Protecting consumers from unfair trading practices

Consultation Regulatory Impact Statement

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Introduction

In August, the Treasury released a Consultation Regulatory Impact Statement (CRIS) examining options to protect consumers from unfair trading practices.

HIA takes this opportunity to respond to the CRIS.

The CRIS observes that there are certain types of commercial conduct which are not covered by existing provisions of Australia's consumer laws (such as misleading or deceptive or unconscionable conduct), that can be described as unfair trading practices, 'unfair business practices' or 'unfair commercial practices' and can result in significant consumer and small business harm.

The CRIS proposes a range of options to respond to these scenarios including:

- Extending the statutory unconscionable conduct provisions to capture 'unfair conduct'. Courts have drawn a distinction between conduct that is unconscionable and conduct that is unfair. HIA understands that this proposal would look to send a clear signal that unfair conduct that falls short of the threshold for unconscionability should also be prohibited.
- Introducing a new general prohibition on unfair trading practices.
- Introducing a combination of general and specific prohibitions on unfair trading practices.

HIA opposes the adoption of any of these options and supports the status quo.

While HIA acknowledges that corporate practices that may be seen to be 'unfair' may be undesirable, this does not necessarily equate to the need for a regulatory response. As set out in the CRIS, the existing regulatory framework is comprehensive and constantly evolving through case law and regulatory changes.

Further the CRIS does not adequately distinguish between measures targeted at consumer to business arrangements versus, business to business arrangements. To that end, the CRIS does not then assess the costs and benefits of any proposed interventions on each cohort. Of note the CRIS is titled 'protecting consumers' yet the detail of the CRIS does not so clearly distinguish. This is problematic when assessing regulatory responses.

In principle HIA is not opposed to taking steps to ensure the economy and the community are protected from unfair trading practices that cause significant detriment but HIA is concerned that additional moves down this path would serve to:

- Offend the principles of freedom to contract and limited government intervention in commercial arrangements.
- Inappropriately impose a consumer protection approach on business-to-business arrangements.
- Add cost.
- Create contractual uncertainty.

The Residential Building Industry

The residential building industry, including the home improvements and alterations market, is a key component of the Australian economy. The residential building industry is also the dominant sector in the building and construction industry.

While often overlooked, in reality the practice and paradigm in the residential building industry differs significantly from those businesses operating in commercial and civil construction and a range of other sectors of the economy to which the proposed options would apply.

The terms and conditions for commercial builders and those engaging in government contracts are significantly different from the terms and conditions for a builder working on a residential building project.

Commercial projects and government works are generally characterised by:

- a tendering process that often forces negative margins with the hope that future variations will cover the shortfall;
- the use of retentions;
- longer payments terms (up to between 45 and 60 days compared to 21 days in residential);
- limitations on a builders ability to select subcontractors;
- contract administration by a superintendent/ architect;
- significant amounts for liquidated damages; and
- long defects liability periods.

Such elements are not present in the residential building industry, which faces equally as challenging yet different factors such as:

- the homeowner, whose significant emotional and financial investment places additional pressures on the builder and trade contractors;
- prescriptive statutory contractual arrangements;
- quasi regulation of payment terms through the involvement of financial institutions;
- ineffective, time consuming and often litigious methods of recouping late payments;
- demanding terms of trade from suppliers; and
- significant exposure to uncontrollable events such as inclement weather and fluctuations in the supply of building materials.

The residential building industry is heavily regulated when compared to other building sectors and other sectors of the economy.

Home builders must manage a complex web of national, state and local laws, regulations and codes. These range from planning, design, environment, health and safety, to local authority inspection and certification and a multitude of building, electrical, mechanical and plumbing processes.

The businesses must also comply with a legislative framework that spans licencing, ATO contractor reporting requirements, dispute resolution, builders warranty obligations and contractual requirements.

Notably, the statutory consumer protection frameworks established around the country distort the usual allocation of risk in favour of home owners, influencing the arrangements that home builders enter into with their subcontractors and standing at odds with the Abrahamson Principle, namely that *'a party to a contract should bear the risk where that risk is within that party's control'*.

While residential home building laws differ around the country residential builders are generally required to incorporate a number of mandatory terms and conditions into their contracts for the benefit of home owners.

For example, a contract with a home owner must include:

- mandatory terms and conditions such as the name of the parties, a description of the building works, the contract price and any plans and specifications;
- variations must be in writing;
- implied warranties of materials and workmanship;
- limits on deposits and bans on up front progress payment;
- limits on the estimated amounts of prime costs and provisional sums;
- requirements that builders take out warranty insurance; and
- outlawing and/or voiding unconscionable contractual provisions.

It is generally accepted practice in the residential building industry for the builder to claim upon defined progress stages being completed. With the exception of the deposit, it is uncommon for builders to claim in advance of work being undertaken. In fact, draw downs on project finance is normally only available when lenders are satisfied with completion of certain recognised building stages.

In addition, a residential builder is required to obtain all variations in writing and is required to have these signed by the parties. If these requirements are not strictly complied with a builder may not be paid for the variation.

There are significant cost implications associated with these regulations.

The cyclical nature of the residential building industry is relevant to the relationships between contracting parties.

The high cost and highly regulated nature of the industry together with the small business profile of firms also means that they are especially susceptible to economic cycles and changes in government policies and regulation.

There are also inherent uncertainties in contract prices which arise from the fact that works are required to be priced before construction commences and are based on technical, financial and workforce assumptions, together with material costs/availability, access to site, timeframes, weather and statutory approvals/ delays.

Finally, a consistent challenge for builders is maintaining cashflow under a negative cash flow model. Whilst a trade contractor is typically paid for work in arrears and must finance this cost, the same holds true for builders who must ‘finance’ an owner’s costs.

Subcontractors and suppliers will naturally not wait for the substantial client to builder payment late in the duration of the job and often builders must source other financing arrangements to keep cash ‘flowing’.

Builders in the residential building industry ordinarily fund their works by way of debt financing. Revenue on the other hand is derived from client payments which are highly regulated and paid after completion of work and after the building costs are incurred.

The builder's reliance on cashflow to manage operations and cyclical conditions exposes them to an even greater extent in the event of non-payment by a client.

All of these factors lend against further regulation in respect of contractual arrangements in the residential building industry.

Freedom to contract

HIA supports the general principle that parties should be free to contract and agree upon their own terms and conditions. This principle ensures the efficient operation of the market for all businesses operating in the residential building industry. Businesses are established as part of the market economy, and with the expectation of their dealings being subject to the principles of 'buyer-beware'. Businesses, big and small, recognise there are risks involved with all commercial activities and that it is up to them to assess these risks before proceeding.

Paternalistic restrictions on conduct, raise a number of problems, particularly as it undermines the sanctity of the contract.

Only where there is an overwhelming case for regulation, such as clear evidence of market failure, should governments interfere in commercial arrangements between contracting parties.

Consumer protection regulation on businesses

Small business owners have many unique challenges including access to business finance, increasing sales in a challenging economic environment, managing employees under Fair Work laws and operating under onerous taxes and government regulations.

Ultimately, however a business owner is not a consumer requiring government protection. They are running their enterprise with a view to make a profit and reward.

Businesses are, or at least should be, more aware of their legal rights and should understand the consequences of entering into contracts.

Businesses have the capacity to make an informed decision based on an assessment of risks, including trading risk against return. Business owners may rationally decide not to obtain legal advice or not to properly review the terms of a contract to assess the risk. Business owners may decide to not negotiate or review so called 'unsalient terms' or 'unfair trading practices' on the understanding that, on the whole, the entire commercial relationship benefits them.

To view the arrangements between businesses through a 'consumer protection lens' is simply inappropriate. HIA strongly recommends that any progress in respect of the options proposed in the CRIS adequately differentiate between regulatory approach affecting consumer to business arrangements versus business to business arrangements.

Added cost

HIA does not support laws or regulations that impose further unnecessary and inappropriate costs on business transactions.

Moves that would see business contracts subjected to further scrutiny will inevitably increase the compliance burden on businesses.

If additional measures are adopted the direct costs of doing business will naturally increase as a result of having to review existing contracts for compliance, potential reallocation of risk and a consequent repricing of goods and services.

Any further regulation of business transaction will have an ongoing cost in education and advising businesses. It is not simply a 'one off' cost of amending contracts to comply with the new laws.

This risk premium will significantly increase if further uncertainty is added to subcontracts through the application of new regulatory arrangements. This entire risk premium is ultimately paid by new home owners.

Undermining contractual certainty

The adoption of any of the proposed policy options will cause uncertainty for contracting and subcontracting arrangements in the residential building industry and any additional regulation of subcontracting and building supply contracts will cause unnecessary confusion and uncertainty.

Construction contracts usually contain terms to manage unique risks such as:

- Land acquisition and planning risks;
- Project delays;
- Industrial disputation;
- Increase in costs e.g. increase in costs of labour or materials;
- Design and construction defects;
- Third party infrastructure or services on which the completion of the project relies, e.g. access roads are not constructed;
- Market risk; and
- Regulatory changes.

Any potential regulatory changes will create uncertainty in the application of such terms in construction contracts, potentially disturbing longstanding industry practice. Such uncertainty is likely to lead to further disputes, increase inconvenience and delay for consumers and increase costs.

For instance, under the standard form residential building contract, a homeowner client is empowered to require rectification of defective work.

A builder's failure to comply with such a direction amounts to a breach of contract. This may entitle a client to take over or suspend the work, to terminate a contract for breach or in some instances to undertake the rectification work themselves at the expense of the builder.

The risk associated with rectifying defective work in the head contract/building contract will then be accommodated in subsequent contracts in the contracting chain. Most standard subcontracts provide that a subcontractor is liable for rectifying the defective work if they were responsible for the defect and a timeframe for rectifying same. Failure by the subcontractor to do so is likely to amount to a breach of the subcontract in which case the builder will need to engage another subcontractor.

Some parties notwithstanding their breach of contract may allege the time allowed to rectify was deficient or unfair.

Especially in cases that require rectification work involving defective plumbing, which might involve substantial rectification works over and above the initial trade work such as replacing expensive tiles, fitting and partial demolition of walls and replacement of pipework, this is likely to be an expensive exercise.

Should any of the options in the CRIS progress they have the potential to impact not just on subcontracting and supply agreements but on all commercial construction contract arrangements; this should be avoided.

Existing arrangements for business to business contracts

The *Independent Contractors Act 2006* (ICA) establishes an unfair contracts jurisdiction. The Federal Court has jurisdiction to review a "services contract" if that contract is alleged to be "unfair" or "harsh".

The Court's very broad discretion in determining whether a contract is unfair or harsh, includes looking at:

- the terms of the contract when it was made;
- the relative strengths of the parties to the contract;
- whether any undue influence or pressure was exerted upon, or any unfair tactics were used against, a party to the contract;
- whether the contract provides total remuneration less than the rate of remuneration for an employee performing similar work; and
- any other matters the Court considers relevant.

The Court may make an order setting aside in whole or in part the contract or may make orders varying the contract. The Court may also make interim orders to preserve the positions of the parties while the matter is being determined.

Not only does the ICA already represent a *'substantial level of protection'*[1] and commonwealth unfair contract laws have been in place since July 2010 for consumer contracts and November 2016 for small business contracts. Under the existing laws, applicants can seek declarations from the courts that terms in standard form ('take it or leave it') contracts are void and unenforceable.

Recent changes to the commonwealth unfair contracts laws have substantially expands their application to a wider range of contracts, introduces financial penalties and gives courts greater flexibility in terms of remedies. The changes to the UCT laws are extensive.

The ACCC will have new powers to issue penalties for breach of the unfair contracts laws and make it an offence to enter into a standard form contract with a small business that contains an unfair term.

The changes will also expand the scope of the laws to cover a business that has fewer than 100 employees (previously 20) or has a turnover for the last income year of less than $10,000,000.

Importantly, the contract value threshold has been removed entirely and will mean that many more small businesses will have the protection of the UCT laws regime.

[1] Decision Regulatory Impact Statement (2015) *Extending Unfair Contract Term Protections to Small Businesses*, Consumer Affairs Australia and New Zealand

Finally, as a part of the Governments IR reforms *Fair Work Legislation Amendment (Closing Loopholes) Bill 2023*, it is proposed that the Fair Work Commission be given jurisdiction to deal with unfair contracts terms involving small businesses.

The CRIS provides examples of some (asserted) limitation on the unfair contract laws being ‘unfair’ conduct that goes beyond the terms of the contract. HIA has concerns with this sentiment.

Firstly, an unfair application or interpretation of an otherwise fair contract term may actually be a breach of contract and should be dealt with via those mechanisms.

Secondly, as has been experienced through the implementation of the unfair contracts laws, determining what is ‘unfair’ is notoriously difficult and attempting to regulate behaviour that would require an assessment of its operation in practice through a prism of ‘fairness’ is clearly fraught with difficulties and is therefore ill-advised.