

Unfair Term Protections submission

We wish to make a submission in response to the Consultation Paper, *Extending Unfair Term Protections to Small Business*.

We have advised local and overseas clients extensively on the application of:

- the unfair contract term protections for consumers;
- the Australian Consumer Law (*ACL*) protections for consumers and business; and
- related industry-specific regulation.

Drawing on this experience, we comment on some issues relevant to the proposed extension of unfair contract term protections to small business.

Executive summary

If the Government extends unfair term protections to small business, the drafting should incorporate:

- A "small business contract" test that is clear, certain and easily measurable by both parties to the contract at the time they enter into the contract.
- An "unfair term" test capable of being applied with certainty in a business context.
- An understanding that business contracts and relationships contain inherent imbalances in size, negotiating power and resources. These factors do not necessarily make a term or contract unfair.

Finally, industry-specific issues (including industry-specific regulation) will need to be considered. The merits of accommodating an industry-specific issue so as not to impose undue burden will need to be weighed against the potential regulatory uncertainty and complexity of having too many different approaches or exceptions for unfair term protections.

Detailed comments

1. "Small business contract" test

Several challenges arise with determining the meaning of "small business" for the purpose of defining a "small business contract" attracting the unfair term protections. Ultimately, the test adopted will need to be sufficiently straight-forward and unambiguous for both parties to apply it easily, accurately and at the time the contract is made. As a matter of transparency, fairness and certainty for all parties, it should be clear whether or not any small business unfair contracts regime will apply in any particular situation. However, the need for simplicity carries the risk that the test will be an ill-suited test for some cases. Examples of factors to be weighed up when examining potential tests include:

- **Amount paid / payable test:** A threshold amount paid or payable for supplies like the existing ACL test for acquiring goods or services as a consumer,¹ may be the easiest test to apply. It is an established test that is already understood. Enquiries would not need to be made about a party's size or turnover, nor would a small business need to make disclosures about its operations. However, a test based on the price of supplies alone would mean that the regime would have a too broad application and would mean, for instance, that a large business acquiring supplies of small value could rely on the small business protections in its dealings

¹ Section 3, Australian Consumer Law.

with another large business. To partly address this concern, public companies could be ineligible for the protections, as has been done for unconscionable conduct.²

- **Turnover test:** A test based on turnover would require disclosure by a small business and/or investigation by the other party. Small businesses may be reluctant to disclose information about their turnover and/or operations. The turnover information may not be readily available. A turnover test may, unless it is applied on a corporate group basis, mean that the regime could apply to an entity with a low turnover within a corporate group with significant bargaining power.³ To address this concern, a turnover test could be determined by reference to the corporate group, i.e. the turnover of the contracting party and their related body corporates (but this adds more complexity). A turnover test also highlights the need for a policy decision on whether "small business turnover" should be the same amount across all industry sectors.⁴
- **Employee numbers test:** A test based on employee numbers also requires disclosure by a small business and/or investigation by the other party (and raises similar concerns about complexity as a turnover test). Whether employee numbers include contractors, permanent or full-time equivalent personnel, or seasonal staff will need to be considered. Determining an appropriate number for the purposes of this test is also problematic - different measures are already used by the Australian Taxation Office, the Australian Bureau of Statistics and under industrial relations law when considering what constitutes a "small business". There are also industry-specific small business tests such as the test applied by the Telecommunications Industry Ombudsman (TIO).⁵

Finally, it is worth exploring how the current concept of "consumer contract" might be extended to a "small business contract" context. The current test of what is a "consumer contract" has a relatively narrow focus in terms of the covered supplies.⁶ The supplies must be acquired for the predominant purpose of personal, domestic or household use or consumption. A question for the small business test is whether, similar to the consumer test, small business contracts should be limited to those where the small business is acquiring as an end user. If broader application was to be considered (eg, to extend protections to where a small business is the supplier to a large customer who sets standard form terms or a range of different contracting arrangements such as reseller arrangements), then thorough investigation should first occur of the potential impact.

2. "Unfair term" test

To provide sufficient business certainty, the test for a term in a business-to-business contract being unfair may need greater clarity. For example, greater guidance could be provided about how industry-specific factors and business models can be considered in applying the unfair test (and by doing this give meaning to what may be "relevant" to consider). When the unfair term protections for consumers were introduced, there were already unfair term consumer laws in Australia (such as Victoria) and overseas jurisdictions which provided useful guidance on relevant factors. In contrast, there is much less existing guidance for applying unfair term protections specific to business-to-business transactions.

² Section 21(1) Australian Consumer Law.

³ For example, a related company established to enter into contracts to purchase supplies for the group but that does not itself earn any revenue.

⁴ For example, turnover is likely to be higher for a business in the mining sector that is small relative to businesses it transacts with in that market, than a personal services focussed service such as in the personal grooming and beauty sector.

⁵ The TIO test for handling telecommunications complaints from small business is 20 full-time employees and \$3,000,000 annual turnover.

⁶ Section 23(3) Australian Consumer Law examines whether the purpose for the supply of goods or services or sale or grant of an interest in land is to an individual wholly or predominantly for personal, domestic or household use or consumption.

Matters to be considered include:

- Businesses will likely seek clarity on to what extent they can reflect self-interest or create an imbalance of rights and obligations in terms. In particular, a supplier will seek guidance on its ability to reflect in its supply terms constraints or flow through terms placed on the supplier by those that it is dealing with further up the supply-chain.
- Determining what constitutes a legitimate interest of a party is one of the more difficult aspects of the unfair term test to apply. A supplier might, for example, include terms that extensively limit the supplier's liability in order to keep the supplier's insurance or other risk-based costs down. It will be important for suppliers to know if these cost of doing business factors can be considered as legitimate relevant factors.
- The current unfair consumer contracts regime applies the test of whether the term is "not reasonably necessary" in order to protect the legitimate interests. In a commercial context it may be more appropriate to consider whether the term is reasonable taking into account the legitimate interests of the counter-party (as well as the contract as a whole as required under the current test).
- The current test of detriment does not require that the detriment be material or ongoing. If the test in its current form is applied to the small business protections, a small business subject to detriment which is minor or has no lasting impact, could rely on this to avoid performance of their obligations. That would seem an inappropriate outcome.

3. Industry-specific considerations

There are several federal, state and territory industry-specific regulatory regimes addressing terms on which parties must do business. Extending unfair term protections to small business will need to consider the interplay of the existing regimes and not unnecessarily increasing the regulatory burden and complexity.

We list below a few industry examples where business-to-business agreements are subject to regulation:

- The *Motor Dealers and Repairers Act 2013* (NSW) (*MDR Act*), has addressed the unfair terms and standard form contract aspects of the ACL in an industry specific manner.⁷ While adopting the definition of "unfair" from the ACL, other factors which may be taken into consideration when determining if a term is unfair include whether it was reasonably practicable for the motor dealer to negotiate the contract, whether independent or other legal advice was obtained, and whether any undue influence, unfair pressure or tactics were used against the motor dealer.⁸
- The Franchising Code of Conduct contains minimum disclosure obligations, mandatory franchise agreement requirements and requires that franchisees consider obtaining appropriate legal and financial advice before entering a franchise agreement.
- The ACCC has specific regulatory powers and oversight over certain industries such as telecommunications, energy, Australian airports and container stevedoring. In some cases the ACCC powers and oversight extend to contract terms.

⁷ This Act applies to the supply of motor vehicles from a manufacturer to a motor dealer for the purposes of resale.

⁸ Section 146(3) *Motor Dealers and Repairers Act 2013* (NSW).

- The Telecommunications Consumer Protection Code⁹ incorporates industry-specific unfair terms provisions which operate in conjunction with the ACL to protect consumers and small business.

An issue will be whether contracts for these already regulated industries should be subject to additional regulation under extended unfair term protections for small business. The potential for further unfair term protections specific to small business to result in duplication, confusion and inconsistency with existing regulation will need to be weighed against the potential uncertainty of applying different approaches for different industries.

4. Consequences of extending unfair term protections

An obvious concern in extending the unfair term protections to small business is that not all small businesses do the right thing. Both parties to a contract need sufficient certainty that they can enforce the deal that has been struck between them to conduct business.

There is a risk that a small business will voluntarily enter into a transaction either in full knowledge of its terms or wilfully ignoring its content with a view to later relying on the unfair term protections in order to avoid agreement obligations it freely accepted. For example, a small business may voluntarily choose to deal with a particular supplier which has a very restricted liability regime, however that regime may result in the small business paying a much lower price than is on offer from other suppliers. In other words, the restricted liability regime was part of the overall bargain that the small business chose.

Approaches that might assist on dealing with the potentially unfair consequences of extending this regime are:

- To have different consequences for an unfair term. For example, rather than being automatically void, the term may be amended to the extent of the unfairness (as determined by the parties to the contract or an external party).
- Change the onus of proof so that it is the responsibility of the small business to show that the term is unfair (rather than the other party having to prove that it is not).
- Use of an opt-out mechanism where parties agree that that the small business has been fully informed of the relevant risks, has considered the consequences which may flow from such risk and has sought, or chosen not to seek, external legal advice. An opt-out may be more applicable where the parties have a long standing relationship, or where they are contracting in industries which are already highly regulated.

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⁹ This Code is an industry code regulated under the *Telecommunications Act 1997* (Cth).