National Fire Industry Association
Australia
Contractors at the Frontline of Fire Protection

Consultation – Exposure Draft

Submission

Treasury Laws Amendment (Measures for a Later Sitting) Bill 2021: Unfair Contract Terms Reforms

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Executive Summary

The Federal Treasury has released an Exposure Draft for the *Treasury Laws Amendment (Measures for a Later Sitting) Bill 2021: Unfair Contract Terms Reforms* (**the Draft**) and seeks feedback to the proposed amendments to the Australian Consumer Law (**ACL**) and *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**).

The pyramidal structure within the Building and Construction Industry (**BCI**) has the effect of bargaining power between parties becoming increasingly imbalanced along the contractual chain. Principal contractors are often able to transfer risk on key issues to subcontractors, with subcontractors being heavily burdened by a disproportionate level of risk.

It's often the case that sub-subcontractors at the base of the pyramid both have the least capacity to bear the financial risks associated with the project, but also the least capacity to negotiate more reasonable and balanced terms. In most instances, contractual documentation is presented on a 'take it or leave it' basis and subcontractors often accept unfair terms because they are reluctant to cause tension in commercial relationships.

This imbalance of bargaining power within the BCI has had a devastating impact on the most vulnerable parties. Unfair Contract Terms (**UCTs**) causing unfair contractual risk allocation has undoubtedly contributed to the high levels of insolvency within the Australian BCI.

The National Fire Industry Association (**NFIA**) made a formal submission to the *Review of Enhancements to Unfair Contract Term Protections – Consultation Regulation Impact Statement*, which addressed the impact of UCTs for subcontractors, and the questions set out in the RIS.

In previous submissions on this issue in the Federal jurisdiction and across State and Territory jurisdictions, we have provided various examples of commonly used UCTs which disproportionately disadvantage subcontractors and should not be permissible. Please see ***Appendix A*** of this submission for this list.

The NFIA is pleased to provide comment on the Draft.

The National Fire Industry Association

The NFIA is the peak association operating in the Fire Protection sector. We represent employers, suppliers and industry stakeholders who work at the frontline of Fire Protection, with over 80 percent of the commercial Fire Protection work undertaken in Australia being completed by NFIA Members.

The NFIA believes that regulatory frameworks should protect the safety of the community and property, provide adequate consumer protection, recognise and accommodate industry practice and standards, require registration of practitioners, and be linked to the national training package framework.

The Australian Fire Protection Industry

The NFIA is committed to the delivery of quality Fire Protection training across all aspects of Fire Protection.

NFIA Members operate across all areas of the Fire Protection sector, including the design, construction, installation, maintenance, inspection, testing, and certification, of the following systems and equipment:

- passive fire protection;
- special hazard systems;
- water-based fire protection;
- portable fire protection; and
- electrical fire protection (including fire and smoke detection and alarm systems and emergency lighting).

The Fire Protection Services industry contributes over $2.4 billion to the Australian economy every year. Over 2000 businesses pay nearly $700 million in wages each year and industry revenue is projected to increase at a compound annual growth rate of 3.4% over the five years through 2022-23, to reach $2.8 billion.

The IBISWorld Industry Report *OD5424 Fire Protection Services in Australia* (February 2018), claims that despite the presence of vertically integrated multinational giants, the industry has a low level of market share concentration as the top four players are estimated to account for about 27.4% of industry revenue. The two major companies have a combined market share of only 20% and are both part of large multinational companies operating globally across several related industries. Twenty years ago, the two major companies are estimated to have had 80% of the market.

There are now many State, regional and local players constructing, installing and servicing fire protection systems to small, medium and major buildings across the full scope of class 2 to 9 buildings as well as higher risk facilities such as fuel depots, harbours and similar developments. Over half the industry enterprises employ between one and 19 people (53.1% in 2014-15) and a further 44.4% have no directly employed labour. As the minor players have increased their share of the total market, the industry has become more diverse, while also growing substantially.

Where twenty years ago, the two major companies offered a form of institutionalised but limited 'industry' training to their people, it could be argued that the industry was less in need of regulation. However, as the industry has grown substantially and its make-up has evolved, it is now predominately made up of many more, smaller independent contracting companies. That market growth and diversification has provided customers with better contractor choices, better outcomes, and better pricing but, at the same time, raised the need for more over-arching regulation.

The Problem

The BCI operates as a pyramid scheme, with the client at the top, who then enters into a head contract with the head contractor, and with the head contractor subsequently entering into a series of subcontracts with subcontractors. Because of this structure, the bargaining power between parties becomes more imbalanced the further one goes down the contractual chain.

Often the head contractor will agree to contractual terms that will have all risks on key issues transferred to the head contractor because it knows that if it does not, then it is probable that the project will be awarded to one of its competitors who would be prepared to accept the principal's terms. The head contractor knows that it will be able to pass on its onerous contractual terms to its subcontractors by insisting that

subcontractors execute a 'back-to-back subcontract' (i.e., where the subcontract incorporates the same terms as the head contract).

In this way, unfair terms and risks are transferred down the contractual chain with the sub-subcontractors at the base of the pyramid not only having the least capacity to bear the financial risks associated with the project but also being the least able to negotiate a set of more reasonable and balanced terms. In most instances, contractual documentation is presented on a 'take it or leave it' basis and subcontractors often accept unfair terms because they are reluctant to cause tension in commercial relationships.

This imbalance of bargaining power within the BCI has had a devastating impact on the most vulnerable parties. Not only has the pyramidal structure caused parties at the lower end of the hierarchical chain to assume the risk of insolvency of parties higher up the pyramid, but it has also resulted in significant injustice, particularly where, as a result of the unfair conditions, the party who has carried out construction work has been unable to obtain payment for such work.

Uncertainty of income caused by unfair contractual risk allocation acts as a disincentive to business expansion and innovation, and employment. Unfair contractual risk allocation has also undoubtedly contributed to the high levels of insolvency in the Australian construction industry. In 2017/18, 1642 construction companies became insolvent. This represented 22% of all insolvencies in Australia, by an industry which produces around 9% of Australia's GDP, and a far greater percentage of insolvencies than any other industry. This is because instead of the risk of cost overruns, design errors etc being properly managed by those who are able to manage and so minimise the risk, it is simply shifted onto the subcontractors at the bottom of the contractual chain who have no real ability to manage the risk of design errors, delays and cost overruns etc, or bear the associated financial burden.

It is because of this imbalance of power that the legislatures in the various jurisdictions have felt it necessary to intervene and to provide assistance to the more vulnerable party. For example, the Queensland Government has introduced new reforms to improve security of payment in the building and construction industry. The *Building Industry Fairness (Security of Payment) Act 2017* introduces a number of measures which are designed to strengthen security of payment.

However, despite the introduction of UCT protections for small businesses, unfair terms are still prevalent. Most contracts for which small businesses seek the assistance of the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) still contain clauses that the Ombudsman considered to be unfair.

Response

The NFIA sees the critical issues needing to be addressed are:

1. identifying standard form contracts;
2. identifying who is protected against unfair contract terms; and
3. identifying prohibited terms.

We commend those elements of the Draft which could serve to strengthen protections for subcontractors against unfair contract terms, as outlined in the Explanatory Materials. In particular, we support:

- making the use of, and reliance upon, UCTs (in standard form contracts) unlawful, and granting courts the power to impose civil penalties;
- flexible, and practically useful, remedies for courts when a term is declared to be unfair;
- creating a rebuttable presumption provision that terms which have been found to be unfair, that are subsequently included in similar circumstances, are presumed to be unfair;
- increasing the business eligibility threshold (to less than 100 employees) so that more subcontractors are captured by, and can obtain benefit from, the protections;
- improving clarity around the definition of 'standard form contract', including by providing further certainty on factors such as repeated use of a contract template, and whether there was an effective opportunity to negotiate afforded;
- prescribing that repeated use of a contract must be considered by courts when determining whether a contract is 'standard form'; and
- going to the determination of whether a contract is 'standard form, prescribing matters which courts must not consider when determining whether a party was required to accept (or reject) contract terms, or whether a party was given an *effective* opportunity to negotiate.

Further to these issues, in previous submissions on this issue in the Federal jurisdiction and across State and Territory jurisdictions, we have provided various examples of commonly used UCTs which disproportionately disadvantage subcontractors and should not be permissible. Please see ***Appendix A*** of this submission for this list. Increased prescription around what an 'unfair' term is, for example via rebuttable presumptions, would strengthen deterrence for principal contractors to not use UCTs in the first instance.

Regarding the proposed increase to the eligibility threshold by introducing an annual turnover threshold of less than $10 million, the NFIA is concerned however that, particularly given this test relates to turnover (and not some other measure, such as profit), and in light of increasing business costs – particularly in the construction industry where material and labour costs are constantly rising, this threshold will prevent genuine subcontractors from accessing protections and have little effect. The NFIA supports all BCI contracts having legal protections against UCTs, and would support a phased approach commencing at $10 million, gradually increasing over a number of years.

To address the clear imbalance of power in the BCI, the NFIA would strongly support a targeted education campaign undertaken alongside the proposed amendments, which highlighted specific examples of UCTs within the BCI and clearly explained the processes that businesses should follow when they suspect that a contract may contain UCTs. Providing examples of contract terms commonly found in industry-specific contracts which could be deemed unfair would be helpful in incentivising businesses to not use these in standard form contracts. This would also work to avoid some of the impact of the imbalance of bargaining power which makes subcontractors reluctant to attempt to negotiate fairer terms. **Appendix A** to this submission contains clauses which the NFIA considers could be appropriate to deem, or presume to be, unfair.

Appendix A: Examples of Common Unfair Contract Terms

The following list sets out examples of common unfair contract terms which are unduly onerous on subcontractors. As mentioned above, prohibiting specific types of clauses (or particular uses of specific types of clauses) or alternatively introducing a rebuttable presumption that such terms are unfair, would deter principal contractors from using such terms in the first instance, and thereby afford greater protections to subcontractors.

- **Clauses which confer power to assign and/ or novate the contract, to the detriment of the other party and without that other party's consent**
    - These clauses empower the principal contractor to act as the subcontractor's attorney with authority to execute documents on the subcontractor's behalf to give effect to a novation of the subcontractor's agreement. It has the effect of enabling one party to unilaterally assign the contract and causes imbalance between the parties.
- **Clauses requiring payment of deposit before the subcontractor can institute legal proceedings**
    - These clauses require the subcontractor to pay a sum (in some cases equivalent to 10% of the amount being claimed) to the head contractor before action can be taken (court, dispute resolution, etc.). Such clauses effectively grant security for costs to the head contractor without a court order.
- **Warranty clauses for design and document accuracy**
    - Design risk occurs where the plans and drawings supplied by the principal contractor to the subcontractor with the tender documents (relating to, for example, existing site conditions or design of the work) are inaccurate or incomplete. These inaccuracies result in the subcontractor incurring costs which cannot be recovered, as the subcontractor has provided a 'warranty' in the subcontract that it has reviewed the relevant plans and documentation and satisfied themselves as to their accuracy and completeness.
- **Clauses permitting termination for convenience/ restricting termination to one party**
    - These clauses generally permit one party (usually the principal) to terminate the contract due to 'convenience'. Both the nature and the one-sidedness of this clause indicates its potential to be an unfair term. This inevitably leaves subcontractors out of pocket.
- **Clauses deeming wrongful termination to be for convenience**
    - In the event that a head contractor's termination of a subcontractor is found to be wrongful by a court or arbitrator, these clauses have the effect of deeming the termination to be one of convenience, and therefore protected under the contract. This inevitably leaves subcontractors out of pocket.
- **Indemnity clauses which excessively extend liability to the subcontractor**

- Most contracts contain various provisions under which the subcontractors indemnify the head contractor against all types of losses, including those resulting from the negligence or conduct of the head contractor themselves. For many of these, the subcontractor cannot be insured.

- **Release upon claim made**

  - Where a subcontractor makes a progress claim or request for valuation, these clauses have the effect of preventing subcontractors from any further claim for any prior work. Subcontractors can therefore be left with out of pocket for expenses incurred on the job, but which have not yet been billed to the subcontractor (by the supplier, for example).

- **Clauses 'prohibiting collusion'**

  - Some contracts seek not only to prohibit subcontractors from colluding with other tenderers (which is illegal under the *Trade Practices Act*) but also from communicating in any way with an association or with an association of which a subcontractor is not even a member but of which another tenderer might be a member. If the prohibition was for the purpose of preventing collusion, that would be acceptable but an absolute prohibition which would prevent a subcontractor obtaining useful information from its association which may assist it with the tender process (such as a legal opinion provided to the association for its members on the terms of a tender) goes too far and is not reasonable. Whilst these clauses might be interpreted as a measure to prevent collusion (which is clearly illegal regardless of the clause's inclusion in the contract), the clauses often in fact prevent subcontractors from obtaining cost effective legal advice.

- **Clauses permitting defect rectification by 3rd parties**

  - Some contracts provide that during the defect liability period, the head contractor is permitted to have a 3rd party carry out defect rectification without notifying the subcontractor, thereby denying them the opportunity to attend to it themselves. At the same time, the head contractor has the right call on the subcontractor's bank guarantee or subcontractor's retention moneys. The retention moneys are there as security against the risk of defects that sub-contractors do not rectify, not to fund someone else to do work.

- **Deeds of release to obtain practical-final completion**

  - If a subcontractor wants to be given practical completion (and receive 2.5% of their retention money), they are forced to sign a deed of release, which requires them to release the builder from any further claims. Such practices have subcontractors 'over a barrel'.

- **Statements which restrict or deny rights to implied warranties**

  - Such clauses can impose unreasonable limitations on implied warranties, for example, where the head contractor does not warrant the fitness or suitability of any services it provides, such as electricity or lighting.

- **Obligation to accelerate without compensation**

- These clauses oblige the subcontractor to accelerate works if directed by the head contractor, but do not allow for compensation for any extra costs incurred as a result. This is commercially unrealistic.

- **Limited liability clauses which exclude, or disproportionately limit, the main contractor's liability, even where they are partially at fault**

  - A common feature of most construction contracts is a limitation of the parties' liability to each other. These limitations of liability may be considered unfair.

- **Prior works warranty**

  - Before commencing work on a particular part of a site, subcontractors are being asked to warrant that prior works carried out by other trades are 'suitable' for them to do their work. It is unreasonable for subcontractors to determine the completeness, and potentially carry the liability for, another party's work.

- **Provision that prevents a supplier from offering a bank guarantee or similar surety as an alternative to cash retention**

  - Clauses of this nature limit a supplier's rights and are not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term.

- **Extension of Time (EOT)**

  - The timeframes within which EOT claims must be made have come down dramatically in recent years. The level of detail required to be put in a claim has also been increased. If a subcontractor only has three to five days to make an EOT claim, it is unrealistic to expect them to provide a detailed breakdown of the costs, causes, estimated length of delays involved and what is planned to overcome the delays.

  - Further, when an extension is granted, as often as not, that does not entitle a subcontractor to any compensation for the extra costs incurred and sometimes, even where the head contractor is the cause of the delay. Commonly, if a subcontractor does not provide all that information within that limited time frame, the potential claimant is excluded from making a claim.

- **Variation Claims**

  - The timeframes within which subcontractors must make a claim for a variation have also been increasingly shortened, down to a matter of a few days. Notwithstanding that, sub-contractors are commonly required to give full details not just of what it is the claim is about but also the legal basis upon which the claim is based and that includes, whether this is based on a term of the contract or some other legal principle such as an equitable claim. This expectation is unreasonable in such timeframes.

- **Delay Claims**

- Delay claims relate to the right of a party to claim damages for delays such as inclement weather or industrial action. Subcontractors are now commonly deemed to have taken into account any such delays in coming to a price and time for completion of the project. This is simply unrealistic.

- **Restrictions on Key People**

  - Some contracts prevent the subcontractor from reallocating or replacing key persons on the job without the head contractor's consent. This unreasonably interferes with a subcontractor's business operations and is unnecessary because head contractors already have alternative remedies if the subcontractor fails to perform the contract adequately.

- **Indemnities**

  - Most contracts are now littered with provisions under which the subcontractors indemnify the head contractor for all types of losses. For many of these, a subcontractor cannot be insured. What is worse, some contracts even provide that the head contractor is not liable for any costs which the subcontractor incurs even where it is the result of negligence on the part of the head contractor. That defies hundreds of years of accepted legal principles and is also uninsurable.

- **'Design Coordination Problems' & Inadequate 'Work Descriptions'**

  - In many contracts, if there is a problem arising from the design undertaken by the subcontractor or design work done by someone else, or the work description has left something out, it is the subcontractor's responsibility to overcome the problem and absorb any costs caused by the problem. This is notwithstanding that the design failures may have been the design failures of the head contractor, the principal, or their consultants such as hydraulic consultants or mechanical engineers. It is unreasonable for a subcontractor to be burdened with the contractual risk and responsibility for rectifying mistakes made by specialist consultants. These types of clauses are inevitably linked with prohibitions on the sub-contractor making any claim in relation to any such failure by the consultants, head contractor or principal.

- **Termination for Insolvency**

  - Termination for insolvency clauses can be drafted in such a way that the definition or determination of insolvency is at the discretion of the head contractor. 'Insolvency' is being defined more and more as a question of arbitrary opinion of the head contractor, including terms which go so far as to define insolvency to include where the head contractor "reasonably forms the view that the contractor is insolvent".

- **Automatic Rollover**

  - These terms are automatic renewal terms that do not provide reasonable notice to notify and/or a period to exit the renewal may be unfair. This occurred in ACCC v Chrisco Hampers (Federal Court 2016), where it was held that an automatic rollover clause was unfair.

- **Intellectual Property Transfers & Warranties**

- Some contracts specify that a subcontractor must warrant its ownership of all intellectual property used in the works, which may be unrealistic. Further, some require that a subcontractor assigns all rights in such intellectual property to the head contractor.

- **Moral Rights**

  - Contracts usually require subcontractors to indemnify the builder/contractor against any liability it may suffer as a consequence of some breach of the moral rights of a person such as one of the subcontractor's employees. Many subcontractors do not adequately cover off against this risk in their employment contracts, as they really have to, given that claims of this type can be substantial.

- **Set Offs**

  - Contracts commonly allow the builder/contractor to set off any money which sub-contractors may owe them under some other contract against moneys they owe, under the subject building contract. Strangely enough, a reciprocal right allowing sub-contractors to do the same, is never included.

- **Right to Vary Down Scope**

  - These clauses allow the head contractor to vary the scope of work under the subcontract without limitation and are vulnerable to misuse. In a recent example, a principal sought to vary down the scope of works to almost zero using such a clause. Our opinion is that such broad clauses used in that way may not work but regardless, it places the subcontractor in a very difficult position it if is done to them.

- **Compulsory dispute resolution before Payment Claim**

  - The insertion into a contract of a clause mandating participation in a dispute resolution process before a subcontractor has a right to lodge a Payment Claim can be used to slow down cash flow and increase legal costs. In turn, this puts more pressure on subcontractors to resolve disputes by giving up justifiable claims. That said, if the process is too convoluted and will take too long, such clauses can be struck down.

- **Right to Inspect your Records**

  - A clause which gives the head contractor the right to inspect a subcontractor's records at any time, could be used against a subcontractor in unexpected ways. Many of them are drafted so broadly that the head contractor could use them during a dispute to gain access to documents they are not otherwise entitled to. A reciprocal right for subcontractors is never included.

  - Further, such clauses that give the head contractor the right to inspect a subcontractor's records at any time can be drafted so broadly that it could be used during a dispute to gain access to documents they are not otherwise entitled to.

- **Proof of 'Financial Robustness'**

  - These types of clauses entitle the builder/contractor to give notice that they require the sub-contractor to provide proof, satisfactory to the builder/contractor that the sub-contractor is "financially robust".

- **Release Upon Claim Made**
    - Clauses which provide that submitting a Progress Claim or a request for valuation constitutes a bar for any further claim for any prior work, can leave the subcontractor out of pocket for expenses incurred on a job but which have not yet been billed to the subcontractor by the supplier for example. It is particularly concerning where contracts contain such a provision with respect to final Progress Claims and under which, the subcontractor is deemed to release the head contractor by the mere act of having made a final Progress Claim or submitted a request for valuation for a final Progress Claim. These clauses commonly also seek to rule out any type of legal action whatsoever by the subcontractor in relation to anything that has occurred prior to that date. Notwithstanding that, they never seek to prohibit the head contractor from making a claim against the sub-contractor in relation to any such prior work.
- **Statutory Declarations & Releases**
    - These clauses require a subcontractor to submit a statutory declaration with their payment claim or request for valuation stating that all workers and suppliers have been paid. Some even require subcontractors to declare that all sub-subcontractors and suppliers have paid their staff.
- **Termination for Inadequate Progress**
    - Clauses which entitle the head contractor to terminate a subcontractor's contract for inadequate progress because they are holding up the works, or failure to comply with a Project Program, are generally fair and reasonable (provided the head contractor cannot unilaterally alter the program). However, increasingly common are clauses which allow the head contractor to terminate the contract for 'unsatisfactory progress' without any reference to objective criteria (such as the project program). Such clauses are vulnerable to misuse by head contractors, resulting in contracts being terminated without true or fair cause.
- **Unilateral Variation Clauses**
    - Unilateral variation clauses provide that a subcontractor is bound to execute variations to their scope of work if directed by a principal. In *ACCC v Bytecard Pty Limited* (Federal Court 24 July 2013) it was held that the right to unilaterally alter a contract was unfair.
- **Variation claims and unreasonable notification period for extensions of time**
    - Clauses may impose onerous and unnecessary preconditions or bars on claims for delay or for disruption caused by the principal. For example, where claims require high level of details to complete within unreasonably timeframes that can be as little as two days. These short time bars are designed to make it difficult for subcontractors to meet notice obligations and thereby lose entitlement to payment.
- **Termination Clauses - Effect**
    - Termination clauses can be worded to result in an imbalance of power and risk where the legitimate interests and rights are not proportionate, particularly where powers are

provided to the recipient of goods and services to terminate but more limited powers are conferred on the supplier of those goods and services to terminate.

- **Compulsory Arbitration**
    - Clauses which mandate participation in a dispute resolution process before the subcontractor can lodge a payment claim under security of payment legislation can have the effect of slowing down cash flow and increasing legal costs, thereby increasing pressure on subcontractors to resolve disputes by giving up justifiable claims.
- **Seizure of Equipment**
    - Some contracts will include clauses that give head contractors the right to seize a subcontractor's equipment to pay moneys claimed to be owing to the head contractor. Usually, one needs a judgment before this can enforce a claim for payment. However, by a clause like this, sub-contractors are effectively contracting to give the builder/contractor a right of execution before determination of any dispute.
- **Clauses which entitle a principal or head contractor to exercise its absolute discretion against the interests of another party**
    - These clauses cause an imbalance of power by giving one party unilateral decision-making powers. It has the effect of enabling one party (e.g. the head contractor) to unilaterally determine whether the contract has been breached or to interpret its meaning.

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