Unfair Contract Protection for Small Business.

Submission to:
Consumer Affairs Australia and New Zealand

In response to:
Consultation Paper

Extending Unfair Contract Term Protections to Small Business

1 August 2014

SUBMISSION BY

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PURPOSE

- This submission is made by the Australian Institute of Architects (the Institute) to Consumer Affairs Australia and New Zealand (CAANZ) in response to the Extending Unfair Contract Term Protections to Small Business – Consultation Paper, May 2014.
- At the time of this submission the Executive Committee of the Institute is: David Karotkin (National President), Jon Clements (President-Elect), Paul Berkemeier (Immediate Past President), Ken Maher and Steve Grieve.
- The Chief Executive Officer is David Parken.

INFORMATION

Who is making this submission?

- The Australian Institute of Architects (the Institute) is an independent voluntary subscription-based member organization with approximately 10,000 members, of which approximately 6,300 are architect members (registered or registrable under State and Territory Architects Acts).
- The Institute, incorporated in 1929, is one of the 96 member associations of the International Union of Architects (UIA).
- The Institute represents the largest group of non-engineer design professionals in Australia.

1.0 INTRODUCTION

1.1 Purpose of submission

1.1.1 The Institute is pleased to provide comment to the CAANZ on extending unfair contract protection to small businesses. The Institute also commends to CAANZ the submission made by Insurance Brokers Limited (IBL). IBL is the Institute's subsidiary insurance broker which through its contract review service to its clients, deals at the 'coal face' with the terms of standard form conditions of engagement for supply of architectural services.

1.2 Expertise of the Institute

1.2.1 The Institute seeks to advance the professional development of the architectural profession and highlight the positive benefits of good design in addressing the concerns of the community in relation to sustainability, quality of life and protection of the environment.

1.2.2 The Institute promotes responsible and environmentally sustainable design, and vigorously lobbies to maintain and improve the quality of design standards in cities, urban areas, commercial and residential buildings.

1.2.3 The Institute has established high professional standards. Members must undertake ongoing professional development, and are obliged to operate according to the Institute's Code of Professional Conduct. The Institute's Professional Development Unit offers an extensive program at national and state level, continuing to keep members informed of the latest ideas, technology and trends in architecture and the construction industry.

1.2.4 The Institute represents the profession on numerous national and state industry and government bodies, advising on issues of interest to the architectural profession, other building professionals and the construction industry.

1.2.5 Particular areas of expertise include:

- quality assurance and continuous improvement
- industry indicators and outcomes
- market analysis
- risk management and insurance
- marketing and communication
- policy development and review
- technical standards
- environmental sustainability.

1.0 COMMENTARY

1.1 Commentary on questions raised by the Consultation Paper.

Almost without exception, the membership the Institute represents comprises "small businesses" in the terms commonly understood, although we appreciate that there is scope as explored in the Consultation Paper for variable definitions of small business. The Institute's commentary on the questions is confined to the contracts by which architects are engaged by their clients to provide architectural services. This is the area in which the Institute perceives a need for the regulation of contract terms.

1.2 Response to questions raised by the Consultation Paper

(with questions reproduced and responses below each question)

1 How widespread is the use of standard form contracts for agreements with small business and in what circumstances are they used?

In relation to the supply of architectural services, standard form contracts are primarily the means of engagement by clients of architects. In the context of the construction industry where there is widespread use of standard forms produced by industry bodies and Standards Australia we have some difficulty with the notion that a "standard form" comes about *merely* because it is a form presented by one party to the other without negotiation from the outset of the contractual relationship. However, by either definition, the engagement of architects by standard form is widespread. This is both the result of legislation affecting architects which mandates written terms of engagement with clients, and the publication of standard terms by the Institute which its members can propose as the form of engagement to their clients. However, whether the industry standard forms are used as a base document or not, it is rare for a larger business or government to engage an architect with a form of engagement that is not a standard form according to the definition used in the Consultation Document.

2 What types of transactions are they commonly used for, that is for which goods and services, in which industries and over what range of transaction values?

Please refer to the answer to Question 1, above.

3 What are some of the benefits and disadvantages of standard form contracts?

Undoubtedly, negotiation from scratch at every engagement would create significant transaction costs for both parties. The traditional advantages of standard forms are well recognised. However, it is the non-negotiability arising from the imbalance of bargaining power which results in what the Institute considers to be commonly found unfair terms and that imbalance would result in the same unfair terms, whether the negotiation was conducted from scratch, or whether "negotiation" occurred at all.

4 To what extent are businesses reviewing standard form contracts or engaging legal services prior to signing them? Does this depend on the value or perceived exclusivity of the transaction?

The Institute's response to this question is largely anecdotal, whereas IBL's submission is able to quantify its answer, to some extent. Our response is that this would vary widely, as could be expected, where prior experience with the negative impacts of unfair terms will be an incentive to expend resources on review and engaging legal services, as will be a perception of value, significance, or perception of the likely "difficultness" of a client.

5 To what degree do small businesses try to negotiate contracts that are presented on a 'take it or leave it' basis? Are there types of goods and services where small businesses are more likely to try to negotiate contracts?

The Institute's feedback from its members, and its own experience with Government at times, is that where services are being offered to a client with greater bargaining power, terms are largely non-negotiable, therefore on a 'take it or leave it basis'.

6 What considerations influence the design of terms and conditions in standard form contracts?

In relation to the offer of services to clients where the client determines the terms, considerations which are of concern involve risk allocation from the client to the service provider.

7 What terms are businesses encountering that might be considered 'unfair'?

There are a number of typical terms in contracts for supply of architectural services, of concern mostly because they involve risk shifting to the party least able to control them. Typically, they concern the granting of indemnity to the client which does not depend on fault by the supplier and/or taking on uninsurable risk which is vastly greater in monetary terms than the consideration for performance of the contract. The Institute's view is that indemnities are almost always an unfair term demonstrating inequitable bargaining power, as what party in an equal or superior position would grant an indemnity which overrides rights otherwise available to it?

In our view, any term which requires the architect (or other professional services provider delivering advice and knowledge rather than physical things) to assume risk which is beyond their common law and statutory responsibility, is unfair.

8 Do these terms relate to the operation of the contract or to remedies available under the contract?

Principally, they relate to the remedies available.

9 What detriment have businesses suffered from UCTs and are there examples of business sectors where detriment is particularly prevalent?

Where the unfair terms are about remedies, of course consequences vary. However, a contract term such as an enforceable indemnity which overrides contractual fault creates an incentive for the party giving the indemnity to settle disputes on unfavourable terms rather than assert contractual and common law rights in the face of the ultimate enforcement of the indemnity by the other party.

10 How do unfair terms in standard form small business contracts impact on confidence and trust in the market?

The common explanation from the powerful client for unfair terms (as the Institute perceives them as described above) is one or both of, that the terms are the policy of the client and unchangeable, or, that they would not be used. Unsurprisingly, our members report that the fact that such terms are retained, despite attempts to have them removed by our members as the weaker party in the transaction, suggests that they will be used and this does promote distrust and lack of confidence.

11 Who is including 'unfair' terms in contracts to small businesses? Is it larger business and/or a third party (such as a lawyer) drawing up the contract?

Larger businesses and Government are the primary sources of unfair terms for the small businesses we represent. Inevitably there is or has been lawyer involvement in drafting

the terms, but presumably on the instruction to minimize risk to the larger business or Government.

12 Is it the terms or the process by which some contracts are negotiated between small business and business to be the primary issue for small businesses?

In the Institute's experience the two factors are indistinguishable in effect. The issue is bargaining power. Without bargaining power, an unfair term cannot be negotiated out of a contract even if so-called negotiation is available.

13 To what extent do small businesses engage legal services prior to signing standard form contracts? What transaction value does a contract need to have for businesses to engage legal advice? Are there any other factors that would influence a business' decision to engage in legal advice prior to signing a standard form contract?

Small businesses we have experience with, rarely engage legal services, as the margins to enable this cost are unavailable. As outlined in IBL's submission, contract advice services when available, such as for their insurance clients, are heavily utilized. However we stress that legal advice means little if the terms are non-negotiable or bargaining power prevents their effective negotiability.

14 Are there examples of instances where risks have been unfairly shifted to small businesses in contracts?

Yes, in our view such risk shifting is the norm rather than the exception.

15 How are small businesses currently addressing issues with respect to UCTs? Are they resolving complaints informally or addressing complaints through more formal channels such as regulators?

There are no effective regulatory channels for the nature of unfair terms we describe above.

16 How many businesses offer goods and services to small businesses via standard form contracts?

The question is not applicable to the Institute's response.

17 How many of these contracts treat business customers and consumers differently?

The question is not applicable to the Institute's response.

18 To what extent are businesses relying on/enforcing unfair contract terms?

The evidence of the frequency of enforcement is not available, but as we noted above, when settlement of claims is the norm, it is not necessary in most cases for the larger business to *actually* enforce the term, because the small business or its insurer or legal representative in negotiating settlement is well aware of the "big stick" in the contract.

19 Do existing regulatory mechanisms provide comparable protection for small businesses from the inclusion of unfair contract terms in standard form contracts? Do they achieve the overall policy objective of helping to provide a level playing field for small business customers when interacting with other businesses through standard form contracts?

In our opinion, no.

20 What is the extent of any overlap between the proposed UCT law for small businesses and existing regulatory mechanisms?

In our opinion, very little.

21 Do existing enforceable regulatory mechanisms provide adequate, accessible and timely avenues for redress?

In relation to the kinds of unfair terms we refer to, the existing mechanisms provide little to no avenue for redress

22 What role do market forces play in reducing the incidence of UCTs and are they sufficient to address the problem?

In relation to the kinds of unfair terms of concern to the Institute, market forces are the reason for their existence, because there is unequal bargaining power.

23 Do UCTs impact upon competition between businesses, particularly by increasing the cost and risk of doing business for small businesses more than for large businesses? Is there scope for greater competition between businesses in the absence of UCTs?

This will vary according to circumstances. As discussed in the Consultation Paper, small businesses who are unaware of the unfair terms and their impact because they have not the resources to consider the terms presented to them will not be deterred by risk or potential cost. Larger small businesses, or those responsive to education provided by bodies such as the Institute, are likely to be more sensitive to the existence of the unfair terms. Some larger small businesses with higher bargaining power through reputation or exclusivity, may have more success in removing unfair contract terms such as we have described.

24 Are there any industry led responses that currently address the identified problem, and have they been effective or ineffective?

The professional consultant industry in general works constantly to educate service providers and encourage the negotiation of such terms out of contracts of engagement. However, as noted above, imbalanced bargaining power hampers its success.

25 Are future industry led responses a viable approach to addressing the problem?

In our opinion this is unlikely unless the more usual bargaining power inequality in favour of the client seeking professional services was to be reversed.

26 Are existing regulatory interventions and mechanisms effective?

As noted above, in our opinion, no.

27 Would information disclosure requirements impact the decision of small businesses to review standard form contracts and/or consider the terms included in standard form contracts?

In the commercial context we are addressing in this submission, and given general awareness through the activity of industry bodies of the types of clauses considered unfair in this commercial context, it is unlikely that disclosure requirements would have a significant impact.

28 What are the costs to business in complying with disclosure obligations relating to other types of information?

The question is not applicable to the Institute's response.

29 Would a list of unfair terms or a default template created by the government, or by industry, assist small businesses in considering whether to sign a standard form contract?

Please refer to the answer to question 27.

30 Would these approaches reduce the incidence of unfair terms in standard form contracts?

In our opinion, this would be unlikely to have a significant impact.

31 How would these approaches impact on the flexibility of businesses to include terms that may be unfair in some instances, but are not unfair when applied to their particular circumstances?

Given our answer to question 30, we offer no comment.

32 Would the benefits of a targeted legislative response (such as only deeming specific unfair terms offered to small business as void) outweigh the costs of such an approach?

If the targeted unfair terms were those which in professional consulting services, including architecture services, are considered unfair, then certainty about what was unfair and void would be a general advantage because it would be unnecessary to take enforcement options as the ultimate remedy. Conversely, if instead, the only legislative response is to target unfair terms are not those which the professional consulting service industry recognizes as unfair, then there is no value to our industry sector.

33 How would such an approach interact with existing regulatory protections?

In our view, as there is virtually no protection from unfair contract terms in existing regulatory protections there is no interaction to be concerned about.

34 Are particular types of terms in standard form contracts (such as unilateral contract variation, or termination rights) more likely to be considered 'unfair' by small businesses?

There are particular types identified in the Consultation Paper, and the existing Consumer legislation, but as we have identified in the above, there are others, including the indemnity clauses we are most concerned about.

35 Does this option reduce flexibility for businesses to provide contracts which provide overall benefits to consumers? Would some businesses move to negotiated contracts?

The types of unfair terms we are describing have no relevance to overall benefit to consumers, other than that where government is concerned, risks that are transferred to architects and others, but which are, as a consequence of the unfair terms such as indemnities, uninsured if they come to fruition, have ultimately no benefit to the consumers government represents (as taxpayers)

36 Are there any unintended consequences that could arise from this option?

We foresee none.

37 If businesses were unable to include UCTs in their agreements, would small businesses be able to better compare the value of competing offers to supply/acquire?

This question is not relevant to our submission because the small businesses we represent are making competing offers to each other, large businesses, (if small businesses are those which are not publicly listed companies – see our response at the beginning of this section), or to consumers.

38 To what extent will contracts be reviewed if these new laws were implemented?

As we have set out above, the issue for the industry sector we operate in is not whether or not contracts are reviewed, but the ability of the small businesses to achieve a better outcome after review in the face of unequal bargaining power.

39 For businesses who offered standard form contracts to consumers prior to the introduction of the ACL, what was the estimated compliance cost from adapting to the ACL UCT laws?

We have no information on this.

40 Are there other options not considered in this paper that would effectively address the problem?

We have no further options to offer.

41. What are the benefits and disadvantages of each definition option?

From the perspective of the Institute's membership, a definition that excludes some members who nevertheless in relationship to exposure to unfair terms are equally disadvantaged by them.

42. What option is the most appropriate definition for extending the UCT laws? Should it be defined by business or transaction size?

In our opinion, in the context of the Institute's membership, the unfair contract terms protection ought to be applied in favour of "businesses that are not publicly listed".

43. Should the extension of the UCT provisions provide protection for small business when they acquire and supply goods or services?

The Institute considers that the protection should extend to contract terms in both aspects.

44. Should any extension void unfair terms in a small business to small business contract?

As a matter of principle, in our view, there is no justification for allowing one kind or size of small business to have exemption.

45. Do you consider that the UCT laws within the ASIC Act should be extended to apply to small business contracts?

This question relates to extension of reforms to the financial services and as such is not of relevance to our submission.

August 2014