SQUIRE PATTON BOGGS

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Unfair Contracts Terms Legislation has Come Into Effect as of 12 November 2016

In our August 2016 edition, we wrote about the imminent extension of the unfair contracts terms regime in the Australian Consumer Law to certain small business contracts, which could potentially have an effect on contracts in the construction industry.

This legislation has now come into effect as of 12 November 2016.

We reiterate the key features of this legislation.

A term of a "small business contract" as defined, is liable to be declared void, if the term is unfair, and the contract is a "standard form contract".

The legislation defines what a "small business contract" and what a "standard form contract" is, and also provides guidance on when a term will be considered "unfair".

Two key requirements of a "small business contract" are:

1. At the time the contract is entered into, at least one party to the contract is a business that employs fewer than 20 persons.
2. An upper monetary limit on the contract value. Either of the following applies:
   (i) The upfront price payable under the contract does not exceed AU$300,000
   (ii) The contract has a duration of more than 12 months and the upfront price payable under the contract does not exceed AU$1 million

There is a rebuttable presumption that the contract is a "standard form contract". In considering whether the contract is a "standard form contract", the legislation provides a list of matters to be considered. The tenor of the matters to be considered is whether one party was essentially given the contract on a "take it or leave it" basis, without having an effective opportunity to negotiate the terms of the contract.

A term will be considered unfair if it meets all of the following criteria:

(a) It would cause a significant imbalance in the parties' rights and obligations arising under the contract

(b) It is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term

(c) It would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on

Implications of the Reform

This new regime has the potential to render unenforceable, a number of clauses common in contracts in the construction industry. For example:

(a) Terms that permit a party to unilaterally vary "the characteristics of the goods or services to be supplied" under a contract as raised as an example of a potentially unfair term in the ACL

(b) Time bars may potentially fall foul of the unfair term regime as they tend to be imposed on one party to the contract (creating an imbalance) and, if relied upon, cause a detriment by restraining a party's entitlement to make claims for time or money

(c) Liquidated damages clauses which are not considered penal on the test in Andrews v ANZ, may nevertheless be rendered unenforceable as unfair because the standard required to be considered unfair is arguably lower than that to be considered penal

Key Takeaways

To limit exposure to the new protections extended to small businesses, contractors are encouraged to immediately:

(a) Undertake a review of their contracting practices and systems to determine whether any of their existing standard contracts contain terms which may be considered unfair under the new regime

(b) Take steps to amend any non-compliant standard contracts

(c) Consider the implications of these new amendments in respect of contractual arrangements up the contracting chain, especially in the case of 'back to back' contractual provisions

Resisting the Calling on Performance Bonds Becomes Exceedingly Difficult

General Principles

In the current construction climate a growing number of principals (and head contractors) are calling on their unconditional bank guarantee, performance bond or undertaking (**performance guarantee**) provided by their contractors (or subcontractors). Performance guarantees are often for substantial sums and represent a significant financial commitment.

It is accepted law that if a principal has an entitlement to call on a performance guarantee then the principal should be able to do so without enquiry or qualification.[1] However, in limited circumstances a contractor can successfully apply for an injunction to restrain recourse to the performance guarantee.

For a court to grant an interlocutory injunction restraining a demand on a performance guarantee, the contractor will need to show:

- There is a serious question to be tried, which has a sufficient likelihood of success justifying the preservation of the status quo pending the final resolution of the claims
- The balance of convenience favours the granting of an injunction
- Damages will not be an adequate remedy for the contractor if the injunction is not granted[2]

The Federal Court decision of *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* 249 ALR 458 (***Clough***) summarised and reinforced a line of decisions[3] holding that a principal seeking recourse to a performance guarantee (and a financial entity to whom a demand for payment under a performance guarantee has been made) would not be restrained, subject to the following exceptions:

- The principal acting fraudulently (e.g. dishonest intent or recklessness as to the truth of statements or an unsubstantiated threat to call on a bank guarantee)
- The principal acting unconscionably
- Breach of a negative stipulation in the contract (i.e. an express or implied proscriptive condition is breached)[4]

The last exception recognises that in determining whether a party can call upon a performance guarantee, the primary focus will be the proper construction of the contract.

In addition to the exceptions outlined in Clough, the courts have also recognised the importance of reputational damage to the contractor as a result of calling on a performance guarantee in weighing the balance of convenience.[5] The contractor must demonstrate that there is actual risk of reputational harm if the injunction application is dismissed.

However, these exceptions have been tempered over recent years.

Reputational Harm

In *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98 (***Sugar Australia***), the Court of Appeal made clear that the courts will not restrain the issuing of a performance guarantee on the basis of reputational harm. In particular, Justice Kaye noted that by agreeing to the contractual clause governing the performance guarantee, Lend Lease assumed the risk that a call may be made on the performance guarantee. The court noted that disputes are extremely common under construction contracts and that a dispute in relation to the performance guarantee would therefore be unlikely to have any adverse impact on Lend Lease in the marketplace.

The Court of Appeal held that if a principal was restrained from having recourse to the security, this would undermine the purposes of the performance guarantee provision, which are to allocate cash flow risk to the contractor rather than the principal pending the resolution of any disputes between the parties.[6]

This was also held to be the position in the recent WA case of *Duro Felguera Australia Pty Ltd v Samsung C & T Corporation* [2016] WASC 119.[7] The applicant argued that if an injunction was not granted it would seriously adversely impact its ability to tender for work on future projects as the payment of the security would very likely have to be disclosed in any future tender. This would damage its reputation as the perception in the market place would be that it was an unreliable contractor. On this ground of reputational harm Justice Le Miere held:

> "The risk of hardship and the risk of damage to reputation were risks assumed by Duro when it agreed to provide securities on terms that recourse could be had to them merely on Samsung considering bona fide that it is or will be entitled to the relevant amount."[8]

His Honour then referred to *Sugar Australia* by stating a bald assertion of reputational harm is insufficient as it is notorious that disputes are commonly part and parcel of building contracts.[9]

1 *Wood Hall Ltd v Pipeline Authority* (1979) 41 CLR 443 at 457.

2 *Australian Broadcasting Corporation v O'Neill* (2006) 227 CLR 57.

3 E.g. *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812; *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1999) 15 BCL 158.

4 *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* 249 ALR 458 at [77].

5 See *Thiess Pty Ltd v Pacific National (Victoria) Pty Ltd* [2009] VSC 670; *Barclay Mowlem Construction Ltd v Simon Engineering (Aust) Pty Ltd* (1991) 23 NSWLR 451.

6 *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98 at [232]-[233].

7 Note: there is an appeal pending on this decision.

8 *Duro Felguera Australia Pty Ltd v Samsung C & T Corporation* [2016] WASC 119 at [75].

9 *Duro Felguera Australia Pty Ltd v Samsung C & T Corporation* [2016] WASC 119 at [77].

This demonstrates that the courts are tempering back a contractor's ability to rely on reputational harm as a significant factor in considering the balance of convenience when seeking to restrain a call on a performance guarantee.

Conclusion

Contractors should be mindful that an application to restrain recourse to an unconditional performance guarantee is only granted in exceptional circumstances. Reliance on general reputational damage as a significant factor in support of an application for such a restraint is unlikely to be helpful to the application.

Liability of Engineers – Codes and Standards

The liability of engineers for professional errors generally arises from three sources:

- Breach of the contract of engagement
- Breach of a duty outside the contract to use professional care and skill
- Misleading or deceptive conduct in contravention of the Competition and Consumer Act

Is following accepted practice sufficient for an engineer to discharge the normal duty of care? This is not always the case. The overriding requirement on a professional engineer is to exercise due care and skill in the circumstances. As well, the contract terms can impact on liability, including on the scope and standard and care, and protection from liability.

There are different types of standards and codes applicable to engineers:

- Codes having the force of law e.g. the Building Code of Australia; asbestos product regulations; electricity regulations etc.
- Codes that are specifically required to be complied with by contract e.g. Australian Standards; the client's design criteria
- Codes and standards that do not have force of law but may be relevant to the proper performance of professional duties

Assuming that there is no contractual requirement to comply with an applicable standard or code, does non-compliance with a technical code mean the engineer would be negligent, that is, in breach of the duty to exercise due care and skill?

Non-compliance with a code or standard will not necessarily be a breach: *Management Corp Strata Plan No 2575 v Lee Mow Wood* [2011] SGHC 112 (Singapore High Court).

There can be some scope for the engineer to depart from the code and use professional judgement but effectively non-compliance with the code may put an evidentiary onus on the engineer to show the action in question was proper and adequate.

But what about the case where the engineer does comply with the code – can the engineer still be liable?

The engineer can still be liable if the engineer blindly adheres to a code, in circumstances where the code may have been subject to criticism, or there may be a more suitable code. In *BHP Coal Pty Ltd v O&K Orestein & Koppel AG* [2008] QSC 141, the engineering company which designed a bucket wheel excavator was found liable in negligence despite the design engineer following an applicable standard, as the current standard was under academic and professional review and there were other standards that provided for a more conservative design. It was held that, in the circumstances, a reasonable professional engineer would not have designed merely to meet the current standard.

Absent specific treatment in the contract of engagement, engineers will be expected, as part of the discharge of their professional services, to have regard to applicable codes and standards.

Engineers are expected by courts in discharging their duty of care to:

- Be aware of applicable codes and standards
- Keep abreast of any criticism of them and their reliability (generally and in comparison to other standards and codes)
- Know the gaps in the standards
- Exercise proper engineering judgement and apply proper engineering principles if departing from any widely accepted codes or standards

Blind adherence to a standard or code may not absolve the engineer from responsibility or liability.

On the other hand, failure to follow a code or standard may not necessarily mean the engineer is negligent.

At the end of the day, the general principle of professional liability is overriding – has the engineer exercised the required degree of care and skill taking into account all the circumstances of the case?

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