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ACL UNFAIR CONTRACT TERMS AND STANDARD CONSTRUCTION CONTRACTS

CHINELLE VAN DER WESTHUIZEN* AND PHIL EVANS**

ABSTRACT

The unfair contract terms (UCT) provisions in the *Australian Consumer Law* (ACL) have radically affected the common law rights and obligations of parties using ‘standard form’ contracts in Australia. The provisions could be described as the most significant reform to the consumer law framework in Australia since the introduction of the *Trade Practices Act 1974* (Cth) (TPA). The provisions now apply to both consumer and small business contracts. With respect to UCTs, where a court finds that terms in standard contracts are ‘unfair’, it may refuse to enforce all or any of the terms of a contract or arrangement. Standard form contracts are widely used in the building and construction industry and a number of terms appear to be inconsistent with the ACL provisions. This article considers the common law doctrine of unconscionability with respect to UCT clauses, the development of UCT legislation and the application of UCT legislation to typical construction industry contracts.

I INTRODUCTION

Historically common law emphasised the sanctity of contract. This was traditionally known as ‘*pacta sunt servanda*’.¹ It was the basis of the principle known as ‘freedom of contract’ which was the central theme of 19th century mercantile dealings promoted by the advocates of ‘laissez-faire’.² The phrase describes a system or approach that opposes any regulation or interference by the government in economic affairs beyond the minimum necessary to allow the free enterprise system to operate according to individualism and economic freedom. Nevertheless, under common law (and prior to any legislative intervention) equity has intervened and parties are not really free to contract as they wish. The common law has long recognised factors which would vitiate a contract. These are incapacity, illegality, mistake, misrepresentation, duress, undue influence and later unconscionable conduct. The central theme in each of these causes of action, which may give rise to the vitiation of a contract, is essentially lack of consent described historically as ‘*consensus ad idem*’.³ In contract law it means there must be a general ‘meeting of the minds’ of all parties involved and everyone involved has accepted the offered contractual obligations of each party to the agreement. This is the first principle of enforceable contracts. However, the concept of a contract being held to be harsh or unfair where there was

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¹ Latin for ‘agreements must be kept’.

² French for ‘Let (people) **do** (as they choose)’.

³ *Consensus ad idem* is a Latin term that means ‘agreement’.

no evidence of the absence of free consent was difficult to reconcile with the competing principles of freedom to contract or sanctity of contract.

Consequently, where a contract is based on mutual agreement and free choice, and once agreement has been reached, the parties will be held to their word. No matter how harsh the terms of a contract were, the parties, particularly commercial parties bargaining at arm's length, would be bound by the agreement. That principle was well established at common law. In *Printing and Numerical Registering Company v Sampson*⁴ it was stated:⁵

If there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice.

In more contemporary times this principle was applied in a construction law context in the case of *South Australian Railways Commissioner v Egan*.⁶ The facts are briefly that Egan had contracted to build a number of railway bridges and culverts for the South Australian Railways. A term of the contract provided that if work did not proceed to the satisfaction of the Chief Engineer or if Egan failed to carry out any of its terms, the Commissioner could terminate it.

In that event, any money then owed to Egan would be 'forfeited' as would his plant and equipment that he was using on the project. The Commissioner in exercising this power, terminated the contract and Egan's plant and equipment on site were forfeited. Egan disputed the Commissioner's power and commenced litigation. He was unsuccessful.

It was clear from the judgement that harshness by itself was not considered to be an invalidating factor no matter how much the court would have liked it to be. As Menzies J stated:⁷

This appeal is concerned with perhaps the most wordy, obscure and oppressive contract that I have come across. It is the standard form of contract which the South Australian Railways Commissioner requires those executing railway works for him to sign....The contract is so outrageous that it is surprising that any contractor would undertake work for the Railways Commissioner upon its terms. It is, of course, a contract to which the doctrine of *contra proferentem* applies. The employment of such a contract tempts judges to go outside their function and attempt to relieve against the harshness of, rather than give effect to, what has been agreed by the parties. Courts search for justice but it

⁴ (1875) LR 19 Eq 462.

⁵ *Ibid* 466.

⁶ (1973) 130 CLR 506. The case is also authority that there is no cause of action as a consequence of the engineer or superintendent, whilst an employee of the owner or principal, acting as an independent certifier under the contract (517).

⁷ *Ibid* 512.

is justice according to law; it is still true that hard cases tend to make bad law.

Menzies J further noted that he was bound by the law and the contract must stand. Therefore, 'harshness' is not a characteristic the court will consider when determining whether to set aside the contract due to unfairness.

II SETTING ASIDE CONTRACTS UNDER COMMON LAW

While the principle of freedom of contract was still paramount, the common law provided for the setting aside of agreements as noted above where a party entered into a contract on the basis of misrepresentation, undue influence, duress, mistake or unconscionable conduct. Courts were thus able to provide some protection for weaker parties from the consequences of unfair or harsh contract terms. However, the protections were limited and constrained by the necessity to prove each of the elements which constituted 'unfairness' with respect to the relevant cause of action. As a result, the court focused on the issue of consensus and whilst it could set aside the agreement in total there was no power to delete any unfair terms in the agreement. Although the authors appreciate the significance of the aforementioned common law rights, this article will focus on the unconscionable doctrine.

A subsequent advance was the extension of issues dealing exclusively with 'consent' to develop a common law doctrine of unconscionability, based upon basic concepts of justice and fairness by attempting to prevent the taking of advantage of a 'weaker' party by a 'stronger' party in circumstances deemed 'unconscionable'.⁸ However, the doctrine initially was somewhat constrained. In *Bridge v Campbell Discount Co Ltd*,⁹ Lord Radcliffe stated:

Unconscionability must not be taken as a panacea for adjusting any contract between competent persons...Since the courts of equity never undertook to serve as a general adjuster of men's bargains...I am not certain that it would be a desirable achievement to try to reconcile all the rules under some simple general formula.

Furthermore, in *Lloyds Bank Ltd v Bundy*¹⁰ Lord Denning, consistent with his concerns for general justice and fairness, suggested that it was possible to find a common theme or general doctrine of unconscionability:

By virtue of it, the English law gives relief to one who without independent advice

⁸ See, eg, *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51; *Blomley v Ryan* (1956) 99 CLR 362.

⁹ [1962] AC 600, 626.

¹⁰ [1975] QB 326, 329.

enters into a contract upon terms which are very unfair or transfers his property for consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs and desires, or by his ignorance and infirmity, coupled with undue influence or pressures brought to bear on him by or for the benefit of the other.....Again I do not mean to suggest that every transaction is saved by independent advice. But the absence of it may be fatal, with these explanations; I hope this principle will be found to reconcile the cases.

In the Australian jurisdiction this first manifested in the definitive case of the *Commonwealth Bank of Australia Ltd v Amadio*.¹¹ In *Amadio*, the court set aside a mortgage and bank guarantee given by elderly Italian immigrants in favour of the bank to secure an overdraft facility to be granted to their son's building company. At the time of the execution of the documents, the Amadios were misled by the bank into believing that their liability was limited to \$50,000 and for a period of six months. The son's company subsequently failed and the bank made demands on the guarantees. The Amadios then sought to have the mortgage and guarantee set aside. They were successful.

The decision was based on a number of factors. The bank had deliberately misled the Amadios regarding the terms of the guarantee; they had traditionally relied on their son for advice; they were elderly with limited business acumen and poor English language skills and there was an absence of any independent legal advice. At the same time the doctrine was not unfettered. In the decision, Deane J listed the essential factors necessary to establish a successful plea based on unconscionability. These include:¹²

- (i) A party to a transaction was under a *special disability* in dealing with the other party with the consequence that there was an absence of any reasonable degree of equality between them and
- (ii) That *disability was sufficiently evident to the stronger party* to make it prima facie unfair or 'unconscientious' that he procure, or accept, the weaker party's assent to the impugned transaction in the circumstances in which he procured or accepted it

Where such circumstances are shown to have existed, an onus is cast upon the stronger party to show that the transaction was *fair, just and reasonable*.

The issue of a special disability or special disadvantage is determined by considering the relationship between the parties and assessing whether the weaker party's capacity to make a decision in their best interest was significantly (and detrimentally) influenced by the stronger

¹¹ (1983) 151 CLR 447.

¹² (1983) 151 CLR 447, 475.

party. However, in order to argue a special disadvantage, the decision that is taken by the parties to enter into the contract must affect the judgement of the parties in such a way that it creates a situation where parties do not act in their own best interest.¹³ In this respect, Mason J held that ‘because times have changed, new situations have arisen in which it may be appropriate to invoke the underlying principle’.¹⁴ As a result, subsequent decisions have held that special disability or disadvantage can arise through ignorance and trust on belief of the weaker party¹⁵ or even infatuation or severe emotional dependence.¹⁶

As can be seen from the above discussion, under common law there are a number of issues with respect to unconscionable conduct claims. Firstly, the doctrine of unconscionable conduct *exclusively relates to the facts and conduct of the stronger party at the time of entering into the contract*. Next as noted by Deane J, in *Amadio*, the burden of proof lies with the person affected by the conduct to establish the essential factors necessary to establish a successful unconscionable conduct claim. Further, in addition to the time and cost involved in private litigation, the principal remedy available to the court is the setting aside of the agreement in total and the court had no power to strike out any ‘unfair’ terms. The capricious application of the equitable doctrine of unconscionability contributed to the adoption of a statutory form of unconscionability.¹⁷ This statutory form was positively received especially under the *TPA* and newly adopted *ACL* regime, which is beneficial for small businesses in the construction industry, as will be discussed below.

III SETTING ASIDE CONTRACTS UNDER STATUTE

As mentioned above, the freedom of contract is not unfettered. It is a freedom set within limits dictated by parliament which provides protections to vulnerable parties in order to prevent abuse. Consequently, in addition to the expansion of the common law ability to set aside bargains which have not been freely entered into, there have been a number of statutory developments relating to unconscionable conduct since the *Amadio* case. In particular the former *Trade Practices Act 1974* (Cth),¹⁸ expanded with the introduction of the *Australian*

¹³ Ibid 462 (Deane J).

¹⁴ Ibid 463.

¹⁵ *Garcia v National Australia Bank Ltd* (1998) 194 CLR 396.

¹⁶ *Louth v Diprose* (1992) 175 CLR 621; *Bridgewater v Leahy* (1998) 194 CLR.

¹⁷ Mark Sneddon, ‘Unconscionability in Australian Law: Development and Policy Issues’ (1992) 14 *Los Angeles International and Comparative Law Review* 545, 546.

¹⁸ Sections 51AA, 51AB and 51AC. For the application of section 51AA and business entities see *ACCC v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 15. Section 51AC was considered by the courts a number of times in order to identify the meaning of unconscionability between businesses. In these cases, it was highlighted that the

Consumer Law (ACL),¹⁹ *the Contracts Review Act 1987 (NSW)*,²⁰ the various state Fair Trading Acts,²¹ legislation dealing with domestic building contracts²² and provisions dealing with financial services.²³

It is beyond the scope of this paper to consider the respective legislation referred to, suffice to say that whilst the statutory remedies permit agreements created unconscionably to be set aside, and in some cases the award of damages, they do not permit a court to prohibit or delete ‘unfair’ terms in a contract. It is only through the intervention of the *ACL* that the UCT regime is now applicable to set aside a contract due to UCT provisions in a contract. This, as noted, is a significant step to protecting not only individuals, but also small businesses (particularly those in the construction industry) who enter into standard form contracts and do not have the necessary safeguards under the statutory unconscionable provisions. As noted by Coggins in relation to the application of the UCT regime within the construction industry:²⁴

The pyramidal contracting structure, and imbalance in bargaining power between head contractors and subcontractors, in the Australian construction industry produces contract terms that may be considered onerous to the point of being unfair.

Therefore, the aim of this article is to consider the imbalance of rights and obligations between construction contracting parties within the ambit of the *ACL* provisions as a result of unfair contracting terms between these parties. In order to achieve this aim, it is necessary to first

court will regard some conduct more than simply challenging business behaviour. See, *Australian Competition and Consumer Commission v Lelee Pty Ltd* [1999] FCA 1121; *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* [2000] FCA 1365.

¹⁹ *Competition and Consumer Act 2010* (Cth) Sch 2 ss 20-22.

²⁰ The *Contracts Review Act* became law in NSW on 15 April 1980 following the NSW government commissioning of an investigation into harsh and unconscionable contracts and report (The Peden Report) by Professor John Peden in October 1976. The aim of this Act is for the court to declare that certain contracts are ‘unjust’ that is defined in s 4 of the Act to include terms that are ‘unconscionable, harsh or oppressive and injustice shall be construed in a corresponding manner’. Harsh and unconscionable contracts: report to the Minister for Consumer Affairs and Co-operative Societies and the Attorney-General for New South Wales [Sydney]: [Dept. for Consumer Affairs], 1976.

²¹ For example, *Fair Trading Act 2010* (WA). Following the introduction of the TPA all states and territories incorporated prohibition on unconscionable conduct in their fair trading laws. These provisions essentially “mirrored” the terms of section 51AB of the old TPA. This was required in view of the constitutional limitations of the TPA and in order to statutory protection against unconscionable conduct in consumer transactions involving ‘persons’ rather than corporations.

²² For example, *Home Building Contracts Act 1991* (WA). Section 15 of the HBCA prohibits behaviour by a builder which is ‘unconscionable, harsh or oppressive’.

²³ For unconscionable conduct in the provision of financial services see *Australian Securities and Investments Commission Act 2001* (Cth) ss 12CA-CC.

²⁴ Jeremy Coggins, “‘Levelling the Playing Field’ – A Proposal for the Regulation of UCT in Construction Contracts” (2019) 35 *Construction Law Journal* 271, 273.

address the origins of the UCT provisions in standard form consumer contracts before expanding on its application towards small businesses in the construction industry.

IV UCT IN STANDARD CONSUMER CONTRACTS AND THE *ACL*

The traditional unconscionable conduct legislative provisions have not been satisfactory with respect to preventing the use of UCT in both consumer and small business contracts. As a result, the Australian Government Productivity Commission noted in 2008 in its Review of Australia's Consumer Policy Framework²⁵ that there were a number of difficulties in using the existing unconscionable provisions of the *TPA* to prevent the use of unfair terms in consumer standard form contracts.²⁶ In part, these included the length of time and costs in applying the unconscionable conduct provisions in the *TPA*²⁷ and further actions under the unconscionable provisions of the *TPA* did not provide the court with the ability to strike out UCT provisions.

Consequently, in 2010, the *Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010* (Cth) introduced UCT provisions into the nationalised *TPA* focusing on standard form contracts.²⁸ These provisions became effective on 1 July 2010. Subsequently the *Trade Practices Amendment (Australian Consumer Law) Act (No 2) 2010* (Cth), which became effective on 1 January 2011, incorporated the UCT provisions within the *ACL*.²⁹ This was a significant step towards protecting contracting parties based on the moral and economic reasons attached to statutory UCT.³⁰ The national unfair contract regime, under the *ACL*, provides that a court may determine that a term of a standard form consumer contract is unfair and therefore void as an alternative claim to unconscionability.³¹ Traditionally, the unfair contract term provisions primarily dealt with 'consumer contracts'; however, the provisions were subsequently extended to small businesses (as will be discussed under Part V).

²⁵ Productivity Commission, *Review of Australia's Consumer Policy Framework* (Productivity Commission Inquiry Report Volume 2, 30 April 2008) 411-412 <<https://www.pc.gov.au/inquiries/completed/consumer-policy/report/consumer2.pdf>>.

²⁶ *Ibid.*

²⁷ The unconscionable conduct prohibitions are now found in ss 20 and 21 of the Australian Consumer Law (*ACL*).

²⁸ See *Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010* (Cth) ch 5.

²⁹ *Competition and Consumer Act 2010* (Cth) sch 2 pt 3-2.

³⁰ The Productivity Commission, in their review of Australia's Consumer Policy Framework, stated that 'unfair acts can undermine trust and social capital generally, increasing the cost of all kinds of transactions between people', 415.

³¹ Similar UCT provisions exist under the *Australian Securities and Investments Commission (ASIC) Act* in relation to standard form consumer contracts for financial products and services.

A Consumer Contract Classification

In line with the purpose of s 23(1) of the *ACL*, a ‘consumer contract’ shall be identified as a contract for the (a) supply of goods and services or (b) the sale or grant of an interest in land, to an individual who acquires it wholly or predominately for personal, domestic or household use or consumption.³² While these provisions are expanded under s 23(3), the test for identifying a ‘consumer contract’ is still very much a subjective one. However, the core examination of this section is the ‘acquisition’ of goods or services by a small business defined under the *ACL*.

B Standard Form Contracts

The term ‘standard form contract’ is not defined under the *ACL*. However, a ‘standard form contract’ can be characterised where one party has the bargaining power in negotiations and is made on a ‘take it or leave it’ basis.³³ These may also be described as ‘adherence’ contracts and the analogy being that the contract terms ‘stick’ to the weaker party who is requesting the goods or services on a ‘take it or leave it basis’ and not having the opportunity to negotiate terms that would be fair, equitable and practical.³⁴ However, guidance on how to interpret a standard form contract can be found in the extensive list of factors set out under s 27(2) of the *ACL* Which provides the following factors to be taken into account;

‘(a) whether one of the parties has all or most of the bargaining power relating to the transaction;

(b) whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties;

(c) whether another party was, in effect, required either to accept or reject the terms of the contract (other than the terms referred to in section 26(1)) in the form in which they were presented;

(d) whether another party was given an effective opportunity to negotiate the terms of the contract that were not the terms referred to in section 26(1);

(e) whether the terms of the contract (other than the terms referred to in section 26(1)) take into account the specific characteristics of another party or the particular

³² *ACL* s 23(3).

³³ Australian Competition and Consumer Commission, ‘UCT’ (14 March 2013) (Webpage) <<https://www.accc.gov.au/publications/unfair-contract-terms>> 4.

³⁴ Raufdeen Rameezdeen and Anushi Rodrigo, ‘Modifications to Standard Forms of Contract: The Impact on Readability’ (2014) 14(2) *Australasian Journal of Construction Economics and Building* 31, 31-32. See also Michael J Trebilcock, *The Limits of Freedom of Contract* (Harvard University Press, 1997) 119 and how these contracts may affect the rights and obligations of parties under the contract.

transaction;

(f) any other matter prescribed by the regulations.’

Although the court is given statutory guidance on whether a contract is a ‘standard form contract’, s 27(1) provides a rebuttable presumption that if a party to a contract alleges that the contract is a standard form contract, it is presumed to be such. Therefore, evidence needs to be provided to the contrary in order to escape application of the UCT regime. It is noted by Giancaspro that; ‘Whilst standard form contracts are beneficial in many ways, they are clearly capable of being engineered in an excessively unbalanced manner’.³⁵ Therefore, it is the purpose of the UCT provisions to cover unfair standard form contracts through a variety of circumstances as outlined below.

C Meaning of Unfair under the UCT Provisions

The test applied to determine whether a term is unfair under the ACL, is set out under s 24(1) and provides essentially that a term of a standard form ‘consumer contract’ will be unfair if:

- (i) it would *cause a significant imbalance* in the parties’ rights and obligations under the contract;
- (ii) it is not reasonably necessary in order to *protect the legitimate interest* of the party who would be advantaged by the term to the contract (note that the party who would be advantaged by the term must prove that it is reasonably necessary); and
- (iii) it would *cause detriment* to a party to the contract if it were to be applied or relied upon. [own emphasis added]

For section 24(1) to apply, all three features of the test must be established and proved in order for a court to find that a term is unfair. A further consideration for the court is to take into account the extent to which the term is transparent, and the contract as a whole.³⁶ Section 25(a)-(n) provides an extensive but not exclusive list of the types of terms that may be considered unfair.³⁷ However, terms that set the upfront price and subject matter of a contract, and terms

³⁵ Mark Giancaspro, ‘Unfair Contract Terms and Small Business Contracts: Insights from Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd and the Case for Small Business Protection’ (2018) 26 *Competition and Consumer Law Journal* 25, 26.

³⁶ *Ibid* s 24(2)(a).

³⁷ Examples under *Competition and Consumer Act 2010* (Cth) sch 2 s 25 include: ‘(a) a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract; (b) a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract; (c) a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract; (d) a term that permits, or has the effect of permitting, one party (but not another party) to vary the

that are expressly required or permitted by another law are excluded from the UCT provisions.³⁸ The rationale for this exclusion under the ACL is that consumers who enter into a contract will reasonably be expected to understand these particular terms on a basic level and make decisions based upon them.³⁹ There may also be some form of negotiation between the parties on these matters. Ultimately it is argued by Coggins that ‘to assess whether it is unfair, a term must be viewed in the context of the particular contract and the circumstances of its use’.⁴⁰ Hence, the contract, with its UCT, will be viewed as a whole in order to determine whether it is considered void or not.

The effect of an unfair term in a consumer contract is that it is void.⁴¹ If a court makes a declaration that a term is unfair and a party subsequently seeks to apply or rely on the unfair term, the court may make a range of orders including, but not limited to, varying the contracts or arrangements; refusing to enforce any or all of the terms of the contract; or directing the person to refund money or property to the injured person.⁴² Therefore, the parties may still be bound to the contract if the contract is able to continue without the unfair term. This is further clarified by Murdoch and Zhang who state that:⁴³

There are no immediate consequences for a party advantaged by an unfair term. That is, it is not a breach of the ACL to include an unfair term in a contract. Rather, it is up to the party disadvantaged to point out that the unfair term is void and pursue a claim for damages or a court injunction if the advantaged party attempts to enforce the term.

However, as mentioned above, the UCT laws did not apply to a contract for the supply of goods or services between businesses prior to 2015. With the increase in UCT on a commercial level, the UCT regime under the *ACL* for small businesses formed some discussion on the introduction of these provisions on a business-to-business level. The subsequent part will provide a discussion on the UCT regime, as highlighted above, on small businesses. Notwithstanding the standard contract theory of ‘freedom to contract’, this part will argue that the recently adopted UCT regime, subject to the promotion by the ACCC and the awareness of the provisions by

terms of the contract; (e) a term that permits, or has the effect of permitting, one party (but not another party) to renew or not renew the contract.’

³⁸ *Ibid* s 26(1).

³⁹ Australian Treasury, ‘Review of Unfair Contract Term Protections for Small Business’ (November 2018) 2-4 <https://consult.treasury.gov.au/market-and-competition-policy-division-internal/c2018-t342379/supporting_documents/Discussion_Paper__Review_of_UCTs%20%20Final.pdf>.

⁴⁰ Coggins (n 24) 274.

⁴¹ *Competition and Consumer Act 2010* (Cth) sch 2 s 23(1).

⁴² *Ibid*.

⁴³ Nicole Murdoch and Sandy Zhang, ‘A Commercial IP Perspective on the New UCT Protection under the ACL’ (2017) 30(6) *Australian Intellectual Property Law Bulletin* 139, 139.

small businesses should provide these small businesses within the construction industry with the much-needed protection in relation to standard form contracts and hidden UCTs.

V SMALL BUSINESS CONTRACTS AND UCT REGIME UNDER THE *ACL*

In 2009, the Commonwealth Treasury noted that the UCT provisions under standard consumer contracts should not only apply to ‘consumer contracts’ but be extended to business-to-business transactions and stated:⁴⁴

Standard-form contracts are used by parties irrespective of the legal status or nature of the party to whom the contract is presented, and without any effective opportunity for that party to negotiate the term. In such cases, it would be invidious to suggest that the same term, which may be considered unfair in relation to a contract entered into by a natural person, would not be similarly unfair in relation to a business, where neither of them is in a position to negotiate the term.

As a result, the federal government passed the Treasury Legislation Amendment (Small Business and UCT) Bill 2015 on 27 October 2015 to include small businesses as part of the unfair contract term regime under the *ACL* provisions. In introducing the Bill, the Hon. Bruce Billson MP (Minister for Small Business) stated:⁴⁵

This legislation will extend the consumer unfair contract term protections to cover standard form, small business consumer-like contracts that are valued below a prescribed threshold... With today’s introduction of this legislation we have met each of our small business election commitments... That is why I have been committed to provide a ‘fair go’ for small business by extending the unfair contract protections currently available to consumers to cover the small business sector.

The objectives of the amendments were further highlighted by Weston:⁴⁶

...founded on the premise that small businesses, like consumers, are vulnerable to unfair terms in standard form contracts due to their reduced bargaining power and inability to absorb the costs or contract risks should they eventuate. Small businesses may lack the resources to retain legal advice or representation to negotiate a standard form contract or assist in managing damage should difficulties arise.

⁴⁴The Treasury, ‘Consultation on Draft UCT Provisions’ (11 May 2009) <https://archive.treasury.gov.au/documents/1537/PDF/The_Australian_Consumer_Law_Consultation_Paper.pdf> 8.

⁴⁵ Explanatory Memorandum, Treasury Legislation Amendment (Small Business and UCT) Bill 2015 (Cth). Also see Elizabeth Spencer, ‘The Applicability of UCT Legislation to Franchise Contracts’ (2013) 37(1) *University of Western Australia Law Review* 156, 159 where it was stated that ‘businesses are consumers, whose confidence in efficiency, fairness and certainty are important to any economy’ and therefore is subjected to similar protection under the unfair contract term regime as consumers.

⁴⁶Freya Weston, ‘Creating an Even Playing Field: Extending Unfair Contract Term Protections to Small Business’ (October 2016) *Australian Civil Liability* 117, 117.

Consequently, the amended s 23(1) provision relating to standard form contracts between businesses commenced on 12 November 2016. The new laws apply to any new or renewed contract entered into on or after this date. If an existing contract was varied on or after 12 November 2016, the law also applied to the varied terms.⁴⁷

As mentioned earlier, the unfair contract term provisions apply to standard form contracts, with the amended version including small businesses. The amended s 23(1) of the ACL now provides:

- (1) A term of a consumer contract or *small business contract* is void if:
 - (a) the term is unfair; and
 - (b) the contract is a standard form contract. [emphasis added]

Based on this amended provision, one of the jurisdictional issues is that only ‘small businesses’ (with the exception of consumers) dealing with ‘standard form contracts’ fall within the new *ACL* provisions. Where a contract is deemed to be a standard form small business contract, a number of parties can apply to court for a declaration that a term in the contract is an unfair term. These include the parties to the contract, the Australian Securities and Investment Commission (ASIC), or the Australian Consumer and Competition Commission (ACCC). In order to determine a cause of action under the provisions of the *ACL*, it is firstly necessary to determine if the contract is a ‘small business standard form’ contract containing proscribed ‘unfair’ terms. In relation to the building and construction industry, the meaning of a ‘small business’ is an important consideration as it is claimed that most businesses in this industry are either sole traders or very small, employing less than 20 people.⁴⁸

A What is a ‘Small Business’ Contract in Construction?

In general, s 23(4) of the *ACL* states that a contract will be a *small business contract* if:

- (i) the contract is for a supply of goods or services, or a sale or grant of an interest in land; and
- (ii) at the time the contract is entered into, at least one party to the contract is a business

⁴⁷ See, Peter Sise, ‘The Extension of Unfair Contract Term Provisions to Small Business Contracts: A Lack of Clarity’ (2016) 23 *Competition and Consumer Law Journal* 217.

⁴⁸ Australian Industry and Skills Committee, ‘IRC Construction’ (14 December 2018) (Webpage) <<https://nationalindustryinsights.aisc.net.au/industries/construction>>.

that employs fewer than 20 persons; and

(iii) either of the following applies:

- (a) the upfront price payable under the contract does not exceed \$100,000;
- (b) the contract has a duration of more than 12 months and the upfront price payable under the contract does not exceed \$300,000.

An important consideration is thus the ambit of the term ‘small business’ within the construction industry. This is central to understanding how the Act and unfair contract term provisions apply to businesses as set out under the *ACL*. From s 23(4), there are two clear thresholds that need to be met. The first relates to the restriction of employees within the small business. According to the Explanatory Memorandum to the Bill, the 20-employee restriction was adopted, by the Australian Bureau of Statistics and the ‘the headcount measure...has been found by the ABS to provide a good proxy of small business’.⁴⁹ The second monetary threshold was also an important consideration and the comments made as part of the Bill on this requirement included words to the effect of ‘By creating a threshold, the Bill places the onus on small businesses to undertake due diligence for high-value transactions. The committee considers this the fairest approach’.⁵⁰

However, the draft consultation paper by the Australian Treasury suggested other options to what would entail a ‘small business’ for the purposes of the unfair contract term regime. These included the following which were subsequently adopted in the UCT legislation:⁵¹

- (i) businesses falling outside the definition of public-listed companies;⁵²
- (ii) businesses negotiating contracts under a certain threshold;⁵³
- (iii) considering the annual turnover of the business;⁵⁴ and

⁴⁹ Explanatory Memorandum, Treasury Legislation Amendment (Small Business and UCT) Bill 2015 (Cth) [3.127].

⁵⁰ *Ibid* [2.70].

⁵¹ The Treasury, ‘Extending Unfair Contract Term Protections to Small Businesses’ (23 May 2014)

<<https://treasury.gov.au/consultation/extending-unfair-contract-term-protections-to-small-businesses>>.

⁵² *Ibid* 60.

⁵³ *Ibid* 61.

⁵⁴ *Ibid* 62.

(iv) taking into account the employees within that business.⁵⁵

A further important consideration is s 23(5) stating that ‘In calculating the number of employees, each full-time, part time and casual employee constitutes one person. However, a casual employee is not to be counted unless that person is employed on a regular and systemic basis’.⁵⁶ This is a valid consideration in relation to subcontractors and the type of set up within such a business. From a 2016 survey undertaken by the Australian Small Business and Family Enterprise Ombudsman, it was revealed that 61% of businesses in Australia consist of sole traders (acting on an individual basis) in a commercial setting and 9% of small businesses employing less than 19 employees.⁵⁷

B What is a ‘Standard Form Contract’ in Construction Agreements?

Standard form contracts are typically used for the supply of goods and services to consumers in many industries. These include, but are not limited to, telecommunications, finance, domestic buildings, gyms, motor vehicles, travel and utilities.⁵⁸ In terms of the burden of proof under the unfair contract term provisions, if a party to a proceeding alleges that a contract is a standard form contract, it is helpful to consider the general provisions of the UCT provisions in respect of standard form contracts before considering the specific application of the *ACL* to specific terms found in construction contracts.

The first reported ‘standard form contract’ case under the amended s 23 provision for business purposes is *Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd*⁵⁹ where it was found that a standard form small business contract contained numerous UCT clauses. Apart from the UCT clauses found in the standard form contract, the court observed that the contract was a ‘densely packed page of small print terms and conditions’ that is not transparent and in breach of s 24(2) of the *ACL*.⁶⁰ Therefore, the element of ‘transparency’ is an important consideration especially in the construction industry where standard contracts are

⁵⁵ *Ibid.* See in general, Trish O’Sullivan, ‘The Definition of “Consumer” – Will the Real “Consumer” Please Stand Up’ (2016) 24 *Competition and Consumer Law Journal* 23.

⁵⁶ *Competition and Consumer Act 2010* (Cth) sch 2 s 23(5).

⁵⁷ Australian Small Business and Family Enterprise Ombudsman, *Small Business Counts Report* (Report, 2016) 8 <https://www.asbfeo.gov.au/sites/default/files/Small_Business_Statistical_Report-Final.pdf>.

⁵⁸ Australian Competition and Consumer Commission, ‘A Guide to the UCT Law’ (9 September 2015) <http://consumerlaw.gov.au/files/2015/09/Unfair_Contract_Terms_Guide.pdf>

⁵⁹ [2017] FCA 1224.

⁶⁰ *Ibid* [60].

often drafted in legal jargon and provided to small businesses on a ‘take it or leave it’ basis.⁶¹ It is further noted by Evans in his Report to the Minister for Commerce that all sections within the construction industry should be made aware of their rights and obligations in relation to UCTs under the ACL provisions.⁶²

The term ‘standard form contract’ is used generically to describe the main forms of General Conditions of Contract (GCOC) used in the construction industry. These fall within two groups. The GCOC documents prepared by Standards Australia⁶³ and those produced by a range of professional organisations including the Property Council of Australia, The Master Builders Association of Australia, the Australian Institute of Architects and the Housing Industry of Australia. Whether the construction industry GCOC fall within the UCT regime will depend on the provisions as set out in section 23(4).

In construction, AS2124-1992 and AS4000-1997 are designed for use on major building and engineering projects where a ‘superintendent’ is engaged to administer the contract. The superintendent may be an independent professional or a firm of consultants⁶⁴ or an employee of the principal. The contract price may be calculated as a lump sum or re-measurement (schedule of rates/bill of quantities) or a combination of these. Though Standards Australia (SA) intended to discontinue publication of the AS2124-1992 (which itself replaced the superseded 1978, 1981 and 1986 editions) when the AS4000 contract was released, AS2124 remains available as a current Australian Standard (AS) and the anecdotal evidence suggests that it is used in preference to AS4000.

The advantages of the use of standard form contracts in the Australian construction industry have been well documented. As far back as 1990 it was stated:⁶⁵

Standard forms of contract are preferred by the industry to contracts that are individually drafted for each project, if for no other reason than that as both parties are more likely to be fully familiar with the obligations assumed by each party using a Standard form they will thereby reduce incidents of dispute caused by concealing

⁶¹ A similar standard form small business contract with UCTs were argued in the case of *WOW! Travel Pty Ltd v Qatar Airways (Civil Claims)* [2018] VCAT 1219.

⁶² Phil Evans, *Report on the Operation and Effectiveness of the Construction Contracts Act 2004 (WA)* (Department of Commerce, 2 August 2015) <https://www.commerce.wa.gov.au/sites/default/files/atoms/files/cca_review_report.pdf>.

⁶³ The two most common AS GCOC used in the construction industry are AS2124-1992 and AS4000-1997.

⁶⁴ See *Peninsula Balmain Pty Ltd v Abigroup* (2002) NSWCA 211.

⁶⁵ NPWC/NBCC, ‘No Dispute – Strategies for the Improvement in the Australian Building and Construction Industry’ (A Report by the NPWC/NBCC Joint Working Party, May 1990) 9-10.

obligations in unfamiliar documents.

More recently, the benefits of standard form contracts have been noted in the research report by the Melbourne University School of Law.⁶⁶ The report is extensive and detailed and states in part that 68% of contracts are based upon AS standard form contracts and the dominating factor identified by participants was the familiarity with the forms. Their widespread use over time and familiarity enables participants to clearly understand the meaning of terms and their rights and obligations under the contract. Additionally, the dispute resolution procedures used in these standard forms are very effective with respect to quick and economical resolution of disputes. The AS standard forms have been prepared after long consultation with relevant stakeholders and interested parties and are subject to review and revision from time to time. A significant benefit in their use is that the risk is ‘balanced’ between the contracting parties.

Unless subject to non-complying amendments or inclusions in the Special Conditions section, the main provisions in the AS suite of GCOC would generally not fall within the UCT provisions of the *ACL* with the exception of those terms discussed below. However, sections of the construction industry are characterised as a consequence of the use of what might be described as bespoke contracts⁶⁷ usually prepared by the dominant contracting party. A number of submissions to the Western Australian review of the operation and effectiveness of *Construction Contracts Act 2004*⁶⁸ provided a number of examples of terms which would now be prohibited under the provisions of the *ACL*. These fell within the definition of small business contracts as the contracts involved were predominantly sole trader subcontracts satisfying the criteria in section 27(4) of the UCT legislation.

Put simply, the above factors and those listed under s 27(2) of the *ACL* are indicative of an agreement between two parties, where the terms and conditions of the contract are set by one of the parties, and the other party (often the vulnerable party) has little or no ability to negotiate more favourable terms and is thus placed in a ‘take it or leave it’ position.⁶⁹

⁶⁶ John Sharkey AM, Matthew Bell, Wayne Jovic and Rami Marginean, *Standard Forms of Contract in the Australian Construction Industry* (Research Report, June 2014), <https://law.unimelb.edu.au/__data/assets/pdf_file/0007/1686265/Research-Report-Standard-forms-of-contract-in-the-Australian-construction-industry.pdf>.

⁶⁷ Bespoke contracts are contracts that are written for the specific requirements of a project and are used when standard form contracts are not suitable for the project.

⁶⁸ Phil Evans, *Report on the Operation and Effectiveness of the Construction Contracts Act 2004 (WA)* (Department of Commerce, August 2015)

<https://www.commerce.wa.gov.au/sites/default/files/atoms/files/cca_review_report.pdf>.

⁶⁹ These types of contracts may also be described as Adhesion Contracts.

C Defining 'Unfair Terms' in Construction Standard Form Contracts

In determining which terms of a construction contract might fall within the provisions of the *ACL* the starting point is considering ss 24 and 25 of the *ACL* which define the meaning and application of unfair terms within a standard form small business contract. There is a four -step approach to identify whether a term is unfair within standard form construction contract.

1 Section 24(1)(a) of the ACL

The first limb of the test requires a consideration of whether there is an imbalance of the parties' rights and obligations through the weighing of favorability. The requirement under this test is for the imbalance to be so significant that it affects the substantive operation of the contract as a whole.⁷⁰ It should be emphasised that it is not the overall conduct of a party that renders the contract unfair.⁷¹ It is whether the 'term' is unfair. In *Ferme v Kimberley Discovery Cruises Pty Ltd*,⁷² Jarrett J explained that:

Section 24(1)(a) requires an inquiry into the balance "in the parties' rights and obligations arising under the contract"...As the applicant submits, *the issue is "whether a term of a contract is unfair, not whether the overall conduct of the Respondent is or was unfair"*. Section 24(1)(a) directs attention to the rights and obligations arising under the contract. That is a matter for objective assessment according to those terms properly construed. (emphasis added)

Although the common law makes provision for some default rules in relation to parties' rights and obligations, it is the significant tilting of the unfavourable impact of the unfair contract term towards the disadvantaged party that will be taken into account.⁷³ This is reiterated by Willett stating that 'The requirement of significant imbalance is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour'.⁷⁴ In relation to construction contracts, 'terms that set the upfront price payable are generally excluded from the UCT legislation and may be one of the main 'balance tilting' criteria to consider under s 24(1)(a).⁷⁵ The upfront price payable includes any payments to be provided for the supply, sale or grant under the contract that are clearly disclosed at or before

⁷⁰ *Director of General of Fair Trading v First National Bank plc* [2002] 1 AC 481, 494; *Australian Competition and Consumer Commission v CLA Trading Pty Ltd* [2016] FCA 377 [54].

⁷¹ If 'unfairness' overall is an issue a cause of action may lie in the unconscionable conduct provisions in sections 20 and 21 of the *ACL*.

⁷² [2015] FCCA 2384 [64].

⁷³ Jeannie Paterson, 'The Australian UCT Law: The Rise of Substantive Unfairness as a Ground for Review of Standard Form Consumer Contracts' (2009) 33 *Melbourne University Law Review* 934, 944.

⁷⁴ Chris Willett, *Fairness in Consumer Contracts: The Case of Unfair Terms* (Ashgate Publishing, 2007) 230.

⁷⁵ See, eg, *Jetstar Airways Pty Ltd v Free* (2008) 30 VAR 295; [2008] VSC 539 [129].

the time the contract is entered into. This includes any contingent payments which are preferable to the supply, sale or grant under the contract which are disclosed at the time the contract is entered into. For the purposes of determining whether a contract falls under the relevant threshold (\$300 000 or \$1 million) to meet the definition of a ‘small business contract’, any amounts that cannot be calculated with certainty at the time the contract is entered are unlikely to be included in the calculation of the upfront price payable. In terms of construction contracts there are a range of costs which cannot be determined at the time of entering into the contract including variations, extras and costs associate with latent conditions.

A useful example relates to price variation clauses and how these clauses extend beyond what is reasonably necessary. This may impact a small business and cause a significant imbalance of their rights and obligations within a construction contract. Another example of how small businesses may be where the ‘time clause’ is so weighted in favour of the bigger construction contract party that it breaches s 24(1)(a). These examples will be further expanded on below.

2 Section 24(1)(b) of the ACL

For a small building and construction businesses to argue UCT under the *ACL*, it is important to note that s 24(4) places an onus on the larger business or the person who would benefit from the contract to prove that it is done as part of its legitimate interest.⁷⁶ In order to prove some form of legitimate interest, Patterson remarks that:⁷⁷

By showing that the term protects the trader from business risks inherent in the transaction, as opposed to being an opportunistic attempt to appropriate gains not contemplated as part of the original bargain.

Therefore, a term in a construction contract will not necessarily be unfair if it is to protect the legitimate interest of the larger business. However, it is important to also prove that it is ‘reasonably necessary’ for the term to bring about a legitimate interest. In *Abraham v Gogetta Equipment Funding Pty Ltd*,⁷⁸ the tribunal held that:⁷⁹

a term of a contract is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, unless that party proves otherwise. In other words, the onus is on the Respondent to prove to the Tribunal that

⁷⁶ Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth) [5.27]-[5.28].

⁷⁷ Jeannie Paterson, *UCT in Australia* (Thomson Reuters, 2012) 58.

⁷⁸ [2017] NSWCATCD 22. This case involved a rental agreement.

⁷⁹ *Ibid* [70].

this Term is necessary to protect its legitimate interests.

From this it is clear to suggest that the court will take into account ‘proportionality’ in order to weigh up the imbalance between the parties.⁸⁰ It has also been argued by Clarke and Erbacher that s 24(1)(b) mirrors the factors in determining unconscionable conduct under s 22 of the ACL.⁸¹

3 Section 24(1)(c) of the ACL

In order to bring a claim under the UCT regime, it is important to argue that the stronger or more advantaged party to the contract caused ‘detriment’ to the interests of the weaker party. However, this provision has been the centre of attention in that the ‘detriment’ caused does not have to be financial in nature. In this respect, Harbison J held that:⁸²

There does not seem to be much that can be said about the concept of the imbalance being to the detriment of the consumer. The *only matter* to be flagged about those words is that it is clearly an imbalance which is to the consumer’s detriment and not an imbalance to the detriment of the trader, which is important in considering this definition. [emphasis added]

This is confirmed by the Explanatory Memorandum to the Bill which states that ‘Detriment is not limited to financial detriment. This is designed to allow the Court to consider situations where there may be other forms of detriment that have affected or may affect the party disadvantaged by the practical effect of the term’.⁸³

Therefore, in a construction contract scenario, considerations such as delay of work, inconvenience and hardship may all be relevant to take into account as a form of ‘detriment’ under s 24(1)(c). This may be claimed as such by the small business.

4 Sections 24(2)-(3) of the ACL

Phillips comments that ‘the law affects only the “structure” of the contract, with the emphasis on a “balance of power” under the contract’.⁸⁴ A commercial agreement can become convoluted in the interpretation of the terms in a standard form small business contract. As a result, apart

⁸⁰ See, for example, *Director of Consumer Affairs v AAPT Ltd* [2006] VCAT 1493 (2 August 2006) [36].

⁸¹ Philip Clarke and Sharon Erbacher, *Australian Consumer Law* (2018, 6th ed, Thomson Reuters) 499.

⁸² *Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd* [2008] VCAT 2092 (24 October 2008) [36].

⁸³ Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth) [5.32]-[5.34].

⁸⁴ Ken Phillips, ‘Does Australia’s Unfair Contracts Act Limit or Enhance Contractual Freedom?’ (2016) 36(3) *Economic Affairs* 341, 343.

from ss 24(1)(a)-(c), the court must also take into account the contract in its *entirety* as well as the *transparency* of the particular term, allowing fairness in its application.⁸⁵

This is an important consideration for the court because it has been noted that small businesses, specifically independent contractors, do not read and/or understand a standard form contract making the likelihood of unfair terms being present in the contract, more probable.⁸⁶ Often, the standard form contracts signed by small businesses within the construction and building industry is drafted with difficult and tedious legal jargon which makes it susceptible to UCT clauses.⁸⁷ Hence, the court will be strictly interpreting s 24(3) taking into account the legal jargon, plain language, legibility and whether the standard form contract was readily available to the small business.⁸⁸

Transparency considerations such as font size and the way in which the contract is presented to the small business will be taken into account and in conjunction with the contract as a whole under ss 24(2)-(3).⁸⁹ Overall a general test for unfairness will be applied by the courts to determine the impact of the UCT clauses between the construction contracting parties.⁹⁰

Upon review of the application of s 24 in its totality, the case of *Australian Competition and Consumer Commission v Christco Hampers Australia Ltd*⁹¹ provided a detailed stance as to the application of the UCT provisions. Edelman J held that he agreed with senior counsel's submissions in relation to the construction of s 24 and held:⁹²

- (1) for a term to be unfair it must satisfy the requirements of all of s 24(1)(a) to (c);
- (2) the onus is upon the applicant to prove the matters in ss 24(1)(a) and 24(1)(c) but it is upon the respondent in relation to s 24(1)(b);
- (3) Section 24(2)(a) only requires the Court to consider transparency in relation to the

⁸⁵Ibid ss 24(2)-(3).

⁸⁶ See in general, *Baltic Shipping Dillon* (1991) 22 NSWLR 1, 25.

⁸⁷ This was referred to in the case of *Oceanic Sun Line Special Shipping Co Inc v Fay* (1988) 165 CLR 197, 204.

⁸⁸ *Competition and Consumer Act 2010* (Cth) Sch 2 s 24(3) states: 'A term is transparent if the term is: (a) expressed in reasonably plain language; and (b) legible; and (c) presented clearly; and (d) readily available to any party affected by the term.'

⁸⁹ In *Australian Competition and Consumer Commission v JJ Richards & Sons Pty Ltd* [2017] FCA 1224 (13 October 2017) [60] the court held that the terms of the contract 'were not presented in a way that drew them to the customer's attention'.

⁹⁰ This was also highlighted in Melvin Eisenberg, 'The Limits of Cognition and the Limits of Contract' (1995) 47 *Stanford Law Review* 211; Todd Rakoff, 'Contracts of Adhesion: An Essay in Reconstruction' (1983) 96 *Harvard Law Review* 1173.

⁹¹ [2015] FCA 1204.

⁹² Ibid [43].

particular term that is said to be unfair and only in relation to the matters concerning that term in s 24(1)(a) to (c);

(4) similarly, the assessment of the contract as a whole in s 24(1)(c) only requires the Court to consider the contract as a whole in relation to the particular term that is said to be unfair and only in relation to the matters concerning that term in s 24(1)(a) to (c);

(5) as the Explanatory Memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth) provided at [5.39], “if a term is not transparent it does not mean that it is unfair and if a term is transparent it does not mean that it is not unfair”; and

(6) guidance can be had to s 25 which provides examples of unfair terms.

The principles outlined above, would apply equally to both consumer contracts and small business contracts. The application of standard form small business contracts is central to the construction industry. Therefore, it is worth identifying the types of clauses that may be caught under s 24(1) that will affect a small business/subcontractor in the construction and building industry.

VI UCT CLAUSES COMMONLY FOUND IN CONSTRUCTION CONTRACTS

Authority referred to such as *Australian Competition and Consumer Commission v JJ Richards* set the landscape in that protection against UCTs in standard form contracts is warranted in the case of small businesses. It is therefore vital to extend similar protections to small businesses within the construction industry who often engage with standard form contracts and ‘hidden’ unfair terms. Whether a particular term in a construction contract is unfair will depend on the circumstances surrounding the contract terms, including the context of the contract as a whole.⁹³ However, as noted earlier, s 25 of the *ACL* provides a non-exhaustive list of terms the court may take into account in order to obtain whether contract terms are considered ‘unfair’. While the *ACL* protections have to date only been applied to a standard form construction contracts containing a non-disparagement clause (discussed below) there are a number of terms besides those listed under s 25, which are commonly found in construction contracts that may be caught by the legislation.⁹⁴

The terms are not discussed in any order of priority. They include:

⁹³ *Competition and Consumer Act 2010* (Cth) sch 2 s 24(2).

⁹⁴ See, eg, Coggins (n 24) 280.

A Default, Insolvency and Termination for Convenience Clauses;

B Non-Disparagement Clauses;

C Interest on Overdue Payments;

D Extreme Time Bars;

E Unilateral Variation clauses;

F Unreasonable Prime Cost (PC) Items and Provisional Sums (PS);

G Latent Conditions Clauses; and

H Liquidated Damages Clauses (especially in the case of residential building work which underestimate the owner's loss due to delay).

A Default, Insolvency and Termination for Convenience Clauses

The normal default provisions in a contract permit the Principal to recover damages and terminate the contract for breach of what are generally termed 'substantial' breaches of the contract. Examples of substantial breaches are usually given in the contract, and in essence they reflect the situations which would give rise to the innocent party to elect to terminate the contract for breach of a condition falling within the common law principles. That is a breach which would render performance of the contract something substantially different from that which was agreed to.⁹⁵

However, an increase in the use of express termination or termination for convenience clauses (TFC) or termination 'at will' clauses are frequently noted, which give the Principal or Owner the right to unilaterally terminate a contract.⁹⁶ These clauses were originally used in large infrastructure or defence contracts to ensure that government is able to act freely in order to vitiate contractual obligations where it is in the public interest, or where policy may change, even though this may interfere with the normal common law contractual rights of the other party. They are now being used in a range of construction agreements. The wording is typically as follows:

⁹⁵ See *Associated Newspapers Ltd v Bancks* (1951) 83 CLR 322.

⁹⁶ See in general, William Dixon, 'Termination for Convenience or Not?' (2017) 45(3) Australian Business Law Review 229-242; Andrew Stephenson, Lee Carroll and Jey Nandacumaran, 'GAR Know How Construction Arbitration: Australia' (July 2019) Corrs Chambers Westgarth <<https://corrs.com.au/site-uploads/images/PDFs/Insights/article-arbitration-gar-know-how-construction-arbitration-2019-australia.pdf>>.

Without prejudice to any of the Principal's other rights and powers under this contract, the Principal may at any time for any reason within its sole discretion upon 10 Business Days' Notice to the Contractor terminate the Contract. Upon receipt of such notice the Contractor shall remove its Constructional Plant from the Site, shall otherwise cease the performance of its obligations under the Contract and shall endeavour to mitigate any expense or losses that it or the Subcontractor may incur or has incurred in relation to its obligations under the Contract.

Prior to the introduction of the *ACL* UCT provisions, courts have upheld the enforceability of TFC provisions.⁹⁷ Where the principal has discretion, whether or not to terminate the contract, if the termination clause provides it with an absolute and uncontrolled discretion which it is entitled to exercise for any reason it might deem advisable, that right will be unfettered. Particularly if it has been brought to the contractor's attention or was subject to discussion at the time of entering into the contract.

In *Thiess Contractors v Placer (Granny Smith) Pty Ltd*⁹⁸ Thiess unsuccessfully argued that a TFC clause was unenforceable and was inconsistent with Placer's good faith obligations. The court held that Thiess was well aware of the risks of agreeing to the contract with the termination clause in it and accepted those risks.⁹⁹ However s 25(b) of the *ACL* identifies as potentially unfair, a term permitting one party (but not the other) to terminate a contract. This significant imbalance and disadvantage cause a potential risk in the context of standard form contracts with small business where the principal's legitimate interests are not proportionate.

It would appear that a TFC clause will be unfair if the process for termination is not mutual (and it rarely is) and does not provide that the Contractor is to be compensated for its losses including loss of profit and an overheads contribution on the balance of the work. If this is absent then there is also the possibility that this clause may be considered as penal or depending on the facts, as unconscionable.¹⁰⁰

Whilst not relating to a construction contract, but nevertheless illustrative of the principles, the ACCC in a review of selected industries with respect to unfair terms, considered two standard form publishing contracts.¹⁰¹ They contained terms that allowed the publisher to terminate for

⁹⁷ *Theiss Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* [2002] WASCA 102; *Starlink International Group Pty Ltd v Coles Supermarkets Australia Pty Ltd* [2011] NSWSC 1154.

⁹⁸ [2002] WASCA 102.

⁹⁹ *Ibid* [19].

¹⁰⁰ *Competition and Consumer Act 2010* (Cth) Sch 2 ss 20-22.

¹⁰¹ Australian Competition and Consumer Commission, *Unfair Terms in Small Business Contracts: A Review of Selected Industries* (ACCC Report, 9 November 2016)

‘any breach of the contract’. In response to action by the ACCC, one publisher was required to amend its standard form contract to provide that it can now only terminate the agreement for a ‘material’ breach. Whilst the second publisher explained the circumstances in which it felt it should be able to terminate the contract, it failed to justify why it was reasonably necessary to be able to terminate for ‘any possible breach’ accordingly tilting the balance of the rights and obligations between parties. The ACCC considered that broad, unrestrained terms were likely to be unfair in accordance with the ACL.¹⁰² This application may be similarly applied to small businesses contracting in the construction industry.

B Non-Disparagement Clauses

During 2017 and 2018, the ACCC commenced actions against two building companies in connection with non-disparagement clauses,¹⁰³ 101 Residential Pty Ltd (101 Residential) and Wisdom Properties Group Pty Ltd (Wisdom Homes). In the case of 101 Residential, a Perth (WA) based building company used a building contract containing non-disparagement clauses that prohibited customers from publishing any unapproved information about the company, including online reviews.¹⁰⁴ These were held by the ACCC to be unfair and in December 2017 101 Residential was required to remove the non-disparagement clauses and compensate clients and provide a court undertaking that it would not prevent customers from publishing general feedback relating to Residential.¹⁰⁵ 101 Residential also included in an annexure to its building contract an exclusion of liability clause which sought to exclude the company from any liability for damages or compensation for distress or inconvenience,¹⁰⁶ any loss of profit, loss of use or any indirect or consequential loss. These clauses were held to be inconsistent with the statutory guarantees automatically provided to consumers under the *ACL*. Further they were likely to

<https://www.accc.gov.au/system/files/B2B%20UCT%20%20Final%20%20Unfair%20terms%20in%20small%20business%20contracts%20%20A%20review%20of%20selected%20industries_0.PDF>.

¹⁰² Ibid.

¹⁰³ According to the Macquarie dictionary, ‘disparagement’ means ‘to bring reproach or discredit upon’ or ‘to speak of slightly’: *The Macquarie Dictionary* (Federation, 2001). Therefore, non-disparagement clauses in a contract entails a person not speaking ill or negatively about a business in this regard. This will include writing a review online or publishing material in hard-copy format.

¹⁰⁴ Australian Competition and Consumer Commission, ‘WA Building Company Amends Unfair Contracts’ (Media Release, December 2017) <<https://www.accc.gov.au/media-release/wa-building-company-amends-unfair-contracts>>.

¹⁰⁵ The undertaking can be viewed at <<https://www.accc.gov.au/system/files/public-registers/undertaking/1204819-1-87B%20Undertaking%20-%20%20101%20Residential%20Pty%20Ltd%20-%20signed%2015%20December%202017.PDF>>.

¹⁰⁶ The exclusion is interesting in that damages for disappointment and distress are not normally recoverable for breaches of building contracts.

amount to a false or misleading representation concerning the existence, exclusion or effect of any right or remedy in breach of s 29(1)(m) of the *ACL*.

The second non-disparagement action by the ACCC occurred in 2018 as a result of the use by Wisdom Properties Group Pty Ltd (Wisdom Homes) over the period 2008 to 2018 of a term in its agreement that prevented its clients from making any statements about the agreement or services provided without the written consent of Wisdom Homes.¹⁰⁷ If the client breached the non-disparagement clauses, a term of the agreement also allowed Wisdom Homes to suspend the building works. The ACCC accepted a court enforceable undertaking in June 2018 in which Wisdom Homes agreed the terms were unfair and would not enforce the clauses or use similar clauses in its agreements.¹⁰⁸

It is important to note that there were no court proceedings against either 101 Residential or Wisdom Homes and consequently no determination by a court that the non-disparagement clauses were indeed ‘unfair’ in accordance with the *ACL* even though both companies agreed the terms were unfair. However, it would appear that a court would strike out the non-disparagement terms in accordance with ss 24(1)(a)-(c) of the *ACL* in conjunction with ss 24(2)-(3).

Nevertheless, the actions by the ACCC have clearly placed builders on notice that the use of these terms will attract the attention of the ACCC.

C Interest on Overdue Payments

Construction contracts normally contain an express term specifying a rate of interest if any moneys due to a party are unpaid after the date on which they should have been paid. Clause 42.9 of AS2124-1992 and clause 37.5 of AS4000-1997 states that if no interest rate is stated in the contract, then the rate of interest shall be 18%.¹⁰⁹ At first sight it would appear that this interest rate is usurious or perhaps penal and would be struck down. It had been proposed, that

¹⁰⁷ Australian Competition and Consumer Commission, ‘Wisdom to Remove Unfair Contract Terms’ (Media Release, June 2018) <<https://www.accc.gov.au/media-release/wisdom-to-remove-unfair-contract-terms>>.

¹⁰⁸The undertaking can be viewed at <<https://www.accc.gov.au/system/files/public-registers/undertaking/Section%2087B%20Undertaking%20%20Wisdom%20Properties%20Group%20Pty%20Ltd%20-%20Signed%205%20June%202018.PDF>>.

¹⁰⁹Australian Standard AS2124-1992

<<http://www.housing.wa.gov.au/contractors/termsandconditions/Documents/Australian-Standard-General-Conditions-Contract-AS-2124-1992.pdf>>; Australian Standard AS4000-1997

<https://www.gippswater.com.au/application/files/4515/0216/8959/COR_17_59222__4000-1997_General_Condition_of_Contract_-_Amended_Mark-Up.PDF>.

the two existing Standards were to be merged into a single Standard, AS11000:2015 (AS11000) to supersede AS4000 and AS2124. In AS 11000 the interest rate under the contract, unless otherwise specified, would be 12% lower than the 18% currently provided for in AS4000 and AS2124.¹¹⁰ In contracts other than the AS general conditions of contract, it would appear that where a nominated rate of interest has been struck out, or perhaps silent, it would be held that the parties intended interest to be paid in the prescribed circumstances at a reasonable rate.¹¹¹ However, it is considered that an interest rate of 18%, would fall within the prohibitions of ss 24(1)(b) and (c). Therefore, the courts may take into account the legitimate interests of the party who would be advantaged balanced against the detriment it causes.

D Extreme Time Bars

All construction contracts will contain provisions requiring the builder or contractor to notify the owner or superintendent of cause of delay. These times will be strictly applied and can result in the loss of a party's rights if certain requirements are not met within a stipulated time.¹¹² That is, the right will be time barred.

The typical clause will be in a form as follows:

If the Contractor does not provide the Superintendent, within the requirements of the contract, any claim or notice within 14 days of the Contractor becoming aware of the circumstances giving rise to the claim or notice, the Contractor shall not be entitled to the claim or to any claim whatsoever arising from those circumstances.

Courts will strictly enforce time bar provisions with respect to extension of time variation claims.¹¹³ However, the principal as superintendent is obliged to act honestly and impartially in deciding to enforce a time bar provision.¹¹⁴ The reasoning is that in a typical contractual chain each party will have a reciprocal obligation to notify the party above it of an event that is likely to delay the progress of works or cause those works to cost more money. Unless such notice is given in a timely manner at each point in the contractual chain, the owner or principal may incur losses, as a consequence of failure to comply with its own contractual obligations and additionally a superintendent will require time to assess the basis of the claim.

¹¹⁰Standards Australia, 'AS11000: General Conditions of Contract' (January 2015)

<<https://www.standards.org.au/news/as-11000-colon-general-conditions-of-contract>>.

¹¹¹ *Re SC Molineaux & Co and Board of Trustees of Sydney Talmudical College* (1965) 83 WN (Pt 1) NSW 458.

¹¹² See, eg, clauses 35.5 and 42 of AS2124-1992.

¹¹³ *CMA Assets Pty Ltd Formerly Known as CMA Contracting Pty Ltd v John Holland Pty Ltd* [No 6] [2015] WASC 217.

¹¹⁴ *Peninsula Balmain v Abigroup Contractors* [2002] NSWCA 211.

However, a time bar could deprive a builder or contractor for a legitimate payment or an extension of time to complete the works if required notices, and information, are not given within the times specified in the contract. A clause that requires extensive information to be given, in writing, within an exceptionally short timeframe, could be deemed to be unfair and the court will now be likely to consider if the actual time bars specified are reasonably set having regard to the criteria set out within ss 24(1)(a)-(c) of the *ACL* and obligations of those parties who attempt to invoke the time bar clauses.

E Variations to the Work

The power to unilaterally vary the characteristics of the goods or services to be supplied is listed in s 25(d) of the *ACL* as an example of a term in a standard form contract that is unfair. In the construction industry context, this relates to the power to vary the scope of works or services to be supplied. A variation can arise after the commencement of the works at the initiative of either party, or from circumstances beyond the control of both parties such as latent conditions or changes in legislative requirements. As an example, clause 40.1 of AS 2124-1992 describes variations as being directions given by the superintendent to:¹¹⁵

- (i) Increase, decrease or omit any part of the work under the contract;
- (ii) Change the character or quality of any material of work;
- (iii) Change the levels, lines, positions or dimensions of any part of the work under the contract;
- (iv) Execute additional work; or
- (v) Demolish or remove material or work no longer required by the principal.

However, the ability to order a variation is not unfettered and any variations ordered must fall within the scope of the works.¹¹⁶ It has long been held at common law that the principal or superintendent does not have the right to instruct variations and unless the contract expressly permits the principal or superintendent to order variations, the contractor can refuse to perform the variation.¹¹⁷

¹¹⁵ Australian Standards (n 109). Similar wording is found in clause 36.1 of AS 4000-1887.

¹¹⁶ See *Wegan Constructions Pty Ltd v Wodonga Sewerage Authority* [1978] VR 67.

¹¹⁷ See *Ettridge v The Vermin Board of the District of Murat Bay* [1928] SASR 124.

The AS General Conditions of Contract variation clauses are extensive and equitable in terms of protecting contractors where variations are ordered by the superintendent. That is the variation clause provides the contractor with the opportunity to confirm whether the proposed variation can be affected, and if so, to provide a proposal for details relating to cost and time for performance.¹¹⁸ Conversely, where a contract provides for the principal or superintendent to direct a variation before there is agreement with respect to scope, price and time, there is the risk that the term will be unfair¹¹⁹ if it requires the contractor to comply, with the terms (possibly detrimental) yet to be agreed or determined later. To avoid this the variation term should expressly provide the builder or contractor with an opportunity to accept or reject the variation and to confirm any time and cost consequences prior to proceeding with the variation.

F Prime Cost (PC) Items and Provisional Sums (PS)

Prime Cost (PC) items and provisional sums (PS) are two of the items in a standard building contract which can give rise to unfairness as a consequence of inflated estimated costs prepared by the builder or contractor. Even though a contract may be described as ‘lump sum’ or ‘fixed cost’ the final sum will vary (usually by way of increase) as a consequence of the actual or final cost of the PC and PS items.¹²⁰ The two items are different. A PC item is an amount of money included in a contract sum to purchase specified item such as floor covering, ceramic tiles, kitchen and bathroom fittings.¹²¹ The nature and type of these items is known to the parties who will agree to an estimated amount which is expressly included (usually in a contract annexure) in contract. The items will be selected by the client prior to construction and any difference in the price as stated in the contract and at the time of completion will be adjusted by way of an increase or deduction in the lump sum price.

On the other hand, a PS is an amount of money expressed in the contract to cover any work and materials, the nature, extent and price of cannot be quantified at the time of entering into the contract.¹²² Typically these will include site works, foundation conditions, provision of septic tanks and ancillary plumbing and drainage, or in additions and extensions where the adequacy of structural support is unknown. Like PC items where the estimated cost differs from the actual cost incurred in completing the construction, the final amount will be adjusted to reflect the

¹¹⁸ See clauses 40.2 to 40.5 of AS2124-1992.

¹¹⁹ With respect to *Competition and Consumer Act 2010* (Cth) Sch 2 ss 24(1)(c) and 25(d).

¹²⁰ Master Builders WA, ‘Prime Costs and Provisional Sums’ (2016) <<https://www.mbawa.com/prime-costs-and-provisional-sums/>>.

¹²¹ *Ibid.*

¹²² *Ibid.*

actual cost. There is currently some legislative protection to owners under the *Home Building Contracts Act 1991* (WA) which stipulates that a builder must estimate the cost of such items at or above the lowest amount these items could reasonably cost, which must not be understated.¹²³ Section 12(1) specifically states that:

A builder must not enter into a contract that contains an amount or an estimated amount for a prime cost item or a provisional sum if the amount or estimated amount is misstated by being less than the least amount that it could *reasonably cost* to supply the item or perform the work to which the amount relates. (emphasis added)

From this, it is evident to state that the reference to ‘reasonable cost’ is problematic. The contract will generally state that the owner is not permitted to supply or arrange PC items which must be supplied by the builder and there is no opportunity to negotiate this provision. Additionally, anecdotal evidence suggests that builders will typically cost these items well above the cost at which an owner could independently obtain these items and where supporting documentation is supplied in support of the cost there is no opportunity to independently confirm the validity of these costs. These types of clauses lend themselves to small businesses and Contractors being protected under the s24 UCT provisions.

G Latent Conditions Clauses

The term latent condition is usually considered in relation to sub-soil conditions but may refer generally to items which are dormant, hidden or concealed.¹²⁴ The items are not exclusive but can include hazardous or toxic materials, groundwater, utility services and more usually differing foundation materials.¹²⁵ For example, the latent condition may consist of rock of a different composition to that shown in pre contractual geotechnical investigations. Therefore, latent conditions are confined to physical conditions.¹²⁶ They do not include shortages of labour or inflation. Frequently they are defined to exclude weather conditions and the water table level.

The term may be defined differently in various contracts and it can include any physical condition on or about the site which the contractor could not reasonably have anticipated or identified at the time of tendering or prior to the commencement of the works under the

¹²³ *Home Building Contracts Act 1991* (WA) s 12(1).

¹²⁴ Barry Tozer, ‘The Illusion of a Latent Conditions Clause’ (July/August 2008) *Australian Construction Law Newsletter* 26.

¹²⁵ *Ibid.*

¹²⁶ Thomas Uher and Phillip Davenport, *Fundamentals of Building Contract Management* (UNSW Press, 2009) 243.

contract.¹²⁷ The term should not be confused with the term latent defects which refers to defects that exist in the work that cannot be ascertained or identified by making reasonable enquiries or conducting reasonable investigations at the time of practical completion. With respect to the typical GCOC AS2124-1992 (clause 12), AS4000-1997 (Clause 25) and AS4300-1995 (Design and Construct), each contain similar definitions of latent conditions that may lead to UCT under s 24(1)(a)-(c).¹²⁸

By way of example, AS2124-1992 (clause 12.1) defines latent conditions as physical conditions on or under the site or its surroundings which differ materially from the physical conditions which should reasonably have been anticipated by the contractor at the time of tender, if the contractor had examined all information made available by the principal, examined all information relevant to the risks, contingencies and other circumstances that are obtainable by reasonable inquiry and from inspection of the site and its surroundings.¹²⁹ The latent condition clause in these standard contracts has been reproduced in numerous construction contracts, for example, the Australian Building Industry Contracts (ABIC) suite of contracts.¹³⁰ The Australian Standard clause is now the most well-known latent condition clause in Australia. It provides the contractor with an entitlement to recompense for additional costs caused by a latent condition whether or not the latent condition constitutes a variation.

The form of contract prepared by the Property Council of Australia which is used particularly for non-residential building projects (PC-1 2000) has a latent conditions clause using similar wording to AS2124 but also requires the principal or owner to provide a warranty to the contractor that it has made all relevant information about the site available to the contractor.¹³¹ The PC-1 contract has been written specifically in order to protect the interests of building owners and project financiers.

¹²⁷ Ibid 243-244.

¹²⁸ The Standards Australia (SA) Technical Committee MB-010, *General Conditions of Contract*, were revising the suite of Standards related to general conditions of contract, AS2124: 1992 and AS4000: 1997. Under the proposed revision, the two existing Standards were to be merged into a new suite of Standards, AS11000: *General conditions of contract*. The proposed AS 11000 was meant to supersede AS2124:1992 and AS4000:1997 however the proposal has been deferred.

¹²⁹ Australian Standards (n 109).

¹³⁰ The Australian Building Industry Contracts (ABIC) are jointly published by the Australian Institute of Architects and Master Builders Australia. ABIC contracts are intended for use in building projects where an architect administers the contract. They are designed to make contract administration clear and less prone to dispute or time-consuming negotiation.

¹³¹ See, eg, Sergio Capelli, 'The Property Council of Australia Standard Form Contract – A User's Guide' (1998, 22) *Australian Construction Law Newsletter* 16.

The terms of standard form contracts and construction contracts generally govern which party bears the risk for those latent conditions. The benefits arising from the use of the standard form latent conditions clause is that it attempts to balance or allocate the risk equitably.¹³² Put another way: which party who is best equipped by possessing the relevant site information or the greater expertise and ability to principally bear the risk? Consequently, these terms would not be considered unfair and would comply with the UCT terms provisions.¹³³

However, there are some contracts which place the burden of the risk with respect to latent conditions on the contractor and at common law, initially the courts gave very limited relief to contractors when encountering delays or additional costs because of latent defects. In *Pakenham v Board of Land and Works*,¹³⁴ the Court stated:¹³⁵

We think that the statement in the contract that ‘the contractor is to satisfy himself as to the correctness of the levels and dimensions’ sufficiently indicate the intention of the parties that each was to take his own risk of the accuracy or inaccuracy of the plans.

In the Australian jurisdiction, in *Dillingham Constructions Pty Ltd v Downs*¹³⁶ it was stated that ‘a party who has contracted to carry out building work on or under land is duty bound to satisfy themselves of the nature and characteristics of the land both on the surface and below it’.¹³⁷ Additionally some contracts still require the contractor to bear the risk for any latent conditions at the site as in *Abigroup Contractors Pty Ltd v Sydney Catchment Authority (No 3)*.¹³⁸ If the wording of the latent conditions clause in the contract prevents any additional cost caused by the latent condition to be recouped as the cost of a variation, the contractor may have a strong claim based on the UCT provisions in the *ACL*.¹³⁹ These costs should be borne by the principal on the basis that the latent condition arose due to the nature of their site and that they would have more knowledge about their site than the contractor despite a contractor having a reasonable opportunity to inspect the site.

¹³² Ibid.

¹³³ *Dillingham Constructions Pty Ltd v Downs* [1972] NSWLR 49.

¹³⁴ (1874) 5 AJR 37.

¹³⁵ Ibid 38.

¹³⁶ [1972] NSWLR 49.

¹³⁷ Ibid 56.

¹³⁸ [2006] NSWCA 282.

¹³⁹ Additionally if the owner or principal has provided misleading or deceptive information with respect to the site the contractor may have a claim in tort as in *Morrison Knudsen v Commonwealth* (1972) 46 ALR 265 where it was held that the Commonwealth failed to take reasonable care to ensure that the tender information was accurate, or under the misleading or deceptive conduct brought under the then section 52 of the *Trade Practices Act 1974*.

Prohibitions in a contract in these circumstances would cause a significant imbalance in the parties' rights and obligations under the contract and are not reasonably necessary to protect the legitimate interest of a party to the contract and would cause detriment to a party to the contract if it were to be applied or relied upon.¹⁴⁰

H Liquidated Damages Clauses

The basis of a claim in contractual damages is that the innocent party is entitled to be compensated for the losses which flow from the breach. At the same time the common law recognises the rights of parties to freely agree at the time of entering into the contract to estimate losses payable upon the breach without the need to prove the quantum of the loss. These clauses (whether time or performance related) are triggered by a breach on the part of the contractor, being a breach of an obligation either to complete the works by a nominated date or to a guaranteed standard of performance. The obligations are expressed in what is generally known as a liquidated damages (LD) clause.¹⁴¹ They are a common feature of construction law contracts¹⁴² as both parties recognise the benefits in the use of an LD clause. In particular they remove the need for the 'innocent' party to prove the actual quantum of the loss suffered, encourage contract performance and provide certainty by allowing the parties to determine their rights and liabilities regarding the loss following a breach of one or more of the terms of the contract.¹⁴³

To date courts have generally enforced LD clauses even if it results in an outcome that is unfair to either party again on the basis that the parties have had to negotiate the term at the time of entering into the contract and as discussed above will be bound by the term.¹⁴⁴ Nevertheless, the doctrine of contractual penalties will apply if terms result in the incurrance of an extravagant and unconscionable amount, in the event of breach of contract by one party or inserted in *terrorem* of the offending party.¹⁴⁵

¹⁴⁰ *Competition and Consumer Act 2010* (Cth) Sch 2 ss 24(1)(a)-(c).

¹⁴¹ See in general Larissa Welmans and John Naughton, 'The "Interest" Based Penalty Tests in *Paciocco and Cavendish/Parkingeye* and the Law of Penalties and Damages in Australia and the United Kingdom' (2017) 44(1) *University of Western Australia Law Review* 157.

¹⁴² AS2124-1992, Clause 35.6. 35.7 and AS4000-1997 Clause 34.7.

¹⁴³ Frank Bannon and Louise Dargan, 'Determining whether a Liquidated Damages Clause Constitutes a "Genuine Pre-Estimate of Loss"' (2014) 26(9) *Australian Construction Law Bulletin* 149, 150.

¹⁴⁴ *Multiplex Constructions Pty Ltd v Abgarus Pty Ltd* (1992) 33 NSWLR 504.

¹⁴⁵ *Ibid.*

In *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd*¹⁴⁶ Lord Dunedin set out the four principles to be applied in determining the distinction between liquidated damages and penalties:¹⁴⁷

- (i) If the sum is extravagant or unconscionable in comparison to the greatest loss conceivable from the breach, it is a penalty; and
- (ii) If the breach is the failure to pay money, and the sum is greater than the sum that ought to have been paid, it is a penalty; and
- (iii) If it is a single lump sum which is payable on the occurrence of one or multiple events, some of which only warranting trifling damages, there is a presumption that it is a penalty; and on the other hand
- (iv) Because the consequences of the breach are very hard or maybe impossible to estimate, it does not mean it is a penalty. Rather, there is a presumption that it is a liquidated sum.

These four principles have been consistently applied in Australian authority,¹⁴⁸ and have had significant influence of the application of the doctrine of contractual penalties. However, the application of these principles is nevertheless problematic as seen in the appeal from the decision in *State of Tasmania v Leighton Contractors Pty Ltd (No 3)*.¹⁴⁹ In a lengthy judgement handed down in November 2004, the Supreme Court of Tasmania found that the amount deducted as liquidated damages by the State was a penalty and had to be repaid to Leighton.¹⁵⁰ The State's appeal to the Full Court related solely to this finding arguing that the primary judge erred in fact or in law in holding that the daily rate of \$8,000 for liquidated damages agreed between the State and Leighton constituted a penalty.

In 2005 the Full Court of the Supreme Court of Tasmania handed down its judgement in the *State of Tasmania v Leighton Contractors Pty Ltd*.¹⁵¹ The Full Court commented on the subjectivity of the different terms used in various cases to characterise a liquidated damages clause as a penalty, such as 'extravagant', 'exorbitant', 'not a genuine pre-estimate' and 'unconscionable' and noted that these words described differing conceptual approaches to the

¹⁴⁶ [1915] AC 79.

¹⁴⁷ Ibid 86-8.

¹⁴⁸ See *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656 at [32] and *Paciocco v Australia and New Zealand Banking Group Limited* [2015] FCAFC 50 [400].

¹⁴⁹ [2004] TASSC 132.

¹⁵⁰ Ibid [333]-[335].

¹⁵¹ [2005] TASSC 133.

test of whether the stipulated amount was a penalty.¹⁵² The Full Court noted a number of matters which should be taken into account in assessing whether the clause in question is a penalty and analogous with UCT considerations the equivalence of bargaining power at the time of agreement.¹⁵³

Put simply, as seen from both the first instance and appeal decisions, the current criteria with respect to penalties are not definitive and are capable of various interpretations. The entrenched position represented by *Dunlop* has now been further altered by the decision of the High Court in *Paciocco v Australian and New Zealand Banking Group Ltd.*¹⁵⁴ Following this decision where there has been a breach of contract triggering the LD clause, a court *must* consider the ‘legitimate interests’ of the non-breaching party in performance of the contract. If trying to have the LD sum set aside as a penalty, the breaching party must establish that the amount or other performance obligation sought to be enforced by the non-breaching party, is extravagant or unconscionable compared to the legitimate interests it protects.¹⁵⁵

The majority held that the overarching test appropriate in the determination of whether the sum stipulated is a penalty is whether such a sum is out of all proportion to the ‘interests of the party’ which it is the purpose of the provision to protect.¹⁵⁶ These interests may be of a general commercial nature. Relevantly the then Chief Justice French noted in *Paciocco* that the penalties doctrine has been haphazardly developed and may benefit from statutory reform.¹⁵⁷ The application of the UCT provisions to liquidated damages will be interesting in the context that, previously, under the common law, provided they were not penalties, they were valid and enforceable. This may no longer be the case.

Clearly there is significant subjectivity associated with the interpretation and application of the essential terms such as ‘extravagant’, ‘exorbitant’, ‘not a genuine pre-estimate’ and ‘unconscionable’. Further the additional protection now provided to the party relying on the clause as a consequence of the “legitimate interest test” together with the observation by the former Chief Justice of the HCA strongly suggests that the law relating to penalties would benefit from statutory reform. Consequently, an alternative to the application of the penalty

¹⁵² *Ibid* [11]; [16]-[17].

¹⁵³ *Competition and Consumer Act 2010* (Cth) Sch 2 ss 24(1); 25 and 27(2).

¹⁵⁴ (2016) 333 ALR 569.

¹⁵⁵ *Ibid* 586.

¹⁵⁶ *Ibid* 652.

¹⁵⁷ *Ibid* 575.

doctrine with respect to LD is the application of the provisions in ss 24(1), 25 and 27(2) of the *ACL*.

Alternatively, rather than focus on the *Dunlop* approach which concentrates on the validity (albeit acknowledged as an estimate) of the stipulated sum it would be more equitable to focus on the behaviour of the parties with respect to the insertion of the term as assessed against the *ACL* UCT criteria.

VII CONCLUSION

There are difficulties in using the unconscionable provisions of the *ACL* to prevent the use of unfair terms in consumer or small business standard form contracts. In part these include the length of time and costs in applying the unconscionable conduct provisions in the *ACL* and also actions under the unconscionable provisions of the *ACL* do not provide the court with the ability to strike out UCT. Although there has been legislative change in relation to protection of small businesses under the UCT provisions of the *ACL*, is still questionable whether there is sufficient protection afforded to small businesses, especially in the construction industry.

With respect to the construction industry, the ACCC has identified in its 2019 *Competition Enforcement Approach and Objectives* that its priorities involve focusing on (amongst other areas), UCTs in the construction sector.¹⁵⁸ In his annual CEDA address, ACCC Chair Rod Sims launched the ACCCs 2019 *Compliance and Enforcement Policy* and stated in part:¹⁵⁹

We will also be continuing our focus on the business-to-business unfair contract term laws, particularly in the agricultural sector, but also in many others. UCT can cause great harm to small businesses and farmers. The commercial construction sector will also continue to be a focus area. We have a dedicated Commercial Construction Unit looking at both competition and consumer issues in this sector. The work of the Commercial Construction Unit includes supporting the current CDPP prosecution of the CFMMEU, and we anticipate bringing further proceedings this year against other parties. This sector faces many anti-competitive and unfair practices: more than most other sectors. (Underlining by authors)

Currently, the inclusion of UCT clauses, whether in a consumer or small business standard form contract, is not unlawful. Therefore, the ACCC is also advocating changes to the UCT law by

¹⁵⁸ Mr Rod Sims, Australian Competition and Consumer Commission, 'Compliance and Enforcement Policy' (Speech, Committee for Economic Development Australia (CEDA), 26 February 2019) <<https://www.accc.gov.au/speech/2019-compliance-and-enforcement-policy>>.

¹⁵⁹ Ibid. See Tjakie Naude, 'Unfair Contract Terms Legislation: The Implications of Why We Need it for Its Formulation and Application' (2006) 17 *Stellenbosch Law Review* 361 for a detailed discussion on the need for UCT provisions towards vulnerable contracting parties such as small businesses.

way of prohibiting UCT in standard form contracts and introducing penalties for such an inclusion and in turn strengthening the UCT laws significantly for small businesses. In this respect, Mr Sims further announced that:¹⁶⁰

First, we have already been advocating for reforms to the current unfair contract laws. At present, it is only when a term is declared to be unfair by the Court that it becomes void and unenforceable. The inclusion of unfair contract terms in contracts is not prohibited and the ACCC is not able to seek penalties for this conduct. This provides a number of challenges for an economy wide enforcement agency. Businesses have low incentives to change their behaviour absent sanctions, knowing that if questioned, they can quickly agree to change their contracts and move on...The point here is that compliance with the law must be the responsibility of all firms; the ACCC's role is both in general education and in enforcement action to encourage this compliance. The ACCC has argued that now is the time to prohibit unfair contract terms and impose penalties for their inclusion in standard form contracts. The guidance given by the ACCC since introduction of these laws in 2011 and recent ACCC court action should enable all businesses to avoid including UCT in their standard form contracts.

The extent of a court's power under the ACL to set aside or amend allegedly unfair provisions in standard form construction contracts is still in its infancy. Whilst in some instances conjectural, this paper has identified a number of common provisions in standard construction contracts which could be considered unfair with respect to the UCT ACL provisions. Parties who include unfair terms in standard form contracts face the risk of costly litigation (and perhaps penalties in future) together with possible reputational damage if the court makes findings that a party included unfair terms in its contract and/or the ACCC requires public undertakings acknowledging the breach of the UCT provisions in the ACL.¹⁶¹

It is trite to say that ignorance of the law is no excuse. The information¹⁶² provided to the construction industry by the ACCC since introduction of the UCT laws and recent ACCC actions relating to non-disparagement clauses are clear warnings to avoid including UCTs in standard form construction contracts particularly ad hoc or bespoke contracts.¹⁶³

¹⁶⁰ Ibid.

¹⁶¹ The list of recommendations from the ACCC in relation to its ACCC Enforcement Priorities Compliance Policy include: (a) civil penalties applicable to illegal UCTs; (b) expanding the protection of small businesses through an amended classification of 'small business'; (c) amendment of the term 'standard form contract'; and (d) extending the UCT provisions to government contracts.

¹⁶² Australian Competition and Consumer Commission (n 157). See also Australian Small Business and Family Enterprise Ombudsman, 'Review of Payment Terms, Times and Practices: Advice to The Minister for Small and Family Business, Skills and Vocational Education' (March 2019) <<https://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-payment-times-report-2019.pdf>>.

¹⁶³ The Australian Competition and Consumer Commission commenced proceedings - *ACCC v Smart Corporation Pty Ltd t/a Australian 4WD Hire* (2019) arguing that non-disparagement clauses should be considered an unfair term. The outcome to be expected, in line with the review of the UCT legislation, is that the ACCC will be successful in their arguments in order to provide additional protection to small businesses.

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