



Law Council  
OF AUSTRALIA

*Business Law Section*

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# **Exposure Draft Legislation to extend unfair contract terms to small business**

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

12 May 2015

## 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 Exposure Draft Legislation to extend unfair contract terms (**UCT**) protections to small business (**Exposure Draft**) and the associated explanatory materials and Decision Regulation Impact Statement (**Impact Statement**) released by the Government on 28 April 2015.

## 2. Focus of submission

The Committee lodged a previous submission to Government on the May 2014 consultation paper published by Consumer Affairs Australia and New Zealand *Extending Unfair Contract Term Protections to Small Businesses*.

The Committee does not intend to repeat the observations and suggestions made in that submission, or to comment further on the underlying recommendation and stated policy of the Government to extend unfair contract term protections to small businesses.

Rather, the Committee has focused its review upon the Exposure Draft, with a view to ensuring that the extension of UCT regulation to small business contracts is consistent with the Government's stated aims. The Committee is also concerned to ensure that the introduction of UCT regulation does not unduly impact on other regulatory regimes which govern the contractual terms with small businesses, or create uncertainty for businesses seeking to comply with, or obtain, the benefit of the regime.

## 3. Definition of 'small business contract' is likely to capture high value transactions

### Proposed definition of small business contract

The Exposure Draft (as reflected in Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015) provides that the following provision be inserted at the end of section 12BF of the *Australian Securities Investments Commission Act 2001* (**ASIC Act**) and section 23 of Schedule 2 of the *Competition and Consumer Act 2010* (**ACL**):

- "4. A contract is a **small business contract** if:
- (a) [the contract is for a supply of goods or services or a sale or grant or interest in land; and] [to be inserted into the ACL only]
  - (b) at the time the contract is entered into, at least one party to the contract is a small business; and
  - (c) either of the following applies:

- (i) *the upfront price payable under the contract does not exceed \$100,000;*
- (ii) *the contract has a duration of more than 12 months and the upfront price payable under the contract does not exceed \$250,000.”*

### **Intention of the Government**

Pursuant to the Impact Statement, the Committee understands that the Government's intention is to extend the consumer unfair term protections to include “*low value contracts*” involving small businesses, to assess the value of a contract pursuant to the overall “*transaction value*” of the contract and to exclude from the regime “*high value commercial transactions*”. This is supported by a number of statements in the Impact Statement including the following (emphasis added):

*“The preferred option is a legislative extension of consumer unfair contract term protections to include low value contracts involving small businesses... The Commonwealth recommends the legislative extension:*

- *apply a small business size threshold of fewer than 20 employees, combined with a **transaction value threshold** of \$100,000 (and \$250,000 for contracts of more than 12 months) to target low value small business transactions...*

*This approach achieves an appropriate balance between protecting those businesses most likely to lack sufficient resources and bargaining power, while preserving contractual freedom and certainty, and encouraging businesses to take reasonable steps to protect their interests.” (at page xii).*

...

*“A **transaction value threshold** could also be used to limit the scope of the protections to maintain the onus on businesses to take reasonable steps to protect their interests. To achieve this, a threshold would be set at a value above which it would be considered reasonable for a business to undertake due diligence by, for example, seeking legal advice.” (at page 23).*

...

*“Small businesses have a number of similarities to consumers in that they often lack the resources and bargaining power to adequately review and negotiate contracts for low-value day-to-day transactions. However, unlike consumers, small businesses are also engaging **in high-value commercial transactions that are fundamental to their business, where it may be reasonable to expect that they undertake appropriate due diligence**...Providing a protection against unfair terms for small businesses engaging in such high-value contracts may reduce the possibilities available to small businesses.” (at page 23).*

...

*“Such an approach would support time-poor small businesses entering into contracts for day-to-day transactions, while ensuring they do their due diligence **when entering into big contracts that underpin their business model**.” (at page 24).*

### **Use of ‘upfront price’ expands the reach of the regime to high value transactions**

The mechanism used in the Exposure Draft by which to define this 'transaction value' is the existing concept of 'upfront price' contained in section 26(2) of the ACL and that currently applies to the consumer unfair terms regime. The Committee does not consider that the use of 'upfront price' as currently defined is an appropriate concept through which to reflect or ascertain overall transaction value.

The 'upfront price' payable under a consumer contract is defined in section 26(2) as:

*...the consideration that:*

(a) *is provided, or is to be provided, for the supply, sale or grant under the contract; and*

(b) *is disclosed at or before the time the contract was entered into,*

*but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event."*

Importantly, the purpose of the upfront price definition currently in the ACL is to exclude certain terms from the operation of the consumer unfair terms regime. It is not a term that is currently used to define or identify the value of a contract.

Section 26(1) of the ACL provides that section 23 (the unfair terms prohibition) does not apply to a term of a consumer contract to the extent, but only to the extent, that the term sets the upfront price payable under the contract.

Accordingly, the effect of the current definition of upfront price is that terms that set the consideration payable for supplies under a consumer contract *are not* subject to the consumer unfair terms regime, but terms that set consideration that is contingent on the occurrence or non-occurrence of a particular event *are* subject to the consumer unfair terms regime. It was never intended that this definition be used as a threshold by which to calculate overall transaction value.

The difficulty with adopting this definition of upfront price as the mechanism by which to determine contract value is that it excludes any payments under the contract that are 'contingent' upon the occurrence or non-occurrence of a particular event.

There are many examples of contracts with small business that contain forms of contingent payments such as sales commissions (where payment is contingent upon a sale occurring) and fees for service (where payment is contingent upon services being provided). Examples include franchise agreements, dealership agreements, distributor agreements, mortgage brokers and financial adviser arrangements and wholesale supply arrangements. These types of contracts are likely to fall into the category of contracts that 'underpin the business model' of the relevant small business.

Prices for individual goods and services to be acquired or supplied under a contract may also arguably be forms of 'contingent' consideration, in circumstances where the total price for the goods or services is determined by reference to the number of units actually ordered, or the volume of services actually supplied (the relevant contingent event being the ordering of the goods/supply of the services).

In each of these examples, the overall transaction value of such contracts may be well in excess of the thresholds set out in the Exposure Draft. However, the exclusion of contingent payments means that the contract as a whole may fall under the proposed regime. The use of the upfront price concept will result in a range of payments that would otherwise legitimately be considered as part of the overall transaction value of a

contract falling outside the threshold calculations, with the result that high value transactions will be caught.

**Definition may also capture contracts for multiple supplies where one supply falls under the specified thresholds**

The use of the upfront price definition also raises the question of whether an entire contract will be subject to the unfair terms regime if there is a supply of multiple goods or services under the contract, one of which is priced at less than \$100,000 or \$250,000 (as the case may be).

For example, an agency or dealer agreement may provide for a range of various payments for different goods or services to be supplied or acquired under the contract such as a license fee of \$150,000 per year, advertising support fees of \$25,000 a year, commission payments and fees for equipment and goods to be acquired from the franchisor for resupply to customers (with no overall volume requirements). In these circumstances, some of the prices for goods or services to be supplied under the contract fall under the relevant threshold (for example, the royalty fee payment and the individual price of particular goods). However, the “transaction value” of the contract overall and the various multiple supplies may be significantly greater than the thresholds.

The definition of upfront price refers to the consideration that is to be provided for *the supply under the contract*. It is not clear in these circumstances whether the fact that one type of supply under the contract has a “price” of less than \$100,000 is sufficient to capture the entirety of the contract, notwithstanding that other payments for different supplies under the contract mean that the contract has an overall transaction value significantly above this threshold.

Finally, it is not clear how the upfront price concept is intended to apply in circumstances where the total value of payments expected to be made under a contract is dependent upon the level of goods or services supplied or acquired under that contract. For example, if there is a contract for the supply of goods for \$500 per good and there is no minimum order requirement, but it is reasonably expected that the total number of goods supplied under the contract will be over 1,000, is the intention that the regime apply such that:

- (a) the contract falls within the regime because the individual unit price specified in the contract for the goods is less than the thresholds; or alternatively
- (b) the contract falls outside the regime because the total value of the consideration reasonably expected under the contract is above the thresholds?

For the reasons above, the Committee believes that the proposed definition of small business contract and, in particular, the utilisation of the concept of “upfront price” within that definition gives rise to significant uncertainty as to which contracts will be captured and the real risk that high value transaction contracts will in fact be subject to the regime, notwithstanding the Government’s intention that this not be the case.

**Alternative drafting**

To address these issues, the Committee recommends that the definition of ‘small business contract’ be amended as follows:

*A contract is a **small business contract** if:*

- (d) *[the contract is for the supply of goods or services or a sale or grant or interest in land; and] [to be inserted into the ACL only]*
- (e) *at the time the contract is entered into, at least one party to the contract is a small business; and*
- (f) *either of the following applies:*
  - (iii) *the total consideration for the goods or services to be supplied under the contract is reasonably expected not to exceed \$100,000;*
  - (iv) *the contract has a duration of more than 12 months and the total consideration for the goods or services to be supplied under the contract is reasonably expected not to exceed \$250,000.”*

Whilst the Committee acknowledges that this definition, when combined with the employee thresholds contained in the Exposure Draft, does not address the fact that a business may not know with certainty 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 in genuine low value transactions.

#### 4. Potential for overlapping regulatory compliance

The Committee is also concerned to ensure that the introduction of the regime does not give rise to requirements for businesses to comply with multiple (and potentially contradictory) unfair terms requirements. The Exposure Draft contemplates that the proposed laws do not apply to a business contract that is covered by a law of the Commonwealth, a State or Territory that is a law prescribed by the regulations (see sections 41 and 14 of the Exposure Draft).

However, before the Governor General can make a regulation for the purposes of these sections, the Commonwealth Minister must be satisfied that the law provides “*enforceable protections for small business... that are equivalent to those provided by [the proposed amendments]*” and “*the Minister must take into consideration:*

- i. any detriment to small business of that kind resulting from the prescription of the law; and*
- ii. the impact on business resulting from the prescription of the law; and*
- iii. the public interest.”*

The Committee considers these requirements to be unduly restrictive. As articulated in the Committee’s previous submission, the Committee believes that there is a compelling case for specific exemption for industry codes that are prescribed under section 51AE of the *Competition and Consumer Act 2010 (CCA)*.

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".

The Committee is concerned that the extension of UCT regulation to such agreements will create uncertainty and increased costs for the affected industries.

The Committee also believes that consideration should be given to enable the Minister to exempt contracts that are covered by other forms of unfair term protections such as industry codes that are the subject to mandatory compliance (for example, the Telecommunications Consumer Protection Code, which also has unfair term protections for small business services) and, potentially, the Grocery Code of Conduct. Both of these Codes have been subject to significant industry input and consultation, and the extension of unfair term protections in the ACL will introduce additional regulatory compliance requirements to those provided for in these Codes.

## 5. Other matters

### **Excluded businesses**

The Committee repeats its previous submission that UCT protection should not be available to a small business that is a publicly listed company, a business carried on by an authority of the Commonwealth, a State or Territory, or is related to another corporation which, either individually or in conjunction with the business in question, meet these two tests (this is necessary to avoid small subsidiaries of larger corporate groups so that large corporations are not unduly protected by the UCT regime and take proper interest in their relevant subsidiaries).

### **Inconsistency of application with consumer contract regime**

The definition of a 'small business contract' in the Exposure Draft is capable of applying to contracts between a small business and an individual, and regardless of whether the individual is acquiring goods/services from the small business, or supplying goods/services to a small business.

This gives rise to an inconsistency between the Exposure Draft and the current consumer unfair terms regime. Currently, sections 23 of the ACL and 12BF of the ASIC Act apply to the consumer unfair terms regime only where an individual is *acquiring* goods or services, or an interest in land, and not where an individual is *supplying* goods, services or land. This means that:

- (a) where an individual is supplying goods/services to a business that is *not* a small business, no unfair terms regime will apply; but
- (b) where an individual is supplying goods/services to a small business, the small business unfair terms regime *will* apply.

To resolve this anomaly, the Committee recommends that contracts between a small business and an individual are carved out from the definition of 'small business contract'.