

EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESS

SUBMISSION



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INTRODUCTION

Master Electricians Australia (MEA) is grateful for the opportunity to contribute a submission to the consultation paper released in May 2014.

MEA forms part of the Electrical Contractors Association (ECA) Group of Companies and is the peak industry body for contractors who operate in the electrical, data, communications and fire sector of the building and construction, mining, heavy industry and domestic services industry throughout Australia. Currently representing over 2000 electrical contractors Australia-wide, the ECA has been active for over 74 years, making it one of the longest standing industry associations of its kind.

To assist in preparing the submission MEA has conducted consultation with members regarding their experiences with unfair contracts in their day to day business operations.

What has become apparent to MEA over the years and during consultations and preparation of this submission is that small business must be afforded unfair contract term protection due to their unique role in purchasing, supplying and adding value to goods and services within the Australian economy.

Whilst in many cases state based regulation goes some way to protect small business in the electrical industry, there are some serious gaps which larger companies can and do take advantage of the position small business which we view has a detrimental effect.

The Electrical Industry

The IBISWorld Pty Ltd Report E3232 (2014) (IBIS report) on electrical services in Australia details the industry contributes \$18.3 billion a year to the Australian economy through 35,000 business. Electrical contractor revenue is generated from multiple sectors of the economy however two thirds of the revenue is generated in the commercial building and heavy industry and engineering sectors.

With 35,000 businesses in the electrical industry the market is a competitive market to enter and survive in. As such businesses continually review what work is available with tendering processes attracting a large mix of both large and small contractors vying for work. According to the Federal Governments publication Small Business Report; Key Statistics and Data (2012) show that 95% of businesses in Australia are defined as small business. This equates to almost 34,000 electrical businesses which would be classified as a small business.

Building/Construction and Heavy/Engineering Industry as referred to in the IBIS report are major segments whereby electrical contractors source approximately two thirds of their revenue. These industries however are at polar ends in terms of number of participants, resource allocation and size of businesses particularly when looking at the mining and major construction sectors. In these industries the majority of work is controlled by a small number of large national and multi-national corporations in tier one but also tier two companies.

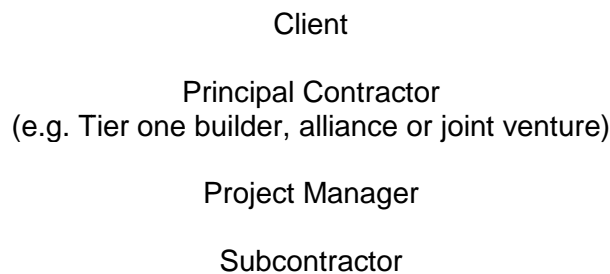
These large corporations have the size, control and power of resource allocation whereby they frequently issue contracts on a 'take it or leave it basis' and use their market power over small businesses to engage in contracts where there is no negotiation undertaken, and that variation of these standard contracts rarely occurs by a subcontractor through negotiation.

It is therefore MEA's suggestion that small businesses who either acquire or supply goods and services should be afforded protection.

Nature of Industry

All parts of the electrical industry are highly regulated due to the high level of risk with electrical work. Apart from the domestic electrical market of service and repair, it is rare for an electrical contractor to be completely in control of works being undertaken in a given circumstance. Their role is to provide technical products, install and commission equipment.

Electrical contractors work with project managers, construction companies, miners and manufacturers to keep business maintained, repaired or create new infrastructure. This work is based on a contractual hierarchy as shown below:



The electrical trade is the last to be engaged on a site and is heavily involved in installing, commissioning and testing of all equipment, buildings and services. This, combined with the level of risk and regulation in Building, Construction, Mining and Heavy Industry, gives a landscape where all parties have significant obligations and a duty of care to multiple parties. It also creates a significant number of fail points where things may not go to plan and cause contractual disputes. As such at all levels of parties are cautious and protect their own position as much as possible.

Due to the risk of complicated disputes regarding quality of work, scope of works, variation to work, payments, negligence and duty of care in the building and construction industry each state in Australia has legislation that deals with how and when payments are made, and in many cases describe a default payment term should the contract be silent on the matter. The industries generally follow a process whereby parties have different mechanisms to ensure payment. They are:

- Retention Money – a deposit from one level of the hierarchy to the next higher level as a form of guarantee of workmanship. Repayment of this money is made once practical completion of the project / work is reached and relevant warranty periods have expired. This money is withdrawn from the cash flow of the business and subcontractors rarely get full retention monies returned.

- Progress payment – a regular payment by one level of the hierarchy to a lower one upon completion of work as described in the contract. This may be as frequently as weekly or for a set stage of the project (e.g. completion of slab, or lock up stage in a new commercial building). MEA members regularly provide feedback to us where they experience payment terms which are contrary to legislation however in many cases they feel unable to address the issue without jeopardising the awarding of contracts or reducing the chances of further work.
- Liquidated damages – payment of a predetermined calculated amount for loss incurred by a higher level of the hierarchy should the work not be completed by the deadline. In many instances in contracts we have seen subcontractors indemnify the principal contractor against their damages from the client. Resulting in a subcontractor being liable for their damages and that of the principle contractor.

Whilst the above three areas are covered by state based legislation it does form the background to other clauses being experienced by small business that does require assistance through the unfair contracts protections.

MEA members are, in the majority, small businesses and do not have the resources to critically analyse contracts and lack the specific education or understanding of complex legally drafted documents, many of which are not drafted in plain English and continue to reference latin and other legal terms.

Member's experience is that legal advice at a basic level commences at approximately \$350.00 per hour and in many instances \$450.00 per hour for advice is not uncommon. This presents a significant barrier to accessing legal advice. Particularly when, in the very competitive market of the electrical industry, profit margins of packages of work are small.

The Major Contractual Problems

MEA's national technical and workplace relations hotlines regularly receive questions concerning three major types of contract clauses. Listed in no particular order, these are:

- Cancellation for Convenience
This is a clause allowing one party to terminate a contract, even in the absence of substantiation of the other party's fault or breach, and without suffering the usual financial consequences of a breach.

The practical application of this clause operates from contractor to subcontractor and small businesses in many cases have to absorb their own costs. When examined through the Consumer Unfair Contracts it is our view that this type of clause in the current consumer arena would be:

- A term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract
- A term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract
- A term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract.

- Damages

Liquidated damages can be described as damages, the amount of which the parties designate during the negotiation of a contract for the injured party to collect as compensation upon a specific breach (e.g. non completion of work). However other damages can also be included in such clauses.

Common features, which in a small business context may be seen as unfair, are those which force a subcontractor to indemnify the contractor from legal Torts including negligence, defamation and third party action.

The feedback received from small business is that in many cases not only do they agree to liquidated damages, without understanding how they are calculated, but also the subcontractor indemnifying the principal contractor for liquidated damages that may be applied by the client of the project. In some cases recently described by members amounts of \$120,000 per day are not uncommon. This amount for a small business is not sustainable and in many cases would result in an expensive legal defence worth many more times than perhaps the contract net profit is worth and risk the continued financial viability of the business. It is MEA's view that in these cases small business must be afforded protection due to the improper balance of negotiation power.

If we examine and align the relevant Consumer rights, these clauses demonstrate a breach of the following protections:

- A term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract
- A term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract
- A term that limits, or has the effect of limiting, one party's vicarious liability for its agents.

- Variations / Extensions of time

In MEA's experience the most common cause for dispute amongst companies is variation to the "scope of work" and delays. Consumer protection law ensures that one party may not unilaterally change the product and services. A change in scope of work may come about for any number of reasons including poor planning and design, environmental impediments, concerns or issues, changes to legislation, industrial action, supply delays or changes and revised needs from a client.

MEA has experienced many concerns from small business members regarding requests for variations being verbally approved however later, due to restrictive variation clauses in contracts, limits the ability of small businesses to claim, and receive payment for, the work undertaken.

MEA receives feedback from members whereby many tens of thousands of dollars have been lost. This is particularly the case whereby a contractor requests the subcontractor to vary the scope of work and does not follow up with a confirmation order or written variation. Most variation clauses state that it is the responsibility of the subcontractor to submit confirmation of the work prior to undertaking. However when faced with a lengthy legal battle to recover monies over a verbal conversation many small businesses do not pursue the claim and end up absorbing the cost. In effect there is the ability for the Contractor to vary the agreement but no guarantee that the work

will be paid for. This is a common result on sites particularly when deadlines are tight and practical completion deadlines are looming. Many small businesses concentrate on completion of work as they are ensuring that they do not breach their liquidated damages clause. The situation for many small contractors is that they are faced with a 'commercial decision' of how big a loss they wish to make under these circumstances. This is an untenable arrangement and these businesses often suffer considerably, sometimes fatally, as a result.

If we examine and align the relevant Consumer rights we see that these clauses may fit under the following protections:

- o A term that permits, or has the effect of permitting, one party unilaterally to vary the characteristics of the goods or services to be supplied, or the interest in land to be sold or granted, or the financial goods or services to be supplied under the contract.

Turning to the specific questions asked in the consultation paper we will respond to each of the questions. In preparation for the submission we have also sought the views of members in their experiences. We will reference feedback from members that we have gathered recently about the use of unfair contract terms in our responses.

1. *How widespread is the use of standard form contracts for small business and what are their benefits and disadvantages?*

The use of standard form contracts in all of these industries including the electrical industry is wide spread. Our experience is that many of the contracts develop as terms come in and out of favour, or as case law clarifies issues. As such, contracts between Clients and Major businesses alter to reflect the precedence. These are then picked up by smaller operators and eventually these filter down the contracting hierarchy however the practicality and applicability of these clauses to small businesses have magnified effects.

For example, as referred to earlier the 'trickling down' effect of substantial liquidated damages clauses to these small contractors looms as massive risk to the business and are markedly disproportionate to the value of the works they are responsible for.

2. *What considerations influence the design of terms and conditions in standard form contracts?*

As mentioned in question one the design of contracts is driven by case law changes with a purpose to divert risk to other parties as much as possible. This risk can be legal, financial and in some cases reputational as well.

As well, the purchasing power of the client has significant impact on the terms offered. For example, major clients often set unreasonable 'terms of payment' for invoices issued to them. It is not uncommon for these timeframes to be up to 90 days.

In one case a member had agreed to terms under tender documents for payment terms of 30 days. However, it came to light that the major client had an accounts payable policy that debtors of a certain 'level' (a level they set) would only be paid under terms of 90 days.

It took legal representation and a series of letter exchanges, delaying the payment further, for the client to meet the terms of their contract.

3. 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?

In the industries we deal with standard form contracts are extensively used and should be used. However feedback from members was that it is common for contracts to be reviewed in less than an hour and rarely is legal advice sought. A major barrier to this is the previously mentioned cost. MEA members believe that contracts should deliver fair and equitable protections for all parties and not based on the size of the engagement and the relative size of the parties in the contract. However many small businesses do not believe they can change a large corporation's position on items and as such do not pursue changes through negotiation, instead choosing to accept their lot in life and accept that's just the risk they live with. Obviously with most small businesses capital and security is usually sourced from their own home and personal assets.

4. To what degree do small businesses try to negotiate standard form contracts?

This will depend to a large extent on the skill of the owner, the asset and work reserves, maturity of the business and the economic factors more broadly within the economy. It is fair to say those that have been in the industry a long time are not scared to walk away from contracts and the work when circumstances are not right. It is fair to say that those with longevity in the industry have learnt some very hard lessons in their business careers. Contract negotiation is not a skill that comes easily to many and hands on experience in negotiation and contract risk assessment has been the class room of learning from experience rather than formal education regarding contracts, torts and liabilities.

5. Is it the terms or the process by which some contracts are negotiated that is the main concern for small businesses?

In discussions with members generally it is the terms that are the cause concern.

It is possible that the experience of the members has been polarised to this view as they believe they lack the position from which they can enter into negotiations. However, their view is the process is also a concern, especially where a small business is attempting to negotiate with a large corporation that is not willing to compromise and vary their position.

6. How do small businesses differ from consumers in relation to their interaction with standard form contracts?

In short small businesses do not differ from consumers in relation to standard form contracts. As described by the Australian Consumer law guide:

“a standard form contract will typically be one that has been prepared by one party to the contract and is not subject to negotiation between the parties – that is, it is offered on a ‘take it or leave it’ basis. Standard form contracts are typically used for the supply of goods and services.”

- *whether one of the parties has all or most of the bargaining power in the transaction*
- *whether the contract was prepared by one party before any discussion occurred between the parties about the transaction*
- *whether the other party was, in effect, required to either accept or reject the terms of the contract in the form in which it was presented*
- *whether the other party was given any real opportunity to negotiate the terms of the contract*
- *whether the terms of the contract take into account the specific characteristics of the other party or the particular transaction”*

Source A guide to the unfair contract terms law 2010

7. What terms are businesses encountering that might be considered ‘unfair’?

Please refer to the section “Major Contractual Problems” of this submission.

8. What detriment have businesses suffered from unfair contract terms?

In consultation with members our responses vary on the subject of effect of unfair contracts. We are informed about legal cases, regularly refer members to solicitors for assistance, and we hear regularly about companies writing off debts and in many cases loosing significant six figure sums regarding retention monies. Many members when contract disputes arise receive demand letters or notices whereby principal contractors are issuing demand letters for significant contract breaches, where in many cases those breaches do not involve action by the small business.

An example of this was in 2013 when the new Queensland Children’s Hospital was suffering illegal industrial action from a group of workers for a period of 9 weeks. A picket line was in place and workers were concerned that they should not cross the picket line due to threats and intimidation. However the Principal Contractor while applying to the Fair Work Commission for orders for a return to work also wrote to the subcontractors threatening liquidated damages of \$120,000 a day for non completion of work.

9. What protections do businesses currently have when they encounter unfair contract terms and are they sufficient?

In many cases there are remedies in place, however the biggest barrier to accessing those remedies is the cost and time taken to prosecute. Generally the courts are available however with legal fees averaging approximately \$7,000 to \$10,000 to appear for a one day trial, plus case preparation time, this forms a serious barrier to most small businesses. Larger better resourced companies may prolong the case through different means and in many cases rely on the lack of resources from the small business to impede the prosecution of a strong case against them. It is either discontinued or a much smaller settlement is taken.

10. What regulatory responses are already in place that aim to protect small business from unfair contract terms and how effective are these mechanisms?

In relation to construction industry relevant states have in place legislation for building industry payments. These include tribunal and independent evaluators being engaged

prior to involving the courts. This is not well understood by small businesses and we would certainly encourage each state to provide further education and information dissemination regarding these topics. Breach of contract, indemnity, negligence and other such breaches remedies are not effective for small business due to cost and power imbalance between the parties.

As well, these Building and Constructing Industry Payment Acts only cover work on construction projects. The scope of the legislation precludes other types of construction activities from which these contracts impact on business.

Definition of small business

In previous changes to consumer law protection it has been relatively easy to define a consumer. However to achieve the Government's objective in extending unfair contract protection to small businesses the definition of a small business will need to be clear and concise to ensure that Courts, Tribunals and Commissions have a very clear defined set of criteria. This will need to include a point in time consideration for reasons discussed later in this submission.

In various Government departments and jurisdictions small businesses are defined in different ways.

Australian and Securities & Investment Commission (ASIC) defines small business as:

“a company with two out of these three characteristics:

- *an annual revenue of less than \$25 million*
- *fewer than 50 employees at the end of the financial year, and*
- *consolidated gross assets of less than \$12.5 million at the end of the financial year.”*

Source <http://www.asic.gov.au/asic/asic.nsf/byheadline/Small+business+-+What+is+small+business?openDocument>

The Fair Work Act section 23 defines a small employer as

23 Meaning of small business employer

*(1) A national system employer is a **small business employer** at a particular time if the employer employs fewer than 15 employees at that time.*

(2) For the purpose of calculating the number of employees employed by the employer at a particular time:

(a) subject to paragraph (b), all employees employed by the employer at that time are to be counted; and

(b) a casual employee is not to be counted unless, at that time, he or she has been employed by the employer on a regular and systematic basis.

(3) For the purpose of calculating the number of employees employed by the employer at a particular time, associated entities are taken to be one entity.

*(4) To avoid doubt, in determining whether a national system employer is a **small business employer** at a particular time in relation to the dismissal of an employee, or*

termination of an employee's employment, the employees that are to be counted include (subject to paragraph (2)(b)):

- (a) the employee who is being dismissed or whose employment is being terminated; and
- (b) any other employee of the employer who is also being dismissed or whose employment is also being terminated.

The Productivity Commission, in its report Regulator Engagement with Small Business 2013, describes a small business via a number of key characteristics including:

- “it is independently owned and operated, that is, it is not part of a larger corporation or controlled by another firm
- the owner manager is the principal decision maker
- the owner manager contributes most, if not all, of the operating capital”

Various **State Governments** have an exemption for small business in relation to payroll tax based on the amount of wages paid. These include

State	Threshold*	FTE** Equivalent
Qld	\$1,100,000	14.7
NSW	\$ 750,000	10.0
Vic	\$ 555,000	7.4
SA	\$ 600,000	8.0
TAS	\$1,250,000	16.7
WA	\$ 800,000	10.7
NT	\$1,500,000	20.1

Source [*www.payrolltax.gov.au](http://www.payrolltax.gov.au) 31/7/2014

**Assuming AWE ABS November 2013 of \$1,437.00 per week

The Australian Tax Office (ATO) definition of small business is:

“Small business entity

You are a small business entity if you carry on business with less than \$2 million aggregated turnover. When we say 'you' we are referring to the individual, partnership, company or trust that carries on the business.” Source

<https://www.ato.gov.au/Business/Small-business-entity-concessions/In-detail/Eligibility/Am-I-eligible-for-the-small-business-entity-concessions-/?page=10>

The Australian Bureau of Statistics (ABS) defines small business as:

*“For statistical purposes, the Australian Bureau of Statistics (ABS) defines a **small business** as an actively trading business with 0–19 employees. **Micro businesses** are small businesses with 0–4 employees. **Actively trading businesses** are businesses that have an ABN and are actively remitting in respect of a GST role.”*

Source Report: Australian Small Business: Key Statistics and Analysis, December 2012

The Australian Privacy Act has set an exemption for those businesses with a turnover of less than \$3,000,000 as long as those businesses do not participate in certain areas of business such as health or credit reporting.

Examining the above there are three methodologies and two time periods regulators use in various combinations to define small business.

Methodologies

- a. Number of employees
- b. Annual turnover
- c. Business ownership and operating characteristics

Period of time

- a. Financial Year
- b. Point in time

MEA notes that the consultation paper also raises the extent of the transaction amount. We believe that this would unnecessarily disadvantage those employers with higher than average input costs or those who are operating in a new and emerging market or technology. Using this model presents complication whereby the value of a product / service in one transaction assumes a small business becomes a large business without consideration of the input costs and relevant profit margin. It would be the same as assuming that a consumer becomes a business simply because they purchase a good over a certain value. When in actual fact the status of the business has not changed.

MEA believes that this would not achieve the governments intent for small business to access the unfair contract terms provisions.

It is the view of MEA that a combination of the methods and periods we have detailed should be used in determining the definition of a small business.

In utopia it would be advantageous for all federal legislation to align to allow consistent understanding and increase compliance within the business community however we recognise that this is not achievable within this process.

MEA would recommend that a definition of small business contain the following:

1. That at time of tender / negotiation / request for quotation of services / supply determines the point in time to formulate the business size;
2. The annual turnover of the business in the previous financial year is less than \$2,500,000 (indexed each year to the Australian headline CPI rate); and
3. That the number of employees employed by the small business is less than 15 by simple head count taking into account all related entities.

MEA would also suggest that any changes in legislation require all parties to the contract to disclose in the contract the above information to ensure that both parties are aware that the business qualifies for the protections that the Government is proposing. This will also clarify for the courts and reduce as far as practical a party's ability to argue otherwise and thus cause delay and for more legal expenses to be incurred.

We believe that should the parties have a dispute during the life of a contract and the courts are required to determine whether or not the contract when originally formed was unfair due to it finding significant imbalance, not reasonably necessary and would cause detriment to the company, that this 3 pronged definition would achieve the Governments aim of defining those who are eligible for unfair contract term protection.

Should the extension apply to capture a contract where a small business either acquires or supplies goods or services?

This consultation paper has raised the above question. It is MEA's submission that the protections being considered are a must for small business and should cover small business who supply and acquire goods. As discussed earlier this position is relevant due to the circumstances whereby electrical small business purchase supply and value add to customer's businesses and in many cases suppliers of product are multinational or national wholesalers and suppliers. It would be an anomaly to protect a business only in one upstream transaction rather than covering transactions that flow in both directions.

Extending the laws to capture small business to small business

MEA is of the view that if there are 2 small businesses they should also have the same access to protections from unfair contract terms. However to better clarify this along with regulation we would suggest that the Federal Government create standard form contracts of a general nature that comply with the changes but are a pro-forma for the businesses to use. These would be utilised when neither party has a standard form contract, thus reducing costs, or in the event when the parties cannot agree on a contract that is under negotiation. This contract should then provide a balance and ensure that the small business rights as detailed are contained within the contract.

There are various examples including standard building contracts, tenancy agreements etc in each jurisdiction that currently achieve the same outcome.

Summary

In summary MEA is supportive of changes to the unfair contract terms protections being extended to small business that includes:

- An evaluation of a small business at the time negotiations take place; and
- Business turnover in the past financial year was less than \$2,500,000; and
- Business employs less than 15 employees;
- Includes small business contracts involving supply or acquisition of goods or services with another business;

- Includes protection for small business to small business contracts;
- Making the following conditions illegal:
 - A term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract
 - A term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract
 - A term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract
 - A term that limits, or has the effect of limiting, one party's vicarious liability for its agents
 - A term that permits, or has the effect of permitting, one party unilaterally to vary the characteristics of the goods or services to be supplied, or the interest in land to be sold or granted, or the financial goods or services to be supplied under the contract
 - A term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract
 - A term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract
 - A term that permits, or has the effect of permitting, one party to vary the up-front price payable under the contract without the right of another party to terminate the contract.

MEA appreciates the chance to make this submission and we would advise that in the event there was a further opportunity to participate in public consultations or relevant government committee hearings we would make our relevant officers available.

Jason ODwyer
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