SQUIRE PATTON BOGGS

Construction Matters

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In This Issue

Stop Press!

The federal government has been negotiating with crossbench senators for the passage of its "Secure Jobs, Better Pay" industrial relations reform. Two commitments agreed with Senator Pocock are of particular interest to Construction Matters readers:

1. A commitment from the prime minister to consider and respond to the recommendations of the Murray Review within this term of government to better protect subcontractors (see our commentary on the Murray Review at the time)
2. Task the new National Construction Industry Forum with providing advice to government on measures that will ensure contractors are paid accurately and in a timely manner in the construction industry

Both of those commitments are likely to give a national focus to security of payment law (and law reform), which has to date been lacking, and will be keenly watched.

One More Year of Living Dangerously – The Effect of the Unfair Contract Terms Amendments for the Construction Industry

Authors – David Starkoff, Hao Zhou, and Emma Lu

The Act in Outline

On 9 November 2022, the Treasury Laws Amendment (More Competition, Better Prices) Act 2022 commenced. This legislation substantially strengthens the provisions of the Australian Consumer Law (ACL) in relation to unfair contract terms (UCT) in two ways:

1. The Act broadens the scope of the UCT regime, particularly through the expansion of the definition of "small business"
2. The Act creates significant penalties for UCTs in standard form contracts with consumers and small businesses, as well as the reliance on them. Currently, while UCTs are void, there are no penalties.

Construction industry participants are enthusiastic users of standard or common form contracts at all levels of the contracting and subcontracting chain. As well as government and industry standards – e.g. the venerable AS suite, GC21, NEC, and International Federation of Consulting Engineers (FIDIC), many industry participants have their own standards or usual terms of subcontract or supply.

It is likely that many construction subcontracts—particularly towards the bottom of the contracting pyramid—will be considered "small business contracts" and therefore subject to the UCT provisions.

Particularly for corporations with large turnovers (common in the construction industry), the maximum penalties can be crushingly large.

The Act provides a one-year grace or transition period before the reforms commence. Construction industry participants should use that period to critically review their standard or usual documents, as they may be subject to significant penalties if they contain terms a court considers "unfair".

The consequences are now significant. The maximum penalty for a breach is now at least AU$50 million for corporations, with each UCT constituting a separate contravention.

It can be expected that the Australian Competition and Consumer Commission (ACCC) will look for opportunities to robustly enforce the amended law. The ACCC has previously identified unfair contract terms as a priority for their Commercial Construction Unit. In this financial year, the ACCC has once again indicated a focus on the construction sector. In light of the one-year transition period, it is likely that ignorance or indolence will not be regarded as an excuse.

Our team is ready to assist you should you require any further information on these developments.

Broadening the Application of the UCT Provisions

The underlying principle that the UCT provisions apply only to "consumer contracts" or "small business contracts" is unchanged. However, the definition of "small business contract" has been broadened considerably.

Currently, a "small business contract" requires a party to the contract be a business that employs fewer than 20 persons, and it to be for an upfront price of not exceeding AU$300,000, or be a long-term (more than 12-month) contract with an upfront price not exceeding AU$1 million.

From 9 November 2023, the upfront price requirement has been removed. Instead, at the time the contract is made, one party must have fewer than 100 full-time equivalent employees or have a turnover of less than $10 million. Many construction industry subcontracts will be caught by this increase in scope.

Penalties for Making or Relying on UCTs

UCTs will continue to be void.

In addition, the Act introduces significant civil penalties for those parties who propose or reply on UCTs. The penalties are in line with the civil penalties applicable to unconscionable conduct, indicating the seriousness with which UCTs are now regarded.

For corporations, the maximum penalty is the greater of $50 million, three times the value of the benefit from the contravention (if it can be determined), or 30% of an adjusted turnover during the contravention period (at least 12 months).

For individuals, the maximum penalty will be $2.5 million.

A separate contravention will occur for each separate unfair term proposed in a contract, meaning that the maximum penalty can quickly escalate – particularly for corporations with large turnover who have included multiple unfair terms in standard contracts.

Terms of Particular Concern

For construction contracts, industry participants should pay particular attention to below clauses as they may potentially constitute an unfair contract term:

- Variation provisions that allow the head contractor/principal to unilaterally vary the terms of the contract or the scope of works at any time without the need of giving proper compensation to the contractor
- Indemnity clauses that excessively extend liability to the subcontractor beyond what would reasonably be necessary to adequately protect the head contractor against loss or damage
- Limitation or exclusion of liability clauses that exclude or disproportionately limit the liability of the main contractor even if they are partially at fault
- Termination clauses allowing the head contractor to cancel the agreement at any time "for convenience" and without reason or default by the other party
- Entire agreement clauses or terms that imply that the subcontractor has no recourse to remedies outside the terms of the contract
- Time bars that may provide onerous timeframes and notification procedures for subcontractors to claim variations or an extension of time under the contract
- Principal discretion clauses that purport to give the head contractor the exclusive power to determine certain terms of the contract, for example, whether a term has been breached or whether work is considered defective.

In determining whether a term of a contract is unfair, the court considers the contract as a whole and takes into account the extent to which the term is transparent (i.e. expressed in plain language, is legible, clearly presented and readily available to any party affected by the term) and any other matters it considers relevant.

Summary of Changes

The key changes are summarised below.

	Current law	Proposed law
Penalties for UCTs in Standard Form Contracts	None. There is no civil penalty provision.	Civil penalties apply for making a contract which includes a UCT. Each UCT included is a separate contravention. Civil penalties apply for applying or relying on, or purporting to apply or rely on, a UCT.
Other Remedies and Orders	The term is deemed void; however, the contract will continue to operate if it is capable of operation without the UCT. The court may make compensation orders in favour of a person who has suffered, or is likely to suffer, loss or damage.	In addition to current powers, the court may make orders to void, vary or refuse to enforce all or part of the contract to redress loss or damage, or prevent or reduce likely loss or damage. The court may also make preventative orders and prevent the same or a substantially similar term from being made in any current contract the person is party to, or any future contract the person will be a party to.
Small Business Contracts	At the time the contract is entered into, at least one party is a business that has fewer than 20 employees. The upfront price payable under the contract must either be: • AU$300,000 or less • If the contract has a duration of more than 12 months, AU$1,000,000 or less	At the time the contract is entered to, at least one party is a business that satisfies either or both of the following: • Fewer than 100 full-time equivalent employees • Annual turnover (with some exceptions) less than AU$10 million No upfront price requirements.
Standard Form Contracts	In determining whether a contract is a standard form contract, the court must consider the following factors, in addition to matters it thinks relevant: (a) Whether one of the parties has all or most of the bargaining power (b) Whether the contract was prepared by one party before any discussion occurred (c) Whether another party was, in effect, required either to accept or reject the terms of the contract (d) Whether another party was given an effective opportunity to negotiate the terms of the contract (e) Whether the terms of the contract take into account the specific characteristics of another party or the particular transaction (f) Any other matters set out in regulations.	In addition, the court must consider whether a party has entered into a contract that is the same or substantially similar to another contract entered into by that person and the number of times this has been done.
What is Unfair	A term in a standard form contract is considered unfair if the term: • Would cause a significant imbalance in the parties' rights and obligations arising under the contract • Is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term • Would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on	Unchanged

Not So Hastie Decisions

Liquidators' Proprietary Interest Claims in Proceeds of Performance Bonds Rejected and Head-contractor Statutory Set-off Rights Upheld

Authors – Masi Zaki and Kate Spratt

The Hastie Group Ltd. (liquidators appointed), and its related entities, fell into external administration on 28 May 2012.

Five years later, the liquidators commenced proceedings in the Federal Court pursuing a receivables case[1] and a bank guarantee case[2] against various major Australian and foreign construction companies (Head Contractors). In total, the liquidators sought to recover approximately AU$120 million for the benefit of creditors. However, the wind has been taken out of the liquidators' sails, over a decade after Hastie's collapse, in a comprehensive judgment delivered by Middleton J on 2 November 2022.[3]

Significant Matters Canvassed

The trial in the main proceedings throughout March to May 2022 was only concerned with the liability issue of whether the applicant companies and their liquidators were entitled, in principle, to the recovery of the property in question, and to the rights they asserted as against the Head Contractors. His Honour was not concerned to determine the quantum issue. The proceedings were very complex and hard fought, and included various interlocutory disputes (and judgments) involving over 20 separate plaintiffs and, at one point, 30 separate defendants. His Honour's judgment is comprehensive and justifiably covers the complex contractual and factual background to the claims, as well as the novel legal points taken primarily by the plaintiff liquidators.

Those points concerned, amongst other things:

- Evidentiary onuses in external administration contexts
- Reliance on statutory provisions by external administrators when faced with incomplete records (or undisclosed contracts)
- The power (or obligation) of external administrators to insist on proof of debt processes as a precondition to claims
- The nature and timing of claims when creditors seek recourse to statutory setoff provisions as defensive measures
- Whether liquidators serve as trustees
- Proprietary rights to the proceeds of performance bonds or guarantees, and the application of statutory moratoriums against recourse to same
- The limitations on actions vesting in external administrators, and whether concise statements are capable of sufficiently pleading claims to avoid statutory bars.

It is well beyond the scope of this note to consider, sensibly, each of those points. However, we have set out below our preliminary insight while noting that His Honour's judgment addresses each of those points, and others, in detail. The implications of the decision should be closely considered by the relevant stakeholders, particularly as distress levels in the construction sector (but more broadly) remain constant.

The Two Cases

In the receivables case, the Hastie entities and liquidators alleged that the Head Contractors failed to pay to the Hastie entities the cumulative sum of AU$60 million in "receivables" owing as at 28 May 2012.

In the bank guarantee case, the plaintiffs alleged that, after the appointment date, the Head Contractors impermissibly drew the cumulative sum of AU$63.5 million against performance bonds that were taken out by the Hastie entities and provided to each of the Head Contractors as an alternative to the retention of monies from progress payments under their respective subcontracts.

The plaintiffs further alleged that:

- The monies owed in receivables, and the monies drawn down by the Head Contractors against the performance bonds, were each property of the Hastie entity that performed the work under the subcontract and provided the bank guarantee or performance bond
- The liquidators sought to recover those monies to apply them in satisfaction of the liabilities of each of the Hastie entities, in accordance with Chapter 5 of the Corporations Act 2001 (Cth) (Act).

1 *Hastie Group Ltd (In Liq) v. Multiplex Constructions (Formerly Brookfield Multiplex Constructions Pty Ltd)* (No. 3) [2002] FCA 1280 (Hastie No. 3), [4].
2 *Ibid.*
3 *Ibid.*

The Head Contractors' Contentions

The Head Contractors' respective positions against the receivables case and bank guarantee case were broadly aligned. In respect of the alleged receivables, the Head Contractors contended, first, that no valid receivables were ever owing under the relevant subcontract. Second, if a receivable is owing, they are entitled to set off that amount (pursuant to s 553C of the Act) against monies owed by the Hastie entity to the respective respondent, under the relevant subcontract, by reason of the loss and damage it has suffered by the Hastie entity's being unable to complete the works under the subcontract. Third, they contended that the value of their claims against the relevant Hastie entity was greater than the amount of the unpaid receivables alleged, and the amount of the guarantee proceeds held by them.[4]

In respect of the bank guarantee case, the Head Contractors denied the plaintiff had any "proprietary rights" in the proceeds of the respective guarantees. Accordingly, their position was that the plaintiffs' recourse to various provisions of Chapter 5 of the Act was unmeritorious and not applicable.[5]

mportantly, after the appointment date, the Head Contractors each declined or refused to pay the amounts allegedly owing as at that date to the Hastie entities.

Instead, each Head Contractor:

- Elected to terminate or suspend performance of their respective subcontracts
- Stated that they had or would incur costs and expenses to have other providers perform the services the Hastie entities now could not perform, and asserted an entitlement to set off against the amount sought by the relevant Hastie entity
- Either retained the bank guarantee provided by the relevant Hastie entity despite a request for its return, or took recourse against same[6.]

Key Determinations

The scope of His Honour's determinations is significant. The reasons for those determinations are naturally complex and warrant close inspection to determine specific implications from the viewpoints of different stakeholders. In general terms, however, the following key determinations arose from His Honour's judgment:

- The Head Contractors were each entitled to the benefit of the application of setoff pursuant to the principles set out in s 553C in the winding up of the Hastie entities. Importantly, that entitlement is not dependent on any precondition of lodging a proof of debt in the winding up, or on the determination of the liquidators as to the application of s 553C setoff in respect of the relevant claims, as was contended by the liquidators.[7]
- By operation of the various contractual instruments in relation to the bank guarantees and performance bonds, the Head Contractors were conferred proprietary interests in not only the physical guarantee instruments, but, more importantly, the proceeds of the guarantees drawn down (once those proceeds were received).[8] Conversely, the Hastie entities did not possess proprietary interests in relation to the guarantees that relevantly affected, or somehow defeated or impaired, the proprietary interests of the Head Contractors in the proceeds of the bank guarantees drawn down. Any proprietary interests or rights of action that the Hastie entities once possessed as choses in action were of no consequence or utility for the purposes of the Hastie entities' claims against the Head Contractors.[9]
- The Head Contractors are not otherwise restrained from retaining the guarantee proceeds by virtue of ss 555 and 556 of the Act, or Chapter 5 of the Act generally. As such, they are entitled to retain the guarantee proceeds, subject to the final accounting of the respective claims of the Hastie entities and the Head Contractors.[10]

His Honour made various other important findings, including as to the scope and statutory intentions of Chapter 5 of the Act. Importantly, the liquidators' contention that, as at the appointment date, each Hastie entity (and its liquidators) served as trustees, was rejected.

4 *Ibid.*
5 *Ibid.* [8].
6 *Ibid.* [15].
7 *Ibid.* [98].
8 *Ibid.* [99].
9 *Ibid.* [100].
10 *Ibid.* [103].

His Honour determined that contention was premised on a fallacy[11], such that His Honour observed that the High Court[12] had rightly determined that:

> "Excessive significance should not be attributed to statements in nineteenth century British cases, decided at a time of endeavours to 'flesh out' the developing body of statute law [on companies] by use of principles derived from a range of sources in the general law. These sources included the law of agency, partnership, bankruptcy, and trusts. It later was recognised that some of those endeavours miscarried. One was the attribution to directors of the character of trustees of the assets of the company, and another the treatment of a company in liquidation as trustee of its assets for distribution among creditors."[13]

His Honour determined that the references in the jurisprudence to a company in liquidation, or a liquidator, as "trustee", was an analogy to describe the effect of the insolvency statute in operation under the Act (and its earlier incarnations).[14] Further, that:

"All that was intended to be conveyed by the use of the expression 'trust property' and 'trust' in these and subsequent cases... was that the effect of the statute was to give to the property of a company in liquidation that essential characteristic which distinguished trust property from other property, *viz.*, that it could not be used or disposed of by the legal owner for his own benefit, but must be used or disposed of for the benefit of other persons."

Accordingly, His Honour found that, per *Linter*, the Hastie entities were not trustees of property for creditors, and nor were the liquidators.[15]

Implications for Key Stakeholders

His Honour is yet to make final orders in the proceedings. Nonetheless, the decision on the liability issues raises potentially significant implications for key stakeholders. The liquidators in Hastie were not only challenged by well-resourced and well-represented Head Contractors, but the nature of their claims were such that their position changed over time. In fact, each Head Contractor complained about the impermissible and unfair departure by the liquidators from the agreed common issues, the pleadings and the relief originally sought in their second further amended originating process.[16] His Honour was not impressed by "recasting of issues" but acknowledged that some of those movements arose from concessions and an appreciation by the liquidators of the inherent difficulties with their case.[17]

Irrespective of the alleged quantum of claims in unpaid receivables and wrongful recourse to bonds type cases, liquidators may wish to revisit the merits of their position, considering his Honour's decision. In particular, the contextually novel interpretation of Chapter 5 advanced by the Hastie liquidators warrants close inspection.

In contrast, head contractors, project sponsors or joint venture partners in infrastructure and contraction projects will not be disturbed by His Honour's findings. That said, there are significant lessons that can also be drawn by them from, without limitation, the structure, terms and enforceability of some of the specific contracts in question, and the strategy employed by the Head Contractors in Hastie, both before and after the appointment date. Finally, funders and proponents of the type of claims considered by His Honour may wish to carefully revisit their case theories and claim merits in light of the judgement, and the seemingly imbedded uncertainty in the sector (and broader market).

11 *Ibid.* [159].

12 See, *Sons of Gwalia Ltd. v. Margaretic* (2007) 231 CLR 160 at [37] per Gummow J and *Federal Commissioner of Taxation v. Linter Textiles Australia Ltd. (In liq.)* (2005) 220 CLR 592 (*Linter*) at 611 [48]-[49] per Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ.

13 *Franklin's Selfserve Pty Ltd. v. Federal Commissioner of Taxation* (1970) 125 CLR 52 at 69–70 per Menzies J.

14 *Hastie* No. 3, [160].

15 *Ibid.* [161].

16 *Ibid.* [30].

17 *Ibid.* [31].

Major Proposed Reforms to Residential and Commercial Building Laws in NSW

Author – David Starkoff, Emma Salkavich, and Emma Lu

Continuing its "Construct NSW" strategy with a theme of "trustworthy buildings", which aims to restore consumer confidence in the building industry, the NSW government has released consultation drafts of legislation effecting significant changes to the building laws in New South Wales. Though it is unclear whether legislation will be passed before the upcoming NSW State election in March 2023, this legislation has been developed by the government in consultation with industry, so is likely to remain on the agenda regardless of the result of the election.

The government published consultation drafts of three Bills:

- The Building Compliance and Enforcement Bill 2022 (BCE Bill)
- The Building Bill 2022 (Building Bill)
- The Building and Construction Legislation Amendment Bill 2022 (BCLA Bill).

BCE Bill

The BCE Bill will replace and expand the Residential Apartment Buildings (Compliance and Enforcement Powers) Act 2020 (which only applies to residential apartment buildings) and apply to all buildings. It will create a holistic legislative framework for the regulation of building compliance and enforcement across the building sector. In summary, the BCE Bill:

- Includes consolidated and strengthened investigation, information gathering and on-site powers (including powers of entry and search and seizure)
- Introduces a demerit points scheme to deter licence holders from committing offences and provides sanctions for repeat offenders
- Includes various remedial actions for noncompliance with building enforcement legislation that can be utilised by the regulator, including enforceable undertakings, stop-work orders and rectification orders
- Continues and expands the developer notification scheme
- Increases penalties for serious matters
- Provides that a director or other influential individual involved in the management of a corporation may be personally liable for an offence committed by a corporation against the building enforcement legislation (ss 156 and 157 of the BCE Bill).

Building Bill

The Building Bill applies to residential and commercial building works, but not to infrastructure or civil construction works. The Building Bill is expected to commence in late 2023 or in 2024. By way of summary, the Building Bill:

- Will replace the Home Building Act 1989 (NSW) (HB Act)
- Expands licensing requirements to cover trades in the commercial sector (and to designers), no longer limiting them to those who carry out residential and/or specialist building work
- Revises and expands on the existing statutory warranty scheme under the HB Act (which is proposed to remain limited to residential building work), including replacing the definition of "major defect" with the broader concept of "serious defect"
- Expands the definition of "developer", thus affecting who will be responsible for contractual and statutory warranties and obligations under the home building compensation scheme and the like
- Transfers building and subdivision certification under the Environmental Planning and Assessment Act 1979 (NSW) (EPA Act) to the Building Bill
- Consolidates the duty of care provisions from the Design and Building Practitioners Act 2020 (NSW) (DBP Act) and the EPA Act into the Building Bill, and – consistent with the broadening of the reach of the legislation – designers, inspectors, certifiers and builders of nonresidential buildings or who carry out subdivision works will owe duties of care to subsequent/future owners
- Introduces a new regulatory scheme for prefabricated and manufactured housing, among other reforms.

The statutory warranty scheme will only apply to residential building work and not to commercial buildings, however. The NSW government has indicated it is considering whether to extend the timeframe of statutory warranties for serious defects from six years to 10 years, and from two years to three years for other (minor) defects.

BCLA Bill

The BCLA Bill proposed amendments to numerous Acts. But, of particular interest, the BCLA Bill proposes to amend the Building and Construction Industry Security of Payment Act 1999 to expand the scope of the adjudicator's investigatory powers and provide further recourse for review of adjudication determinations.

First, similar to provisions currently in place in Victoria, a party to an adjudication will be able to seek a review adjudication if the claimed amount exceeds the adjudicated amount by at least AU$100,000; or the adjudicated amount exceeds the scheduled amount by at least AU$100,000. The review application must be made to the same authorised nominating authority to which the original adjudication application was made. Any disputed amount must be paid into a trust account before a review application is made. The review application cannot raise matters that could have been made to the original adjudicator, but otherwise the review adjudicator can make a fresh decision.

Second, it is proposed that an adjudicator may, unless both parties object (currently, it requires both parties to agree):

- Carry out an inspection of a matter related to the claim
- Arrange for testing of the matter or thing to which the adjudicated claim relates
- Engage an appropriately qualified person to investigate and report on a matter to which the claim relates.

If you would like any further information or explanation on the proposed reforms and what they may mean for you, feel free to contact the Construction & Engineering team at the firm.

Toolbox Topics

The Rise of "Greenwashing"

Amid the growing prominence of environmental, social and governance (ESG) strategies and initiatives, regulators are increasingly scrutinising business's ESG statements to ensure that their actions are delivering on their bold promises. In late October, the Australian Securities and Investments Commission (ASIC) took their first action for Greenwashing against an ASX-listed company. To help businesses navigate this increasingly stringent landscape, our legal experts explain "all this fuss about greenwashing", and are available to support by providing careful and independent advice that will ensure that a business properly understands the risks it faces.

A View From Across the Pond – Global Supply Chain Disruption

In recent years, significant world events, including a pandemic, Brexit, and the Russia/Ukraine conflict, to name a few, have had profound effects on the global supply chain. In turn, this has created a multitude of problems for businesses, particularly in the construction industry, to operate as usual. Our legal experts across the globe provide helpful insight into managing the impact of major supply chain shocks on contracts for manufacture, distribution and sale of goods in the UK, as well as providing a US perspective on how supply chains are breaking down with practical discussion on the way forward.

Did You Know About...Our Global Supply Chain Law Blog?

Supply chain legal issues have become increasingly prominent as supply chains become longer, leaner, and more international. Our blog discusses legal issues that arise in the supply chain, both those that cut across industries and those that are industry specific. We focus specifically on the legal issues that most often lead to litigation in the supply chain – a result that no one wants! We discuss current cases, important nuances in the law that can affect supply chain relationships, and ways to make supply chain legal practices more robust, particularly in light of today's global supply chains.

Upcoming Events

Construction Deconstructed

8 December 2022 | 7:30 to 9 a.m. AWST

Please be aware that this is an in-person event, held in Perth. If you would like to attend, please register your place here.

As economies continue to experience uncertainty, with inflationary pressures and continued labour and material shortages impacting supply chains, property development and construction sectors remain volatile.

In this seminar, we look at managing risk in construction and property development contracts.

Topics covered include:

- Identifying the warning signs
- Project execution issues
- Commercial issues
- Market and trading changes
- Identifying and addressing threshold issues – What to consider before you move forward
- Contractual/statutory rights and obligations
- Project status, operational, commercial and market imperatives
- Future project execution and implications

Presenters

- Partner **Masi Zaki** is a restructuring lawyer, assisting clients in commercial negotiations, contentious and noncontentious turnarounds and distressed transactions.
- Partner **Melissa Koo** is a construction lawyer, advising on front- and back-end construction, energy and infrastructure projects.

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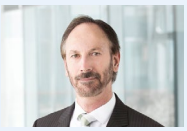

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Construction Matters is taking a break over the festive period and our next issue will be available in early 2023. We extend the compliments of the season to all readers