Fair Trading and Other Consumer Legislation**

These Acts have contributed to new causes of action where there are limited grounds of defence, particularly under the Trade Practices Act where there are prohibitions on limiting liability.

ICA will shortly provide a submission to the Commonwealth Attorney-General recommending that these Acts be amended allowing for contributory negligence.

- (d) **Increasing number of claims and claims costs.** Australian Prudential Regulation Authority figures show between 1998 and 2000, the number of public and products liability claims increased from 55,000 to 88,000, a 60% jump. (It should be remembered that not all claims reach court. Statistics on litigation alone do not give a true indication of the trends.)

The APRA statistics are showing a shortfall over this period of \$960 million. This figure will continue to rise as claims originating in this period continue to be made many years later. (See(e)).

Attached as Appendix 1 is a study of Public Liability Claims by size band. It must be noted that this study is based on a sample of data from insurers and is therefore necessarily imperfect. It also contains differences in reporting years by individual insurers and excludes HIH data.

Nevertheless, there are some key features in the study which are useful to highlight.

- The trend in average claim size has doubled from 1996 to 2001
- In 2001 only 3% of claims numbers were responsible for approximately 50% of costs

- In 2001 14% of claims were settled for more than \$20,000 (ie 86% for less than \$20,000)
 - The majority of claims are for amounts of less than \$5,000
- (e) Liability insurance is called **long tail business**, because it can take many years after a policy is written to determine the final result of claims originating in that year. By contrast motor and property insurance claims can be closed off quickly and the results of trading are known shortly after the end of that year.

Because of the Statutes of Limitations that apply across various jurisdictions in Australia, claims can be made many years after a policy has expired. For example if a child of one year of age in NSW was injured, legal action could be commenced some 25 years after a policy has expired. There is no need to commence legal action until the child achieved majority at 18 years of age when the Statute of Limitations of 3 years applies. A further extension of 5 years may also be granted. Extensions may also be granted in circumstances where the injured party was not aware of the due course of the injury and being able to sue.

This creates uncertainty for liability insurers who may pay a claim in future years based on a premium charged years before. The type and amount of claim may have increased substantially based not only on inflation but also on the current developments.

Insurance Statistics Australia collects data from subscribing companies from the general insurance market. The statistics provided below track the increasing loss ratio of combined insurers portfolio over a number of years. For example a loss ratio at the end of 1994 (the year in which the policy was issued) of 42% had increased to 121% six years later. In other words claims costs recorded in statistics for recent years will continue to grow as claims come in years later.

Accident Year	Premium	Development Year						
		1	2	3	4	5	6	7
		Loss Ratio By Development Year (%)						
1994	140.4M	42	72	88	105	112	114	121
1995	152.8M	45	73	92	113	120	124	
1996	197.0M	55	91	109	128	144		
1997	229.1M	59	93	111	144			
1998	217.4M	45	77	105				
1999	197.6M	37	66					
2000	193.0M	37						

- (f) **Proliferation of higher risk recreational activities.** This could include activities such as bungee jumping, tobogganing, adventure trails, which are often undertaken by people who do not have the appropriate level of fitness for that activity.
- (g) **Collapse of HIH Insurance** HIH had a large share of the liability market. Its collapse in March 2001, reduced the financial capacity of the industry to provide this type of cover.
- (h) **Terrorist attack 11 September 2001.** This loss is the biggest insurance payout in the history of the industry. While all classes of business will be affected a substantial part of all claims will relate to liability actions brought against various organisations. This has resulted in increased insurance

costs across the global market. The result of this loss has been a reduction in capital and increased premium.

- (i) **Reinsurance costs.** While the underwriting result in Australia influences the premium we pay for a range of general insurance products, it is also linked to the international insurance market. In simple terms part of the premium paid is a reinsurance levy to fund major losses. Even before the terrorist attack reinsurance prices were under significant pressure due to significant losses incurred by the industry. This reinsurance premium fund has also assisted Australia in the 1999 Sydney hailstorm for example.
- (j) **Insurance taxes**

Australia has the highest taxes on insurance in the world. (Source Deloitte, Touche Tohmatsu 2001).

Taxes and Charges on Public and Products Liability Insurance					
State	S/D Rate	Premiums	GST	Stamp Duty	Total
	%	\$thou	\$thou	\$thou	\$thou
New South Wales	10	319,229	31,923	35,115	386,267
Victoria	10	197,217	19,722	21,694	238,633
Queensland	8.5	110,255	11,026	10,309	131,589
South Australia	11	54,111	5,411	6,547	66,070
Western Australia	8	60,324	6,032	5,309	71,665
Tasmania	8	10,804	1,080	951	12,835
Aust. Capital Territory	10	6,015	602	662	7,278
Northern Territory	10	2,836	284	312	3,432
Total		760,791	76,079	80,898	917,768

Note 1: Premium income is taken from Form 10 of APRA Selected Statistics on General Insurance. State taxes are based on a state of risk basis, so that the figures above are therefore indicative only.

Note 2: The above premium revenue figures are premiums earned. Stamp duty and GST are calculated on premiums written. The figures are therefore indicative only.

Generally speaking for every increase of \$100 in public liability premiums, a further \$20 in government taxes will be added.

APPENDIX C
APLA Submission to National Ministerial Meeting, pp7-14



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NATIONAL MINISTERIAL SUMMIT INTO PUBLIC LIABILITY INSURANCE

APLA Submission

20 March 2002

PART C CAUSES OF INCREASING INSURANCE PREMIUMS

1 Demonstrable Causes

Premiums for all insured risks in Australia declined in the latter half of the 1990s. At the same time, Australia experienced a sustained period of economic growth and prosperity. Premiums were down because of competition between insurers, a generally stable reinsurance market, and stable risk factors throughout the latter part of the 1990s. These low costs coincided with high business prosperity and high levels of consumer confidence.

Insurance premium prices were unsustainably low for part of this period as competition resulted in a depletion of reserves and a decline in insurance company profits. Towards the end of 1999, premiums began to increase. In 2000, they had increased by approximately 15-20%. The upward trend in premiums has continued throughout 2001 and into this year.

Commerical Classes	1993 ^a	1994	1995	1996	1997	1998	1999	2000	2001	1H02 ^b
Property	100	99	91	74	59	52	51	54	62	69
Commercial Motor	100	99	95	88	80	75	76	79	85	89
Liability	100	102	97	81	66	61	63	70	80	90
Professional Indemnity	100	104	99	86	69	61	61	65	79	85

Table 1 Premium Levels Adjusted for Inflation³

^aFigures for 1993-2001 relate to full financial year periods. ^bRelates to a six-month period, June-Dec 2001.

Table 1 shows the inflation adjusted premium rates for the liability insurance class in Australia. 1998 was a peak year during the period of price competition between insurers. Premium levels were only 61% of 1993 levels. Currently, premium levels are still only 90% of what they were in 1993. Indeed, given that claims inflation exceeds the CPI, it is likely that average premium rates are still below their 1993 levels.⁴

There are several reasons for the recent increases in public liability insurance premiums, including:

³ Ibid.

⁴ Ibid.

- A lack of regulation in the Australian insurance market
- Aggressive competition between domestic insurers in the 1990s
- The collapse of HIH and industry mergers
- A renewed focus on profitability by insurers
- Increased reinsurance costs
- Changes in the international risk environment
- A decline in investment earnings
- The cyclical nature of insurance profitability and premiums
- New capital adequacy requirements
- The impact of taxes and levies

Each of these points is discussed in further detail below.

a) Lack of Regulation in the Australian Insurance Market

Major disruption occurred in the Australian and international insurance market in 2000/1. The Australian Prudential Regulation Authority (APRA), the body responsible for prudential regulation of the Australian insurance industry since 1998, claims that it inherited 'flawed and outdated' systems for supervision and regulation of the general insurance industry.

This relaxed regulatory environment permitted insurers in the HIH group to compete irresponsibly with very low premiums and inadequate prudential reserves.

b) Aggressive Competition Between Domestic Insurers in the 1990s

The Australian insurance market was aggressively competitive throughout the late 1990s. That competition forced other insurers to lower their own premiums to unsustainable levels and contributed to the magnitude of the eventual HIH collapse. This price competition was led by some insurers in order to generate premium income in long tail products and to inflate their balance-sheet earnings.

The 2002 Delloitte & JP Morgan Insurance Survey compared commercial liability premiums⁵ over the last decade and adjusted them to reflect inflation. Surprisingly, they found that in 1998 premiums were only 61% of what they were in 1993. As at early 2002 they are still only 90% of what they were in 1993 (see Table 1, page 6).

By 1998 business had become used to receiving accessible, low-cost liability insurance from insurers such as HIH. However, their underwriting conduct was unsustainable, and eventually ceased when there was a shake-out in the market and competition declined. The insurance cycle turned and the environment switched from one in which insurers competed for consumers, to one where consumers were competing for insurance.

The speed at which premiums increased has caught business by surprise. What they perceive to be massive hikes in premiums are relative only to what they have become used to. Business does not realise that 1998 was not the norm, it was bargain-basement sale time. Current premium concerns are relative to what consumers were paying at the lowest point in the price competition cycle.

⁵ Which include public liability and product liability.

This aggressive competition also succeeded in dramatically increasing the number of insurance policies issued. Insurers are now having to pay out on claims made under policies written when premiums were at their lowest.

If free markets and competition are desirable economic policy ambitions in Australia⁶ then the savings in premiums garnered in periods of high competition in past years should be balanced against the high premiums presently seen. On the application of such economic theory, premiums will, presumably, again fall as insurers see opportunities to increase market share when other costs factors such as investment returns and reinsurance costs improve.

c) The Collapse of HIH and Industry Mergers

Since 2000 there has been a dramatic decline in the level of competition between insurers, and therefore a complete shift in the insurance market. This decline has occurred because of:

- i) Mergers between major players such as AMP/GIO, QBE/Mercantile Mutual, NRMA/GIO, etc; and
- ii) The collapse of HIH insurance in March 2001.

At the time HIH collapsed it was Australia's second largest general insurer. The group consisted of over 200 subsidiaries, including seven Australian insurers and re-insurers, and others overseas. The collapse of HIH in the insurance industry is as significant on its own, in competition terms, as the collapse of Ansett has been to the airline industry.

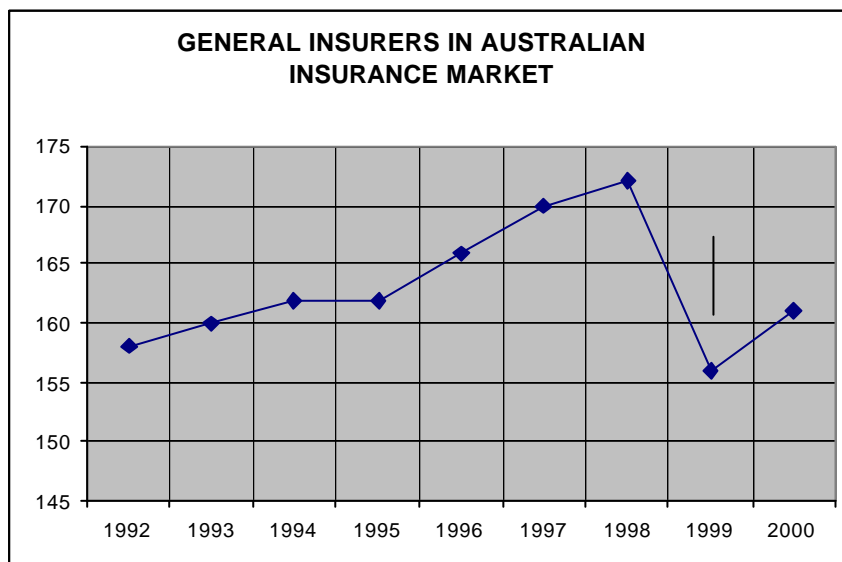


Figure 1 General Insurers in the Australian Insurance Market⁷

⁶ Commonwealth Governments for over a decade have promoted such policies.

⁷ Based on data in the Australian Prudential Regulation Authority (APRA), *Annual Report 1996 to 2000*.

d) Renewed Focus on Profitability by Insurers

Insurers in a competitive marketplace reduce premiums in response to price competition. Most will incur significant losses to prevent the erosion of their market share. These losses have to be recouped when competition declines.

The decline in competitive pressure between general insurers enabled the remaining players to become more focused on increased profitability.

The collapse of HIH has meant the remaining insurers in the market have been able to pick and choose their customers while simultaneously increasing premiums, in much the same way that Qantas has been able to increase its market share since Ansett folded.

e) Increased Reinsurance Costs

All of the above factors were operating to push premiums up before 11 September 2001. Since then the world insurance market has been thrown into turmoil.

Most insurers, particularly the small to medium ones, do not insure for the total risk under policies they write. Usually they will take the bottom layer of risk and will reinsure to cover themselves if claims exceed that layer. Often many different reinsurers will hold part of the risk on a particular policy, with their liability only arising once earlier layers have burnt through.

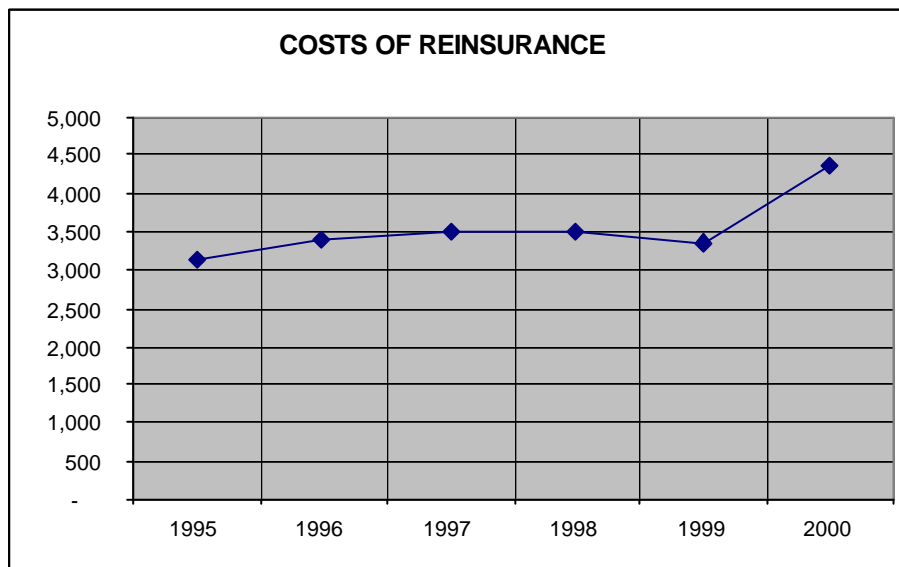


Figure 2 Costs of Reinsurance⁸

This means that premiums charged by local insurers reflect the cost of reinsurance in the global marketplace. The events of September 11 have produced a contraction in the reinsurance market, as major overseas insurers are now focusing on their local markets rather than assuming risks in less well-understood markets, such as Australia. This has resulted in greatly increased reinsurance costs, even without the risk of further terrorist attacks. This has occurred at a time when the cost of reinsurance was already under

⁸ Based on data in the Australian Prudential Regulation Authority (APRA), *Annual Report 1996 to 2000*.

pressure due to the fall in the Australian dollar from in excess of US80 cents in 1996 to US52 cents at present.

Insurance is an international industry. Events that occur in other parts of the world directly impact on global reinsurance rates. These increases are passed on to Australian consumers as increased premiums.

f) Changes in the International Risk Environment

Recent press reports cast doubt on whether major international events (such as the 2004 Olympics, the World Cup Soccer, etc) will be able to obtain insurance cover. These are international events, far removed from the local insurance market.

This reluctance to insure major events will have an impact on the availability of general insurance in Australia. Local insurers are for the first time concerned about major terrorism. Any event where a lot of people are exposed to risk, such as large entertainment venues, football matches etc, are potential targets. Even if the real risk is low, the potential insurance impact is high, so insurers must cater for that possibility.

All insurers that provided free terrorism cover prior to 11 September 2001 continue to remain exposed under policies that were written before that date. This has caused them to panic, pushing up premiums on new policies to retrospectively cover the terrorism risk exposure under current policies.

g) Decline in Investment Earnings

Insurers take premiums today in exchange for the risk that they may have to pay out in the future. Insurers invest the money they collect and use the earnings on those investments to increase their profitability.

On top of poorly performing international equity markets, the world economic outlook has changed considerably after September 11. Interest rates are at their lowest levels for decades. Recent rate reductions in the USA have produced a 'real' interest return after inflation of zero percent. The real rate in Australia is a little better (currently about 2%).

All major international equity markets recorded negative double-digit percentage returns during the last financial year. The impact of September 11 on international equity markets and the returns achieved by insurers is illustrated in the example of the Victorian Transport Accident Commission (TAC). This government-owned insurer, recorded its first ever loss in 2001, due entirely to the downturn in international equity markets. In its annual report for 2000/2001, an after-tax operating loss of \$192 million was recorded.⁹ Further, TAC's investment return of 2% was well below the budget of 7.5%, all due to the poor returns from international equity markets during that year.¹⁰

⁹ In 1999/2000 the TAC achieved a profit of \$447 million.

¹⁰ Transport Accident Commission, Victoria, *Annual Report 2000-2001*, p 35.

h) Cyclical Nature of Insurance Profitability and Premiums

Insurance company profitability is a cyclical phenomenon, as is the case in every other sector of the economy.

During the mid-1990s there was an over supply of cover in the insurance market. The resulting price competition between insurance providers in turn led to the under pricing of premium rates, poor underwriting of risk and an increase in claims frequency. Major underwriting losses ensued, with insurers losing around \$0.38 for every dollar of premium collected. As a result, many insurance providers have been reducing cover for this class or have ceased providing lower layers of insurance cover. The reduction in capacity in turn had led to a rise in premium rates.¹¹

The need for a rate increase is further highlighted by the poor profit results of the liability class over seven years between 1993 and 2000. On average this class has made a loss, with the average profit margin for premiums being 16.2%.¹²

At present, insurers are moving out of the lower end of the cycle. When the economy improves they will, for a while, make very high profits before again entering into the downward phase of profitability. The following graph illustrates how the insurance cycle works.

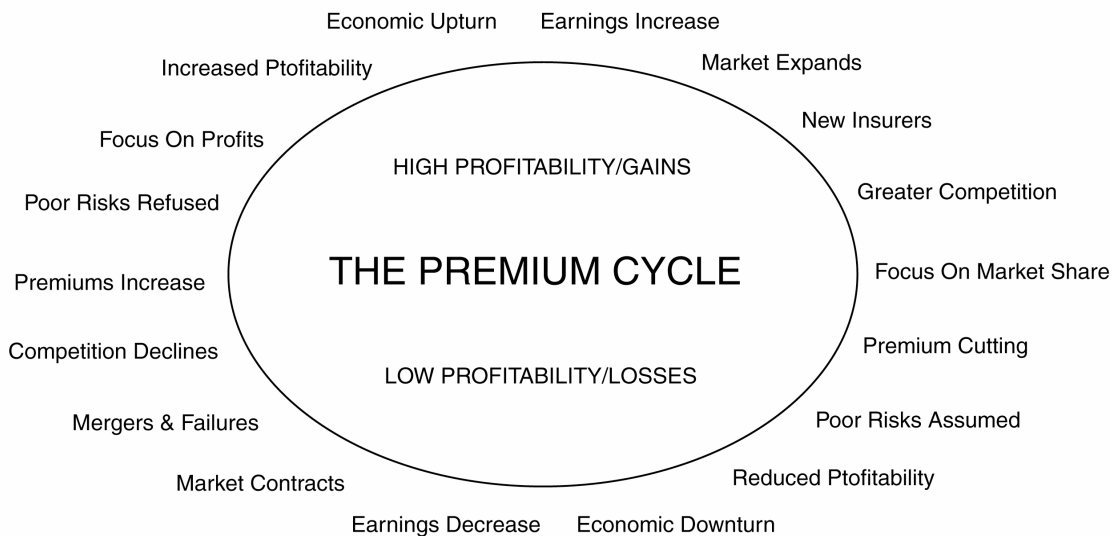


Figure 3 The Insurance Premium Cycle

¹¹ JP Morgan & Deloitte Touché Tohmatsu/Trowbridge Consulting, *2002 Interim Insurance Survey*, February 25 2002, p 15.

¹² Ibid p 6.

i) New Capital Adequacy Requirements

In 2001, APRA released new prudential standards for general insurance companies in Australia. The new regulatory framework included reforms to the capital adequacy requirements. According to APRA, the previous regulatory environment allowed insurers to lower solvency requirements by under-pricing or under-providing.¹³ The new APRA Prudential Standards include a minimum regulatory capital requirement of at least \$5 million (previously the minimum was \$2 million). While it has been argued that the new requirements will be a burden for insurers, APRA contends that the new capital requirements are a reasonable expectation for regulated institutions, and are not excessive relative to other regulated sectors. For example, the minimum capital requirement for the banking sector is \$50 million; for life insurers and building societies, \$10 million; and for approved trustees, \$5 million.¹⁴

APRA has road-tested its new capital requirements on existing insurers, comparing existing capital requirements with the new proposals. It concluded that regulatory requirements for the industry would rise by 40-50%. Importantly, APRA believes that in most cases the additional capital requirement could be met from existing reserves and that only a few companies would need to obtain new capital injections.¹⁵

Therefore, if an insurer did not have enough capital to meet this new financial requirement, then one way to deal with the problem would be to increase premiums to absorb the cost of compliance. Another is to close its doors, further reducing the capacity of the industry to meet demand, and fuelling further increases in premiums by those left in the market.

j) The Impact of Taxes and Levies

The impact of current government taxes and levies on public liability premium rates is becoming an increasingly important issue. In 2000, the NSW State Government received \$40.3 million in stamp duty on public liability insurance premiums.¹⁶ Nationally, the Federal Government collected over \$89 million in stamp duty on the liability class that same year.¹⁷

Insurance taxation in Australia is high and the levels of taxation are different in each jurisdiction. For example, the Victorian tax rate is four times the tax rate in Queensland. Furthermore, in states where the Fire Service Levy (FSL) is applied,¹⁸ it forms part of the tax base for GST on insurance. This effect is further compounded by the fact that the FSL plus the GST provide part of the tax base on which stamp duty is charged.

According to Geoff Carmody of Access Economics, the GST on general insurance has been misapplied as it taxes the whole premium rather than insurance margins as was originally

¹³ One of the factors which possibly contributed to the ultimate collapse of HIH Insurance.

¹⁴ Byres, Wayne, *The New Capital Adequacy Regime*, APRA Seminar on General Insurance Reform, May 2001.

¹⁵ Ibid.

¹⁶ Beaton, P., NSW Shadow Minister for Insurance Regulation, *Carr Hypocritical on Insurance*, Media Release, March 8 2002.

¹⁷ Insurance Council of Australia, *Liability Insurance*, February 2002, p 9.

¹⁸ Victoria, New South Wales, Western Australia and Tasmania.

intended. Consequently, the effective GST rate on general insurance far exceeds the required 10%. Eventually, this cost is passed onto those taking out insurance policies.¹⁹

When premiums increase, the proportion of premiums that goes to government authorities also increases. It is recommended that taxes and levies on insurance premiums be reviewed and perhaps the excess earned this year from these taxes be set aside for the assistance of those sectors worst affected by the hikes in premium costs.

2 Refuted Causes of Premium Increases

The following issues have been raised by various parties in this debate as contributing factors in the rise of public liability insurance premiums:

- Increasing litigation
- Increasing claims
- 'No-win, no-fee' costs arrangements
- Lawyer advertising
- Legal costs

In this section APLA examines each of these issues in turn, and proves they have no bearing on current premium increases.

a) Increasing Litigation

It has been suggested that changing societal attitudes towards compensation is a causal factor in rising premium rates for public liability insurance. Improvements in education and access to the media have meant that the public is more aware of their rights to recover damages from third parties. It is alleged that this has led to a widespread belief within the community that there should be 'compensation for any loss, which used to be considered fate, luck or an accident.'²⁰ Indeed, 'Australia has been regularly quoted as being the second most litigious society after the USA.'²¹ The latter statement is based on a paper written in 1983 by a US academic, who admits that his basis for the comparison is deficient.²² The paper was never meant to be a scientific comparison of litigation rates between the two countries and is now 19 years out of date.

The veracity of these arguments is questionable given the lack of credible quantitative or qualitative evidence to support them. According to the annual report of the Australian Productivity Commission, litigation has not increased in Australia; rather it has decreased at an average annual rate of 4% over the last three years (see Figure 4 below).²³ If society were becoming more litigious, would there not be a corresponding rise in litigation rates? In light of the lack of evidence supporting this claim, it is disturbing that it continues to be

¹⁹ Geoff Carmody, *General Insurance: Suffering Tough Times – And Tougher Taxes*, paper presented at the 2002 ICA NSW Conference.

²⁰ ICA, *Liability Insurance*, February 2002, p 11.

²¹ *Ibid* p 1.

²² Marc Galanter, "Reading the Landscape of Disputes: What we know and don't know (and think we know) about our allegedly contentious and litigious society", 1983 *UCLA Law Review*, 31:4, p 4.

²³ Australian Productivity Commission, *Annual Report 2000-2001*, p 409 and Table 9A.1.

APPENDIX D

Appendix 2 of Kehl's paper: Liability Insurance Premium Increases:
Causes and Possible Government Responses

Appendix 2: New Zealand Accident Compensation Scheme²⁵

The accident compensation scheme provides accident insurance for all New Zealand citizens, residents and temporary visitors to New Zealand. In return people do not have the right to sue for personal injury, other than for exemplary damages. The scheme:

- provides cover for injuries, no matter who is at fault
- eliminates using the courts for each injury
- reduces personal, physical and emotional suffering by providing timely care and rehabilitation that gets people back to work or independence as soon as possible
- minimises personal financial loss by paying weekly earnings compensation to injured people who are off work
- focuses on reducing the causes of these problems – the circumstances that lead to accidents at work, at home, on the road and elsewhere.

The scheme is administered by the Accident Compensation Commission (ACC) which spends about \$NZ1.4 billion each year on rehabilitation, treatment and weekly compensation. To fund these services, the ACC collect premiums. The ACC also earn income from investing premiums.

All New Zealanders pay premiums for ACC cover. Premiums are set to pay for the current and future costs of all claims made in that year.

The government funds the costs of injuries to people whom are not in the paid workforce. The government funds this on a 'pay-as-you-go' basis, meaning that ACC collects enough today to pay for all costs today. The government sets premiums. They result from recommendations from ACC's Board of Directors following a formal public consultation process. As a result of improved scheme performance, premiums have begun to fall and over the past two years have reduced by nearly \$NZ500 million, a 25 per cent drop.

The premiums paid to ACC are assigned to one of seven accounts. When there is an ACC claim for this type of injury, the compensation is funded from this account.