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Small business unfair contract laws commence on 12 November 2016

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The *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth) (**Act**) makes important changes to the *Australian Consumer Law* (**ACL**)[1] which will take effect from 12 November 2016.

The intention of the Act is to extend consumer protection provisions (which previously applied only to individual consumers) to small businesses. The amendments specifically apply to contracts for the supply of goods or services and therefore will impact on smaller construction-related contracts such as purchase orders, minor works, supply agreements, standing order arrangements and some subcontracts.

How will the amendments affect you?

In general terms:

- Any *'unfair term'* in a *'small business contract'* is void, but the balance of the contract will (where possible) continue to bind the parties.[2]
- Only *'standard form contracts'* for the supply of goods or services, or the sale or grant of an interest in land, are affected.
- At least one party to the contract must be a small business which employs fewer than 20 persons.

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- The amendments only cover contracts that:
  - do not exceed a $300,000 *'upfront price'*; or
  - if the contract has a duration of more than 12 months, do not exceed a $1,000,000 *'upfront price'*.

Some terms are not affected

Certain key terms of a contract are not covered by the new laws, and cannot be regarded as unfair:

- terms that set the price payable;
- terms that define the goods or services being supplied; and
- terms that are required or permitted by another law (including any consumer protection or building industry laws).

What is a standard form contract?

This is not a reference to an Australian Standard, but instead means in effect a form of contract provided by one party to the other without a reasonable or effective opportunity to negotiate terms.[3] This form of contract is of course common in the construction sphere where smaller scale subcontractors are often offered standard terms and conditions, for example as part of a purchase order or standard supply arrangements, which are not subject to amendment. This type of scenario, the take it or leave it approach, is likely to be a standard form contract under the new laws. Where there is any reasonable negotiation on terms, then the contract is less likely to be affected by the legislation.

The new laws require a court, in assessing a contract, to have regard to the parties' respective bargaining power and whether the terms take any account of the specific parties or transaction.[4] Importantly, the contract is presumed to be a standard form contract unless it is proved to the contrary.[5]

Monetary caps

The *'upfront price'* monetary limits which define *'standard form contracts'* at first seem simple. The *'upfront price'* is the price payable as disclosed at or prior to the time the contract is entered.[6] The upfront price does not include any other amount that is payable on the occurrence of a particular event,[7] such as variations or, apparently, even provisional sums.

Certainly a $300,000 cap for an individual contract appears clear. A question that however arises is what is an individual contract? Many contractors work with their subcontractors or smaller suppliers on standing order arrangements whereby periodic orders are issued throughout the year under a standard set of conditions. Depending on the wording of the standard order, each order may be an individual contract irrespective of the cumulative value of the orders exceeding $300,000.

Such arrangements may reflect the new laws' second category of *'standard form contracts'*, those for a value not exceeding $1,000,000 over a period of longer than 12 months. Again, there are some potential difficulties with this definition. For example, if you have a contract for $500,000 delivered over a six month period, then you would immediately assume that it does not fall into either category of standard form contract - it is for greater than $300,000 and it is for less than 12 months.

However, what if the contract includes defects liability provisions that provide for claims for defects or damaged goods to be made over a period of 12 months after supply? Is the contract then effectively a contract for a duration of up to 18 months? There are certainly arguments that a defects liability period is distinct from a simple stand-alone warranty (particularly where specific contract rights and obligations such as final payment claims are linked to the

defects liability period) and, as such, forms part of the contract duration. As a result, construction contracts with an up-front price of between $300,000 and $1,000,000 may potentially be a standard form contract where the defects liability period takes the entire contract duration beyond 12 months. That is especially so where the contract provides that retention monies are not to be disbursed until the expiry of the defects liability period.

What is a small business?

The new laws apply to contracts where one party employs fewer than 20 persons. Casual employees are included if they are engaged on a regular and systematic basis.[8] Neither the Act nor the ACL defines *'employee'*, so the common law meaning will apply. While it is beyond the scope of this article to address employment law, there may certainly be scope for argument as to whether a person engaged nominally as a contractor may be regarded as a de facto employee in certain circumstances. Comparable ambiguity may apply to company officers and non-active partners in a business. Similarly, a *'Special Purpose Vehicle'* entity established to pursue a large development may nonetheless qualify as a small business due to its few employees, notwithstanding the large value of the project under its control.

It is obviously difficult to know how many people are employed by a business you are contracting with. Accordingly, when dealing with a party that may well have fewer than 20 employees, it would certainly be prudent to make specific enquiry, or else to act cautiously and presume that the new laws may apply.

What is an *'unfair term'*?

For a term to be unfair under s 24 of the ACL, the term must:[9]

- cause a significant imbalance in the parties' rights and obligations;

- not be reasonably necessary to protect the legitimate interests of the party advantaged by the term; and
- cause financial or other detriment to a party if it is relied upon.

Many people will read those three requirements and be concerned primarily with the last one; i.e. whether it will cause financial or other detriment to the small business. However, it is important to realise that all three requirements must be met to render a term unfair. The purpose of the legislation is to achieve a balance. It is not enough to show that there will be a financial burden on a small business or that there is a significant imbalance in the parties' rights. An unfair term must go beyond this - it must also be unnecessary to protect the contractor's legitimate interests.

In assessing whether a term is unfair, the Act requires that you take into account the transparency of the term; i.e. whether it is expressed in plain language that is legible, presented clearly and available to any party affected by the term.[10] Accordingly, principals and contractors are encouraged to ensure that their contracts and standard terms specify the parties' obligations in terms as clear and understandable as possible.

Under standard form contracts with small businesses covered by the new laws, principals and superior contractors will

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potentially be limited to terms reasonably necessary to protect their legitimate interests. But what is a legitimate interest? Is the concept limited to a financial interest, or does it include also a reputational interest? The new laws are not clear on the point, but it is likely that it would involve a combination of these factors.

In complying with the changes, careful drafting around the obligations of the subcontractor will be important. There will be no *'one shoe fits all'* approach available, because what is reasonable to protect the contractor will not be the same in each instance and may depend on the specific services or goods being provided by the relevant subcontractor. Similarly, a significant imbalance or financial or other detriment to one contractor may well have different importance to another.

What types of clauses are likely to be considered unfair?

Although the ACL itself provides some examples of general contract terms which might be regarded as unfair,[11] construction contracts are most likely to trigger scrutiny with specific provisions such as the following:

- Blanket exclusions of liability, without proper allowance for any reasonable contribution by the party engaging the small business.
- Termination for convenience clauses requiring no contractual breach, especially where there is no reasonable compensation payable for any loss suffered by the subcontractor as a consequence.
- Clauses that allow unilateral or one-sided amendments to a contract, such as an entitlement to increase prices without prior notice, or an automatic renewal or rollover of contracts (in particular, standing order arrangements) without an opportunity to review based on market conditions.
- A requirement for the subcontractor to undertake certain marketing or steps to protect goods or equipment, without appropriate remuneration or sufficient notice.
- An unfair or unreasonable right to forfeit a deposit or security, particularly if exercisable without notice or a reasonable opportunity to rectify a default.

Other terms which may likely be regarded as unfair include pass-through provisions that do not reflect actual loss; i.e. clauses where the contractor can pass on costs from a third party without any requirement that the contractor will actually incur those costs. This is often the case with discretionary forms of damages or penalties, where a default triggers responsibility in the subcontractor based on the contractor's back-to-back liability to another party (including a parent company). If that back-to-back liability is not actually or likely to be incurred, then the clause may well be unfair on the basis that it is not reasonably necessary to protect the contractor's interests.

Neither the scenarios set out above nor the examples listed in the ACL itself[12] are an exhaustive list. In determining whether a term is unfair, the courts must have regard to the nature and effect of the provision in accordance with s 24 of the ACL.

Who determines whether a term is unfair?

The new laws provide simply that an unfair term in a standard form contract is void.[13] No decision of a court is prescribed as a pre-requisite. The courts do however have the power to make declarations that terms in a small business contract are unfair,[14] and to order compensation or other relief in favour of the affected party.[15]

But unless and until either party[16] takes the matter to a court, claims that a contract term is unfair will be necessarily uncertain.

If one party asserts that a term is unfair and refuses to comply with it, the options left for the other party, short of court action, are largely commercial ones.

One untested aspect of the new laws' application relates to payment claim adjudication under the *Building and Construction Industry Payments Act 2004* (Qld).[17] An adjudicator may well accept a party's submission that a term is unfair and automatically void under the ACL, and make a determination on that basis.

Transitional arrangements

The changes apply to all *'small business contracts'* entered into on or after 12 November 2016.[18]

Contracts entered into prior to that date will only be affected in the following circumstances:[19]

- where the contract is renewed on or after 12 November 2016, the changes apply to conduct that occurs on or after the renewal date; and
- where a term of the contract is varied on or after 12 November 2016, the changes apply to the varied term in relation to conduct that occurs on or after the date on which the variation takes effect.

Conclusions

What do the new laws actually mean in practice?

For construction contracts which do not involve a small business and are outside the monetary caps, nothing has changed. However, when contemplating entering into any contract for the supply of goods or services with a party which may have fewer than 20 employees, caution must be exercised.

Principals and contractors should be mindful of:

- any features of the contract (including standing arrangements or a defects liability period) which will take the contract duration beyond 12 months; and
- components of the price payable (such as variations and provisional sums) which may not be taken into account in assessing whether the *'upfront value'* of the contract exceeds $300,000 or $1,000,000 (as applicable).

Standard contracts and terms must be reviewed to maximise their prospects of overcoming any assertion that they are unfair:

- the other party should be given an opportunity to negotiate contractual terms, if appropriate;
- terms must be drawn in clear and transparent language; and
- provisions which create any significant imbalance between the parties, or a financial or other detriment, should be re-drafted to clearly show their necessity to protect the proponent's legitimate interests.

Given the transitional arrangements provided for by the Act, any extension or variation of a small business contract entered into prior to 12 November 2016 must also be considered in light of the Act's application.

The changes do present several areas of uncertainty and it remains to be seen how courts (or, indeed, adjudicators or arbitrators) will interpret the new laws. Until the scope and application of the legislation has been explored (perhaps by an individual subcontractor, industry group or ACCC[20] test case), principals and contractors should certainly err on the side of caution.

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[1] The Act makes similar amendments to the *Australian Securities and Investment Commission Act 2001* (Cth), to regulate *'financial services'* provided to small businesses.
[2] Australian Consumer Law, s 23.
[3] Ibid, s 27(2).
[4] Ibid.
[5] Australian Consumer Law, s 27(1).
[6] Ibid, s 26(2).
[7] Ibid.
[8] Australian Consumer Law, s 23(5).
[9] Ibid, s 24(1).
[10] Ibid, ss 24(2) and (3).
[11] Ibid, s 25.
[12] Ibid, s 25.
[13] Ibid, s 23(1).
[14] Ibid, s 250.
[15] Ibid, s 237.
[16] Or the Australian Competition and Consumer Commission (**ACCC**), which also has standing under s 250.
[17] And its interstate counterparts.
[18] *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth), s 209A(1).
[19] Ibid, s 209A(2).
[20] Australian Competition and Consumer Commission.

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A Legal Guide to Contract Works and Construction Liability Insurance in Australia

Patrick Mead, Partner

This book has been prepared for insurers, their advisors and other professionals involved in the construction and engineering industry.

The aim of this book is to examine the issues arising from the interpretation of contract works and construction liability insurance policies by courts in Australia and the United Kingdom.

Each Chapter explores different aspects of these policies through the use of case analysis and the judicial interpretation of policy wordings.

Through the detailed analysis contained within the book, it is hoped it will afford the reader a greater understanding of the process of, and approach to, policy wordings by the courts.

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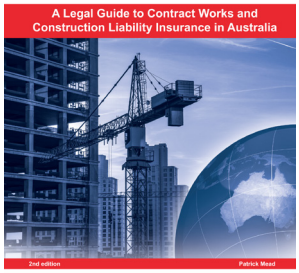

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