

Resolution of Small Business Disputes Submission to Options Paper June 2011

Independent Contractors Australia (ICA) is pleased that the Federal Government has initiated a discussion on the resolution of commercial disputes affecting small business people. ICA was formed in 2000 and since then has actively called for improved commercial dispute-resolution processes for small business people.

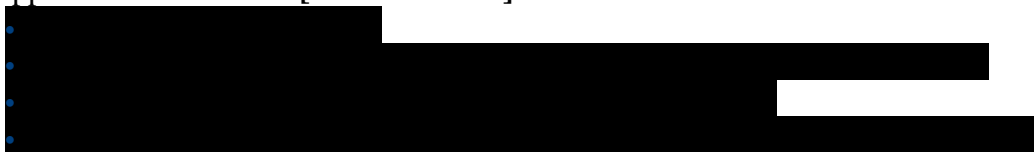
In May 2011, the Federal Government released a discussion and Options Paper on dispute resolution for small business. The paper is available here:

<http://www.innovation.gov.au/SMALLBUSINESS/DISPUTERESOLUTION/Pages/default.aspx>

This submission is a response to the Options Paper.

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1. Summary

General Principles

- Small business people constitute the dominant sector of the economy.
- Current dispute-resolution processes fail small business people. This lowers trust in commercial activity and damages economic strength and growth.
- Better dispute resolution will fail if small business protections from unfair contracts are not implemented.
- Small business financing will improve if unfair contract protections are introduced, combined with improved dispute-resolution processes.

Specific positions

ICA recommends:

- Keep dispute resolution local. Extend and apply the Small Business Commissioner (SBC) model to all states and territories.
- Government must lead by doing. Government bodies must apply fair contracts and have disputes arbitrated through SBC.
- Parties must attempt resolution before going to SBC.
- No lawyers allowed for disputes below defined dollar amounts.
- SBC (or Advocate/Ombudsman) must be independent of government.
- Mediation at SBC level is compulsory before access to other courts is allowed. If a party fails to act in good faith at SBC level they can bear all legal costs at other court jurisdictions.
- Education programmes are needed to promote contract information and processes and good contract models.

2. Background and principles

Understanding small business people

Concepts

There are 2.1 million self-employed people in Australia. This is the small business community. The key to understanding them is that these 'businesses' are in fact 'people'. They are individuals. They are no different from consumers. They are consumers. They are no different from employees. They are employees, of themselves. This is their uniqueness. They ('we') are businesses, consumers and employees all at the same time. This reality or 'truth' about small business clashes with regulatory concepts of business.

In economic and regulatory policy terms, 'businesses' are traditionally viewed as management systems, operated by employees. In this context, when a business is in dispute with another business, the regulatory conception is that it is not individual people *per se* that are in dispute, but rather the two businesses as systems. It is collectives (of employees) in dispute with other collectives (of employees). In addition, it is the business that is involved in risk, not the individual employees who are taking risks.

This regulatory concept applies to larger private enterprises and applies even more to government undertakings when government is engaged in commercial activity. Government employees are even less exposed to risk than are employees of private-sector businesses. But this concept does not fit with the truth of what a small business is. Small businesses are people. They are individuals. They are personally at risk when ‘being a business’.

Key statistics

The 2.1 million self-employed business people in Australia form 19 per cent of the workforce. They comprise:

- 1.1 million who do not employ others.
- 1 million who do employ others. This group employs around 5 to 6 million others.

Combined, they constitute:

- 7 to 8 million of the 11.5 million Australian workforce
- Around 98 per cent of Australian private-sector businesses.

(Statistics available at <http://www.contractworld.com.au/research/ica-numbers4.php>)

Based on these statistics, small business is the dominant sector of the economy. For the 2 per cent of private-sector businesses that are not small businesses and for government instrumentalities it is not possible to ‘do’ business without a significant involvement with small business people.

Why a better system is needed: Trust and the economy

The legal and regulatory environment in which business-to-business dispute resolution operates is dominated by the need to use lawyers. The law is highly technical when it comes to process and to have the substance of a case heard requires considerable legal assistance to ensure that a case doesn’t ‘fall over’ because of errors of a technical nature. In practical terms, the result is that if a business is to access the courts for dispute resolution, \$10,000 is probably needed as the starting point, simply for legal expenses.

This simple commercial reality means that self-employed small business people are effectively locked out from access to dispute resolution through the courts. Consequently, large organisations—be they businesses or government instrumentalities—exercise dominance over small business people in their commercial dealings with them.

ICA’s experience is that, in this environment, self-employed small business people are repeatedly ‘screwed over’ by larger businesses and government. Most of the time self-employed people accept their fate under this regime because they have no other choice. That is, they do not have the financial resources to defend their commercial positions. This acquiescence in the face of commercial intimidation by large business and government is often interpreted by policy makers as meaning that a problem does not exist. ICA disagrees. The problem is substantial.

For some years ICA has been monitoring the situations of individual self-employed people who’ve been confronted by this problem. We have followed many cases and have lent assistance where we can. Some of those cases have developed to the stage

where we have been able to conduct case studies and report on them. Four of the cases form the Appendix to this submission. They detail instances where large organizations have exercised considerable power (many would say it amounts to intimidation) over self-employed individuals—simply because they can. The cases involve:



Against this background, ICA’s primary focus in this submission is how to achieve a dispute-resolution process for small business people that gives them a measure of equality in their power relationships with large organizations.

Small business people need this outcome to ensure fairness, just as fairness is required for consumers and employees. But there are also sound economic reasons.

An economy is an endless process of commercial transactions. The strength and size of an economy is mostly a product of the volume and quality of the commercial transactions that occur. *Trust* is the primary human trait that facilitates commercial transactions. Societies with low levels of trust have fewer commercial transactions and weaker economies. The law of contract is the institutional feature that supports trust in commercial transactions. For that trust to be supported fully the enforcement of contracts must be something that is readily accessible with low transaction costs. This is not the situation faced by self-employed small business people. Contract enforcement is not a practical option for them in most circumstances. Consequently, small business people have low levels of trust in the system. They do not ‘trust’ it. Therefore they are less inclined to engage in contracts and to be entrepreneurial.

Yet the self-employed small business sector is the dominant sector in the Australian economy. Poor dispute-resolution procedures for small business people directly damage the Australian economy. They diminish the capacity for entrepreneurship and innovation and hence economic growth. Improving small business dispute resolution is an important and long overdue economic reform.

Unfair Contracts

An improvement in dispute resolution must be accompanied by improved legislation which provides protections to self-employed small business people from unfair contracts.

Whatever dispute-resolution processes are in place, these will only be effective if small business people are operating their businesses using fair contracts. When considering a commercial dispute, the parties to a contract and a mediator or arbitrator must make decisions based on the contract between the parties. The contract is key. But if the contract is unfair, ‘resolution’ itself will be unfair.

Many lawyers argue that a contract is entirely a matter of ‘offer and acceptance’. In ICA’s experience, lawyers who think this way are either ignorant of the law of

contract or they have an intention to create unfair contracts to shield their clients from accountability. Many economists also think that commercial activity is entirely based on 'offer and acceptance' of contract. Such economists often have little practical understanding of business or the law of contract.

Contracts must be thought of in two ways. There is

- The *structure* of contracts; and
- The commercial *content* of contracts.

It is the structure of contracts that must be made fair. The commercial content of contracts is where parties take risk under offer and acceptance.

In 2010, the Federal Government passed legislation creating unfair contract protections for consumers. Called the Australian Consumer Law, this requires that standard form contracts supplied to consumers must comply with a structure that is fair. A summary of the laws is here:

<http://www.contractworld.com.au/campaigns/ica-integrity-campaign-unfair-contracts-TPA-amendments.php>

In the lead-up to the introduction of the new legislation, the Productivity Commission and the parliamentary inquiries all called for these laws to also be applied to small business. There was agreement from all political parties on the matter as well. Yet, following lobbying from big business interests, the Federal Government chose not to make these unfair contract protections available to small business. In our view, this was a grave error of judgment.

Modelled on the Australian Consumer Law, ICA has put together a Charter of Contractual Fairness. It's here:

<http://www.contractworld.com.au/pages/PDFs/ICA-Charter-of-Contractual-Fairness.pdf>

ICA calls on the Federal Government to immediately extend the unfair contract laws now available to consumers to self-employed small business people.

Small Business Finance

Access to affordable business finance for small business people is a well discussed problem. Finance is generally more expensive for small businesses than it is for big businesses and has to be secured by property. What is never discussed, it seems, is the fact that the predominance of unfair contracts and the lack of access to effective dispute resolution both raise the risk profile of all small businesses in Australia.

- Why would a bank lend money to a small business person when the person earns his or her income through commercial contracts that are unfair and harsh?
- Why would a bank lend money to a small business person when the bank knows that if the person ends up in a dispute, he or she will probably lack the finance to obtain fair resolution through the courts?

Consequently, the system is institutionally stacked against small business people and the banks know it. As a result, small businesses profile as riskier than big businesses. Banks are less inclined to make loans to small businesses and must charge them higher interest rates when they do.

This systemic problem damages the Australian economy. Improving dispute-resolution process and applying unfair contract laws will assist small business to access quality, reasonably priced finance.

3. Specific responses to the Options Paper

Our responses to the Options Paper are heavily focused on making the law effective so that when a small business person is in dispute with a larger organization—either business or government—the focus is on ensuring that the larger organization cannot use its financial or legal power to subvert effective and quick commercial resolution. We are not arguing for a commercial advantage for small business people. Small business people take commercial risks and accept that. Our focus is on dispute-resolutions systems that give each party an equal chance to present its case and for a commercial resolution to be achieved quickly and cheaply.

We recommend the following.

Keep it local

Small business dispute-resolution processes should be handled wherever possible at the local level. We strongly favour the use of the Small Business Commissioner model developed in Victoria, which has produced outstanding results. This model is now being applied in New South Wales, South Australia and Western Australia. We recommend that the other states and territories do the same. There should be no need to duplicate a similar model at the federal level unless it was necessary to apply this to Federal Government departments and instrumentalities.

Government can lead by doing

All governments sectors (federal, state, territory and local) should be required by statute to:

- Comply with fair contract laws and principles when engaging in business with self-employed small business people.
- Refer all disputes with small business people to agreed arbitration processes consistent with the recommendations and principles outlined here.

Referral should be to a Small Business Commissioner when a state/territory or local government has a dispute with a small business person. Commonwealth entities should preferably refer to Small Business Commissioners in the jurisdiction of the residence of the small business person.

Pre-resolution

Parties must demonstrate that they have attempted to resolve their dispute before accessing dispute-resolution procedures.

Limitations on use of lawyers

Where disputes are below a defined dollar amount, lawyers should be prohibited from representing the parties to the dispute.

Commonwealth Small Business Advocate

If the Commonwealth chooses to establish a Small Business Advocate or Ombudsman the Advocate/Ombudsman must have a separate legal structure, be independent from the public service and be appointed directly by the Governor-General. This is, for example, the appointment model for the Small Business Commissioner in Victoria. This will ensure the institutional independence of the Advocate/Ombudsman.

The Advocate/Ombudsman should be charged with giving advice to government departments and instrumentalities on the contracts and processes they have when engaging with small business.

Disputes between small business people and Commonwealth entities should be determined either by

- The relevant State Small Business Commissioners or
- The Commonwealth Advocate/Ombudsman armed with similar processes and powers as a Small Business Commissioner.

Mediation versus arbitration

ICA is aware that the Small Business Commissioner in Victoria favours retaining a mediation service as opposed to extending dispute resolution to arbitration. The reasoning, which we think is sound, is that they prefer to try to keep the parties in a commercial relationship. This is more easily achieved through mediation.

However, ICA is also aware that many larger businesses ‘thumb their noses’ at the Small Business Commissioner. Government departments we understand, in particular, ignore the mediation process. See our case studies Appendix.

We have already recommended that parliaments require their government instrumentalities to comply with fair contracts and simple dispute-resolution processes with arbitration. If unfair contract protections are applied to small business people, we believe that the number of disputes between big and small businesses will decline. Further, if unfair contract protections apply, it will be considerably more difficult for big business to play ‘big lawyer’ games to financially intimidate small business people into submission.

Nonetheless, the mediation processes of the Small Business Commissioners could be enhanced through the following changes.

Taking the Victorian Small Business Commissioner model as a guide, the first step in dispute resolution should remain as mediation. However, if mediation fails, parties have access to the Victorian Civil and Administrative Tribunal (VCAT) and/or other courts. Decisions at VCAT are binding on both parties and each person is responsible for their own legal costs.

Amendments to the powers of the Small Business Commissioner should be considered as follows:

- Access to VCAT (for example) should not be allowed until parties have first gone through the mediation process at SBC.
- The SBC mediator should have powers to recommend that all costs for legal counsel (by both parties) when attending VCAT be borne by the party who

fails to act in good faith during mediation—for example, by not attending mediation.

This would strengthen the influence of the SBC and the mediation process, and many more small businesses would give it a go. Big companies who use law firms to represent them would then incur much higher costs to defend claims against them and would be more likely to settle small claims before mediation.

Education and model contracts

Education of small and large business (and government departments) about fair contracts and fair dispute resolution should be a high priority.

ICA is strongly supportive of two booklets produced by the Commonwealth Department of Innovation:

- *Independent Contractors. The Essential Guide*
<http://www.business.gov.au/BusinessTopics/Independentcontractors/Documents/Independentcontractorstheessentialhandbook.pdf>
- *Independent Contractors. Contracts Made Simple*
<http://www.business.gov.au/BusinessTopics/Independentcontractors/Documents/Independentcontractormadesimple.pdf>

We understand a third booklet on dispute resolution is in the pipeline. These booklets should be heavily promoted to both small and large businesses.

Good, fair contract models should be developed.

Consult Australia (CA) has developed model contracts for use in its industry (consulting engineers, etc). As CA says:

- “Consult Australia developed through Standards Australia, a new *Australian Standard 4122-2010 General Conditions of Contract for Consultants*. The widespread adoption of this standard with fair and reasonable commercial terms will streamline the process of engagement of consultants, improve clarity and certainty of contractual terms and conditions between clients and consultants and ultimately reduce disputes between clients and consultants based on contractual terms”.

More information is available here:

<http://www.consultaustralia.com.au/content/default.aspx?ID=387>

This type of development should be encouraged. Governments should consider partnering with industry associations in funding the development of such models.

ICA has developed contract template models that identify standard clauses that are unfair or fair. <http://www.contractworld.com.au/practical/ica-contract-template-how-to.php>

4. Response to the four options

The Options paper offers four specific models. ICA's responses to each are below.

OPTION ONE – NATIONAL INFORMATION AND REFERRAL SERVICE

The National Information and Referral Service would provide a telephone hotline and website to direct small businesses to relevant existing dispute resolution services. This national, centralised referral service would provide information on what services are currently available in the relevant state or territory. Callers to the hotline would be guided through dispute resolution options and then referred to the appropriate existing service in their state or territory. This option could build on the services already offered by the Small Business Support Line and Advisor Finder.

ICA Response: *ICA support this.*

OPTION TWO – NATIONAL DISPUTE RESOLUTION SERVICE

The National Dispute Resolution Service would provide an information and referral service similar to option one, but would also offer a mediation service where no appropriate low cost dispute resolution service exists. This option would provide dispute resolution information through a website and telephone hotline. Operators would discuss dispute resolution with callers and direct them to appropriate existing services in their state or territory. If no appropriate service exists, a mediator drawn from a standing panel would assist small businesses with their dispute. This option would also offer an awareness and education campaign, which would target specific sectors with a high incidence of disputes.

ICA Response: *ICA supports this on the condition that it acts in a supporting, and not duplicating, role for state and territory Small Business Commissioners. See our previous comments.*

OPTION THREE – NATIONAL SMALL BUSINESS TRIBUNAL

A new Commonwealth tribunal, the National Small Business Tribunal, would be established specifically to resolve small business disputes. The tribunal would have the powers of investigation, conciliation and review, which would be backed by new Commonwealth legislation. Whilst it would provide coverage for a wide range of disputes, it would not deal with code of conduct matters or retail tenancy disputes. This option would provide a national network and a one stop shop approach for small businesses with disputes. The tribunal would be based in a capital city and could potentially use existing federal court infrastructure.

ICA Response: *ICA does not support this. This would unnecessarily duplicate and compete with the role of the Small Business Commissioner in each state and territory. Small business dispute resolution should be kept local wherever possible.*

OPTION FOUR – SMALL BUSINESS ADVOCATE

The Small Business Advocate would provide independent representation of small business interests and concerns within the Australian Government. The advocate would have the capacity for investigating and advising the Australian Government on small business issues, including dispute resolution. An initial referral service will utilise existing low cost state or territory dispute resolution mechanisms. Where a gap in existing services is identified, a suitable mediation service would be established (incorporating aspects of Option Two).

ICA response: *ICA supports this. However, in relation to dispute resolution, the Commonwealth should encourage state and territories to establish Small Business Commissioners. Where Commonwealth departments or instrumentalities are in dispute with small businesses, the dispute should be determined either by*

- *State Small Business Commissioners or*
- *The Commonwealth Advocate/Ombudsman armed with similar processes and powers as a Small Business Commissioner*