EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESSES

**RESPONSE TO
CONSUMER AFFAIRS AUSTRALIA AND NEW ZEALAND
CONSULTATION PAPER**

Introduction

Thank you for the opportunity to comment on the Extending Unfair Contract Terms to Small Businesses Consultation Paper.

Consult Australia is the industry association representing the business interests of consulting firms operating in the built and natural environment. These services include design, engineering, architecture, technology, surveying, legal and management solutions for individual consumers through to major companies in the private and public sector including local, state and federal governments.

We represent an industry comprising some 48,700 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms with combined revenue exceeding $46 billion a year. Our member firms have played vital roles in the creation of some of Australia's iconic public infrastructure, including road, rail, hospital, airport, educational facilities, water and energy utilities, justice, aged care, sports stadia, and urban renewal projects.

Consult Australia is pleased to make a submission and participate in the consultation process informing any decisions made in this regard. Members of our industry frequently report being presented with unfair contracts, with little scope to rectify the terms in question.

In terms of a policy response to this issue, we cautiously welcome the proposed protections, noting that broader solutions are probably also required, and also noting our concerns about the possibility of unintended consequences resulting from such a reform.

To further discuss any issue contained in this submission, please contact Robin Schuck, Senior Advisor, Policy and Government Relations, on (02) 9922 4711 or robin@consultaustralia.com.au.

Our detailed response to the Consultation Paper is set out below.

1. Our Industry

Consult Australia represents professional services providers within the built and natural environment sector. Our members undertake a diverse range of activities, with the common factor being that they provide a service, based on professional expertise. Services include scoping studies, environmental impact assessments, through to designs, reviews and certifications. They are provided on a range of projects varying from mining and resources, through to the development of public infrastructure to designing residential houses.

Depending on the nature of the project, the engagement of a consultant may potentially form part of a complex web of contractual relationships. For major public infrastructure projects, for example, it is common for the client to engage a developer, who in turn will engage a consultant for design elements under the "design and construct" delivery mechanism. Other projects will see a client directly engage a consultant, while others still might see the formation of an alliance body where each party shares in the risk and rewards on offer. The interaction between consultant, client, constructor, and any sub-contractors or sub-consultants engaged is a major aspect of the environment in which our industry operates. Each has a distinct role to play in successful project delivery, with different roles, responsibilities, and mechanisms for resolving issues that arise throughout the project.

Small Business and Unfair Contracts

Our industry and our membership ranges from sole practitioners to multinational companies, across a diverse number of practice areas. While firms of all sizes encounter unfair contract terms, the larger firms typically have an in-house legal team to explain the consequences of unfair terms, and to conduct negotiations. Some of our smaller member firms may have access to legal advice, with a lawyer hired on a retainer basis to provide advice when required. However, a large number of smaller members simply do not have access to this type of advice, and when they sign contracts, do so on the basis of it being a document that wins them the work, rather than as a document allocating rights, responsibilities, and potential future liabilities between the parties.

According to Consult Australia's Economic Forecast, 93% of the firms in our industry are categorised as small businesses (employing 20 or fewer staff, including sole practitioners)[1]. Small businesses in our industry generally undertake work for smaller clients, such as residential work, but they do also provide specialist services for larger projects, where they are often engaged as sub-consultants. In these cases, they may be working on large infrastructure projects that require their specialist skills. The contracts presented to them are generally standard form when the small business is the head consultant working for a smaller client, while small businesses engaged as sub-consultants, will typically be hired on the same terms as the lead consultant.

It must be noted that a key difference between consumers and small businesses in our industry, is that a small consultancy may be part of a much larger web of contracts between a range of parties, which is common practice in the construction sector.

While much of the focus of this consultation is on small business as consumer of goods or services from other goods, in our experience the potential harm they might suffer from unfair contracts results from onerous contracts they are presented with in their capacity as service provider. The impact of those terms is heightened by the strong likelihood that the small business has limited ability to negotiate terms, and invariably has less bargaining power than the party they are contracting with.

2. Unfair Contracts and Their Impact

Members of our industry aggrieved by some of the onerous terms in contracts presented to them would argue that a great number of contracts presented to them are "unfair". Given the nature of this consultation, the definition and nature of "unfair" contracts warrants some consideration.

The existing test applied to consumer contracts for unfairness includes as elements that a term is "unfair" if it causes a significant imbalance in the parties' rights and obligations, it is not reasonably necessary to protect the legitimate interests of the party advantaged by the term, and would cause detriment to the consumer if relied upon[2].

The Consultation Paper applies these same principles to a business scenario. We support as elements of the test, the requirements that the terms cause a significant imbalance in rights and obligations, and the requirement for detriment to result from a term if relied upon. Whether a term is reasonably necessary to

[1] Bills, G (2014). *Economic Forecast 2014: An economic forecast for consulting in the built and natural environment.* Published by Consult Australia. At p4.

[2] From *Consultation Paper* at pV.

protect the legitimate interests of the party who included it is a more complicated element of any test however.

The test of reasonableness in this instance is particularly complicated, and would require further clarification. For example, certain indemnities in a contract may appear reasonable when taken in isolation and without reference to a particular industry or insurance. However, that term may have the effect of creating an uninsurable risk when presented to a member of our industry.

The basic premise of risk management and transfer is that risks should be allocated to the party best able to manage them. Too frequently, parties drawing up contracts offload, rather than manage risk, resulting in risks landing with parties that may not be in the best position to meet this premise. From Consult Australia's perspective, any test of reasonableness should be based on this same notion of risk management.

The basis of this element, as stated at p5 of the Consultation Paper, is that the party presenting the contract has better knowledge about the terms and conditions than the small business. However, while the small business may certainly be at a disadvantage with regard to understanding the impact of the terms and conditions, our experience has been that onerous contract terms are often a product of inadequate client understanding of the impact of these terms.

Risk Allocation and Management

A common theme throughout contracting in the built environment sector is the contractual offloading and "buck passing" of risk, often at the expense of proper risk management activity, and generally based around market power, rather than the ability to manage risk, determining where that risk is allocated. While we recognise the important role consultants play in determining a project's successful delivery, they are also often the party with the least bargaining power, and hence the party to whom most contractual liability is shifted. This has major implications for insurance coverage of their work, but also represents a major impost on the industry in terms of the risk burden, and resources allocated to resolve disputes.

The allocation of risk between parties is a major driver of contractual unfairness within the built and natural environment sector generally. Liability must be managed equitably, with regard to good risk management and the ability of professional indemnity insurance to respond to claims and cover losses. It is important to note that consultants generally have few assets beyond their insurance cover, and hence limited ability to cover liabilities that go beyond that level of insurance cover, or where insurance doesn't respond to a claim.

A fundamental principle of risk management is that each risk associated with a project should be allocated and managed by the party best able to do so. However, it is common practice amongst many clients (especially including public sector clients) to offload all risk and contractual liability to the service provider they are contracting, even where the impact of this move runs contrary to government policies or established notions of best practice risk management. This includes a range of other onerous terms that have been canvassed in other submissions to government and are set out at the bottom of this section.

One important consequence of clients allocating liability to service providers is that they think they have properly managed the risk associated with their project, when in actual fact they have done the opposite by allocating it to a party less able to manage that risk for the overall benefit of the project.

Consult Australia is opposed to requirements of excessive liability contained in a contract on the basis that these requirements promote the acceptance of risks which are beyond the control of any consulting firm. Such practices threaten the sustainability of our industry, produce uncertainty and higher costs for clients and do not promote good risk management to the expectation of the community. To our membership and broader industry, this issue is at the core of unfairness in contracts.

Their impacts are felt through insurance outcomes (discussed below), as well as less desirable project outcomes, and are also simply unfair, which may have longer term practical impacts. The less desirable project outcomes arise owing to a range of factors, including:

- increased time spent on negotiation of terms;
- the requirement for costly legal advice;
- risk being priced into tender prices over the longer term;
- inappropriate risk management practices based on a "deep pockets" approach to litigation rather than carefully managing risk in the first place. Where all contractual risk is allocated to one party, the other party is better able and more likely to "wash their hands" of involvement in managing that risk; and
- diminished competition as potential bidders are deterred from tendering for work.

Insurance and the Consulting Industry

Consulting firms that make up Consult Australia's membership play a crucial role in the built and natural environment sector. They provide the expertise used to scope potential infrastructure, to develop plans to build a project, and come up with solutions to overcome obstacles encountered along the way. Because they are not the final service provider, they are often involved in a potentially complicated web of contractual relationships with the client, contractors that undertake the actual works on site, and sub-consultants to whom specialist tasks may be outsourced.

The consulting industry as a whole is an asset poor class of people and organisations when compared to the parties they are contracting with. Because the service they provide is professional expertise rather than a tangible good, they depend on insurance to cover any liabilities that arise, including contract disputes or failures in the delivery of a final product. Consultants take out extensive and often expensive insurance policies to cover any liabilities that arise, and to ensure they and their businesses don't suffer financial losses.

What is often not appreciated, however, is the interaction between insurance policies and contractual terms and conditions such as those that allocate liability between the parties.

An important principle at the centre of this issue is that insurance will generally only cover a party for losses that they would be liable for at common law. Any contract that assumes liability beyond the common law position risks creating an uninsurable risk, and harming both parties to that contract. Many of the commonly encountered unfair terms described below fall within this category, and represent a major risk to the ability of a consultant's professional indemnity policy to respond to any claim made against them.

Freedom of Contract and the "Level Playing Field"

In analysing potentially unfair contractual terms, many problems are derived from the premise of "freedom of contract," with the notion that all contractual terms are the result of negotiation and agreement between parties.

Unfortunately, this premise is seldom the case, as uneven bargaining power is common, and means one party tends to dictate terms, while the other is forced to accept those terms. Even where negotiations take place, the common outcome is that at best, only minor changes result.

Where parties to a contract have unequal bargaining power, the concept of "freedom of contract" is illusory. Most professional services firms are small businesses and even those that are not operate in very competitive markets where contracts are offered on a "take it or leave it" basis. Very few, if any,

professional firms are in a position to "walk away" from work, even where the work is offered on harsh contractual terms. This is particularly the case in tougher economic environments.

The uneven nature of the negotiation process means that onerous terms which a consultant might be unable to meet often find their way into a contract. Consultants are then faced with the options of pricing that risk into their bid, deciding not to bid for that project, or simply absorbing the risk and its potentially damaging consequences if realised. In the last instance where risk does eventuate, it has the potential to bankrupt a business as insurance won't respond to a claim, and their balance sheet is inadequate to cover the resulting liability.

In Consult Australia's experience, many clients will generally make contracts as aggressive as the law allows them to. When taken together with the uneven basis of negotiations described above, this leads to highly aggressive contracts offered to our members with little ability to address those terms that might not be satisfactory, or could lead to harmful outcomes.

Standard form contracts, by definition, are not freely reached between the parties following negotiation. They are generally used as an efficient way to save the parties costs on negotiation and legal advice, and often on projects where the work is not complicated enough to justify a bespoke contract. In these instances existing standard contracts are often used. Where the standard contract is one that has been carefully developed cooperatively between industry and client representatives, this is a positive move. However, where a standard contract is developed unilaterally, or a client attaches special conditions to an existing standard contract, those benefits may not be realised. In fact, the latter of these instances is particularly problematic as clients add clauses that defeat the very intention of the original standard contract with regard to risk management.

Thus, where the law operates on the theory that a free contract is being reached, providing options for the parties to agree to in terms of how they manage their risks and liabilities, the reality is quite different. Small businesses in our sector are rarely able to negotiate terms in response to a contract presented to them. The Consultation Paper recognises this issue throughout, and it is a vital point to bear in mind when considering risk allocation in contracts.

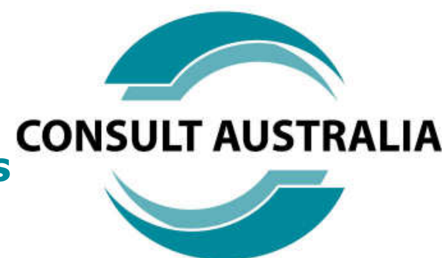
Commonly Encountered Unfair Contract Terms

While the range of onerous contract terms faced by consultants is fairly wide, the main sources of frustration to our industry generally fall within a relatively small number of categories. Each of these meets the test for unfairness as set out in the existing test for consumer claims, and included in the Consultation Paper.

The main cause of onerous contract terms is the contractual offloading of risk by the party presenting the contract. As we have already set out, it is accepted best practice that risk should be borne by the party best able to manage it. However, these terms offload risk to the party with the least bargaining power, and in the case of consultants, often a party not able to manage those risks at all. One such common practice is the contracting out of proportionate liability.

Contracting out of Proportionate Liability

Proportionate liability was a reform brought in following the collapse of HIH, and replaces joint and several liability with a liability system whereby parties are only liable for the share of the loss they are responsible for. However, in those jurisdictions where contracting out of proportionate liability is allowed, this option is frequently used as a default position, even though professional indemnity insurance won't generally cover a consultant who has contracted out of proportionate liability. The issue of proportionate liability is the subject



of an extensive submission made by Consult Australia to the NSW Government, who are currently considering options for reform, and we encourage you to read this for further information on this issue[3].

Indemnities

Another common practice by parties seeking to offload their risk through a contract is the improper use of indemnities. While we consider it reasonable for a consultant to indemnify other parties for the consequences of their actions, they are often called on to indemnify other parties for loss resulting from another party's actions, or otherwise beyond their control.

Both of these practices described above fail the test of allocating risk to the party best able to manage it. In both cases, professional indemnity insurance is unlikely to respond to a claim, and the undesirable project outcomes set out already in this submission may also result. In terms of the Australian Consumer Law test for "unfairness", these terms cause an imbalance in the parties' rights and obligations, in that all obligations are shifted to one party, even when they are not the most appropriate party to meet them. While some clients may argue these terms are reasonably necessary to protect their legitimate interests, in actual fact these practices do not properly mitigate against the liabilities they are hoping to avoid. Finally, these terms would certainly cause detriment to consultants if relied upon, in the form of a financial liability arising, without the benefit of insurance to cover that liability.

Inappropriate Standards of Care

Another common onerous contract term is the use of "fitness for purpose" warranties. These are an appropriate standard of care for constructors, but not for consultants. Consultants provide advice to a client, but cannot control how that advice is used, and accordingly liabilities arising from this term are uninsurable. A more appropriate standard of care is based on a test of reasonableness, with reference to other consultants of similar experience and qualification working on the same project. This term, as with the risk shifting terms, is designed to protect the client, but potentially causes damage to the consultant (if relied upon) and in the process seriously imbalances the rights and obligations of the parties.

A greater range of contractual terms that negatively affect our industry has previously been canvassed in our submission to the Commonwealth Attorney-General's Department Discussion Paper on Traditional Contracting Reform, and we commend that submission as useful background reading to this submission[4].

3. Standard Contracts in the Built and Natural Environment Sector

Standard contracts are a common feature of business relationships in the consulting industry. They are regularly issued by government clients that make up a significant part of our industry's customer base, and through the development of standard contracts by industry itself, such as AS4122 (see the next section for more information about AS4122) or Consult Australia's own standard contracts developed for members, are also regularly used by consultants working for smaller private sector clients. The prevalence of standard contracts is particularly the case with smaller projects, which have less need to cover specific project risks that are more likely to exist with larger and more unique projects.

[3] Consult Australia submission to the NSW Government in response to model Proportionate Liability provisions. Available online at: https://www.consultaustralia.com.au/docs/default-source/contracts-liability/proportionate-liability-reform-submission--march-2014.pdf

[4] Consult Australia response to *Traditional Contracting Reform Consultation Paper* (April 2012). Available online at: http://www.consultaustralia.com.au/docs/default-source/contracts-liability/Response_to_Consultation_Paper_on_Infrastructure_Contracting_-_April_2012.pdf?sfvrsn=0

In general, the use of standard form contracts has the potential to provide many benefits to our industry. They allow for a range of more contentious terms (such as standard risk and liability clauses) to be negotiated between stakeholders (often Consult Australia, together with the client, or government agencies with responsibility for procurement policy) and then used by firms without the need for negotiation or often expensive legal advice. They can also provide comfort to those firms without the resources to legally review contracts, that they are not signing an agreement containing onerous terms they might not be able to meet.

From the client's perspective, the use of standard contracts in our industry allows for more time and energy to be spent on scoping and delivery of the project, rather than contract negotiation.

Standard contracts do however pose challenges if they are not developed in collaboration, or if onerous terms are unilaterally attached to such an agreement after its development. This is especially the case when special conditions are attached with the specific aim of overcoming the carefully balanced risk allocation between the parties.

The Australian Standard: AS4122

AS4122 is the Australian standard contract for use when engaging consultants, and was developed under the auspices of Standards Australia involving a range of relevant stakeholders, including Consult Australia, the Association of Consulting Architects Australia, Australasian Procurement and Construction Council (representing government), Australian Constructors Association, Australian Institute of Architects, and the Master Builders Australia Ltd.

Following careful negotiation, AS4122 was developed to meet the needs of the building and construction industry and clients (including government agencies) through the fair and proportionate allocation of risk in line with current industry best practice. It was also designed to standardise terms to remove the need for negotiation or external legal advice over core contractual terms, saving time and costs.

The latest version of AS4122, released in 2011, is designed to ensure a balance of rights and obligations that are:

- Aligned with the standard of care and duties of a professional consultant under common law;
- Consistent with government policy and the intent of relevant legislation;
- Consistent with sharing risk between client and consultant;
- Based on the principle that each party in a project remains responsible for its own actions;
- Consistent with the terms of professional indemnity insurance readily available in the marketplace;
- Inclusive of a monetary limit on the liability of the consultant to provide certainty for business which in turn allows better commercial decisions to be made.

The intended benefits of AS4122, when used properly are as follows:

- A stronger focus on real risk management instead of illusory liability allocation;
- An overall reduction in adverse risk outcomes;
- Reduced dependency on insurance to treat project risk;
- Reduction in commercial loss claims against consultants;
- Reduction in the cost and amount of disputation between contractors and consultants;
- A positive impact of the availability of insurance cover;
- Broader field of consultants able to compete for government work;
- A more equitable basis for tender submission and evaluation by government;
- Better, more informed, project decision making;

- Increased transparency during the negotiation process;
- Encouraging the use of industry accepted tools and standards;
- Setting good practice benchmarks recognised by clients and industry;
- Limiting the negative impact of excessive or imprudent risk taking;
- Achieve a better project outcome for all parties.

Consult Australia acknowledges that AS4122-2010 is not appropriate in every situation, but has argued that it is a good document to use when a standard contract is required. A range of public and private sector clients have already adopted AS4122 as their standard contract of choice, although many of them have done so with the attachment of special conditions, leading to a range of issues discussed below.

Challenges of Standard Contracts

Despite the obvious benefits for industry, standard contracts also present risks for our members if they are not used in good faith, or contain certain features.

The first of these is the attachment of "special conditions" to an otherwise negotiated standard form contract. For example, a client may use AS4122, which was negotiated between the various stakeholders, but will then attach special conditions that amend the carefully balanced clauses dealing with risk allocation in their own favour by offloading all risk (including risk they are best placed to manage) to the service provider. In our experience, this behaviour is generally a consequence of a client seeking external legal advice, which in turn recommends offloading all risk, without regard to the commercial outcomes.

Standard contracts developed without industry consultation may also be problematic. The allocation of risk is often seen as a "zero sum gain" equation, whereby one party's offloading of risk is seen as a prudent risk management strategy. In actual fact, offloading risk may lead to a range of harmful effects, such as insurance not responding to a claim, or driving certain behaviours that lead to less successful commercial or project outcomes. By consulting with industry, their objections to such terms can be heard, and allow a client to develop an agreement that better addresses each party's interests. Where industry isn't consulted, contracts have the potential to be harsh, and while this primarily affects the service provider, it also has the ability to impact on the client.

One other pitfall occasionally occurring with the use of standard contracts is the use of the incorrect standard contract. This issue is particularly prevalent in our industry, where building contractors and consultants provide vastly different services which in turn require different standards of care. For example, a consultant is most appropriately subject to a standard of care where they are bound to provide advice of a reasonable standard, measured against other consultants of similar experience doing the same type of work. Constructors however provide a tangible item, and "fitness for purpose" warranties are more appropriate in their agreements. Nevertheless, such warranties frequently find their way into consultant agreements, despite the fact that a consultant provides professional opinion rather than a tangible item, and cannot warrant outcomes based on how that advice might be used. This issue is applicable both to specific terms such as that described here, and also for overall contracts, as our members regularly report being presented with construction, rather than consultant, contracts of engagement.

Our Industry's Handling of Standard Contracts

In each of these cases, many of the challenges of standard contracts as presented in the Consultation Paper remain, without the benefits as outlined above. As part of our submission, Consult Australia has surveyed our smaller member firms to ascertain the prevalence of, and how they treat standard form contracts.

In response to the survey:

- Approximately half of the respondents indicated that more than half of the contracts they are presented with are standard form, with only 25% of respondents indicating that 20% or less of their work is done using standard form contracts.
- However, almost 85% of respondents indicated that the standard contracts are for fees of less than $100,000.

These results combined suggest that standard contracts in our industry are very common, and bespoke contracts are used more for larger projects.

- When presented with standard contracts, more than 90% of respondents indicated they review the terms all the time, with the remaining responses answering that they reviewed the terms most of the time.
- The form of that review however is instructive. Just under half of respondents answered that they did not seek professional legal advice, while those respondents who indicated they did obtain professional legal advice overwhelmingly only used this advice sparingly, with more than half of respondents answering that they only obtained that advice for less than 20% of contracts.
- Only one single respondent indicated that they get legal advice for 80-100% of the contracts offered to them.

What can be deduced from this last set of answers is that while small businesses do review the terms presented to them, they are overwhelmingly doing so without the benefit of the advice of a lawyer, or understanding what they are reviewing themselves. This means they may miss out on subtle terms and conditions that could potentially have significant impacts on their business. As legal language in a contract may have a different outcome to that same form of words in plain English, this is a real challenge for small businesses.

In addition to the survey of our members, Melbourne Law School recently completed a comprehensive study of standard form contracts in the construction sector[5], and the results of that study may also provide useful data for this review.

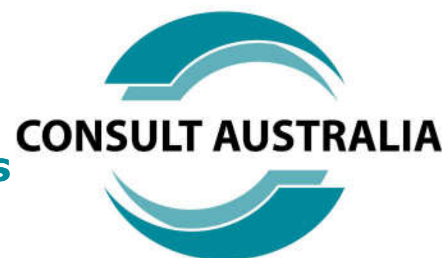
4. Underlying Causes of Unfair Contracts

Consult Australia's argument for fairer contracts is based on a broader argument than simply creating better commercial conditions for our members. Fairer contracts, based on appropriate standards of care and risk management that allocated risks to the party best able to manage them, will bring about a range of benefits to the advantage of all parties, which can be summarised in three categories:

i) Greater certainty that insurance will respond to claims. Where insurance does not respond, our industry has to cover the liability from their balance sheet, which may offer insufficient funds to do so. In these instances the client will end up with the financial liability regardless.

ii) Better project outcomes in terms of cost and time, owing to reduced negotiation, disputation, pricing the increased risk into bids, and an approach to the project based on best practice risk

[5] *Standard Forms of Contract in the Australian Construction Industry: Research Report* (June 2014). Available online at: http://www.law.unimelb.edu.au/staff/events/files/Research%20report%20-%20Standard%20Forms%20of%20Contract%20in%20the%20Australian%20Construction%20Industry.pdf



management, rather than a "deep pockets" approach to litigation following the realisation of a risk.

iii) A fairer sharing of risk and reward, which in the long term may lead to cost savings by becoming a client of choice, and in turn encouraging greater competition for tenders in the future.

Whether unfair contract terms are the result of poor client understanding, an aggressive approach to contracting, or another factor, the fact remains that fairer contracts can work to everyone's advantage.

Procurement Practices and Client Understanding

The tendency of clients to issue contracts with onerous terms may also reflect a particular culture that exists amongst procurement professionals today, particularly within certain organisations.

We have already discussed the common practice of offloading risk without regard to the consequences as opposed to managing that risk properly. This is despite evidence that this practice generally leads to less desirable project outcomes. Previous studies, such as the *Scope for Improvement* reports[6], as well as our own experience from our membership has found that while properly allocating risk does occur, the best project outcomes are realised when the parties work together to address issues encountered, rather than taking a "standard form" approach to procuring services.

Another element of the culture surrounding procurement is knowledge and understanding of the ramifications of particular behaviours and practices, including the effect of particular contractual terms. Unfortunately, many of the people responsible for procuring professional services don't always have the required understanding of the impact on insurance of offloading contractual risk. This was acknowledged in the Productivity Commission's recent report into infrastructure provision in Australia[7]. In our experience, the knowledge amongst clients of the impact of many of the onerous contractual terms described above is particularly poor, or is based on less important considerations.

5. Non-Regulatory Responses: Addressing Underlying Issues

The Consultation Paper has identified a range of solutions to the challenges posed by unfair contracts. Before addressing regulatory responses, including the preferred option of legislation, the non-regulatory options warrant consideration.

As has been suggested already in this submission, there is a strong likelihood that many of the unfair terms in contracts for our industry are a result of inadequate understanding of the workings of professional indemnity insurance, and its relationship with sound risk management principles. As well as the stick of additional regulation, awareness raising actions should therefore be part of the policy solution, irrespective of any decision to extend unfair contract protections.

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[6] Three *Scope for Improvement* reports were prepared in 2006, 2008 and 2011 respectively by Blake Dawson Waldron (now Ashurst). They can be accessed online by following the links at: http://www.ashurst.com/expertise-detail.aspx?id_Content=6580&pageNo=1

[7] Productivity Commission Report No. 71 (May 2014) *Public Infrastructure*. Available online at http://www.pc.gov.au/projects/inquiry/infrastructure/report/contents. At pp133-134.

The advantage of education measures are that they might address a large part of the underlying problem our industry faces leading to the issue of unfair contracts. Where educative measures fail is that a party can only learn about the benefits of better contracting practices if they are open minded and willing to do so, or otherwise have an incentive to learn. Furthermore, from the small business's perspective, greater education on their part does nothing to overcome their underlying problem of unequal bargaining power, where they are seldom able to make the required changes to a standard form agreement.

Nevertheless, there is benefit in developing a list of common contract terms, and the implications of those terms. Such a list would bring greater transparency to many potentially harmful contracting practices, and provide a reference point for small businesses to better understand what they are signing.

One measure that has been implemented in a number states and the Commonwealth is the creation of the Office of the Small Business Commissioner, and similarly offices such as the Office of the Industry Participation Advocate in South Australia. These offices, while all fairly recent creations, have to varying degrees provided useful support to small businesses in terms of advice on unfair contract terms and their implications, as well as representing industry to government clients where public sector procurement has included unfair contract terms. These offices have proven beneficial to our industry, and we would support the creation of similar agencies in other jurisdictions, to undertake an educative function to larger business as well as the smaller businesses they currently target, and also the ability to intervene where public sector clients produce harsh contracts.

Recommendation: *Strengthen Small Business Commissioners or equivalent offices around Australia to undertake educational activities targeted at both small businesses and their clients to enhance understanding of unfair contract terms and their impact.*

6. Regulatory Responses

The principle of regulating the use of unfair contract terms is at face value, one that is most appealing to any businesses that have been on the wrong end of such an agreement. However, deciding what that response looks like is a greater challenge, especially given the possibility of unintended consequences.

Options 3 and 4, as set out in the Consultation Paper, each contain significant challenges to overcome in order to become workable and useful laws. In the case of Option 4, which would compel the parties to negotiation, the hurdle to overcome is that you cannot force a party to a contract to negotiate in good faith against their own wishes. If a party does not wish to negotiate, they could prospectively attend a meeting, but not substantially alter their position. While some parties might attend such a negotiation in good faith, and achieve an improved position, this policy position seems unlikely to us to achieve the desired result.

As for Option 3, extending the existing consumer unfair contract protections to cover small businesses, there are a few issues to address for such a reform to succeed.

As the Consultation Paper correctly identifies (at paragraph 132.4) a running list of unfair contract terms is likely to result in attempts by those producing the contracts to overcome the prohibition through a new set of terms achieving the same outcome. A better solution from our perspective, would be to base any prohibition on unfair contract terms on a set of underlying principles. This would remove the incentive to find "loopholes" and alternative ways to get around any prohibitions, and offer better protection to the small businesses the proposed reform seeks to protect. We acknowledge that this approach may create

enforcement challenges, although with the deterrent effect, we are confident that better outcomes would result from the reform before any policing or enforcement efforts are required.

Because business to business transactions are complex in nature, and generally differ from consumer transactions, the Consultation Paper raises the issue of the reach of the proposed laws. This includes the issues of which parties meet the definition of a small business, the other party that the small business is contracting with, and what the nature of the transaction might be.

While the Australian Bureau of Statics definition of small businesses is based on employee numbers (being less than 20)[8], the survey that Consult Australia undertook of our small business members found that overwhelmingly, the contracts they entered fell below a certain value. This reflects that projects with a greater risk are also likely to come with a larger value. Given the occasional need for bespoke contracts for larger and more complicated projects, we submit that a transaction value may be the best way of defining a party as a small business.

In terms of deciding whether small business to small business transactions should come under any laws, we suggest that applying laws to a transaction between two small business parties may serve an educative effect about the impact of terms and risk shifting. However, we are open minded as to whether to include such transactions in this proposed law.

We do however have a strong view in response to the issue raised at paragraph 128, in that any new provisions should apply to supply of goods or services by a small business as well as covering their acquisition of those goods or services. In the experience of our industry, the harmful effects of unfair contract terms are overwhelmingly encountered in the course of providing services. As this submission has already outlined, small businesses in our industry are regularly faced with unfair contract terms as a part of standard contracts engaging their services, and their inability to negotiate fairer terms is no different to the situation if they were a purchaser. Indeed, from our industry's perspective, for this reform to be of any value, it must cover situations where a small business is acting as supplier of goods or services.

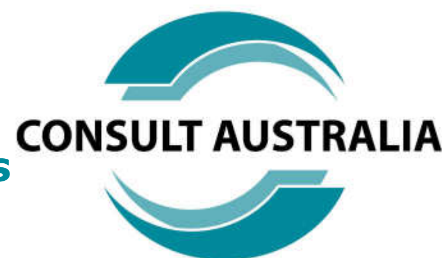
Recommendation: *Any extension of the existing unfair contract provisions to small business must include contacts for supply of goods and services, as well as their receipt.*

The test for unfairness: Who decides and how?

Another issue is how a term is deemed to be unfair, and by whom. The Consultation Paper suggests that the ACCC would have its existing powers enhanced to cover small businesses, and at face value that seems appropriate. However, our concern that surrounds this expansion of existing provisions is that the nature and effects of "unfair" contract terms is significantly more complex than for a consumer case.

For example, simple instances of risk shifting may seem appropriate for consumer transactions, but in the case of business to business transactions may lead to a range of unintended consequences relating to both commercial outcomes and successful risk management. If the ACCC is to undertake this role, not only are an enhanced set of skills required, but a transparent process must be set out ahead of any cases being determined. As each industry will have a different set of conditions that need to be taken into account,

[8] See also http://www.asic.gov.au/asic/asic.nsf/byheadline/Small+business+-+What+is+small+business?openDocument



simply looking at a list of unfair terms is insufficient. In our industry, contractual relationships are often complex, and involve more than two parties. Untangling these relationships to make a determination will pose particular challenges.

A term that may be unfair in one industry may be perfectly reasonable in another. As these reforms are implemented, it is vital that there is acknowledgement that notions of "unfairness" are complex and will not always be easily determined.

We also seek further information as to procedural issues arising out of this reform. Following an ACCC investigation, would action be taken in a court, or would a conciliation process be used first? Litigation has the potential to cost vast resources to business that may undermine the entire reform. The time and money resources required to undertake or defend litigation, while pushing the parties to resolve their dispute in many instances, may also serve as a deterrent to a party continuing to put forward its legitimate case. If a non-judicial option such as conciliation or mediation is determined to be the best solution to unfair contracts, it is important a proper appeals process exists.

Finally, due consideration must also be given to the most appropriate remedy where a dispute is not voluntarily resolved. Compelling the parties to negotiate is problematic in that you cannot compel a party to do so in good faith, where that requires an outcome they don't see the benefit in. While a contract could be set aside, or financial penalties imposed, it is important that the impost of such penalties don't infringe on the legitimate needs of businesses.

Recommendation: *A conciliation based approach should be considered as part of any widening of existing regulations against unfair contracts.*

7. Unintended consequences: The red tape burden

As with any legislative reform, there are challenges to overcome before this reform can be finalised, including the possibility of unintended consequences.

The most obvious of these challenges will be the additional cost and red tape burden for business, acknowledged at paragraph 131 of the Consultation Paper. It may be the case that the benefits of the reforms outweigh this burden, but it is vital that proper consideration be given to the possibility in enacting any new legislation.

Recommendation: *That a thorough Regulatory Impact Statement be undertaken and released publicly for discussion before any legislation is introduced to Parliament.*

8. Conclusion

Unfair contracts are a significant challenge facing our industry. While larger firms have the resources to understand the terms presented to them, small businesses seldom do. The concept of freedom of contract, and a level playing field for parties to negotiate terms (including the allocation of risk) is illusory. The harm

caused by unfair contracts can potentially destroy a business, even where proper steps have been taken to protect against that harm, such as through a professional indemnity insurance policy.

Standard form contracts in and of themselves are not the problem. Standard form contracts can save the parties to that agreement time and money, provided they are developed in consultation with appropriate stakeholders and in good faith. Unilaterally developed standard contracts, or unnecessary special conditions attached to a negotiated agreement however can be more problematic.

Our argument for better contract terms, and fairer allocation of risk between the parties is that this move will lead to better project outcomes, ensure liabilities are properly covered by insurance, and provide fairer outcomes for all parties.

Any solution to this issue must include educative measures, as our experience is that many of the unfair contracts presented to our members are based on a lack of understanding of the consequences of harsh terms. To this end, strengthening the various Small Business Commissioners is worth considering as part of the solution.

Regulatory solutions are appealing at face value, but must overcome a number of issues concerning us. These include the likelihood that any list of prohibited terms will be easily overcome, the ability of the ACCC or other responsible organization to understand the complex nature of commercial contracting, and the differences between industry sectors, and the increased cost and red tape that will doubtless arise as a result. If, however, these issues can be overcome, we will be pleased to support moves to prevent unfair contracts being presented to small business.

Thank you once again for the opportunity to comment on the Consultation Paper.