Extending Unfair Contract Term Protections to Small Businesses

Submission by the Competition and Consumer Committee of the Business Law Section of the Law Council of Australia

5 August 2014

1. Introduction

The Law Council of Australia is the peak national body representing the legal profession in Australia.

The Competition and Consumer Committee (**Committee**) of the Business Law Section of the Law Council of Australia provides this submission in response to the May 2014 Consultation Paper published by Consumer Affairs Australia and New Zealand: *Extending Unfair Contract Term Protections to Small Businesses* (**Consultation Paper**).

2. Executive Summary

The Committee has concerns about the erosion of the principal of freedom of contract. However, the Committee understands and accepts that the regulation of unfair contract terms (**UCTs**) will be extended to standard form business to business contracts.

That being the case, the Committee is concerned to ensure that the extension of UCT regulation to business contracts is consistent with the government's policy intent of protecting "small business".

Additionally, the Committee believes it is imperative that the government consider how the introduction of UCT regulation will impact on other regulatory reform initiatives which are already underway – in particular, the Harper Review of competition law and policy, and the review of the Franchising Code of Conduct.

Our submission, accordingly, addresses the following issues:

(a) We offer some preliminary remarks regarding the context of the review, and the Committee's concerns to ensure that any change to the regulation of UCTs does not undermine other (ongoing) legislative reform initiatives.

(b) Our submission then addresses issues regarding the defining of 'standard form contract' in any extension of UCT laws to business to business contracts.

(c) We discuss possible descriptions of what might constitute an 'unfair' provision of a standard form contract.

(d) We consider the issue of whether there should be exceptions to the application of the UCT provisions, such as agreements already regulated by industry codes prescribed under section 51AE of the *Competition and Consumer Act 2010* (**CCA**).

(e) Possible means of confining UCT regulation to contracts involving 'small businesses' are discussed, including a suggested definition of 'small business'.

(f) Finally, we consider some specific issues regarding the scope of the application of the new law (responding to some of the specific questions raised in the Consultation Paper).

The Committee would welcome the opportunity to discuss the issues raised in this submission further with The Treasury.

3. Preliminary remarks

The Australian Government has made clear, with the support of the States and Territories, that it wishes to introduce new provisions into appropriate legislation to provide a better and more equitable 'unfair contract regime' for the benefit of the small business sector, in particular. This should result, in the Government's view, in the more appropriate and fairer treatment of relationships between small business operators and other players in the relevant market place.

The Committee notes that the Consultation Paper only seeks comments on the options for implementing the extension of UCT regulation to transactions involving small businesses. Accordingly, it is not the intention of the Committee to present arguments putting forward its views that such an initiative is neither appropriate nor warranted, as it has done in previous submissions to The Treasury.[1] However, the Committee notes that it continues to hold the concerns expressed in those submissions.

There are, however, some critical issues that do need to be addressed in the way in which this policy initiative is being pursued, and how it fits in with other important initiatives that the Government had initiated. This applies also to some initiatives taken by the previous Labour government.

The Committee is concerned that, at the same time as the unfair contract review is taking place, there are on hand at least two other very significant initiatives being pursued by the government affecting very similar areas. Accordingly, co-ordination of policy objectives should be an important area of focus.

The Harper Panel is currently undertaking an important review of competition law and policy. This was announced by the Government as a policy issue that it would take to the election and which it has now commenced. This so-called 'root and branch' review of competition law and policy is one that will provide important opportunities for Australia to update its competition law, and to review competition policies that may have been allowed to lapse. A critical area in the current Harper Panel review is in relation to small business in a number of different ways, including a recognition that there is a concern about the ability of small business enterprises in particular, to be able to negotiate fairer contract arrangements with other parties which may have greater power in the market, or which may for some one reason or another, be able to exact terms which may not be as fair to smaller business enterprises as it is felt reasonable.

The Committee understands that whilst there will be an opportunity for some interaction between the Harper Panel and the Treasury Working Party responsible for pursuing the unfair contract regime initiative, that this may be more limited. It is vital, in the Committee's view, that any legislative changes which result from the UCT consultation do not cut across the recommendations of the Harper Panel or vice versa. If that is an inevitable consequence of the work being undertaken by the Treasury Working Party then there should be a very clear explanation as to why the approach taken may differ from the views of the Harper Panel. Unfortunately, as the Harper Panel will not have its views completed until sometime after the Treasury Working Party is likely to have completed its work there is a risk that the views of the Harper Panel, based on its Issues Paper, a Draft Report due in September / October 2014 and the results of a conference

[1] The Committee has made at least three previous submissions to The Treasury on the topic, dated 25 March 2009, 22 May 2009 and 6 August 2009. Copies are available from the Law Council of Australia's website, at: www.lawcouncil.asn.au

to be held in October 2014, and a Final Report, may not be able to be taken into account in the current Treasury review.

The Committee would strongly recommend that some mechanism be put in place to ensure that the two bodies responsible for these initiatives are able to exchange views, discuss differences in philosophy and approach, and come to a sensible and highest denominator in establishing a regime that may be put in place. Until the Committee is aware of the steps that the Treasury Working Party may take in this regard it is not possible for it to be more specific in its suggestions and recommendations. But it is vital that interaction between the two teams is mapped out in a creative and proactive way.

The third important initiative that is being pursued, and indeed legislation has already been tabled in one respect of it, is the reform of the Franchising Code. Here again, there are some critical issues which impact significantly in the context of the general area of unfair contract arrangements. Whilst the Code is a prescribed code under the CCA, it is not clear whether the unfair contract regime to be introduced will be included in this 'statutory arrangement'.

Vitally, the principles underpinning many issues that are part of the new Franchising Code, which cover a number of issues raised in the context of alleged unfair contracts, should avoid conflict with or contradict initiatives to be taken either in the context of the Harper Panel review, or in the context of the proposed UCT regime.

These are the three main policy initiatives but there are others that are also being announced. The proposed establishment of an Ombudsman in the small business area, and the potential for unnecessary duplication by virtue of the existence of State and Territory organisations already established and working in this area, in the pursuit of appropriate reforms in that context, as well as the vigorous enforcement of legislation that the Committee understands is taking place in this context raise potential conflict scenarios. It is vital that there is consistency in approach to basic principles and solutions, and that there is no opportunity provided for the irregular interaction of different regimes, different approaches and different policies. That will inevitably undo the good work that will clearly be undertaken in establishing an appropriate regime for the area of unfair contracts in business to business arrangements.

Whatever approach is ultimately taken, we suggest that the government commit to a review of how the proposals are working within five years after coming into effect, to ensure any unforseen issues or deficiencies are identified and addresed.

The Committee would be happy to provide further commentary and advice in relation to these matters.

4. Definition of 'standard form contract'

The existence of a ‘standard form contract’ forms the basis of the operation of the current unfair terms regime under the *Australian Consumer Law* (**ACL**). The existence of a standard form contract in which a particular term resides is a threshold issue that must be satisfied before any assessment of the term itself can take place. This approach is different to that of the UK/EU, which applies to *terms which have not been individually negotiated* in contracts concluded between a seller or a supplier and a consumer (rather than considering whether the *contract* is standard form).

The Consultation Paper emphasises concerns about the use by traders of 'take-it-or-leave-it' contracts in their dealings with small business. However, the present UCT regime is not confined to this type of contract. The ACL provides no definition of a 'standard form contract'. Rather, a contract will be presumed to be a 'standard form contract' unless proved otherwise and, in considering whether a contract is standard form, a Court must take into account[2]:

(a) whether one of the parties has all or most of the bargaining power relating to the transaction;

(b) whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties;

(c) whether another party was, in effect, required either to accept or reject the terms of the contract (other than the terms … [which define the main subject matter of consumer contracts]... in the form in which they were presented;

(d) whether another party was given an effective opportunity to negotiate the terms of the contract that were not the terms… [which define the main subject matter of consumer contracts]...;

(e) whether the terms of the contract (other than the terms...[which define the main subject matter of consumer contracts]... take into account the specific characteristics of another party or the particular transaction;

…

This approach to determining the existence of a standard form contract extends the regime beyond 'take it or leave it' contracts to arrangements that are not necessarily devoid of any negotiation between the parties. Moreover, in the Committee's experience, the factors set out in the ACL do not necessarily foreshadow unfair practices in a business-to-business context. For example, it is as common for one party to a transaction to prepare a contract prior to discussions (particularly in the move to online contracting) or annex a copy of a contract to a tender request, as it is for another party to only allow the other a very limited window of time to consider their terms. These practices are a necessary corollary of achieving speed, responsiveness, convenience and cost savings in contracting methodologies and reflective of the realities of modern contracting.

Whilst it is arguable that the current approach to the existence of a standard form contract should be maintained for consistency with the existing UCT regime, the present regime is not without practical issues of interpretation and ambiguity. For example, under the present regime it is unclear whether, in order for an agreement to fall outside of the scope of a standard form contract:

- only some terms of the contract need to be negotiated;
- the majority of the terms of the contract need to be negotiated;
- the substantive terms of the contract need to be negotiated; or
- those terms that are important to the business in question need to be negotiated.

Further, it is not clear whether it is intended that standard form contracts developed by industry bodies and trade associations for use in business to business transactions will be the subject of UCT review. The Committee considers that the current approach to

[2] Section 27(2) of Part 2-3 of the ACL.

the question of standard form contracts leaves such contracts open to challenge when used by small business. In many cases, these types of 'standard form' agreement are the result of consultation between key stakeholders in an industry and are not the 'standard forms' of one party to an arrangement. The Committee's view is that the different types of standard form contracts commonly used in business to business transactions should be considered by the Government before extending the application of these laws to small business contracts.

If the Government elects to retain the current ACL criteria in the small business context, the Committee considers it would also be helpful to provide legislative guidance on issues such as what degree and type of negotiation is sufficient for a contract to no longer be considered a standard form contract.

5. Descriptions of what might constitute an 'unfair' provision of a standard form contract

The Committee considers that the existing definition of unfairness and the relevant matters that a Court may take into account in determining whether a term is unfair in section 24 should equally apply in the context of small business contracts, in order to maintain consistency with the current UCT regime.

However, the Committee notes the following matters which it considers the Government should take into account when determining any proposed examples of unfair terms, and what may constitutes 'unfairness', for the purpose of small business contracts:

5.1 Risk assumption and price

The ACCC's UCT and small business complaints data from the period of 1 Jan 2011 - 25 November 2013 (included on page 17 of the Consultation Paper) indicates that just two percent (19 of the 894) of complaints received during this period related to unfairly assigning risk (i.e. contracts that place unfair requirements on the small business for things outside of their control, for example, payment for damage by a third party to equipment). This was the smallest category of complaint received by the ACCC outside of franchising related issues.

Notwithstanding this data, the Consultation Paper emphasises as a key policy aspiration of the extension of the UCT regime to small business the following objective:

> *Small business customers interacting with other businesses through standard form contracts should have confidence that the contract they have entered into is fair and reasonable and that **risks are allocated efficiently.** (Consultation Paper, page 20. Our emphasis.)*

Whilst the Committee recognises that fulsome empirical research may not yet have been undertaken by the Government on the extent and impact of UCTs in small business contracts, the Committee nevertheless considers that this data may also be indicative of the fact that, in many cases, small business knowingly trade off the risk inherent in more onerous contract terms in return for compensation in the form of a lower price for goods or services. In the Committee's view, the price of a deal struck between parties goes to the heart of an assessment of the fairness of such a bargain. In this way, the Committee considers that particularly in the context of small business contracts, a court should be explicitly required (as is not the case under the present

regime) to consider all the relevant circumstances outside the contract, including the upfront price payable under the contract, in determining whether a contract term is unfair. Such a consideration would more accurately reflect the commercial realities of contracting.

5.2 Unfairness and detriment

Under the current UCT regime, a claimant (or regulator) does not need to show proof of actual detriment being suffered – it is enough that the term 'would cause' detriment 'if applied or relied upon'. Moreover, detriment need not be financial detriment – as such, mere inconvenience, for example, may suffice.

Putting aside questions of how to assess non-financial detriment, the Committee considers this threshold is too low in the context of business to business transactions and is likely to manifest in a raft of frivolous and trivial claims, leading to undue pressure on an already strained court system.

The Committee considers that in the context of small business a higher threshold should be imposed, and that only financial detriment (and not non-financial detriment) be contained as a limb of the definition of an unfair term.

5.3 Legitimate interests

The present unfair terms regime includes a concept of 'legitimate interests' (being the requirement that a term is not 'reasonably necessary…to protect the legitimate interests of the party who would be advantaged by the term'[3], which is not an element of other unfair terms regime such as the Victorian regime under the *Fair Trading Act* and the UK regime under the *Unfair Terms in Consumer Contracts Regulations 1999* (UK). Accordingly, there is continued uncertainty as to how a Court (or regulator) will approach and interpret this term. There have also been inconsistent statements made by the Government in expressing what this element means.

If the existing UCT regime is to be extended to small business contracts, the Committee considers that the Government should provide greater guidance to parties on the intended application and interpretation of 'legitimate interests.'

5.4 Examples of unfair terms

Whilst the Committee recognises the desire for guidance as to the types of terms that may be 'unfair,' in the Committee's view, the list of terms in section 25 of the ACL are not, strictly speaking, examples of 'unfair' terms. Rather, they are more properly described as examples of terms which *may* satisfy section 24(1) of the ACL (being the definition of an unfair term).

Whether or not they are in fact 'unfair' needs to be determined, amongst other things, by reference to the other factors described in section 24 (i.e. whether they are reasonably necessary to protect the legitimate interests of the party advantaged by the term and whether the term causes detriment if relied upon), something which section 25 of the ACL fails to disclose. The Committee is concerned that if this section is extended to small business contracts (without adequate explanation and guidance), undue emphasis will be placed on these 'examples' laying the path for undue regulatory interference and potential error.

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[3] Section 24(1)(b) of the ACL.

The Committee also notes the imprecise drafting of certain of the examples in section 25 of the ACL. For instance, the Explanatory Memorandum to the ACL indicates that section 25(1)(c) which states that a term may be unfair if it *'penalises, or has the effect of penalising, one party (but not the other party) for a breach or termination of the contract'* was intended to capture the concept of the 'law of penalties.' The term 'penalise' in this subsection is not limited to legal penalties, however, and contemplates that it may be unfair for any contract term to provide for consequences which flow from its termination.

5.5 Certain 'examples' of unfair terms are inappropriate for small business contracts

Similarly, the Committee considers that a number of the 'examples of unfair terms' outlined in section 25 of the ACL are not appropriate in the context of business to small business contracts.

In the Committee's view, there is real risk in enshrining in legislation, a list of likely 'unfair' terms, where these provisions are not adequately nuanced, nor tested against commercial reality.

The Committee has a particular concern about the following examples which are currently provided (in the context of standard form consumer contracts) as the kinds of terms *'that may be unfair'*:

(a) Limitation of liability clauses

Section 25 (1)(k) of the ACL indicates that a term *'that limits, or has the effect of limiting, one party's right to sue another party'* may be unfair.

As presently drafted, this suggests that, except where there is an express legislative prescription to do so (given the carve out in section 26(1)(c), which would permit such a clause if required or expressly permitted by law), suppliers may be required to accept unlimited liability in some circumstances. For a number of companies, this would require a complete reworking of their insurance arrangements.

(b) Entire agreement / no reliance on representations not set out in the agreement clauses

Section 25(1)(l) of the ACL indicates that a term *'that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract'* may be unfair.

'Entire agreement' clauses are likely to be captured by this description. However, entire agreement clauses are commonplace in business transactions and deliver benefit to both parties to the bargain. They provide certainty for both the trader and the small business customer that materials outside the agreement will not be sought to be incorporated into the contract.

(c) Termination clauses and unilateral variation

Section 25(1)(b) of the ACL indicates that a term *'permits, or has the effect of permitting, one party (but not another party) to terminate the contract'* may be unfair.

Again, there are good reasons why a supplier of goods or services would seek to include a termination clause in their standard agreements without the need for an equivalent termination right for the customer. Take for example, a scenario where the supplier is unable to continue to provide the goods or services to the small business customer, because, for instance, they no longer hold a licence to do so, or are reliant on a third party contractor to provide part of the works and this arrangement falls through. Most companies would provide reasonable notice to customers where such a right to terminate was to be exercised to allow customers to find alternate providers.

The Committee considers that asymmetrical termination rights in small business contracts are not necessarily a sign of unfairness and considers the application of section 25(b) of the ACL to the business context should be properly tested by the Government as to whether it is necessary. The Committee also refers to existing state and territory legislation such as the *Retail Leases Act 1994* (NSW), which, in addition to imposing obligations for landlords and prohibiting unconscionable conduct, provides protection to vulnerable small business entering retail tenancies in relation to termination by a landlord, such as imposing a minimum lease term.

In the franchise context, protections are also enshrined in the Franchising Code of Conduct, which sets out procedural obligations where a franchisor terminates in the absence of a contractual breach by the franchisee and specifies that certain dispute mechanisms apply in these circumstances.[4]

The same is true for unilateral variation rights, which are currently captured by **section 25 (d) of the ACL**. Many companies reserve for themselves a degree of contractual flexibility (i.e. the right to vary the underlying technology for the provision of services, or the right to switch sub-contractors who provide part of the services during the term of an agreement, subject to standards of quality for example), which allows them in many cases to charge less for their goods and services. Such unilateral variation clauses are also commercially justified in circumstances where the term of the contract spans over a number of years, or conditions affecting the ability to supply the goods or services are volatile.

Currently, section 25 of the ACL sets up a paradigm whereby if a consumer does not have an equivalent variation right, there is risk that a clause which gives a supplier a right to vary the terms of an agreement will be deemed unfair. In the context of a supply contract with a small business, it is difficult to see how a properly drafted, albeit unilateral, variation right would be unfair, solely by virtue of the fact that the customer did not have a similar right to vary the agreement (and in all likelihood a customer would not require such a right). Accordingly, in the Committee's view mandating such balancing of rights does not properly address substantive unfairness in a meaningful way, particularly in a business to business arrangement.

(d) Automatic renewal/right to exercise extension of a term

Section 25(1)(e) of the ACL indicates that a term *'that permits, or has the effect of permitting, one party (but not the other party) to renew or not renew the contract'* may be unfair.

[4] Franchising Code of Conduct, section 22.

The ACCC complaints data previously referred to in section 5.1 of this submission indicates the highest level of dissatisfaction in relation to clauses which permit automatic rollover (whereby the contract automatically rolls over for excessive periods for example five years or more).

Firstly, there are many instances where the roll-over of a contract will be beneficial to a small business consumer, particular in the case of essential services, such as telecommunications, electricity and gas services for example, as this allows for continuity of services, where the customer is out of town, is not aware, or has forgotten the contract has come to an end, and services would otherwise be cut-off.

Secondly, the current wording of section 25(1)(e) uses an overly simplistic requirement for reciprocal rights, which does not adequately capture the risk of substantive unfairness, nor does it address the aforementioned dissatisfaction experienced by small business.

6. Code Regulated Agreements and other exceptions

As outlined in section 8 of this submission, the Committee generally considers that it is undesirable to exempt specific groups from the application of particular provisions of the ACL. Such exemptions have the tendency to create anomalies and uncertainty.

Nonetheless, there is one category of exception in respect of which the Committee believes there is a compelling case for a specific exemption, being industry codes which are prescribed under section 51AE of the CCA.

6.1 The Prescribed Codes

Currently, there are four industry codes prescribed under section 51AE of the CCA. The Unit Pricing Code is narrow in its focus, and relates to dealings between grocery suppliers and consumers, as opposed to dealings between businesses that might be affected by the proposed extension of UCT regulation to business contracts. The other prescribed codes are the:

(a) Franchising Code of Conduct;

(b) Oil Code; and

(c) Horticulture Code of Conduct,

(together, the **Prescribed Codes**).

Each of the Prescribed Codes prescribes norms of conduct applicable to dealings between parties to agreements in the affected industries. In particular:

(a) the Franchising Code regulates the conduct of parties to a "franchise agreement" (as defined under section 4 of the Code);

(b) the Oil Code regulates the conduct of parties to a "fuel re-selling agreement" (as defined under section 5 of the Code); and

(c) the Horticulture Code regulates the conduct of traders and growers, including by imposing requirements for the trader to prepare and publish particular terms of trade, and regulating the conduct of parties to a "horticultural produce agreement".

While each of the Prescribed Codes is stated to be for the purpose of regulating "conduct" between participants in the applicable industries, what they in fact regulate is the dealings between parties to specified contracts. For example, the Franchising Code and the Oil Code each stipulate requirements or restrictions on the terms of (respectively) franchise agreements and fuel re-selling agreements in relation to conditions affecting assignment, termination, dispute resolution, limitations of liability and the conduct of marketing or cooperative funds; the Horticulture Code stipulates specific requirements for the terms of trade offered by traders and the provisions of horticulture produce agreements.

6.2 Review of the Franchising Code of Conduct

The Franchising Code of Conduct is the subject of a current (and ongoing) review, which is expected to result in specific amendments taking effect from 1 January 2015 (**Code Review**). The Code Review commenced on 4 January 2013, with a report prepared by Mr Alan Wein presented to Government on 30 April 2013 (**Wein Report**).

The Wein Report recommended (amongst other things) the introduction of a specific statutory duty to parties to a franchise agreement, to deal with one another in good faith. In doing so, the Wein Report specifically noted that it had considered alternatives to such a duty, including the potential introduction of UCT regulation:

> *In addition, there are other potential reforms that could be introduced which, similarly to an obligation to act in good faith, may introduce 'elasticity' into contract law with regard to long-term relational contracts such as franchise agreements. It is sufficient to note that there has been debate about whether the unfair contracts protections for individual consumers under the ACL, or for independent contractors, should also be extended to business to business dealings. Some submissions supported such an approach, others did not.*[5]

While the Wein Report clearly considered the potential extension of UCT regulation to the terms of franchise agreements, it did not recommend such reform. Rather, the Wein Report recommended the introduction of a new duty of good faith into the Franchising Code. This recommendation has since been accepted by the government, has indicated that an obligation for the parties to franchise agreements to deal with each other in good faith will be introduced to the Franchising Code.

The Consultation Paper, in considering the Prescribed Codes, observed:

> *The focus of these codes is largely on unfair contracting practices that have been identified as particularly problematic in the sector and not on unfair contract terms. Where there is a focus on unfair contract terms they relate to narrow circumstances and therefore the codes may not provide effective safeguards against unfair terms more broadly.*[6]

In the context of the Wein Report, however, the Committee does not agree with this observation. While a duty of good faith (as recommended by the Wein Report) undoubtedly regulates behaviours rather than contractual terms, the Committee believes that it would be a mistake to dismiss the relevance of the Wein Report when considering if UCT regulation should be extended to the franchising sector.

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[5] Mr Alan Wein, *Review of the Franchising Code of Conduct*, 30 April 2013, at 81.

[6] Consultation Paper, at para 80.

The Committee considers that the better view of the Wein Report is that it demonstrates that where there are industries in which specific regulation is deemed necessary to redress an imbalance of bargaining power, this is best dealt with by industry-specific regulation. Such regulation can then be tailored and targeted to the specifics and realities of those commercial arrangements.

6.3 Existing protection against UCTs in the Prescribed Codes

The terms of the Prescribed Codes provides further basis for concluding that the application of UCT regulation to these industries is not warranted.

In outlining the case for reform, the Consultation Paper states:

> *For consumers, at least, there is evidence that they often do not read standard form contracts. Those consumers that do read standard form contracts may not understand or value fully the nature of all terms, and if they decide that they do not like the terms on offer they may find there to be minimal or no scope to negotiate changes.*
>
> *Small businesses may experience similar situations and behaviours. Large businesses may present them with standard form contracts and, like consumers* ***they may lack the time and legal or technical expertise to critically analyse these contracts****, and the power to negotiate. In some circumstances these standard form contracts may be used to further enhance or embed the commercial advantage or dominance of the other party well beyond reasonable legitimate commercial interests.*
>
> *The result may be that* ***the party offering the standard form contract has better knowledge about its terms and conditions than the small business*** *and so may include terms that advantage itself, at the expense of the small business.*
>
> (emphasis added)

What these considerations suggest, is that one of the key drivers for the present reform is the concern that many small businesses may not understand the terms of standard form contracts that they are presented with, and may not have the time or resources to critically analyse those terms.

Such considerations simply cannot be relevant to agreements regulated by the Prescribed Codes, due to the specific requirements that they already impose. In particular:

(a) section 11 of the Franchising Code requires that a prospective franchisee obtains independent legal, business and accounting advice regarding a proposed franchise agreement before it is entered into;

(b) section 20 of the Oil Code requires that a prospective retailer obtains independent legal, business, accounting and industry association advice regarding a proposed fuel re-selling agreement before it is entered into; and

(c) section 8 of the Horticulture Code requires that a prospective grower obtains independent legal advice regarding a proposed horticulture produce agreement before it is entered into.

6.4 The problem of over-regulation

For the reasons outlined, the Committee considers that there is no basis for extending UCT regulation to agreements already regulated under the Prescribed Codes. Additionally, however, the Committee is concerned that the extension of UCT regulation to such agreements will create uncertainty and increased costs for the affected industries.

Legislation such as the *Motor Dealers and Repairers Act 2013 (NSW)*, which introduced the application of unfair terms provisions in relation to motor vehicle supply contracts, illustrates the difficulties that will inevitably arise if multiple layers of regulation are imposed on specific industries. The Act was intended to cut red tape in that industry, but has instead been the subject of widespread criticism as unnecessary regulation in light of existing Franchising Code obligations regarding franchise agreement terms and disclosure requirements.

In the case of the Franchising Code, within the next six months franchisors will likely need to amend the terms of standard form franchise agreements in order to comply with the forthcoming amendments to the Franchising Code. Given that the outcome of the present UCT review will not yet be known at that time, an extension of UCT regulation to franchise agreements would then likely require a further round of compliance review and agreement amendments.

7. Confining business to business UCT regulation to contracts involving 'small businesses'

The Committee believes that one of the most important clarifications to make before extending the UCT regime under the ACL is to define the extent of its operation. While the Committee understands that the concept is to extend the regime to cover standard terms contracts entered into by small business, there is really no clarity over what is a 'small business'. Without appropriately defining 'small business', there is no way that the Federal Government, or the ACCC, will be able to govern the extent of the UCT regime.

7.1 Why define 'small business'?

While the Committee supports the extension of the UCT regime, it does not support extension beyond the required ambit. The Committee believes that the required ambit of the extension should be to protect unsophisticated counterparties to contracts who suffer from an imbalance of size, negotiating power or legal understanding and advice.

This is a very difficult concept to measure.

What the UCT regime should not be extended to cover is sophisticated companies, or those that are otherwise able to control the negotiating power. This should not be an inequitable extension of the terms of the regime: it is important to find an appropriate definition that draws a clear line between those businesses that have a full understanding of contractual relations and are merely trying to use the UCT regime to extract themselves from contracts that they now find unfavourable, and those businesses that simply do not have any more legal understanding or comprehension than the standard consumer.

Further, the Committee does not believe that the extension of the UCT regime should be used as a shield by businesses who should otherwise seek legal advice or enter

contracts with their eyes open to the risks of the contract. This is not a regime that should protect the unwise or those ignorant to the law, but should rather directly address a clear imbalance in the negotiating power of parties.

7.2 Characteristics of existing definitions of 'small business'

The Committee notes that there are already a number of legislative definitions for the term 'small business'. The majority of these focus around three key variables. These are:

(a) the number of employees of the business in question;

(b) the value of the assets held by the business in question; and

(c) the annual profit or turnover of the business in question.

With all of the existing definitions of small business, it is the context and the mischief that the legislation is seeking to prevent that drives the various aspects of the definition. As such, this submission considers all the definitions independently in order to attempt to provide some guidance for defining 'small business' in an ACL sense.

7.3 Definition by employees

Small business is a frequently used classification in relation to tax acts. In most instances, this is in order to relieve the burden on smaller businesses with lower turnovers.

Since April 2014, the ATO has offered some services to small businesses only. The service allows small businesses to pay super contributions for their employees in one transaction to a single location. This reduces the burden and transactional complexity placed on small businesses, and could assist where small businesses lack the legal advice or understanding to process complex tax transactions. To access these services, the ATO has defined 'small business' as **any business with 19 employees or less**.

Another definition which applies distinctions based on employees is the definition of small business in s 23 of the *Fair Work Act 2009* (Cth). Under that definition, a small business is one with **fewer than 15 employees**.

While not under legislation, the Australian Bureau of Statistics has informally adopted a definition of small business for its data collection and management. The ABS considers any business which **employees fewer than 20 people** will be a small business. The ABS also characterises these businesses as typically:

(a) independently owned and operated;

(b) owner-managed, and the owner is also usually the primary decision maker; and

(c) where the owner contributes and owns all or most of the firm's operating capital.

Unfortunately, for the purposes of the UCT regime, the Committee considers that these classifications are extremely arbitrary and create far too much uncertainty to the definition of small business, and subsequently the scope of the UCT regime itself. These definitions require contracting parties to be fully aware of the number of employees of their counterpart.

7.4 Definition by asset value or gross turnover

A different definition applied by the ATO is under s 328-110 of the *Income Tax Assessment Act 1997* (Cth), where small business is defined for the purposes of capital gains relief under s 152-5. In that instance, the business must have a **total asset value less than $6 million** and an **annual turnover of less than $2 million**. This helps with reducing the financial burden placed on a small company, but does not necessarily correlate with the legal understanding or contracting power of the company. If a similar definition was applied under the UCT regime, the result would be some relatively large companies (possibly with expert legal advisers) making use of the protections afforded under the ACL, and possibly to the detriment of truly disadvantaged companies.

A further complication of an asset and turnover based definition is the need to determine how those values are measured and how the other contracting party is informed. For example, does a company have to be aware that it is a 'small business' for the purpose of the ACL (implying some legal understanding) and notify the larger party that the transaction will be subject to the UCT regime or lose the protection of the ACL. Otherwise, it would seem to be the task of the larger contracting party to attempt to identify whether the company that it is contracting with is a small business and to be actively aware of the operation of the UCT regime, which would surely place too onerous a burden on the larger company (especially as standard terms contracts are designed to be rolled out frequently and without significant thought to the specific terms of each individual contract). Also, with some creative accounting within a business unit or group of companies, an asset or turnover based definition could easily be abused by larger companies in many instances.

The final tax definition considered in this submission is that of State payroll tax. Again, this definition is based off employees, but is directly linked to the annual wages bill of the company: in NSW and Western Australia the threshold is an annual wages bill of $750,000, whereas in Victoria the threshold is only $550,000. Again, this would appear to be a particularly onerous, if not impossible, task to place on a larger contracting party to ensure that it researches and understands the payroll bill of its counterpart (and in some circumstances, surely impossible to determine). Further, it also has the detriment that it detracts from the ease of use and benefits associated with a standard terms contract, as the research increases costs and legal time, potentially a cost that will be passed through to the smaller contracting party (and ultimately to consumers) if it is required of the larger.

7.5 Considerations of transparency in defining 'small business'

One of the difficulties in defining 'small business' is that criteria which are used in other contexts (such as the business' annual turnover or number of employees) are not readily apparent to the party with which the business is contracting. As such, it may be difficult for the party to assess whether the business is afforded the UCT protections.

The difficulty with available transparent criteria (such as transaction value or more crude distinctions such as whether the business is a publicly listed company), is that they are likely to miss the purpose (which underpins the UCT regime) of protecting small businesses that do not have the funds or legal education to be aware of adequate remedies or protect themselves from imbalances in negotiating power.

Thus, against the need for certainty, it is necessary to balance the need to ensure that the UCT protections are properly limited to those vulnerable small businesses in respect of whom the policy intent of the reform is directed. This is necessary:

(a) to ensure that only the appropriate businesses receive the UCT protection;

(b) to ensure that the important principal of freedom of contract is not eroded more than is necessary in order to meet that policy objective; and

(c) to prevent large businesses from using the UCT provisions to invalidate standard terms provided to them by small businesses (which would, of course, be to the detriment of the small businesses that the UCT regulation is designed to protect.

To illustrate the difficulty in finding an appropriate definition of 'small business', we have overviewed the three possible approaches that might be taken to this problem below. A preferred definition which seeks to balance the need for transparency with the underlying objectives is then proposed.

(a) Approach 1 : adopt a definition of 'small business' which is completely transparent

If one was available, the Committee's preference would be to adopt a definition of 'small business' that is completely transparent, such that a party contracting with that business can easily ascertain whether it is a 'small business'.

The Committee understands that it was on this basis that the Consultation Paper suggested the possibility of defining 'small business' as any business which is not a listed public company. Such a definition would have the advantage of being completely transparent. However, it would also be an extremely broad definition that would include most businesses operating in Australia (including many very large businesses). As such, the Committee does not support a definition in those terms.

The Committee has been unable to identify an alternative definition which is completely transparent having regard to the current level of information which is publicly available about businesses operating in Australia.

(b) Approach 2 : adopt a definition which is not based on inherently transparent criteria, but which requires small businesses to 'opt in' to the protection in order to ensure transparency

A second possibility is to adopt a definition based on criteria including non-transparent elements (such as the business' annual turnover, asset value and number of employees) but include an 'opt in' mechanism. Such a mechanism might require a party who meets the criteria to be a 'small business' to inform the party that they are contracting with that they are a 'small business' in order to obtain the benefit of the provisions.

This approach has some instinctive appeal, because it would confine the category of businesses to which the UCT protections were available to the appropriate category of businesses, while still ensuring that parties contracting with those businesses were aware that the UCT protections were applicable.

The difficulty with this approach, however, is that it would likely deprive many small businesses from obtaining the UCT protections. In particular:

(i) small businesses may be unaware of the need to 'opt in'; or

(ii) small businesses may feel that opting in puts them at a competitive disadvantage, and thus feel pressured not to do so.

On balance, the Committee is therefore not in favour of an 'opt in' mechanism, notwithstanding the resulting lack of transparency as to the circumstances where the UCT provisions will apply.

(c) Approach 3 : adopt a definition which captures the essence of the 'small businesses' who are to sought to be protected, but which is not transparent

Given that an appropriately confined definition of 'small business' which is also transparent is not available, the third alternative is to adopt a definition which captures what is in essence a 'small business', notwithstanding that the definition is not entirely transparent.

In essence, this will be a combination of:

(i) the transparent criteria referred to above in paragraph (a); and

(ii) a mix of non-transparent criteria (such as those referred to in paragraph (b)), sufficient to ensure that the policy intent of protecting small and vulnerable businesses is not exceeded or undermined.

The difficulty with this kind of definition is that a business may not know if they are dealing with a small business or not at the time a contract is entered into. However, this is a shortcoming which cannot be overcome, and must still be balanced with the need to prevent overregulation or the potential for UCT regulations to be used by 'big business' to the detriment of (truly) small businesses.

The Committee also considers that there is minimal risk of harm from the lack of transparency of these few criteria because:

(i) in the case of small transactions, businesses will likely assume that they are dealing with a 'small business' as a matter of efficacy and risk management;

(ii) in the case of larger or more significant transactions, businesses will likely seek to verify whether they are dealing with a 'small business' (and thus need to comply with the UCT provisions) by undertaking appropriate due diligence; and

(iii) in any event, businesses can manage the risk of a lack of transparency by incorporating into their standard form contracts more onerous provisions which apply only to contract parties who are not 'small businesses'.

Importantly, it should be remembered that the UCT provisions will typically be invoked at the time that a party seeks to enforce a right (in the context of a dispute). The priority should therefore be to appropriately confine the circumstances in which a business is entitled to rely on the UCT provisions (at which time the business can assess whether or not it is a 'small business' to which the provisions are available). This will ensure that when a 'big business' is assessing how to proceed in a contractual dispute, it will be prevented from availing itself of the UCT regulations.

7.6 The definition proposed by the Committee

Taking these issues outlined in section 7.5 into account, the Committee believes that the most appropriate definition to apply is one based on a combination of the following elements:

(a) Transaction value

A transaction value allows all businesses to understand the one factor that applies to engage the operation of the UCT regime, rather than relying on small businesses to notify the other contracting party of their status, or requiring all contracting parties to request further information from their counterparts in order to determine whether the UCT regime applies.

The Committee recommends that the appropriate transaction threshold for a small business to be covered under the UCT regime is slightly more than the existing $40,000, and should be closer to a $100,000 threshold.

The Committee believes this to be appropriate as the majority of standard form contracts (which the operation of the UCT regime for small business will be limited to) are generally for transactions which occur frequently, don't require parties to give extensive thought to negotiating every term of the contract and are for a lower dollar value. The Committee believes that a higher threshold will require companies to consider the operation of the UCT regime for transactions where companies should really be receiving independent legal advice rather than relying on the operation of the UCT regime to protect them and their rights.

(b) Business contracts

The Committee submits that the UCT regime extension to small businesses should apply wherever there is a 'business contract'.

Essentially, this would mirror the existing definition of a 'consumer contract', and would ensure that the UCT regime would apply wherever there is a *'contract for the supply or acquisition of goods or services for business use where the amount paid or payable for the goods or services does not exceed $100,000*[7]*'*.

This will ensure that the small business extension is as similar as possible to the existing consumer provisions, relying on existing interpretation by the courts as much as possible.

(c) Excluded corporations

The Committee submits that UCT protection should not be available in instances where the business supplying or acquiring the goods or services:

(i) is a publicly listed company;

(ii) is a business carried on by an authority of the Commonwealth, a State or Territory; or

(iii) is related to another corporation which, either individually or in conjunction with the business in question, meet any of the tests above (this is necessary to avoid small subsidiaries of larger corporate groups, and should use 'related' rather than an idea of 'control' as considered in

[7] The Committee notes that if a specific dollar figure is included in this way it will also be necessary to replicate the provisions set out in the definition of 'consumer' contained in section 3(4) – (9) of the ACL, in order to account for goods or services purchased by mixed supply.

Corporations Act 2001 (Cth) so that large corporations are not unduly protected by the UCT regime and take proper interest in their relevant subsidiaries).

We note that these criteria are all easily ascertainable by reference to public records.

(d) Qualitative criteria

The Committee submits that the final step should be that the UCT regime will be deemed not to apply in instances where the business supplying or acquiring the goods or services:

(i) has a turnover of $2 million or more for the full financial year preceding the relevant acquisition of goods or services (this is similar to the gross turnover test applied by the ATO under the *Income Tax Assessment Act 1997* (Cth));

(ii) holds, or its related bodies corporate hold, a total asset value greater than $6 million at the time when the transaction settles (again similar to the deeming restriction applied by the ATO); or

(iii) employs 15 or more persons (this is a middle ground to the number of employees required to be considered a small business under a number of Acts, and is similar to the definition applied under the *Fair Work Act 2009* (Cth)).

We note that these criteria are all easily ascertainable by a business seeking to determine if it is eligible for the UCT protection (or to verify to its counterpart that it is a 'small business'). As such, any 'red tape' burden that the criteria might result in is minimal.

Conversely, these criteria are not transparent to a party with which the business is contracting. For the reasons outlined in 7.5(c) of this submission, however, the Committee considers that their inclusion is warranted in order to properly confine the scope of the UCT regulation, and to limit the potential for the provisions to be relied on by 'big businesses' to the detriment of the (truly) small businesses that the provisions are designed to protect.

8. Scope of the application of the new law

The Committee provides the following comment on some of the specific questions raised in the Consultation Paper:

8.1 Should the extension of the UCT provisions apply to contracts involving the supply or acquisition of goods or services, or only contracts involving the acquisition of goods or services by a small business? (however defined)

It is the view of the Committee that the extension of the UCT provisions should apply to contracts involving either the supply of goods or services by a small business, or acquisition of goods or services by a small business.

8.2 Should the extension of the UCT provisions apply to contracts between two small businesses, or just contracts where only one party is a small business (however defined)?

The Committee is concerned that, depending on the way in which 'small business' is defined, it may not be appropriate for the extended UCT provisions to apply to contracts between two small businesses.

If the definition of 'small business' that is ultimately adopted is too broad, such that it will in fact include very large businesses who do not need the protection afforded by the UCT regime, it may create a situation where small businesses are in fact disadvantaged. Such large businesses in that situation may be able to challenge the enforceability of a standard form contract presented to them by a (truly) small business. This would undermine the policy objectives of the proposed reforms.

The existing definition of 'unfair' contained in section 24 of the ACL requires that there be a 'significant imbalance' between the parties, but this only refers to whether the *particular term* of the contract creates a significant imbalance. The question of balance between the parties themselves is not a relevant factor to be considered.

While the Committee favours an approach that does not include any exceptions to the application of the UCT provisions, this needs to be balanced against the policy objectives of the reform.

This reinforces the Committee's view that it is essential for the definition of 'small business' to be appropriately confined.

8.3 Should the extension of the UCT provisions also cover financial products and services provided to small business so that the ASIC Act provisions remain consistent with equivalent ACL provisions, or should the ASIC Act provisions continue to apply only to standard form consumer contracts?

With the exception of agreements regulated by Prescribed Codes (for the reasons discussed in section 6 of this submission), the UCT law should apply across all sectors.

The Committee is firmly against laws that apply only to some industry sectors. The ASIC Act provisions should be the same as the ACL. The ACCC/ASIC carve outs already cause anomalies as many contracts are a mix of goods and financial services to have different standards for some of the same contract is to be avoided.

8.4 Should contracts prescribed by law or contracts that mirror a mandatory Code be excluded?

There should be no additional exclusions but contracts prescribed by law or mirroring a mandatory code should be a defence.

The Committee notes that there are existing exclusions applicable to 'consumer contracts' under the ACL (in particular, in section 26 and 28 of the ACL). These exclusions should continue to apply, and should also apply to any extension of the UCT provisions applicable to small business.

8.5 Should any particular types of contracts be excluded?

With the exception of agreements regulated by Prescribed Codes (for the reasons discussed in section 6 of this submission), the Committee is of the view that there

should be no exclusions. This would lead to uncertainty and confusion. The definition of who is covered and what amounts to unfair will exclude agreements that do not warrant intervention.

There may be an argument that contracts involving supply to or acquisition by government agencies should be excluded, the Committee would not favour that. If unfair contracts terms are to be prohibited government agencies should follow such laws.

9. Further contact

The Committee would be pleased to discuss any of the matters outlined in this submission further should it be desired. Please contact Michael Corrigan of Clayton Utz on (02) 9353 4187 or by email mcorrigan@claytonutz.com or Josh Simons of Thomson Geer on (08) 8236 1122 or by email jsimons@tglaw.com.au to facilitate further discussions.