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Manager, Consumer Policy Unit
The Treasury
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Dear Manager

Enhancements to Unfair Contract Term Protections

I write on behalf of Master Plumbers Australia and New Zealand Ltd (**MPANZ**), to provide feedback to the Department regarding the Enhancements to Unfair Contract Term Protections paper.

Master Plumbers Australia and New Zealand (MPANZ) represents member Associations across Australia and New Zealand. We are the collective voice for the Australian and New Zealand plumbing industry and collaborate together on a national and international level. Members of MPANZ protect the health of our community and the environment through the delivery of professional plumbing services. The provision of these services is essential for community health and well-being. MPANZ represents plumbing contractors from sole operators to medium sized plumbing businesses and large contracting firms.

MPANZ members are installers of gas, water reticulation and irrigation systems, fire protection services, heating and cooling, mechanical services/air conditioning systems, sanitary disposal, drainage, metal roofing, wall cladding and other plumbing services. The provision of these services is essential for community health and well-being.

Below is our feedback regarding the Unfair Contract Term Review. We haven't commented about insurance contracts but perhaps Directors might like to add some information to ensure consistency in the operation of the protections. Our submission doesn't answer each specific question one by one but provides feedback and identifies key issues currently being experienced by our members.

Current issues within the sector:

Member consultation has revealed concerns about 'unfair contracts' which have become standard in modern subcontract documents. For example, where a termination for convenience clause can be used. MPANZ strongly supports options being explored to address these unfair clauses. It is simply not possible to have mediation between two parties when one party is able to execute a termination at any time for no reason.

MPANZ knows that there is a need to address other issues that relate to payments to ensure all aspects of uncertainty are addressed. These include variations and the use of bank guarantees. MPANZ believes that bank guarantees should be part of a rapid dispute process. Our membership engagement has shown that it is rare for a subcontractor to be paid on an agreed date. The delay in payment varies from days to months. During this time head contractors, who have received the funds from the principal, are not restricted on how this money is used. Lack of on-time payment results in the requirements for subcontractors to seek alternative funds to cover operational costs such as wages and supplies. Subcontractors are small to medium sized businesses that often operate on small profit margins in order to stay viable and competitive.

On the other hand, head contractors are predominately larger businesses operating throughout Australia. These factors along with a legislative framework that reinforces this market situation have resulted in a significant market power imbalance favouring head contractor, leading to payment insecurity. It is important to note that payment insecurity impacts on all forms of payments throughout the supply chain such as variations as well as progress payments and not just retention funds.

Below is a short summary of the major issues identified through consultation:
Relationships:
Due to the small number of head contractors it is vital for subcontractors to maintain a positive relationship with these contractors in order to be able to continue to successfully tender. These relationships often come at a financial cost as subcontractors are regularly requested to accept lower payments, particularly at final payment

stage, in order to maintain a favourable relationship and secure additional work on the next project with the same head contractor.

Business models:
It is understood that it is common practice for head contractors to use funds associated with one project on another project. This practice causes cash flow disruptions and can often result in the delay of payment. Payment delays are currently regular practice.

Payment timeframes:
Consultation has shown that it is rare for a subcontractor to be paid on an agreed date. The delay in payment varies from days to months. During this time head contractors, who have received the funds from the principal, are not restricted on how this money is used. Lack of on-time payment results in the requirement for subcontractors to seek alternative funds to cover operational costs such as labour and supplies. This alternative funding, most commonly through a bank, attracts interest expenses which in turn further reduces a subcontractor's profit margin.

Variations:
It is regular practice for variations to be a significant part of a project (consultation suggests 10-15% of total cost in dollar terms). Variations are not required to be in writing and are often paid 'on account'. 'On account' payment means that although the dollar amount quoted by the subcontractor is paid by the head contractor it is not an amount accepted as accurate by the head contractor. The amount is instead subject to later negotiation which often occurs at final payment, which may be many months later. Therefore, it is common practice for 'on account' payments to be revised sometime after their payment leading subcontractors to accept a lower final payment in order to reimburse the head contractor for these costs and eliminating their profit margin. This practice ensures that the overall payment for a subcontractor occurs not at a time when work is complete but when a head contractor has the ability to calculate their internal profit margins.

Payment structure: The legislative framework creates a situation where only the head contractor has access to all information. The head contractor is able to request variations and this often occurs without the knowledge of the principal. The costs associated with variations can be reduced or eliminated as part of the final payment. In contrast, when the principal requests a variation the head contractor may not disclose the payment amount to the subcontractor and therefore may not pass on the full payment amount.

Additional reform to place legislative expiry dates on bank guarantees to ensure that they expire on the dates agreed to within the original contract will result in a significant reduction in subcontractor interest expenses. Further, this reform would create certainty for business planning and free up a subcontractor's own capital associated with work that has been completed for employment and business growth.

They are many and varied unfair terms, however the regular offenders seem to be clauses such as the following:

Extension of Time (EOT) The time frames within which EOT claims must be made have come down dramatically in recent years however the level of detail required to be put in a claim has also been increased. If you only have three to five days to make an EOT claim, how realistic is it then for sub-contractors to provide a detailed breakdown of the costs, causes, estimated length of delays involved and how do sub-contractors overcome the delays?

Furthermore, when an extension is granted, as often as not, that does not entitle sub-contractors to any compensation for the extra costs incurred and sometimes that is so, even where the builder/ contractor is the cause of the delay. Commonly, if sub-contractors do not provide all that information within that limited time frame, they are barred from making a claim.

Obligation to accelerate without compensation

These clauses oblige the sub-contractor to accelerate their works if so directed but allow no compensation for any extra costs incurred as a result. This is commercially unrealistic.

Variation claims

The time frames within which sub-contractors must make a claim for a variation have become increasingly short, down to a matter of a few days. Notwithstanding that, sub-contractors are commonly required to give full details not just of what it is the claim is about but also the "legal basis" upon which the claim is based and that includes, whether this is based on a term of the contract or some other legal principle such as an equitable claim. How many sub-contractors are in a position to do that in such a short period of time?

Delay claims
The right to claim damages for delays such as inclement weather or industrial action are under threat. Sub-contractors are now sometimes deemed to have taken into account any such delays in coming to their price and time for completion of the project. This is simply unrealistic.

Restrictions on key people
Contracts now provide that sub-contractors cannot take a key person off the job or replace them with someone else without the builder/contractor or the project manager's consent. Surely if a sub-contractor has won the job it is up to the sub-contractor to perform the contract and if they fail to perform the contract adequately, the builder/ contractor has its remedies.

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

Design coordination problems" and inadequate "work descriptions"
In many contracts, if there is a problem arising from the design, sub-contractors or design work done by someone else, or the work description has left something out, it is the sub-contractors responsibility to overcome the problem and absorb any costs caused by the problem. This is notwithstanding that the design failures may have been the design failures of the builder/ contractor, the principal or their consultants such as hydraulic consultants or mechanical engineers. How can it be reasonable for a sub-contractor to be given the contractual risk and responsibility for rectifying mistakes made by specialist consultants? These types of clauses are inevitably linked with prohibitions on the sub-contractor making any claim in relation to any such failure by the consultants, builder/contractor or principal.

Prior works warranty
Sub-contractors are being asked to warrant that prior to carrying out work on a part of the site where other trades have already carried out works, are "suitable" for the sub-contractor to do their work. Why should a following trade carry the responsibility and potential liability of effectively certifying that something another trade has done was done properly? Is it not the job of the builder/ contractor or the project manager or whoever the superintendent is, to ensure this?

Intellectual property transfers & warranties
Contracts regularly provide that sub-contractors warrant that they own all intellectual property used in the works. Often this is not the case. Further, they commonly provide that sub-contractors assign all their rights in such intellectual property to the builder/contractor. This is not possible if the sub-contractor does not own it. Sub-contractors may also be signing away much more than they think including intellectual property they value and do not wish to give away.

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

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

Defects rectification by third parties Some contracts provide that during the defects liability period, the builder/contractor can have a third party carry out defect rectification without even giving sub-contractors prior notice or an opportunity to attend to it. At the same time, the builder/ contractor has the right call on sub-contractor's bank guarantee or your retention moneys. The retention moneys are there as security against the risk of defects that sub-contractors do not rectify, not to fund someone else to do work.

Seizure of equipment
A right to seize sub-contractor equipment to pay moneys allegedly owing to the builder/contractor, is occasionally included. Usually one needs a judgment before this can enforce a claim for payment. However, by a clause like this, sub-contractors are effectively contracting to give the builder/contractor a right of execution before determination of any dispute.

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

Right to inspect your records A clause which gives the builder/contractor the right to inspect sub-contractors records at any time, could be used against a sub-contractor in unexpected ways. Many of them are drafted so broadly that the builder/contractor could use them during a dispute to gain access to documents they are not otherwise entitled to. Again, strangely enough a reciprocal right for sub-contractors to do the same to the builder/ contractor is never included.

Termination for insolvency Nobody would object to a right in the contractor/ builder to terminate the contract in the event of a sub-contractor's insolvency. However, "insolvency" is being defined more and more as a question of arbitrary opinion of the builder/ contractor.

Payment of deposit before can sue
We have even seen contracts where before the sub-contractor can take action (court, dispute resolution or otherwise) against the builder/ contractor, the contract requires the sub-contractor to pay a sum equivalent to ten percent of the amount proposed to be claimed to the builder/ contractor. Signing a clause like this is effectively granting security for costs to the builder/contractor without a court order.

Stat Dec's and releases Sub-contractors will all be familiar with clauses requiring sub-contractors to submit a statutory declaration with their Payment Claim or request for valuation to the effect that sub-contractors have paid all their workers, sub-contractors and even their suppliers. Some even require sub-contractors to declare that their sub-sub-contractors and suppliers have paid their staff. How many of these statutory declarations are made falsely or without any real knowledge as to the truth of the facts?

Termination for inadequate progress
The concept that a builder/contractor should be entitled to terminate a sub-contractor's contract because they are holding up the works generally is fair and reasonable. Clauses which give that right where the sub-contractor fails to comply with a Project Program are also reasonable provided the builder/contractor cannot unilaterally change it (as they commonly can). However, clauses (which are increasingly common) to the effect that a builder/ contractor can terminate the contract simply because the builder/contractor does not consider the sub-contractor's progress to be "satisfactory" without any reference to any objective criteria, is simply unreasonable especially in circumstances when reference to the Project Program could be made. Such clauses are an open opportunity for the builder/contractor to terminate your contract without true or fair cause.

Termination for convenience
Basically these clauses mean the sub-contractors have a contract for so long as the builder/contractor wants the sub-contractor to have one. They are just about as unfair a term of contract as could be imagined. What is worse is that if they are relied on to terminate sub-contractor services, and are usually not entitled to any claim for loss of profits – something completely inconsistent with common law principles.

Wrongful termination deemed to be for convenience
This is the worst clause which is included in contracts. We have seen a clause where a termination by the builder/contractor, if found by a court or arbitrator to have been wrongful, is deemed to be a termination for convenience. This means that even if the High Court of Australia finds that there has been a wrongful termination of contract by the builder/ contractor entitling a sub-contractor to millions of dollars of damages they will not get it because they have agreed, by signing the contract, to accept that any wrongful termination, no matter how unjustified or unfair that was, was "a termination for convenience" merely entitling them to be paid for the work they had done prior to termination of the contract and for some de-mobilisation costs.

Other problems faced by sub-contractors include:

Bank guarantees not being given back when they should.
Contracts sometimes do not place a clear obligation on the contractor to release the bank guarantees when they should. This is exacerbated by sub-contractors not standing up for their rights and insisting that bank guarantees be given back by seeking a mandatory injunction. This is no doubt partly because of the legal costs involved.

Generally, sub-contractors not being prepared to fight for their rights. Sub-contractors do not believe they will ever be able to have any terms changed and they are worried that the builder will just go to the next sub-contractor who is more compliant. That's not necessarily the case;

Suggested solutions:
"Ban bid-shopping"
MPANZ believes it is time that serious consideration should be given in Australia to outlawing "bid shopping". There are case authorities in these jurisdictions confirming that a sub-contractor who, in breach of the listing requirements, is subsequently not awarded the contract, can sue for loss of profits.

Sub-contract terms not to be substantially more onerous
Another possible legislative reform would be for the government to legislate that sub-contracts cannot be on substantially more onerous terms with respect to a series of listed issues, than the contract between the principal and the contractor. The types of issues which this should apply include but are not limited to:

Extensions of time – the time frames and rules given in head contracts for extensions of time, should be reflected in the sub-contracts;

Delay damages claims – again, the two contracts should reflect each other. For example, if the head contract allows the builder/contractor to delay damages for industrial action and inclement weather so should the sub-contracts. Similarly, if the principal contract does not seek to limit delay damages to two bob fifty a day, nor should the sub-contract be allowed to;

Variation claims – if a principal contract allows the builder/contractor to put in a variation claim "within a reasonable time" the sub-contract should also.

Termination for convenience – if the principal contract provides that if there is to be a termination for convenience, the principal is to pay the builder/contractor compensation including for loss of profits, so should the sub-contract. Termination for convenience clauses are a disgrace and should be unlawful. Other grounds for termination – those in the sub-contract, should not be more extensive than those in the head contract. Finally, the requirement for all variations to be in writing and to be subject to an agreed value within 10 business days will enable both head contractors and subcontractors to better manage either respective cash flow. This will result in less financial hardship, less insolvency and increased employment and business growth. It is clear that a time period of 10 business days will provide the head contractor with ample opportunity to correctly value any variation to an agreed figure.

Thank you for the opportunity to provide feedback regarding Enhancements to Unfair Contract Term Protections.

Kind regards,

Robert Pearshouse
Chairman
Master Plumbers Australia and New Zealand