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Unfair Contract Terms Consultation Paper
Small Business, Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Submitted via the consultations page of the Australian Treasury website

Dear Sir/Madam,

SUBMISSION TO CONSULTATION PAPER ON EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESSES

M+K Lawyers acts for hundreds of manufacturers, suppliers and service providers of all sizes in Australia, but predominately in the mid-size market ($5-$500 million turnover).

We also act frequently in relation to consumer disputes under the current "unfair terms" regime. We are constantly called to act in preparing, advising on and resolving disputes based on business standard Terms and Conditions of Trade, and the like.

As such, we consider that we are well positioned to comment on some pertinent questions posed in the consultation paper: 'Extending Unfair Contract Term Protections to Small Businesses.'

Executive Summary

We submit that the Commonwealth Government should re-evaluate its commitment to extending unfair contract term provisions for standard form contracts to small businesses for the reasons explained in detail attached.

In our view, "Option 2 – Light Touch Non-Regulatory Approach" would be the most effective and appropriate strategy to adopt. Undoubtedly, small businesses need to be aware of their rights and obligations under contracts. Being in business, it is our experience that most business people appreciate the importance and consequences of signing contracts, but some do need to be reminded of, or at least be educated about, the ability to question, negotiate or change the terms offered.

The key reasons behind our opinion are:

1. All businesses need certainty. We expect that the "unfair terms" regime – if extended as proposed - will cause a large increase in disputes between businesses.

2. A change to law will increase the compliance costs of doing business, as will the ongoing compliance costs if standard terms need to be more fully explained, negotiated or changed.

3. In recent years, the burden on businesses arising from legislative change has been significant, including changes resulting from:

   (a) the amendment of the *Competition and Consumer Act* 2010 (Cth);

   (b) the implementation of the *Personal Property Securities Act* 2009 (Cth) (including many resultant PPS Registration costs); and

   (c) the amendment of the *Privacy Act* 1988 (Cth) and the associated Credit Reporting regime.

4. Smaller businesses (that may be covered by the new proposed unfair terms regulation) may experience supply discrimination as a result of efforts to avoid the proposed new regulatory regime.

We acknowledge there may be some specific industries where significant imbalance in bargaining power is systemic, and unfair contractual terms may exist (eg. the automotive, franchising, telecommunications and utilities supply sectors). However, it is our view that, in these cases, existing regulations and enhanced and/or new industry codes would be a better tool to sufficiently protect small businesses.

We consider that the Federal Government is also well positioned to increase small business awareness of the importance of reviewing contracts carefully and making informed decisions in contract negotiations. For example, the Australian Competition and Consumer Commission (**ACCC**) has been a very vocal and effective champion of consumer rights (whether for individuals or business consumers) in relation to the competition and consumer laws.

Further information

Thank you for the opportunity to make submissions. If you have any questions, or require any further information, please do not hesitate to contact the writer on (03) 9794 2621.

Yours faithfully

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SUBMISSION TO CONSULTATION PAPER ON EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESSES

Specific Responses

1. How widespread is the use of standard form contracts for small business and what are their benefits and disadvantages?

From our experience at M+K Lawyers, standard form contracts are widely and routinely used by businesses.

Local and overseas entities (with subsidiaries based in Australia) all conduct business to some degree using standard form contracts with their customers (whether large or small businesses). A supplier's Terms and Conditions of Trade document is, in effect, a standard form contract. The benefits of standard form contracts are abundant, resulting in a more efficient Australian economy whereby businesses can efficiently and cost effectively contract with other businesses.

Standard form contracts create certainty in the market. Businesses contracting with other businesses using standard form contracts have a good understanding of the contract terms and their risk profiles. Extending unfair contract term protections to small businesses is likely to create uncertainty in the market. Large Australian companies and international companies may decide not to contract with Australian small businesses because of the complexity and uncertainty surrounding the extension of unfair contract terms to small businesses.

When conducting business, it can be preferable from an administrative perspective to impose the same or similar terms and conditions on all contracting parties. Doing so provides the supplier with certainty and efficiency in both its business operations and its contract enforcement. We acknowledge that departure from the "standard" terms and conditions can be warranted and/or necessary in some situations. However, we consider that this is most often done only by careful consideration of an "as needs" and case by case basis. Having different terms and conditions for different customers increases the complexity of business, as it can impact and alter accepted risk profiles, levels of insurance coverage and the content and extent of contractual performance obligations etc. This results in increased uncertainty and additional time, staff and financial resources required at both the time of contract negotiation and its enforcement.

In addition, the extension of unfair contract terms to small business contracts would require most (if not all) businesses to review and most likely, amend their terms of trade to ensure compliance. This would impose a time and financial cost for businesses.

Many Australian businesses have also already amended their existing terms and conditions of trade repeatedly over recent years, to take account of relevant legislative changes. For example, businesses have been required to already spend significant time, money and staff resources to ensure their existing terms and conditions of trade reflect the Australian Consumer Law (2009 to 2012), the Personal Property Securities regime (2012 to 2014) and the Privacy regime (2014).

In our view, the benefits (if any) of both contracting parties using standard form contracts are likely to exceed the potential detriment. The legal and time costs associated with these contracts are currently kept to a minimum, given they are standard.

Take the following situation for example. M+K Lawyers has extensive knowledge and expertise in the automotive industry. If (say) an automotive manufacturer was to supply 500 cars to a company, the contract would not likely be a standard form contract. Rather, the contract would need to incorporate certain provisions that are specific to the automotive industry. These provisions would not be relevant when parties are contracting for (say) the supply of sporting apparel.

From our point of view, the proposed extension of the unfair contract term provisions appears to demonstrate an overly simplistic "broad brush" approach, and that attempting to protect all small businesses in the same way will be ineffective. Rather, we submit that regulation of specific perceived "at risk" industries or market sectors would be more effective in achieving the Government's protective aims (eg. industry codes).

6. How do small businesses differ from consumers in relation to their interaction with standard form contracts?

We submit that small businesses and "mum and dad" consumers are completely different, and therefore, so should be the obligations imposed on larger companies when contracting with them. In general, small businesses can be expected to have a better knowledge and understanding of their rights, as well as higher capacity to review the contract terms in comparison to individual consumers.

It is not the responsibility of the Commonwealth Government to impose onerous obligations on companies wishing to contract with small businesses, simply because there is a belief that small businesses may not review the terms and conditions closely (or closely enough). Small businesses must assume some responsibility for ensuring that they understand their obligations and rights under their business contracts, and must take some responsibility for considering and protecting their own business position etc. Whilst it is true that there can certainly be significant imbalances in some negotiations, small businesses as a group per se are not entirely uneducated and vulnerable. We note that many laws already recognise this to some extent (eg. small businesses in some industries can be 'deemed' to know which laws apply to specific elements of their business conduct).

Further, in the current Australian market, most industries are not dominated by one or two businesses. As such, small businesses largely have choice regarding whether to acquire goods or services from a range of suppliers. Small businesses can walk away from contract discussions and can acquire goods and services from another supplier if they are not satisfied with the terms of the contract on offer.

18. To what extent are businesses relying on/enforcing, unfair contract terms?

In our comments here, we have assumed that "unfair terms" as extended to small businesses are those that would likely be unfair under the current legislative regime.

In our view, the perception of whether and to what extent unfair contract terms exist in business contracts is very subjective. Simply because there may be a perception that a contract term is strict or onerous does not necessarily mean that the "bigger" business has unfairly taken advantage of its position, or may try to rely on the term to the unfair detriment of the smaller contracting business.

The ability to have strict or onerous terms (which may subjectively be considered unfair) is a necessity in some contractual situations. Simply extending "unfair contract terms" to all contracts with small businesses does not give businesses any flexibility to impose stricter contractual terms where the situation warrants it or it is otherwise commercially justified.

For example, a large business that supplies well known sporting apparel may supply its clothing to independent small businesses for re-sale. In this situation, the large supplier may want to include fairly strict terms in the contract regarding their brand protection, so as ensure that the smaller businesses do not negatively affect the brand's reputation and positioning. The contract must therefore necessarily tightly stipulate to the small businesses the terms on which they can re-sell the apparel. There may be very strict and unilateral termination clauses, price variation ability and other controls.

This does not – of itself – mean that the contract is unfair; it simply binds the small businesses to respect and uphold the larger business' brand protection requirements, and provides a mechanism of remedy to the larger business for the smaller businesses' failure to comply.

Without these "essential" terms, it is likely that the contractual framework of supply would be significantly different. For example, the larger business may not supply the smaller businesses at all, or the larger business may offer to supply the smaller businesses only at a higher price point. If some current "standard" contract terms become prohibited as a result of the extension of the unfair contract terms laws, then it is conceivable that larger business will feel compelled to take other (perhaps primarily financially-based) steps to obtain compensation from the smaller business for the additional commercial, insurance and other risks being assumed.

In our view, this example highlights that a blanket approach to extending unfair contract terms to all small business contracts would not be the most effective response to the problem. As discussed below, the existing *Competition and Consumer Act*, Australian Consumer Law and industry-specific codes of conduct are a more effective way of addressing the need to protect small businesses in different contractual circumstances.

21. Do existing enforceable regulatory mechanisms provide adequate, accessible and timely avenues for redress?

We submit that the present scope of the Australian Consumer Law currently provides small businesses with sufficient specific protections against some previously unfair conduct. For example, the manufacturer's indemnity provisions in the *Competition and Consumer Act* provide a level of protection to small businesses, by ensuring that suppliers (who are often smaller businesses) are not unfairly held responsible for potential losses or damages that may be caused by bigger businesses (as manufacturer / importer).

Furthermore, the Australian Consumer Law provides both general protections (which create standards of business conduct) and specific protections (which address identified forms of business conduct). The *Competition and Consumer Act* also regulates procedural unfairness in business dealings through the "misleading and deceptive conduct" and "unconscionable conduct" provisions. In addition, the *Competition and Consumer Act* already provides that supply contracts for goods and services cannot exclude, modify or limit specific consumer guarantees (and corresponding indemnity).

25. Are future led responses a viable approach to addressing the problem?

We consider that the Federal Government could introduce information campaigns to raise small business awareness about the importance of reading, considering and understanding contract terms. We expect that small businesses would be more likely to review standard form contracts more closely if they are more aware of the possibilities and practical consequences of strict contract terms in standard form contracts. For example, they will have a better understanding of "what sort" of contract terms to look out for, what potential risks, costs and exposure may arise if the contract is agreed, and what avenues are available to them to investigate and/or negotiate any strict contractual terms presented to them.

In our view, a further potential benefit of this approach is that it may facilitate competition in standard form contracts due to a higher level of awareness, in turn potentially leading to improved quality and increased variety of negotiated terms. This option could create incentives for larger businesses to offer fairer terms (because they can be distinguished from "unfair" terms) and lead to a more efficient allocation of risk between the parties to standard form contracts.

26. Are existing regulatory interventions and mechanisms effective?

In our experience, the current industry specific codes of conduct provide adequate assistance in the protection of specific small businesses in industries where there may be widespread and systemic power imbalances. A range of regulatory obligations are already imposed on the "more powerful" party to ensure that they do not unfairly contract with those parties who are perceived as more vulnerable.

For example, the Franchising Code is already regulated by the ACCC. The proposed reforms to the Franchising Code to come into effect from 1 January 2015 (if accepted) are expected to broadly strengthen the rights of franchisees and increase the obligations imposed on franchisors.

Definition of 'small business'

We note that the Consultation Paper includes a 'focus question' regarding the fundamental issue about how a "small business" would be defined.

A clear problem that we currently see is that there are currently many different definitions of small businesses for the purpose of different regulatory regimes. For example, the Australian Bureau of Statistics definition differs from that of the Department of Industry, which itself differs again from the definition used by the Australian Taxation Office etc.

In our view, the scope of the definition of "small businesses" will be unclear under the current preferred proposal. Obviously, it is imperative that when businesses are seeking to contract with each other, they are able to easily determine whether or not the unfair contract term provisions would apply in the circumstances. Enduring uncertainty around this aspect would increase business and contract costs, and has the potential to overshadow any expected protective benefits.

The consultation paper provides 4 different options when determining the best definition of "small businesses".

The first option is to define small businesses as all businesses that are not publicly listed companies. This is easy to determine. However, we submit that this would not be a true reflection of what truly is a 'small business'. This could potentially lead larger businesses who are not publicly listed companies to hide behind the small business definition to enable contract terms to be deemed unfair when in reality they are able to sufficiently protect their own interests.

The second option put forward is that small businesses are determined by transactions that are below a certain threshold. However, some small business transactions would fall outside this threshold (eg. mortgages) and could still be very risky for small businesses. In this situation, small businesses would not be adequately protected.

The suggested third option is to define small businesses by reference to a threshold value of annual turnover. In or view, this definition is purely arbitrary and would create confusion and uncertainty. Additionally, in our experience, it is currently not common for businesses contracting in the ordinary course of trade to know each other's annual turnover (either exact or approximate). As such, we expect that adoption of this definition would be commercially unhelpful, and create barriers requiring the parties to consider – at the time of entering into each contract - whether the smaller business has met the threshold to invoke protection under the unfair contract provisions.

The final suggestion for the definition is dependant on the number of staff the business employs. In our view, this definition is also fraught with confusion - - for example, would this definition include all employees, or only full time employees? It is also unclear whether this definition would include (for example) employees on maternity, paternity or other carers' leave. At any given time, a small business may not know the number of people currently "actively" employed.

We submit that in practice, the definition of "small businesses" would create uncertainty and confusion to businesses trying to prepare and negotiate contracts. Furthermore, it is possible that contracts considered enforceable may subsequently be deemed unenforceable due to the unintended or unwitting use of unfair contract terms.

We believe that it is incumbent on all businesses dealing in commercial transactions to take a level of responsibility upon themselves to seek legal advice where necessary or desired, and to take the time to review their contractual arrangements in detail, to ensure that any potentially unfair contract terms are fully understood before acceptance.

It is acknowledged that unfairness and imbalance in bargaining positions can affect some small businesses, in some situations, and in some industries. However, we submit that a blanket extension of the unfair contract terms regime to small businesses will disproportionately increase business costs, above the level of any benefit that can be expected.