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Submission to:

# Unfair Contract Terms and Small Business Consultation Paper
Small Business, Competition and Consumer Division

## Introduction

Architectural practices are generally small businesses operating in a highly contractual field, with widespread use of Standard Form Contracts.

Increasing anecdotal evidence indicates that many architectural practices are asked to engage in contracts that unfairly disadvantage the practice. This is a particular concern with small architectural businesses, which have few resources to negotiate or contest the contract, and often suffer an imbalance in bargaining power.

The Association of Consulting Architects (ACA) is the key body representing architectural employers in Australia. The ACA represents a broad membership with many challenges and interests. We offer the following consolidated summary of issues facing architects in relation to contracts as a prompt for further discussion and engagement.

The ACA welcomes this review and looks forward to participating further in this important project.

We note the recent report, Standard Forms of Contract in the Australian Construction Industry, which identified broad support for the use of such contracts. This research found that 68% of the contracts reported upon were based upon standard form contracts, but that 84% were amended from the standard form and that the primary reason for amendment was “the need to shift risk”. Many respondents felt that there was currently no standard form available for use without amendment.

## The Cost of Unfair Contracts

Unfair contracts bring multiple costs and have negative impacts on architectural businesses and the wider community.

### Direct costs

The direct cost of unfair contract terms is born by the contracted party, and affects their ability to run a successful business, to produce work of high quality, to offer good employment conditions and to grow the business.

### Costs to the community

Unfair contracts also mean a substantial cost to the community. The increasingly litigious environment in which architectural practices operate results in less collaborative, innovative and efficient project outcomes for the community.

Where architectural practitioners are exposed to unreasonable liability, or where they are unfairly required to relinquish their intellectual property, the design results for the community will lack experimentation and innovation, and simply repeat past outcomes.

Unfair conditions that result in extra burden or cost to the delivery of services, such as unjustifiable insurance requirements or errors and omission clauses, cannot be absorbed in an already competitive market and so see the cost of architectural work rise for all members of the community.

## Small Business and Architectural Practice

Protections and legislation relating to small business have a significant impact on the architectural profession. The majority of architectural practices fall within the various definitions of 'small business.

For example, 84% of the ACA member practices employ fewer than 20 technical staff, with the membership average being 11.3 technical staff per practice (technical staff include architects and allied professionals). In architectural practices, non-technical administration and support staff would generally account for less than 15% of staff. These membership rates correspond to other data on the profession.

These figures means that the majority of ACA member practices are categorised as small business under the Australian Bureau of Statistics (ABS) definition of small businesses as having less than 20 employees. Many also meet the Australian Taxation Department definition of a small business as one with an annual turnover (excluding GST) of less than $2 million and the Fair Work Australia definition of small business as one with less than 15 employees.

## Contract Types

Architectural practices commonly use Standard Form contracts.

These contracts can quite clearly be divided into two separate areas:

- Service provision contracts for the delivery of architectural services to clients.
- Supply contracts for the provision of goods or services to the business.

Our submission outlines the prevalent issues in both of these contract types.

## Service Provision Contracts

Contracts for the provision of architectural services are used to engage an architect to undertake some or all of the stages in the conceptualisation, design, documentation and contract administration of a building project.

These contracts are very often standard form contracts and fall broadly into three categories.

- Australian Institute of Architects Client/Architect Agreement

  This contract is typically used for smaller or residential projects where a client without significant experience may ask an architect to offer a form of contract.

- Australian Standard Contracts

  AS4122-2010. This new standard for engaging consultants is commonly used by government and institutional clients when engaging architectural services. It is often modified by these clients prior to being offered as the contract form.

- Bespoke Standard Form Contracts

  Many organisations that conduct significant engagement of consultants have developed their own standard form contracts. These contracts are typically the most biased,

Contracts governing architectural services provision are largely focussed on the transfer of risk from the client to the design team. There is a developing tendency for clients to seek to transfer an unreasonable amount of risk to the architectural team, without appropriate compensation for bearing this risk, or to transfer risk for items that are outside the architect's control.

Architects are commonly required to fulfil a role as "primary consultant". In this situation they not only coordinate the full design team of secondary and separate consultants (such as engineers), but are also required to engage them as sub-consultants and therefore accept primary responsibility for their services. This is an important, traditional role for architects. However, many architects are increasingly obliged to fulfil this role under unfair contractual circumstances.

They key issues that regularly affect architects in service provision contracts are as follows:

**Tendering Expenses**

Architects are regularly expected to assemble full project delivery teams and to accept primary responsibility for submission preparation. It is not uncommon for a small to medium project to require 6 to 12 separate secondary consultants, all of which need to be approached, briefed and coordinated simply to provide a detailed submission.

A tight tender market has seen procurement methods that require:

- Excessive numbers of tenderers – for example more than three or four teams each going through the full tendering process outlined above.
- Unreasonable expectations of unpaid professional intelligence – for example, the unpaid provision of concept designs or 'ideas' as part of the submission content.

Best-practice guidelines exist for the tendering of construction services but there are no such guidelines specifically for design services.

**Insurance**

Professional Indemnity Insurance guarantees recipients of design services of financial compensation in the event that the design fails to fulfil requirements.

Two key issues are becoming increasingly prevalent in the contracts preferred for the supply of architectural services:

- Unlimited liability

  Unlimited liability is not a reasonable expectation for the delivery of services. The situation is further exacerbated where larger multinational engineering companies refuse to offer unlimited liability and yet government contracts (as an example) require the architect as primary consultant to offer unlimited liability for the whole team.

- Insurances required

  It is increasingly common for projects to require insurance that is far in excess of the scale of the project. For example, $20M Professional Indemnity Insurance cover is not a reasonable expectation for a $3M capital value project. Such expectations exclude smaller practices from projects for which they are suitable and impose unfair and unnecessary premiums on all proponents.

**Transfer of Ownership**

Two primary legislative mechanisms exist to protect the ownership and attribution of creative endeavours. These are copyright and moral rights legislation. Most contracts for the provision of architectural services require transfer of both copyright and moral rights. The issues are as follows:

- Copyright
  Transfer of copyright should be accompanied by a fair and separate payment.

- Moral Rights
  Moral rights are vested in individuals and cannot by law be transferred yet most contracts have clauses requiring this.

**Damages, Errors and Omissions**

Construction contracts often engage a mechanism of ‘liquidated damages’ to offer a client recourse for delays to completion where they incur other expenses as a result of delays to a building project.

Increasingly, similar damages are applied to the design component of a building delivery. However, where a building contractor is exposed to the full value of a construction contract (say $10M), the architect is exposed only to the design fee (say $400,000) therefore the imposition of the same financial penalties is unfair.

Construction contracts regularly include a ‘contingency sum’ to deal with unforseen cost items. Traditionally the contingency sum was applied to cover minor documentation discrepancies and errors, accepting that design services are constrained by time and budget. However, design ‘errors’ or discrepancies are increasingly being pursued as costs to the designer. The level of fee paid to the

designer and the limited time often provided for design detailing means that this is an untenable approach.

Omissions are items that have not been designed or documented, and therefore not tendered in the construction procurement. It is simply unfair to attribute costs back to the designer for something that was not included within the project scope, and has not been paid for. Contracts that seek to impose costs for omissions on the design team are unfair.

**Non-Contract Matters**

By their nature, service contracts include items within their content that are not specific to the contract. These items reflect a culture of procurement and engagement rather than the contract itself. Nonetheless, they end up being part of the contract.

Three key items that affect architects are:

- Unreasonable Program Expectations

  This item is self-explanatory. All creative and professional services require adequate time to deliver without being unfairly exposed to error and risk.

- Fixed Price Services for Undefined Works

  Traditionally architectural design services were engaged on a percentage of the construction cost. This system worked well because if the complexity or scale of the project increased it generally translated to an increased capital cost and therefore an increased design fee. In contemporary procurement fixed fees are more often than not requested. However, brief preparation and project scoping is often inadequate and project scope ends up greater than the fixed fee should fairly cover.

- Removal of Parts of the Original Scope of Works by the Client that Result In Loss Of Fees

  Large national and multinational corporations are dictating terms as amended clauses with contracts for architectural services (such as AS4122 – 2010) that are unfair and unbalanced during the period of the contract.

## Supply Contracts

Procurement of software is a significant supply-contract challenge effecting architects.

Architectural design software is almost a monopoly, at best a duopoly. Architects are exposed to multinational software providers that dictate when software is upgraded (often more than annually) and then 'cut off' those who do not upgrade by ceasing to support older versions and, more significantly, by compromising interoperability between new and old versions.

Furthermore, many new packages are now released as a subscription-only offer. This means that architects are unable to buy the package and resist upgrades.

The cost of this software is very significant and the forced upgrades are generally unnecessary. As noted in the recent Senate report, software costs for architecture and design companies are significantly higher than the cost in other countries.

## The Solution

The ACA believes that Treasury should consider their policy options in the context of an extremely competitive marketplace.

Policy options that rely on voluntary industry initiatives, or on the notion that market forces will control conditions, will not ensure fair services supply contracts for architects. This is because of an imbalance of power in the current market.

The nature of small architectural businesses mean that practices do not have the internal resources to access current legislative systems, while the current economic climate means they do not have an adequate workflow to allow them to negotiate on an equal level with those offering work.

There is also limited value to be gained from further education and awareness campaigns. Architects' professional representative bodies are already clear on unfair contracting issues and have provided information to members and attempted to lobby procurers of architectural services.

**Policy options**

For the reasons outlined above we propose that Treasury's Policy Options 1 and 2 are unlikely to resolve the key issues.

The ACA suggests that Policy Options 3 and 4 have real potential to resolve unfair contract issues for small architectural businesses. We suggest that Treasury focus on Policy Option 3, as Option 4 introduces a level of resource commitment greater than needed.

The unfair contract terms particularly affecting small architectural businesses are very significantly focused on matters of liability, ownership and attribution.

Many of the unfair contract terms are in fact amended or additional clauses, which have become commonplace in the market in recent years. A clear mechanism to simply void such clauses will significantly resolve the key unfair contract terms affecting architects without requiring small businesses to commit unavailable resources or capacity.

The challenge for Treasury will be to establish precedent or guidance on these matters so that determination of what is unfair is not a protracted process.

We believe there is opportunity for the creation of a Fair Work-style of non-negotiable content for contracts. Non-negotiable items could cover content such as errors and omissions clauses which are void unless they meet non-negotiable requirements for compensation elsewhere.

## About the ACA

The ACA is a not-for-profit, member-based organisation, which represents architectural employers in Australia. The ACA has a firm focus on the business of architecture and is the primary organisation to promote the discussion of business matters in Australian architecture.

The ACA aims to foster excellence in business practice and to advance member's knowledge and skills. Members cover the spectrum of architectural practices – from sole practitioners to large practices – and include individuals, partnerships and companies who provide architectural services under the direction of a nominated architect. The ACA has branches in all states.

We look forward to working further with Treasury as a representative body for small architectural businesses across Australia.

We are able to offer significant expertise and evidence from our membership to assist with the formulation of guidelines in support of Policy Option 3 resolution.

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