Business Council of Australia

submission

Submission to the Department of Treasury Consultation Paper on Extending Unfair Contract Term Protections to Small Businesses

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Working to achieve economic, social and environmental goals that will benefit Australians now and into the future

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The Business Council of Australia (BCA) brings together the chief executives of more than 100 of Australia's leading companies, whose vision is for Australia to be the best place in the world in which to live, learn, work and do business.

About this submission

This is the BCA submission to the Commonwealth Department of Treasury on the Consultation Regulation Impact Statement (RIS) on extending unfair contract term (UCT) protections for standard form contracts to small business.

The purported policy objective is to give small business confidence when entering into standard form contracts that contracts are fair and reasonable and risks are allocated efficiently. Four policy options are analysed in the RIS:

- "Option 1 - The status quo. No action is taken, contrary to the Commonwealth Government's policy commitment.
- Option 2 - Light touch or non regulatory responses.
- Option 3 - Legislative amendment to extend the existing UCT provisions to contracts involving small businesses, in accordance with the Commonwealth Government's policy commitment.
- Option 4 - Legislation to require contracts with small business to be negotiated on request."

The consultation RIS was issued by Consumer Affairs Australia and New Zealand. The Office of Best Practice Regulation (OBPR 2014) observes that the RIS acknowledges that:

- there is limited empirical evidence about the scope of the problem being experienced by small business; and
- the benefits and cost of the options are difficult to measure.

Key points

- The government indicates it wishes to extend unfair contract term protections for standard form contracts currently in consumer law to small businesses. Standard form contracts are an efficient way of managing the terms and conditions for a significant portion of the estimated $500 billion of large business to small business commercial transactions in Australia each year (BCA 2010).
- This policy would add to the stock of business regulation. It is important this review is conducted in a way that is consistent with the Government's commitment to best practice regulation and its red tape reduction program. Any new legislation should be offset by a reduction in the regulatory burden.
- Business acknowledges that an efficient regulatory system benefits business and the broader community by reducing economic, health, environmental and other risks at least cost. New legislation however should only be considered if it is the only way to address a clearly defined problem and the benefits clearly exceed the costs. It is often difficult to remove poor or unnecessary regulations once they are in place. Non-regulatory methods should be considered wherever possible to obtain the desired outcomes.
- The BCA does not consider that the Consultation RIS makes a compelling case for implementing new legislation over alternative non-legislative options. Our concerns with the proposal are:
  - The 'problem' associated with unfair contact terms in business to business transactions itself is not clearly defined. Nor is the extent of the purported problem fully explained or assessed according to how different businesses are impacted according to their type, size or by sector. Benefits to small business from extending the legislation are asserted but not adequately proven or quantified in the RIS.

- A number of existing measures are already in place to provide protection from unfair contract terms. The effectiveness of these protections (such as retail tenancy leases which are already regulated by state and territory legislation) must be considered before taking further action.
- The government's stated preference to legislate on this matter should not prevent a proper evaluation of alternative, lower cost, non-legislative measures which, if found to be effective, should be preferred.
- There is insufficient recognition that new regulation will likely impose additional costs and risks on business and the economy. For instance, new legislation will create a new compliance obligation that adds to costs. Small businesses may be less likely to properly review contracts if they wrongly perceive the law offers wider protections. The prevalence and costs of litigation may increase. Businesses may elect to utilise non-standard contracts to avoid the risk of litigation, which will increase costs. All unintended consequences need to be properly thought through and tested.

▶ We urge the government to reconsider its preference to extend the legislation. Subject to the problem being more clearly defined by this review, non-legislative measures should be prioritised such as providing information and guidance on unfair terms, greater use of industry codes of conduct, industry ombudsmen and existing legal protections.

▶ If the government decides to proceed with additional legislation, it should:

- apply protections via mechanisms already being used in industry codes, such as the Telecommunications Consumer Protections Code, and refined as necessary to address any practical difficulties or problems businesses have encountered when applying those existing code mechanisms.
- ensure the legislation is proportionate to the problem and provide exemptions for sectors where measures are already in place (such as retail leases covered by retail tenancy legislation) or where no identified problem exists.
- be offset with regulatory reductions in keeping with the government's red tape reduction commitments.

Key recommendations

▶ The government should reconsider its preference to legislate to extend consumer unfair standard contract terms protections to small business and be open to using non-legislative measures instead.

▶ The review must first identify the extent of the problem to be addressed before deciding whether policy reform is necessary. Any policy intervention must then be proportionate to the identified problem and subject to a full assessment of costs and benefits.

▶ The final or decision RIS should implement the government's 10 principles for Australian Government Policy Makers and in particular:

- provide further evidence of the extent and nature of the problem.
- identify and assess the costs and benefits of each of the options.

▶ Depending on the nature of the problem identified, the BCA supports primary consideration of non-legislative solutions, such as better information to small business about their legal rights and responsibilities and greater use of industry codes and ombudsmen (Option two in the RIS).

▶ If a legislative option is be pursued, extension of the existing UCT protections should:

- be limited to small businesses with unequal bargaining positions, vulnerability and a level of sophistication that is comparable to those of consumers
- define 'small business' in a clear and transparent manner

- apply only to contracts for the supply of goods or services to small business (not acquisition from small business), consistent with the transaction focus of the existing UCT provisions and the Government's policy commitment to extend the benefit of those existing UCT provisions to small business
- clearly define what is a standard form contract in the context of a business to business transaction, noting that the fact that a contract that takes a standard form need not necessarily be offered on a "take it or leave it" basis
- clearly identify the types of terms in a standard form contract in the context of a business transaction that would be considered to be 'unfair'; and
- ensure there is no unnecessary duplication or overlap with other legislation or regulation.
- retain the ability for a party to justify a condition on the basis that it was reasonably necessary to protect their interests
- allow a sufficient lead time for appropriate transition
- be accompanied with offsetting regulatory reductions in keeping with the government's red tape reduction commitments.

Summary Checklist for New Regulation

This checklist is used by the BCA to assess regulatory proposals and is based on the Business Council of Australia Standards for Rule Making (2012).

Principle	BCA assessment of UCT extension
1. The problem to be solved is well understood Before government seeks to regulate, it must understand the problem or policy priority in depth and test the case for regulation, along with the risks and consequences of not regulating a particular activity.	No. Insufficient evidence is provided in the consultation paper on the nature and extent of the problem. Only the total number of complaints by type of issue is provided, but no further information on the validity or seriousness of the complaints, nor whether they represent a widespread or narrowly defined problem, is provided.
2. New regulation is subject to cost–benefit analysis The costs of new regulation are thoroughly assessed and tested with the community through cost–benefit analysis, which includes an explicit understanding of the costs to the community including business.	No qualitative or quantitative assessment of the four options has been undertaken. Option three in the RIS is listed as 'preferred' because it implements the election commitment, not because it is the most cost-effective way of achieving the policy objective. The policy objective is to give small business confidence when entering into standard form contracts that contracts are fair and reasonable and risks are allocated efficiently.
3. Regulation achieves its objectives at least cost Regulation is carefully targeted to achieve its stated objectives and minimise the cost impacts on the community including business.	No. It is unclear from the information provided as to whether existing protections, such as industry codes and ombudsmen services are adequate or could be changed to reduce any identified problem, and thus avoid new legislation.

The importance of an efficient regulatory system

Regulatory reform should build an efficient regulatory system that benefits business and the broader community by reducing economic, health, environmental and other risks at least cost.

The *Competition and Consumer Act 2010 (Cth)* aims to promote competition, fair trading and consumer protection. To achieve these aims, the Act includes protections for businesses against

unconscionable, misleading and deceptive conduct, and enables the enforcement of mandatory industry codes such as the Franchising Code, Horticulture Code, Oilcode and Unit Pricing Code.

The current regulatory system surrounding business-to-business contract terms therefore already includes legal rules and penalties for non-compliance, as well as self-regulation and co-regulation frameworks. Self-regulation and co-regulation include occupational and industry codes (voluntary or mandatory) of behaviour. The use of complaints mechanisms and the regular publication of regulatory outcomes (e.g. 'competition by comparison') may also be used to encourage desired behaviours.

Australia has benefited in the past from being an early adopter of quality regulatory instruments, and regulatory reforms in product markets that occurred under National Competition Policy in the 1990s. More recent regulatory performance shows signs of deterioration:

- Australia ranks 128th out of 148 nations on the burden of government regulation in the 2013-14 World Economic Forum's Global Competitiveness Index. By contrast, New Zealand ranks 13th. The WEF reports that the business community highlights labour regulations and bureaucratic red tape as being the first and second most problematic factors respectively for doing business in Australia (WEF 2013).
- Australia has a substantial stock of regulations – well over half a million pages of regulation (PC 2008a). We continue to add to this stock at a substantial pace.

For this reason, the BCA is concerned with the preference outlined in the consultation RIS for new legislation before the problem is clearly defined and the costs and benefits of extending legislation are properly compared with those of non-regulatory options.

Regulation is too often used as a quick 'fix' to an immediate problem, with the commitment to regulate made before the problem itself has been found to be either perceived or real. It is then often difficult to remove poor or unnecessary regulations once they are in place.

Is there a problem?

The Consultation RIS identifies the problem as being the imbalance of bargaining power between smaller and larger businesses, and the relative lack of time or legal expertise of smaller businesses to critically review contracts.

In 2010, consumers obtained legal protections under Australian Consumer Law that enables terms in standard contracts to be voided if it is established in court that they are 'unfair'. The Consultation RIS suggests that small businesses may encounter the same imbalance or lack of scope for negotiation and expertise as exists for consumers. The concept of unfairness includes non-transparent and unclear contract terms that cause detriment and a significant imbalance in the parties' rights, but excludes the upfront price.

The policy aim is to give small business confidence when entering into standard form contracts that contracts are fair and reasonable and risks are allocated efficiently. However, the issues facing consumers and small business when entering into contracts differ.

The number and type of small business complaints about unfair contracts made to the Australian Competition and Consumer Commission (ACCC) is used in the Consultation RIS to provide evidence that there is a problem that needs to be fixed.

The Consultation RIS states that the Australian Competition and Consumer Commission (ACCC) received 894 complaints from small business on unfair standard contract terms over a three year period. The largest types of complaints related to contract termination matters, including restrictions on small business rights to terminate the contract and excessive 'automatic rollover' periods (e.g. more than five years).

Unfortunately, no further information is provided in the consultation RIS as to:

- The extent to which these complaints arose in the context of standard form contracts.

- How many of these complaints were resolved administratively or did not require further action.
- Whether certain types of businesses are most affected (e.g. sole traders or the self employed).
- Which industry sectors are most affected.
- What specific legislative option is being proposed.

Information about which businesses and sectors are most represented in the complaints data might assist in pinpointing the nature of the problem to be solved (and how it should be addressed).

Information about how complaints are resolved would also increase our understanding of the nature and extent of small business issues in relation to standard contracts, and they can best be remedied.

Complaints may either be resolved administratively, escalated to an in-depth investigation, or a decision made to take no further action (ACCC 2013).

A better understanding of the complaints might also lead to improvements being made through existing channels (e.g. industry codes) and not require more wholesale changes in the way contracts work. The complaints process is a useful source of information for identifying where more common complaints can lead to a review of practices.

In essence we conclude that the problem needs to be better defined in this review before a decision is made on an appropriate policy response.

It should also be recognised that it is in the interests of business customers to meet the needs of their small business suppliers. In our consultations with BCA member companies we were made aware of intentions to be flexible in meeting the needs of small business suppliers because of the importance of suppliers to the company's success.

What are the benefits and costs of extending unfair contract term protections to small business?

The Consultation RIS describes the proposal to extend unfair contract terms as:

> Consistent with the existing ACL provisions, this option would permit the ACCC, State and Territory consumer agencies or private parties to apply to a court for a declaration that a term of a standard form contract is unfair. Where a court has made such a declaration, then it would be a contravention for a person to apply, or rely on, that term. (p30)

The benefits and the costs of the proposal to extend unfair contract terms need to be more accurately defined to decide whether this legislative reform is really in the interests of business and the wider economy.

The Consultation RIS in its assessment of this 'Option 3' (pp30-39) asserts benefits to small business and the wider economy from 'a more appropriate distribution of risk' but does not offer any further proof for this, nor quantify the benefit.

All new or extended legislation imposes additional costs on the economy. The following increases in business costs would arise from extending consumer standard unfair contract term protections to small business:

- Higher business administrative costs arising from a new regulatory compliance obligation as businesses seek to ensure they are operating within the proposed new provisions in the *Competition and Consumer Act 2010*.
- Increased risks to innovation in business to business relationships as more of these relationships are defined by law rather than mutual agreement.
- Greater risk (and costs) of litigation from extending the protections from consumers to small business.

- It is possible that more contracts will be negotiated separately (ie fewer standard form contracts will be used) to avoid the risk of litigation under the increased protections, adding to the costs of finalising commercial arrangements when compared with using efficient standard form contracts.
- The potential unintended consequence that small businesses might take less care or time reviewing contracts under the false assumption that they are fully protected in all areas of risk by the extended legislation. The proposal should not be seen as an alternative to reading and understanding all contracts in full before agreement.

Extending existing consumer unfair standard contract term protection to small business could discourage standard contracts and increase business transactions costs for both large and small businesses. Most business contracts are in standard form because they avoid costly negotiations.

The increased protections would enable small business to obtain a court decision on whether specific terms in standard contracts are unfair. This is expected to result in greater use of more costly dispute resolution processes for business than existing dispute resolution mechanisms such as those provided by industry codes and ombudsmen.

Unintended impacts from extending the legislation may offset any benefits from new regulation. Extending these protections to small business can increase small business costs because of the additional resources required to negotiate individual commercial contracts. The cost to all businesses, both large and small, of negotiating commercial contracts would rise, resulting in higher costs and prices for all.

The 2008 Productivity Commission (PC) report on *The Consumer Policy Framework* argues against extending unfair contract term protections to small business because:

- there are no clear principles for deciding the extent to which small business should be protected.
- small businesses differ from consumers in many respects.
- such protection is likely to come at a cost to business and ultimately consumers in the form of higher prices.

The Department of Treasury should take care not to unduly rely on the results of its online business survey on unfair contract terms to understand the nature and scope of small business experiences with standard contracts. An overall assessment of the problem should not be based on the 'weight of numbers' of responses. Responses to some of the questions should also be carefully evaluated to check that there is a not a presumption in the question itself that standard contracts contain unfair terms, as this could potentially bias the survey results.

Option 2 is preferred – 'light touch or non-regulatory options'

The BCA's preference is that once the problem is better defined it be addressed in accordance with Option 2 ie consideration of light touch or non-regulatory options. The RIS (p44) lists these as "industry-led initiatives to curtail the use of UCTs, improve small business awareness and information campaigns, information disclosure requirements and the development of guidance material for businesses."

Any assessment of policy options needs to first consider the impact of existing legal protections against unfair small business contracts, including:

- the *Competition and Consumer Act 2010* already provides protections for businesses against unconscionable, misleading and deceptive conduct.
- mandatory industry codes such as the Franchising Code, Horticulture Code, Oilcode and Unit Pricing Code that are regulated by the ACCC.
- voluntary industry codes such as the Produce and Grocery Code of Conduct and the Shopping Centre Council of Australia's Casual Mall Licensing Code of Practice (authorised by the ACCC).

- industry ombudsmen, such as the telecommunications and financial services ombudsmen that provide dispute resolution services for customers, including small business for services provided by certain industry sectors.
- (as per the above), retail tenancy legislation.

This assessment is important to identify whether policy reform is needed, or whether it would be best to improve the operation of existing measures in order to reduce any current problem.

More specific information about the types of standard contract problems experienced by small businesses would facilitate the design of the most effective way of achieving desired business behaviour.

Alternative policy responses to regulation

Alternative policy responses to regulation that should be assessed include:

- better information for business about their protections under the prohibition of unconscionable, misleading and deceptive conduct provisions of the *Competition and Consumer Act 2010*. This would include more accessible information and guidance on unfair standard contract terms, industry codes of conduct and existing legal protections
- regular publication of small business unfair standard contract term complaint outcomes and their resolution by businesses, ombudsmen and the ACCC
- more effective implementation of existing protections, such as industry codes and complaints mechanisms, such as industry ombudsmen
- improving the administration of existing regulatory protections may include adopting ideas from the UK 'nudge unit' about cost-effective ways of obtaining desired business behaviours such as:
  - showing that most businesses 'do the right thing' with a view to building or maintaining their own reputation.
  - specifying the desired business behaviours.
  - encouraging businesses to commit to desired practices.
  - monitoring regulatory outcomes to help identify what regulatory actions are most effective.

The BCA argues that the full range of policy options should be investigated before costly new legislation is imposed.

Comment on the potential implementation of Option 3

The consultation paper states that Option 3 (a legislative amendment to the existing Unfair Contract Terms provisions in the Australian Consumer Law) reflects the Commonwealth Government's policy commitment.

If the government proceeds with this approach, the BCA is of the view that any legislative proposal to extend the existing UCT protections should:

- be limited to small businesses with unequal bargaining positions, vulnerability and a level of sophistication that is comparable to those of consumers;
- define 'small business' in a clear and transparent manner;
- be limited to only apply to contracts for the supply of goods or services to small business (not acquisition from small business), consistent with the transaction focus of the existing UCT provisions and the Government's policy commitment to extend the benefit of those existing UCT provisions to small business;
- clearly define what is a standard form contract in the context of a business to business transaction, noting that the fact that a contract might take a standard form does not necessarily mean that it is offered on a "take it or leave it" basis;

- clearly identify the types of terms in a standard form contract in the context of a business transaction that would be considered to be 'unfair'; and
- ensure there is no unnecessary duplication or overlap with other legislation or regulation.

It is noted that an extension of the existing UCT protections to contracts for the supply of goods or services to a small business would operate so that a term of a contract for the supply of goods or services to a small business is void if the term is unfair and the contract is a standard form contract. That is, any contract for the supply of goods or services to a small business would be subject to the regime, regardless of whether the supplier is itself a small business.

A specific legislative proposal will need to be developed to enable an adequate cost-benefit assessment and comparison of the different policy options in the final or decision Regulation Impact Statement.

It is essential that the final RIS include an estimate of the additional compliance burdens imposed on contracting businesses that will now need to identify contracts subject to additional protections in order to manage the increased regulatory risks.

"Small business"

The BCA submits that "small business" needs to be defined in a way that ensures that any legislative proposal is limited to small businesses that are in a position which is comparable to that of consumers. This is consistent with the Government's policy commitment and is necessary:

- to ensure that corporations entering into contracts to supply goods or services to small business can clearly identify the businesses and transactions to which the regime applies;
- to ensure that the regime does not apply to businesses that are in a position to review and negotiate supply contracts and obtain legal advice; and
- to maintain the sanctity of contract to the maximum extent possible.

This could be done by:

- excluding public companies and other businesses that are not in a position of unequal bargaining power, vulnerability and level of sophistication that is comparable to that of a consumer; and
- applying an expenditure or transaction value limit, drawing upon the definition of "consumer" in the ACL and similar concepts, such as the Telecommunications Consumer Protections Code, which is limited to annual total expenditure with the contractor of $20,000 (clause 2.1) and applies the Australian Consumer Law definition of 'unfair'. Reflecting the need to ensure businesses are able to determine with certainty which contracts are subject to the regime, any criteria that requires parties to have regard to variables such as transaction value or annual expenditure needs to be accompanied by guidance on how it applies in circumstances where supply arrangements are, for example, not for a fixed term or fixed fee.

"Standard form contract"

The consultation paper proceeds on the basis that many businesses pre-prepare standard form contracts that are presented to customers on a "take it or leave it" basis. However, many businesses may use a standard form contract as a starting point from which key terms are negotiated, which delivers cost savings and convenience. There are also standard form contracts developed by industry bodies and certain provisions that are required to be included in some contracts, for example franchise agreements must comply with the Franchising Code.

The legislative proposal should consider the different types of standard form contracts commonly used in the supply of goods or services to businesses and identify the extent of negotiation that is sufficient for a contract not to be considered to be a standard form contract.

"Unfair terms"

The existing Unfair Contract Terms provisions include a list of terms which may be considered to be unfair. The BCA submits that the legislative proposal should consider whether those examples are appropriate examples of terms that may be unfair in the context of a contract for the supply of goods or services to a small business.

For example, a term which permits a supplier to vary the terms of a contract in a way which does not detrimentally affect the ongoing supply of goods or services (e.g. if there is a corporate re-organisation or change in ownership of the supplier) should not be considered to be unfair, but would fall within the example of a term which "may be unfair" under the existing unfair contract terms provisions.

Avoid unnecessary duplication

Any legislative proposal should avoid costly and unnecessary duplication and overlap with state, territory and other Commonwealth regulation, including:

- state and territory regulation that applies to tenancy leases, as argued by the Shopping Centre Council of Australia in its submission to the Competition Policy Review (SCCA 2014);
- any changes that result from the Harper Review;
- the Franchising Code and the reforms to that Code; and
- industry schemes such as the Telecommunications Consumer Protections Code and various ombudsman schemes.

Assessing 'unfairness' in the context of contracts with small business

If the ACL UCTs regime is extended to apply to relevant contracts with small business, it is important that the ability for a party to justify a condition on the basis that it was reasonably necessary to protect their interests should be retained. Further, consideration should be given to expressly expanding this to allow consideration of commercial interests.

Transitional issues

A sufficient lead time to allow for appropriate transition should be sought (at least 12 months). Ideally, the extension of the regime would only apply to new contracts on and from the commencement of the extension.

If the Government does not exclude existing contracts then a consultation period should apply to allow the parties to re-negotiate the offending clause rather than severing it entirely. Any 'unfair' clause should also be deemed severed from the contract rather than making the contract void.

Conclusion

Before new legislation is introduced, more consideration should be given to:

- clearly identifying the problem to be solved.
- identifying alternative non-legislative methods of giving small business confidence that standard form contracts are fair and reasonable.
- legislative options that exclude publicly listed companies, exclude contracts where legislative protections already exist such as retail tenancy leases, and consider effective arrangements in existing industry codes.

The Consultation RIS provides inadequate information about the problems small businesses are currently facing with standard contract terms, and does not assess benefits and cost of the legislative and non-legislative options, even qualitatively.

The Final RIS should implement the government's red tape reduction commitments by:

- implementing the government's 10 principles for Australian Government Policy Makers.
- identifying offsetting regulatory reductions If the government proceeds with new legislation.

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