

Extending Unfair Contract Term Protections to Small Businesses

**Consultation Paper
Issued May 2014**

Consumer Affairs Australia and New Zealand (CAANZ)

Submission by Australian Corporate Lawyers Association

6 August 2014

Small Business, Competition and Consumer Policy Division
Treasury
Langton Crescent
PARKES ACT 2600

Thank you for the opportunity to present this submission in response to the *Consultation Paper on Extending Unfair Contract Terms to Small Business*, released by Consumer Affairs Australian and New Zealand (CAANZ) in May 2014.

ACLA is the peak body for in-house lawyers (lawyers working for businesses and governments) in Australia. ACLA has over 4000 members working across 2,000 organisations ranging from the ASX top 100 and equivalent through to start ups. As the actual conduits of legal practice in the business/government environment, ACLA members are at the coal face of competition law application in this country and are in the unique position of having both sound legal knowledge and a thorough understanding of regulatory impacts within organisations, industries and the broader economy. This puts ACLA in a unique position to comment on the law and its application and to contribute to practical and effective reform that enhances Australia's business and government operations.

ACLA is apolitical. Our interest is in:

- supporting cost-effective legislative implementation,
- minimising red tape,
- providing business certainty to enable easy compliance,
- encouraging education over punitive measures,
- creating a level playing field, and
- promoting alternate dispute resolution over litigation.

Because of the diverse nature of our membership, we do not represent particular self-interest sectorial views, but rather bring to the table the collective wisdom of practitioners in the field. At the heart of this wisdom is that increased regulation should be supported by a robust case for change. In respect of the proposed reform, our members, and their organisations, hold views across the entire continuum about its merits and which option is most appropriate. While we consider that a number of threshold issues would need to be addressed before any reform could be formally supported, including a more cogent case for change, we acknowledge the Government's preferred option and this submission therefore identifies key issues that should be considered.

Should you have any questions about our submission please contact Tanya Khan, Chief Legal Officer, on 03 9248 5500 or tanyakhan@acla.com.au

Kind regards



Trish Hyde
Chief Executive Officer

6 August 2014

INTRODUCTION

Many organisations will be making submissions about which of the four reform options should be implemented. ACLA respects the general arguments that can be made for each, and acknowledges that amongst our members there will be individuals and organisations with particular views supporting specific options proposed. Collectively, we caution proceeding with the proposed reforms without a more cogent case for change. However, as the Government's preferred option is to proceed, ACLA has drawn on the collective wisdom of legal practitioners at the coal face to identify key issues that should be considered in detail in the selection and implementation of any such reform.

ACLA recognises that fairness is a highly valued ethical norm, as well as being enshrined in common law and statutes against unconscionable conduct. Certainly, in a contracting situation (and particularly in a B2B context), it is in neither party's interests to have contractual terms that distract from commercial outcomes. However, a balance must be struck between protecting the interests of small business and the legitimate commercial rights of the parties to, in certain cases, agree to a price/risk trade-off.

It should also be remembered that standard form contracts are an essential business tool, regardless of their size. Standard form contracts provide cost savings and efficiencies, as well as certainty. For the latter, they are a fundamental mechanism to ensure individual employees do not create business risks through creative negotiation.

The use of standard form contracts varies by industry, scale and organisation. Some have already applied the Australian Consumer Law (ACL) Unfair Contract Term (UCT) provisions to B2B activities and, at the other end of the spectrum, are organisations that were unaffected by the introduction of the ACL and for whom this will be new. Another way to view the differences is based on exposure to Australian law. There are organisations that due to their footprint in Australia aim to be a model citizen. At the other end of the spectrum are organisations for which Australia is, at best, a post box and standard form contracts are UK or US based plug and play documents.

We note that there are also a number of separate yet related reviews concurrently being undertaken, including the 'root and branch review' of competition policy being chaired by Professor Ian Harper which may result in changes to the provisions of the Competition and Consumer Act, as well as proposed changes to the Franchising Code of Conduct. It is not clear what the outcomes of these processes will be, how the outcomes will align with each other and what the cumulative impact of these changes on businesses will be. Economically, any benefits purported to arise out of a change to law could be outweighed by costs arising from duplication, implementation, uncertainty and disputes. Accordingly, ACLA strongly suggests that any reform to the UCT provisions be considered not in isolation but in the context of a broad-scale review, that is, as part of the Harper Review.

Should the UCT reforms proceed, the compliance burden will doubtless vary for each organisation, with the heaviest burden and compliance challenge falling to businesses of scale. To ensure unnecessary costs to business are minimised, the requirements of any regulatory reform must be clear, easy to comply with and an educative not punitive approach taken to enforcement.

Threshold 1 – Case for change:

1. ACLA recommends that more work be undertaken to determine the cost/benefit of such reform.
2. ACLA recommends that any reform to the UCT provisions should be considered not in isolation but in the context of broad-scale review, that is, as part of the Harper Review.

CLARITY AND CERTAINTY

Introduction of changes will require changes to business operating models and any uncertainty or inconsistency will lead to the reallocation of risks and a repricing of goods and services leading to higher prices for consumers.

Under the ACL there are three elements that must be satisfied in order to establish that a contract contains an unfair contract term:

- It must be a consumer contract;
- It must be a standard form contract; and
- It must be unfair.

The following explores these three concepts and how they may create certainty or uncertainty.

Defining Small Business is different to defining Consumers

The Consultation Paper acknowledges, and ACLA agrees, that one of the most challenging issues for the reforms will be applying a workable and practical definition of small business.

Currently there are multiple definitions used to define a small business depending on the legislation and regulator. Under Fair Work, a small business has less than 15 employees. ASIC defines small businesses as having two of the following: turnover under \$25M; under 50 employees; or assets less than 12.5M. The ATO classifies a small business as under \$2M turnover. According to ABS a small business is an active business with less than 20 employees. Using the ABS definition, 95.9% of businesses in Australia are small businesses, 3.8% are medium businesses and 0.3% are large businesses (ABS 2012).

The above variances highlight that it is possible to be both a small business and a medium enterprise depending on with whom you are speaking. While clarity and certainty in the definition is critical, we note that whatever criteria is applied there will be inconsistency with other regulatory definitions and this is highly likely to lead to an arbitrary categorisation which will confer an advantage on those businesses which fall within the definition compared to those that have one more employee or earn one more dollar.

ACLA also wishes to draw attention to the fact that the size of a business (turnover or staff) is not an exclusive indicator of its market power. There are certainly cases where an organisation which falls within any of the statutory definitions actually has a superior bargaining position to its larger counterpart through favourable supply and demand conditions.

Current definitions are based on a point in time – was the organisation a small business at the time the employee was dismissed; was the organisation a small business at the time of their tax return; or was the organisation a small business at the time ABS did its study? A definition is easier to apply retrospectively or at a point in time. It is harder to apply a definition over the life of a contract. Firstly, unlike a financial year, there is no one contract term. Secondly, the parties to the contract may start or complete the contract in any number of turnover/employee configurations. Given a contract is about providing certainty to parties, it is counterintuitive to add ambiguity to the application of clauses over the life of a contract.

A further issue is which party will be required to make the assessment of whether a small business is party to a transaction. Who bears the onus to assess this? We would suggest it would be rather impractical for the onus to be on the “larger” company to assess whether its counterpart falls within the definition of “small business” or not. However, this then places the onus on the small business to identify itself as a small business in order to receive the legislative protections – something it may not realise is required.

Additionally, many businesses (including those that might be regarded as ‘small business’) operate and contract through an incorporated company or may be related to (or operated by) large corporations or carried on by authority of Commonwealth/ State/ Territory government, or already protected under industry Codes, and arguably should not be afforded the benefit of additional protection. However, adopting a definition which artificially carves out a particular class may be difficult to assess and apply, and may well have unintended consequences.

While ACLA is not able to offer a solution to what the definition should be, it is clear that the definition of small business involves a number of intertwined issues, and a balancing of interests, that will make this one of the most critical aspects to get right in any reform.

There are options to avoid defining small business, for example:

1. As defined in the ACL for other transactions, the provisions of the reform could apply to any standard form contract under \$40K regardless of whether it is a consumer or business contract. This would apply to all businesses, not just small businesses, but addresses the issue of the parties having to turn their minds to the nature of contracting parties every time a contract is entered into or renewed.
2. Given under ABS statistics, 96% of businesses are small businesses (85% are sole or micro businesses) then the question could be turned into 'why should unfair contracting terms be permitted in any contracts?'. It could be argued that the remaining 4% may also benefit from this protection and a broad application removes onerous impracticalities of trying to define the undefinable. Equally, it is assumed that small businesses will not have an exclusion from complying in their own standard form contracts, so theoretically 100% of businesses should already be included in having to comply.

While both options address the issue of having to consider the nature of contracting parties every time a contract is entered into, such an approach would apply to all businesses, not just small businesses. Application to all businesses is likely to exceed that required to achieve the objective of protecting those businesses that do not have the legal advice or financial standing to adequately protect themselves.

Threshold 2 – Adequately defining small business:

The definition of small business involves a number of intertwined issues, and a balancing of interests, that will make this one of the most critical aspects to get right in any reform, if negative consequences are to be avoided.

Defining standard form contracts is more complex for B2B

One of the great advantages of standard form contracts is that they increase business certainty regarding rights and obligations, as well as enforceability.

The Guide to Unfair Contract Terms Law (Commonwealth 2010) sets out the considerations for determining if a consumer contract is a standard term contract. In particular it cites factors that could indicate a standard form contract as: overwhelming bargaining power of one part over the other; the contract being prepared in advance of discussions; the contract being offering in an accept or reject form; there not being a real opportunity for negotiation of contract terms; and/or the specific characteristics of the parties or transaction are not considered.

Unlike consumer transactions, the balance of power upon entering a B2B contract may not always be as clear. A small company who is the only supplier of a particular consumable for a discontinued machinery line, will have significantly disproportionate bargaining power regardless of the size of its counterpart.

Another area of consideration is that using the criteria of the contract being prepared, offered as accept/reject, or without real opportunity to negotiate terms may have unintended consequences. For example, contracts used to hire consultants, specialists and others on a project basis (approximately 60% of businesses are sole-contractors (ABS 2012)), may under this criteria be a standard form contract, thereby, widening the types of contracts and transactions that would come under this reform. In doing so it provides great uncertainty.

Under the ACL, a consumer contract is presumed to be a standard form contract and the onus of proving otherwise rests with the business. How would this be applied in B2B contracts? What protections would need to be put in place to prevent unnecessary legal costs and lost business productivity in determining if the contract is a standard form contract?

While consistency with the consumer contract application would seem on the surface to be the least impact for organisations, based on the above, this may not be the case. We believe there is a strong argument for greater clarity around what is and is not a B2B standard form contract, and if it applies to all transaction types. Also, the proposal to extend UCT to acquisition as well as supply contracts broadens the reach of affected transactions and further work would need to be done to understand the true impact of this proposal.

Threshold 3 – Clearly defining standard form contract:

Clearly define what is and isn't a standard form contract and provide exceptions where appropriate.

Defining unfair depends on the context

There is an argument that, like B2C contracting, there can be a degree of imbalance in B2B contracts as parties are unlikely to have equal bargaining power in all commercial contexts.

However, unlike B2C contracting, businesses exercise commercial acumen to survive and thrive. While this may not make parties equal in bargaining power, it means that small businesses as a class may not need the same protections as consumers, due to higher commerciality. Furthermore, a business may elect to accept a standard form contract that purportedly has onerous terms, not because it does not have the capability or resources to protect itself, but because there is a commercial advantage to doing so – this could be first mover advantage, the low risk not warranting delaying the transaction or the risk being compensated for through better commercial terms such as pricing.

The more prescriptive the reforms, the greater the risk that the inclusion of a term that is commercially reasonable for the particular circumstances, may be inadvertently prevented. As a class, small businesses should not be prevented from exercising commercial judgement and rights to choose. Nor should businesses operating under Australian law be disadvantaged compared to internationally based organisations.

ACLA suggests consideration be given to including exceptions to the application of the UCT provisions including, for example, where a small business has its own in-house or external legal representation or chooses to opt out of receiving the benefit of the provisions. The threshold should be appropriate, so that legal costs are manageable.

Threshold 4 – Clearly defining unfair terms:

Consider including exceptions to the application of the UCT provisions including, for example, where a small business has its own in-house or external legal representation or chooses to opt out of receiving the benefit of the provisions.

ORDERLY TRANSITION AND EASE OF COMPLIANCE

We note that the introduction of the original UCT law applied to standard form consumer contracts entered into on or after 1 January 2011, and to standard form consumer contracts renewed or varied on or after that date. From this it is possible to assume that the impact on businesses of any extension would be low. However, the degree of uncertainty and potential for significant differences to the application of the UCT for consumer contracts and those that may be applied to small business could result in significant impacts for any organisation, even those that may have had experience with the introduction of the ACL. For example, the proposed expansion of the law to both supply and acquisition contracts, not just supply as under consumer UCT provisions. Additionally, there is a whole new class of

businesses that will be impacted – those that are B2B only. It is the wholesaler, the business service provider or other B2B only trader that will also need time to understand the impacts and implement change.

Should the reforms proceed, we would suggest the following to reduce the compliance burden and costs to businesses:

- Including an appropriate grace period of 12 months to enable compliance. Businesses will need to review existing contractual arrangements and processes, and build repeatable new processes to ensure compliance;
- Providing clear guidelines outlining definitions and exemptions, comparisons showing any differences to the operation of UCT for consumer contracts, and a support service to advise organisations;
- Applying any changes prospectively and not retrospectively. Compliance should be simple for businesses; and
- Applying any changes to new contracts only and not renewals. If the changes applied to renewals, businesses would have to undergo an additional process of initially categorising which existing contracts were standard form contracts on commencement of the changes, then identify at renewal time whether the other contracting party is, had remained or had become a small business and then negotiate changes with that party to accommodate the changes to the law. For any business dealing with standard form contracts this would represent a significant cost and process change.

Threshold 5 – Smooth and simple implementation and compliance:

If the case for change and definition obstacles can be suitably addressed, then to reduce the compliance burden and costs to businesses we suggest the following:

1. Including an appropriate grace period of 12 months to enable compliance.
2. Providing clear guidelines outlining definitions and exemptions, comparisons showing any differences to the operation of UCT for consumer contracts, and a support service to advise organisations.
3. Applying any changes prospectively and not retrospectively.
4. Applying any changes to new contracts only and not renewals.

ENFORCEMENT – EDUCATIVE APPROACH

When it comes to compliance, ACLA wholeheartedly supports education and consultation over penalties and litigation. We respect the right of regulatory bodies to pursue legal remedies and penalties where laws are breached. However, as in all situations, should the reforms proceed, ACLA would support an educative and consultative approach between regulators and business rather than a punitive approach. We believe this will maximise productivity, growth and benefit for Australians.

Some argue that big businesses are inherently bad. Taken to the extreme this means that by the fact that they work for medium or large businesses, over 50% of the population (ABS 2010) are themselves party to the bad intentions. Yet the reality is that most people act with good intentions, and rogues exist in businesses of all manner and size. We believe that all businesses should be supported in compliance and that regulators should approach the marketplace in a constructive way, and be funded appropriately to do so. Of particular note, ACLA does not support the approach of ‘name and shame’ as a means of education or enforcement. It is extremely concerning when a regulator cites one of its powers as “thirdly, there's just the sheer naming and shaming and that is also quite powerful - Companies jealously guard their reputation.” (7.30 Report 29 July 2014). This approach is more effective on large well known businesses and doesn't promote a level playing field for all. Worse, knowing that this approach is readily applied, organisations are reluctant to speak out for fear of repercussions.

ACLA's members favour an approach of early identification of issues or concerns, a consultative and collaborative approach to rectification and one which minimises unnecessary compliance costs on businesses, especially where these could otherwise be avoided through early discussions and resolution of concerns.

In addition to reducing compliance costs, ACLA would also encourage, where possible, early engagement and consultation to occur to minimise or reduce the chance of breach actually occurring. Rather than litigation as a means to enforcement, ACLA is a strong advocate for alternative dispute resolution as a means to more efficiently and collaboratively facilitate and restore business relationships and rectify non-compliance. This is particularly so in a B2B context.

Finally, organisations that have in-house counsel are better placed to understand their compliance obligations. Those organisations without in-house counsel (predominantly small business) may not have the resources to identify and manage the required changes and are therefore at greater risk of inadvertent infringement. This means that, should the reforms proceed, the regulators must provide appropriate access to education and sufficiently detailed guidelines to enable businesses, regardless of size, to achieve compliance.

Threshold 6 – An educative and consultative approach:

1. Opt for a consultative and educative compliance approach.
2. Provide appropriate funding for education and use 'name and shame' as a last resort.
3. Encourage consultation and then alternate dispute resolution, ahead of litigation.

CONCLUSION

ACLA believes that at this point, there are several hurdles to overcome before proceeding, the first of which is to establish a detailed case for change. If the case is valid, then practical and workable definitions of small business, standard form contracts and unfair contract terms must be developed. This is particularly important as any benefits purported to arise out of a change to law could be outweighed by costs arising from duplication, implementation, uncertainty and disputes. To ensure unnecessary costs to business are minimised, the requirements of any regulatory reform must be clear, easy to comply with and an educative not punitive approach taken to enforcement.