Queensland Law Society

Law Society House, 179 Ann Street, Brisbane Qld 4000, Australia
GPO Box 1785, Brisbane Qld 4001 | ABN 33 423 389 441
P 07 3842 5943 | F 07 3221 9329 | president@qls.com.au | qls.com.au

Office of the President

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Consumer Policy Framework Unit
Small Business Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

And by email: AustralianConsumerLaw@TREASURY.GOV.AU

Our ref: Fran 333 – 5

Dear Sir or Madam

***Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015* (Cth)**

The Queensland Law Society (**the Society**), with the input of its Franchising, Banking and Financial Services, Competition and Consumer Law Committees, and its Practice Development and Management Committee, makes the following submissions concerning the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015* (Cth) (**Bill**).

By way of preliminary comment, the Society notes the short timeframe provided for consultation concerning this Bill. More time is required to consider its effect fully.

At the outset, the Society advises that it supports, in principle, the policy reform of extending consumer unfair contract term protections to small businesses entering standard form contracts. However, the Society makes the following comments:

1. The Bill represents an extension to small business clients of already-extant unfair contract provisions which already have potential application to legal practitioners' costs agreements with consumer clients.

2. Problems in the existing legislation and guidance (per submissions previously made in this regard) remain unaddressed.

3. Elements of the proposed legislation (later expounded upon) may create significant uncertainty and, in many instances, be contrary to the best interests of small business.

4. Six months for implementation represents an insufficient time period. Industry consultation is required; however, a timeframe of a minimum of 18 months would seem to be more appropriate, in light of the significant change for the industry which the provisions of the Bill seek to effect.

5. From a practical perspective, the definition of 'small business' is unhelpful: for example, how would a supplier be able to source this information? Perhaps a certificate of not being a small business could be *prima facie* evidence of that fact (similarly to under what was previously section 13 of the Uniform Consumer Credit Code).

6. The draft legislation seems to apply even when both parties are small businesses. This will increase the costs to small businesses which use their own standard form contracts when dealing with other small businesses. Those small businesses will need to review their standard contract terms for unfairness. As whether a term is 'unfair' depends upon the particular

circumstances and is open to different interpretations, there will be increased contractual uncertainty for such small businesses when contracting with other small businesses. These additional costs and risks for small business appear to be an unintended consequence of the draft legislation.

7. The definition of 'small business' can lead to some anomalies which do not seem to have been addressed in the draft legislation. For example, it is not unusual for incorporated joint ventures to have few or no employees. Applying the draft legislation, the joint venture vehicle for, say, two large mining enterprises would be able to seek relief under the unfair contract term regime. A similar anomaly arises where a subsidiary of a large company, or even a large company itself (where the employees are employed through a related service entity), may be able to seek relief under the proposed new regime. This would seem to be at odds with the stated legislative intent. The Society suggests that it may be appropriate that the definition address subsidiary companies that are part of a corporate group, which in reality have the resources of the large corporations at their disposal, by taking into account the number of employees of the broader corporate group in assessing whether that entity employs less than 20 people.

8. The Society notes that the application of a transaction value is arbitrary, arguably too low and may be unnecessary, so that:

   (a) The value of a contract does not correlate to a small business possessing any greater bargaining power. Indeed, the converse may apply where the small business is the vendor. For some small businesses, a large contract may be their life-blood and they would have greater vulnerability in that respect to standard form contracts;

   (b) The Bill's Explanatory Memorandum (**EM**) notes at paragraph 1.13 that '*The threshold for the upfront price payable under the contract reinforces the onus on small business to undertake due diligence for high value transactions.*' However, due diligence does not provide an answer to, or relief against, the imposition of an unfair contractual term on a 'take it or leave it' basis. The reason for the application of a threshold is not strongly justified by the EM;

   (c) A consumer contract involving goods, services or an interest acquired wholly or predominantly for domestic, personal or household use contains no value threshold for the purposes of the unfair contracts term regime. It gives rise to a question why the unfair contract terms regime for consumer contracts has no value threshold but small business contracts (involving persons thought to be similarly vulnerable to standard form contracts) must be subject to a threshold. The Society notes, however, that the policy may be to compare small business contracts to other forms of consumer contracts more generally - which do contain a threshold ($40,000). If that is the comparator, then the issue is whether a transaction value threshold of $100,000 is adequate. The Society suggests that it is not adequate and it should be higher, if a threshold is retained;

   (d) The Decision Regulation Impact Statement observes that:

      i. 22 per cent of small business survey respondents indicated that they were offered contracts valued more than $100,000;

      ii. of the small businesses who reported that they had experienced an unfair term in the past 12 months, around 80 per cent indicated that that the value of the contract in question was less than $100,000. By implication, that means that 20% of small business respondents did experience an unfair term where the value of the contract in question was more than $100,000; and

      iii. 12 per cent of small business survey respondents reported that they were offered standard form contracts valued more than $250,000.

These statistics are significant. The Society is concerned that 20% or more of small businesses could be excluded from coverage by unfair contract terms legislation if the bar is set at only $100,000, with 12% excluded if the upfront price was set at $250,000.

The Committee recommends that either the threshold should be removed entirely, or if it is retained, the $100,000 threshold should be set much higher so that 20% of the target group who are said to be vulnerable to the inclusion of unfair terms in standard form contracts are not excluded.

9. Businesses may face real practical difficulties in trying to identify whether the business they are proposing to contract with is a 'small business.' There is nothing in the draft legislation which allows a business simply to rely upon what they are told by the other business in relation to the number of persons they employ. In the absence of some form of safe harbour arrangement, businesses will either need to undertake extensive due diligence in order to ascertain if the other business is a small business, or revise all their standard form contracts to comply with the new regime. The increased costs associated with this may ultimately be borne by the small businesses which the draft legislation is purporting to protect. Whether a particular casual employee is or is not counted is also an issue that may lead to even further uncertainty.

10. As the relevant time for assessing whether a business is a 'small business' is the time the contract is entered into, a business using a standard form contract will need to consider the issue each time it contracts with a business (i.e. it cannot assume it is not a small business just because it was not a small business the last time they dealt with each other).

11. It is also not always clear whether particular arrangements are one contract or a series of contracts. For example, where there is a master supply agreement, is each order under that agreement a new contract? This creates uncertainty when trying to work out the monetary threshold and in applying the transitional provisions.

12. It is also not entirely clear how contracts of undefined durations are to be dealt with (e.g. revolving credit facilities that are repayable upon demand). Is it to be assumed that such contracts have duration of more than 12 months?

13. There obviously are some benefits to small business that are able to take advantage of the new regime. However, there are some gaps/anomalies in the draft legislation that ought to be addressed. Further, there is little doubt that the new regime will create greater contractual uncertainty and impose additional costs on the businesses that are required to comply with it. It may well be the case that these additional costs are ultimately passed on, by way of higher prices, to the small businesses the legislation is trying to protect.

14. The Society is particularly concerned about the potential effect the new regime may have on financing arrangements. Small Business is already concerned about its ability to access, and the cost of, credit. The extension of the unfair contract terms regime to small business may only exacerbate the difficulties some small businesses have in obtaining credit at a reasonable cost. A credit carve-out ought to be considered here.

15. From a trade creditor supplier perspective, the issues outlined above would substantially increase cost and time of due diligence as well as likelihood of refusing the provision of credit to a small business, or of higher costs of doing so.

16. The transitional provisions appear to directly catch existing agreements on their 'renewal' or 'variation'. It should be made clear in the legislation whether an existing agreement will become subject to the provisions in the following circumstances:

(a) An extension or holding over of an existing agreement as opposed to a renewal (where a whole new agreement is entered into).

(b) A transfer (e.g. an assignment) of the agreement - that may be considered as part of variation however it is not clear. Normally an assignment of a contract by a consumer would not arise on consumer to business transactions because it is more personal (e.g. a mobile phone contract), whereas a sale of a business it is common and in some cases the agreement is assigned.

(c) A third party (such as a master franchisor) having to step in and take over obligations or rights under the agreement as a consequence of the termination or expiry of the master franchise agreement. This may be an automatic step-in but not a variation.

(d) The sale of a franchise system by a franchisor where the agreements are assigned or novated.

17. The Society is of the view that the reverse onus provisions in sections 24(4) and 27(1) of the *Australian Consumer Law* should only apply to consumer contracts and not to business contracts. Those provisions reverse the onus of proof so that the complaining party does not have the burden of proof to establish:

(a) that the clause alleged to be unfair was not reasonably necessary to protect the other parties legitimate commercial interests; and

(b) that the contract is a standard form contract unless the other party proves otherwise.

18. Legislation that seeks to reverse the onus of proof should be reserved only for exceptional circumstances where there is clear policy intent. Whilst there is clear policy intent behind the current provisions to ensure consumers who do not have access to resources do not have the burden of proof, it is not clear why that policy should automatically be extended to business to business transactions. Accordingly the Society suggests that the business claiming the clause is unfair should have that burden of proof.

Extension of Unfair Contract Terms (UCT) protections to Franchise agreements

19. Unless they are expressly exempt or would otherwise fall outside the relevant thresholds it is likely that franchise agreements may become subject to the UCT regime. A number of standard well accepted commercial clauses commonly found in franchise agreements could immediately be susceptible to a claim of 'unfairness' because they were unfair either at the time the agreement is entered into or when the provision is sought to be applied or enforced. Two immediate examples of commonly appearing clauses would include:

a. A contractual provision requiring a franchisee to observe and comply with uniform supplier arrangements across the network. That contractual provision and conduct would normally have been subject to ACCC authorisation or notifications process under the *Competition and Consumer Act* (the CCA). Whilst those applications do relate to conduct, that conduct flows from those commercial terms in the contract enabling the franchisor to rely on that clause to engage in that conduct. There is currently no draft section of the legislation which would place that type of provision in the category of clauses outside the application of the scope of the UCT protections despite the business being authorised to engage in that conduct in reliance on that provision. Arguably one of the matters that a Court should be able to have regard to in determining whether that clause is unfair is whether the conduct of a party when relying on that clause has otherwise been authorised by the ACCC or subject to the notification process under the CCA.

b. A contractual provision requiring the franchisee to comply with the terms of an operations manual (in the same way as all other franchisees in the network) and allowing the franchisor to vary unilaterally its operations manual.

20. The Society suggests that there are certain franchising-specific clauses that Treasury should (after further consultation with Stakeholders in that sector) consider adding to Section 26 of the ACL so that the UCT protections do not expressly apply to those sorts of clauses in a franchise agreement. This would give immediate certainty to a number of extremely common clauses often found in franchise agreements which by the very nature of the relationship need to be uniform and not negotiated.

There would be an immediate benefit in that approach if a franchisor would not have to be prepared to negotiate those provisions and they could therefore remain unchanged and uniform across an entire network, including for example:

(a) The contractual provision giving a franchisor the right to vary, unilaterally, an operations manual (as opposed to the actual variation it is trying to make). If the contractual clause was protected then a franchisee could still argue that the proposed change to the manual itself was unfair (or in the circumstances unconscionable) as opposed to rendering void the entire right to vary the manual and being unable to rely upon it for quite valid changes in the future.

(b) A contractual term that relates to conduct that has successfully been through an application to the ACCC for authorisation/ notification (e.g. supplier arrangements).

(c) A right for a franchisor to assign franchise agreements without the prior consent of the franchisee. Without that protection one franchisee could prevent a sale of an entire network and result in unfair demands being made or concessions sought as a condition of giving that consent.

(d) A contractual reservation of rights (such as internet sales) even though they may not be exploited by the franchisor.

(e) A clause requiring the franchisee to incur a significant capital expense in circumstances where one of the examples (e.g. disclosure) in clause 30 of the Code applies.

(f) A clause that deals with rights and obligations relating to the use of intellectual property and confidentiality.

(g) A clause required to be included in the Franchise agreement under the Code (termination or a complaint handling procedure consistent with Part 4 of the Code). Arguably these types of clauses could be required to be included by law.

21. Treasury would need to consult with stakeholders in that sector to identify precisely the clauses that should be protected by this measure and the examples above are ones that our committee has identified.

22. The Society is of the view that in the draft legislation (Point 32 on page 9) where section 23 of Schedule 2 is proposed to be amended to add a new paragraph (4) it may be require amendment as follows:

(i) *the contract has a duration of 12 months or less and the upfront price payable under the contract does not exceed $100,000;*

23. The Society is also aware that some stakeholders in the franchising sector have suggested that franchise agreements should be a form of agreement that is not covered by the UCT protections of this reform. The implementation of the new franchising code and penalties for

contravention of civil pecuniary penalty provisions is new and not properly tested to see whether it has had the desired effect of changing behaviour.

24. The necessity for obtaining declaratory relief may involve different levels of courts or tribunals applying the law in different States. For example, in Queensland, the Magistrates Court (which has monetary jurisdiction to $150,000) is not empowered to make a declaration. An applicant would be required to file an Application in the District Court, or the Federal Circuit Court (with possible delays in the later due to availability of judges).

25. The Society also notes that to obtain relief a small business will be required to file an application for a declaration that its small business contract contains an unfair term.

Policy intent behind cf legislative impact of the Bill

26. The Society considers that the terms of the Bill do not give proper effect to the intended policy intent underlying the legislation, as it was expressed and delivered in the EM. The Society sets out the following EM references and its comments thereto by way of illustration of this concern:

> 1.2 *Small businesses, like consumers, are vulnerable to unfair terms in standard form contracts, as they are often offered contracts on a 'take it or leave it' basis and lack the resources to understand and negotiate contract terms. There is potential for detriment where unfair contract terms are enforced in standard form contracts with small businesses.*

27. While the above statement concerns high-level overarching principles, it is to be noted that many franchisors do negotiate some (but not all) commercial terms of agreements, and franchisees do regularly obtain advice about a franchise agreement which typically will cost them between $1,500-$5,000. Most franchisees of retail businesses do undertake a due diligence (including a legal and accounting due diligence) although it is not possible to compel them to do so. The cost of obtaining professional advice is also tax deductible and for business purposes, so prospective franchisees are more inclined to get that advice than if they simply wanted to enter into a day to day transactional contract (for example, to purchase a mobile phone or enter into a plan, rent a car etc).

28. The Society would disagree that a prospective franchisee lacks the resources to 'understand' contracts.

29. Unlike other low value commercial contracts the new Franchising Code of Conduct also expressly imposes:

    (a) a mandatory 14 day moratorium after receiving disclosure which allows a franchisee to seek professional advice;

    (b) a mandatory 7 day cooling-off period to get out of the contract for new prospective franchisees;

    (c) a mandatory requirement for a franchisor to obtain a statement in the form required under clause 10 from the prospective franchisee that they have received, read and had a reasonable opportunity to understand the Code and the disclosure document;

    (d) an obligation to give a prescribed pre-disclosure information statement (Annexure 2, Code) outlining the risks of entering into a franchise agreement;

    (e) prescribed warning statements be included in a disclosure document;

    (f) an express obligation on a franchisor to negotiate a franchise agreement in good faith (this obligation expressly extends to pre-contractual negotiations;

(g) contact details of other existing and former franchisees who you can contact when conducting a due diligence;

(h) prescribed information about the business opportunity.

30. In practice, many franchisors may not want to negotiate the contractual provisions of their franchise agreement; however, this is not an issue which touches upon resources and in many cases these franchisees are making a significant investment. The Society also notes that franchisees enter into a franchise agreement by choice (and with the mandatory safeguards which the Code already provides for) and that multiple other business opportunities are available to franchisees.

31. The EM also states:

> *1.3 Consultations indicated that unfair contract terms often allocate contract risks to the party that is less able to manage them (usually small businesses), as they are less likely to have robust risk management policies or be in a position to absorb the costs associated with a risk allocated to them eventuating.*

32. The Society notes here that the franchise model operates on the premise that the franchisee conducts its own business, and as a consequence, risk allocation to the franchisee is not unusual practice. Like any business, however, a franchise is exposed to those risks.

33. The EM also states:

> *1.4 Small businesses often lack in-house legal expertise and the cost of obtaining legal advice, particularly for low-value contracts, can be disproportionate to the potential benefits of entering into such contracts. Where small businesses decide to not enter into contracts due to their lack of confidence in understanding and negotiating terms or the cost of obtaining legal advice, they may miss out on market opportunities.*

34. The Society comments here that franchise agreements are not 'low-value' contracts. To the contrary, a franchise agreement, together with a lease, are usually the two most significant agreements into which a franchisee will enter. Entering into a franchise agreement is a 'serious undertaking' as recognised in the warning statement imposed on the cover of a disclosure document. If the legislation is aimed at 'low value' contracts then it makes sense from a policy point of view to regulate those contracts; however, it should not capture the vast majority of contracts in the process.

35. The EM goes on to set out that:

> *1.7 Small businesses differ from consumers in that they also engage in high-value commercial transactions that are fundamental to their business and where it may be reasonable to expect that they undertake appropriate due diligence (such as seeking legal advice). I agree. This is what the Code promotes and encourages. Limiting the extension of the unfair contract terms protection to low-value small business contracts that are standard form will support time-poor small businesses entering into contracts for day-to-day transactions, while maintaining the onus on small businesses to undertake due diligence when entering into high-value contracts.*

36. The policy intent here seems to be aimed at 'low-value small business contracts' entered into on a day to day basis. A franchise agreement is not a low value contract and not entered into on a day to day basis. The Code and new risk statement required to be given to a prospective franchisee expressly notes the significance of entering into a franchise agreement because it is a 'big decision'. The policy intent appears to be directed at capturing those contracts that are in a sense thrust upon consumers (mobile phone, car rental, software licenses, etc.) on a day to day basis which consumers have no power to negotiate but are required for business operations. The policy intent would not seem to touch upon contracts which go to the heart of the business being conducted. The Society proposes that the draft legislation ought to focus on those types of day to day contracts which are crucial to daily business operations, rather than franchise agreements. The existing misleading/deceptive and unconscionable conduct provisions already operate to protect the public from mischief.

37. The Society notes that despite there being legislation in NSW affording a mechanism for an motor dealer to seek relief for unfair contract terms and unfair conduct for dealers of new motor vehicles in relation to their contractual dealings with their distributors, it appears that by definition most motor dealers would fall outside of the scope of the UCT protections simply because of the monetary threshold test for a small business. It is not clear if the policy intent was to include motor dealers in relation to their contractual dealings with their distributors in this framework specifically but if it was then it would appear a different approach would be required for them to be made subject to that regime.

38. Finally, the Society notes that if a prospective franchisee is recommended to obtain, and gets independent legal, accounting or business advice on the business opportunity then if it chooses to proceed with entering into the agreement it should be excluded from the application of the Bill's proposed protections.

If you would like to discuss these or any other matters, please feel free to contact Shane Budden, Manager, Advocacy and Policy, on (07) 3842 5889 or S.Budden@qls.com.au.

Yours faithfully

Michael Fitzgerald
President