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The Treasury
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Dear Sir/Madam

CONSULTATION REGULATION IMPACT STATEMENT: ENHANCEMENTS TO UNFAIR CONTRACT TERM PROTECTIONS

The Australian Industry Group (Ai Group) welcomes the opportunity to make a submission on Treasury's Consultation Regulation Impact Statement (RIS) for the enhancement to Unfair Contract Term (UCT) protections.

Generally, we support initiatives that promote business growth and competitiveness, including for small businesses. Legislation and regulation can, in the right circumstances, reduce transaction costs and facilitate exchange, for instance by reducing information asymmetries and giving buyers greater confidence in sellers. The neutral enforcement of the law of contract by the legal system has been extremely valuable in this regard. However, it is unnecessary for there to be further government intervention in legitimate commercial contractual relationships between businesses, irrespective of size. As a matter of public policy, governments should respect the freedom for businesses to agree on legitimate contractual terms, unless there is persuasive evidence that intervention would effectively remedy significant existing problems or further boost exchange.

If the proposed reforms were implemented, they would create uncertainty and risk causing harm for businesses that take reasonable steps to ensure their contracts do not set unfair[1] terms on small businesses. Given the difficulty faced by a contract-issuing party in determining whether the other party is a small business, introducing civil penalties may have a dampening impact on the competitive negotiating environment broadly. If the only practical means to manage risk was to ensure that all standard-form contracts included safeguards intended only for small businesses operating in particular contexts, this would diminish the international competitiveness of Australian businesses and very likely harm consumer welfare.

Ai Group's membership comes from a broad range of industries and includes businesses of all sizes. For example, during the ACCC's Digital Platforms inquiry, we received input from businesses in the IT, telecommunications, energy and retail sectors. However, the breadth of scope and impact of the Digital Platforms Inquiry was much broader than this, applicable to many sectors that have the capability of being a digital platform or business.

In this regard, Treasury indicates in its Consultation RIS that it has included consideration of the ACCC's Recommendation 20 from its Digital Platforms Inquiry Final Report, which proposes to prohibit UCTs in any standard form consumer or small business contract and attach civil pecuniary penalties. As we had specifically raised concerns about this ACCC recommendation during its inquiry, our submission is primarily focussed on this issue, as well as addressing the scope of the UCT regime.

At this stage, we would like to provide preliminary views. As further consultation is undertaken, there may be additional matters raised. We would also welcome the opportunity to work closely with Treasury as the review progresses.

[1] Unless otherwise specified, reference to "unfair" in this submission is as defined in section 24 of the Australian Consumer Law (ACL).

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1. Making UCTs illegal and attaching penalties

The ACCC's Recommendation 20 proposes that the existing UCT regime be amended to include civil penalties. Treasury has now brought this recommendation forward as Option 3 in Chapter 4 ("Legality and Penalties") of its Consultation RIS.

The basis for the ACCC's Recommendation 20 was that the existing approach to UCTs as being able to be declared void provided insufficient deterrence, and it considered there were significant information asymmetries and bargaining power imbalances for the consumer, leading to consumers being unable to negotiate a bargain with digital platforms for their personal data. The ACCC considered this to be an economy-wide issue.

Below are the concerns that we raised in our submission to Treasury about the ACCC's Recommendation 20, which we maintain in relation to Treasury's Option 3.

1.1 Substantial existing regulation on unfair conduct

It is important to note that current notions of unfairness in Australian law are at the core of several provisions in the Australian Consumer Law (ACL):

- unconscionability under common law (which is incorporated into the ACL in section 20);
- the statutory form of unconscionability (section 21);
- unfair contract terms (section 23); and
- the "unfair practices" set out in Part 3.

Some elements of fairness also inform other provisions in the *Competition and Consumer Act 2010* (Cth) (CCA), including transparency in dealings in the general prohibition on misleading or deceptive conduct (ACL section 18) and a notion of commercial non-discrimination – or "level playing field" – that can be relevant to cases under the law against the misuse of market power (CCA section 46). There are also a range of sector-specific norms that would overlap with a general unfairness provision, notably rules on "good faith" in franchising and insurance. Taken together, these existing provisions represent substantial regulation of unfair conduct.

1.2 Lack of evidence about an existing problem and unnecessary red tape

It is not clear whether the existing provisions are insufficient to protect consumers and there is no evidence-based reason provided for requiring the introduction of penalties. Without substantiated evidence to the contrary, a case has not been made that a problem exists under the current law; therefore changes should not be made to the existing regime. In other words, the existing UCT regime, and the related protections in the ACL, appears to be working effectively for consumers and businesses. Additionally, this is an example of increasing unnecessary red tape in an environment where Government has committed to reduce it.

1.3 Practical compliance issues

It seems that Option 3 could potentially open the door to significant uncertainty with consequential difficulties in practical compliance by businesses. For instance, the ACCC had noted during its inquiry that prohibitions against UCTs could be used to protect consumers from conduct that they are unaware of, such as certain types of data collection. However, the Privacy Act already sets out the sorts of information for which disclosure is required and it is unclear why an amendment of that mechanism is not the best available means to address these issues.

Another practical problem with Option 3 is setting the penalty threshold value. For example, if the penalty threshold value is based on a percentage of group turnover, this could be completely disproportionate to the actual impact arising from an unfair contract term on a small business.

Further, imposing penalties under the proposed circumstances would impose significant compliance costs and leave businesses in a position where they could not legitimately and reasonably protect their interests. To compensate for those risks, it is likely that many businesses would seek other

mechanisms such as increases in prices or, in some cases, choosing not to deal with some businesses. High compliance costs may be warranted if it can be shown that there will be a significant improvement in conduct or efficiency, compared to the current approach (under which unfair terms are declared void). While the ACCC claims that the current approach does not provide sufficient deterrence, the Consultation Paper offers only anecdotal evidence from one sector (waste management). Instead, further enforcement of the current provisions could help to drive compliance. The ACCC should first rely on its existing powers to regulate the use of unfair contract terms, and bring cases where appropriate and/or necessary.

Finally, if there were to be evidence that demonstrated unfair conduct (excluding unfair contract terms) which was not being effectively addressed by the provisions that regulated such conduct (as discussed above), then it would be more prudent and practical to review the effectiveness of these other provisions (and amend if necessary), as opposed to creating new and separate regulations dealing with unfair conduct.

1.4 Grandfathering issues

Even in the event of there being sufficient evidence to support proceeding with Option 3, existing contracts already in place should be protected and exempted from the effect of this Option. That is, the application of this Option should not have a retrospective effect. Otherwise, changes arising from the Option could lead to open ended challenges to a broad range of existing contracts (agreed to prior to enacting this Option) and create inconsistencies in the execution of these contracts.

1.5 Previous grounds for rejecting penalties for UCTs

The introduction of penalties for UCTs were rejected previously on the basis that the standard of assessment is too ill defined to be applied directly. The same issues arise in the context of Option 3.

The Final Report of the *Review of the Australian Consumer Law* (ACL Review) in 2017 considered and rejected a less ambitious proposal than Option 3. The ACL Review considered an amendment such that it would be illegal to include terms in a contract that had previously been found unfair by a Court. The proposal was rejected, partly because terms should be considered in the context of individual contracts on a case-by-case basis. (The ACL Review report also noted that if a term has been found unfair, the inclusion of that term in a similar contract would constitute misleading conduct on the part of the business imposing it.) Such an approach would leave businesses in a position where they could not include terms necessary to protect their legitimate interests, which may differ from those of other businesses. It would also not take into account the broader context within which a term is used, including whether a term is reasonable when considered in combination with other provisions of the same contract. This same risk of uncertainty would arise with respect to Option 3.

Although the ACCC claimed during its inquiry that the current approach did not provide sufficient deterrence, no evidence was offered to support the claim. Changes to the current UCT laws should only be made if it can be shown that there will be a significant improvement in conduct or efficiency compared to the current approach of terms being declared void.

Ai Group recommendation: In the absence of substantiated evidence to the contrary, the current UCT regime should be considered to be operating appropriately i.e. Option 1 ("status quo") in Chapter 4 ("Legality and Penalties") of the Consultation RIS. Further development and consultation will be required if Option 3 or any other option were to be considered.

2. Definition of small businesses and value thresholds for UCTs

We note that the current UCT regime applies to small businesses with employee numbers of fewer than 20 persons at the time of entering into the contract, and for upfront price payable contracts capped at $300,000 or contracts running over 12 months at $1 million. Treasury considers that there are problems with the scope of the UCT regime – in particular: the headcount threshold does not capture all small businesses; and the value threshold for contracts may be too low. It proposes options to

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address these issues in Chapter 6 ("Definition of a small businesses contract") and Chapter 7 ("Value threshold") of the Consultation RIS. As these areas relate to the scope of the UCT regime, they are considered together in this section.

Defining small businesses and associated value thresholds of contracts under the current UCT regime are areas fraught with complexity, contention and confusion. For instance, there is current uncertainty that arises with respect to the definition of small businesses through "bright line" but arbitrary thresholds on yearly transaction values and employee numbers. It will often be difficult or impossible for businesses to ascertain whether a business is a small business when developing standard form contracts and in individual cases, there is potential for a counterparty to change status simply through growth or attrition in employee base.

2.1 Similar types of issues raised in ACL Review

Although under a different regime, our members have previously objected to a proposal by Consumer Affairs Australia & New Zealand (CAANZ) to increase the monetary threshold value in the definition of consumer from $40,000 to $100,000 under the ACL consumer guarantee regime. Our overarching concerns were that the case for change had not been adequately substantiated and that the proposals would instead result in inappropriate outcomes that were not fit for purpose. We consider that similar types of issues could arise in reviewing the definition of small business and value thresholds under the UCT regime. Elaborating further, key issues that we previously raised included:

- A proposed change to the threshold value is likely to harm small businesses. As with any business, small businesses act as both purchasers and sellers. While CAANZ hoped to protect small business as consumers under the threshold, its proposal would also potentially create a burden on the same small business as suppliers. The cost impact on small businesses as suppliers, as well as other businesses, would need to be examined if it were decided to change the threshold value.

- A monetary threshold value is a blunt and arbitrary instrument that does not provide clarity to the broad definition of "consumer" in the ACL. Consequently, it creates too much confusion and uncertainty for consumers and suppliers. While CAANZ wished to capture small businesses as consumers, the application of the threshold value amounts to blanket coverage for all business purchases under that threshold value. This goes beyond the small business consumer that CAANZ hoped to protect using the threshold approach. As CAANZ had stated, it was never the intention to offer such a blanket protection under the ACL.

2.2 Wider inconsistency with small business definition

There is a wider significant problem with the lack of consistent or standard definition for a "small business" under the *Corporations Act 2001* (Cth), *Fair Work Act 2009* (Cth), Australian Taxation Office, and other regulations/regulators.[2] Under these different regulations, definitions of small businesses may vary according to annual revenue, employee size, consolidated gross assets per financial year, and applicable financial year. The variation of definitions for small business across the different regulations highlights a problem in understanding the scope of applicable parties, including determining the appropriate threshold, and accounting for change in variables that define the small business.

For example, in some sectors, small businesses may fluctuate in employee size according to seasonal changes, given the nature of their work and products, which would be difficult for larger businesses to track. Under these circumstances, it may be easier if small businesses were not defined by employee size (Options 1 and 3 in Chapter 6), but based on another measure such as turnover on a group-wide basis (Option 2 in Chapter 6). Under this scenario, increasing the contract value threshold regardless of the duration of the contract (Option 2 in Chapter 7), or removing the contract value threshold (Option 3 in Chapter 7) would be unnecessary. However, redefining small business to address this scenario

[2] See: https://asic.gov.au/for-business/small-business/.

may not be applicable or helpful for businesses in other sectors that are not heavily influenced by seasonal changes.

2.3 Payment Times Reporting Framework Review

Concurrent to this Consultation RIS, we wish to bring to Treasury's attention that the Department of Industry, Science, Energy and Resources (DISER) is currently consulting on the Payment Times Reporting Framework (PTRF), which includes defining a small business supplier. DISER found that a challenge under the PTRF for larger businesses has been the difficulty in identifying their small business suppliers – such information is not publicly available and costly for all business sizes to collect and verify. In consultation with stakeholders, DISER has settled on the following solution:[3]

> *… a look-up tool to help automate the payment times reporting small business identification process. The lookup service would be based on a 'negative screen' of small businesses, where large businesses could enter identifying information about their suppliers and automatically see if the entities had a negative match to being a large or medium business.*

DISER proposes that a small business will be: "a business with turnover of less than $10 million that is not part of a larger entity or grouping of entities". We note that stakeholders in the DISER consultation have had different views about this definition, which is also an option being considered in Treasury's Consultation RIS (Option 2 in Chapter 6). However DISER has settled on it as producing results that better match with generally accepted small businesses than under a contract size approach.

In the context of the PTRF we have, on balance, considered the turnover definition and negative screen to be the most practical and least costly way of realising the Government's policy commitment around reporting. The exposure draft of the PTRF legislation is still out for consultation and it is not yet clear how quickly the Parliament may deal with it once introduced. However it appears likely to pass, and it presents an unusual outcome where the Commonwealth is considering one definition for small businesses under the PTRF regime, while potentially another definition for small business under the UCT regime. While the definition of small business remains unresolved, a lookup tool could provide a practical and targeted basis for identifying small businesses under the UCT regime. Given the timing of the PTRF, it may be prudent to pay close attention to its outcome and consideration of whether there are any benefits to considering its application in the context of the UCT regime. Nevertheless, a proper cost-benefit assessment will still be required to determine any proposed amendments to the definition of small business under the UCT regime. Actual performance of the PTRF tool, if used, will also need to be monitored and assessed.

2.4 Alternative solution

Separate to the PTRF, Treasury could also consider the introduction of an efficient and effective mechanism for clarifying, at the time a contract is entered into, whether a business is a "small business" or not. For example, a similar lookup tool as discussed above is one option. Such a mechanism would assist both parties, in determining whether proposed terms are unfair or illegal, and contractors, in knowing whether they are protected under unfair contract provisions.

Ai Group recommendation: Further development and consultation will be required if changes to the definitions of small business and contract value threshold under the UCT regime were to be considered. This should include consideration of the PTRF being developed by DISER, as well as other alternative mechanisms for defining small businesses.

[3] Commonwealth Department of Industry, Science, Energy and Resources, *Payment Times Reporting Framework* (Consultation Paper, February 2020), Link: https://consult.industry.gov.au/small-business/payment-times-reporting-bill-exposure-draft/.

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3. Alternative approaches to assist businesses

To avoid unnecessary regulatory intervention, an option that does not appear to have been considered in the Consultation RIS is a mandatory requirement for affected parties to first try and address concerns between themselves before involving a regulator. For example, where a business seeks to rely on the term of a standard form contract with a small business, and the small business believes the term is unfair, the following could be a process to address such a scenario:

1. Resolution between parties: The small business could have a mechanism to raise a complaint directly with the business (which could be via a mandatory reporting process) and give it a reasonable time to review the complaint and attempt to resolve it directly (such resolution could take the form of either removing the term or amending the term so it is no longer unfair).

2. Regulator resolution: In the event the parties cannot agree on an outcome, the small business could then have the ability to engage a regulator (or even an external dispute resolution scheme) to liaise directly with the business and help resolve the complaint.

3. Regulator determination: The regulator can then determine if additional enforcement action is required depending on the nature of the term and actions of the business.

Further, to help reduce uncertainty, an alternative approach could be for regulators to approve "reasonable steps" that contract-issuing parties could take in order to demonstrate they had sought to avoid imposing unfair terms on small businesses in their standard-form contracts. The highly contextual nature of unfair terms means that such steps would not be exhaustive. However, they could potentially be defined on a sectoral basis, and set out in the form of industry codes of practice. For instance, the ACCC previously identified common unfair contract terms in specific industries in 2016.[4] More recently, the ACCC has recommended that the Federal Government implement a code of conduct for the wine industry.[5]

"Reasonable steps" could include: ensuring that particular 'black-listed' terms are not included in standard-form contracts; and, in the case of more ambiguous "grey-listed" terms, these could be periodically reviewed by the contract-issuing party, including the consideration of any external feedback received. We understand that the current legislative approach in the UK is similar to this – certain terms are black-listed, making them unenforceable in all circumstances, while others are grey-listed, meaning that the terms are "potentially unfair", depending on the circumstances.[6] Similar to Australia, EU legislation only implements a grey list, containing a "non-exhaustive list of terms which may be regarded as unfair".[7] In the ACL Review, CAANZ examined the possibility of expanding the list of terms outlined in the ACL that may be unfair (the "grey list"). However, it ultimately opted against this, as the current grey list is "intentionally broad and indicative in nature", with many of the suggested additional terms already captured, or considered unfair if subjected to testing by the courts.[8]

In addition, "reasonable steps" could also include maintaining effective internal dispute resolution processes so that any claims of unfair terms from small businesses are quickly assessed and acted upon, without the need for more costly and time-consuming legal processes. The purpose of such "reasonable steps" would be to provide a safe harbour for businesses seeking, in good faith, to avoid

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[4] ACCC, *Unfair terms in small business contracts: A review of selected industries* (Report, November 2016), Link: https://www.accc.gov.au/publications/unfair-terms-in-small-business-contracts.
[5] ACCC, *Wine grape market study* (Final Report, September 2019), Link: https://www.accc.gov.au/publications/wine-grape-market-study-final-report.
[6] *Consumer Rights Act 2015* (UK); Competition & Markets Authority, *Unfair contract terms guidance: Guidance on the unfair terms provisions in the Consumer Rights Act 2015* (July 2015).
[7] ACL section 25; *Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts* [1993] OJ L 95/29, art 3(3).
[8] CAANZ, *Australian Consumer Law Review* (Final Report, March 2017), p. 56, Link: https://consumerlaw.gov.au/consultations-and-reviews/australian-consumer-law-review/final-report.

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imposing unfair terms, and while recognising that this is highly contextual, subjecting those unwilling to take such steps to a greater risk of enforcement and deterring abusive behaviour. While this is not a perfect solution, it would at least reduce some of the uncertainty for businesses, who (as long as they had done so) could rely on having taken agreed "reasonable steps" to avoid exposure to penalties, provided they have remedied any terms subsequently found to be unfair.

Ai Group recommendation: Further development and consultation should be given to other options to better assist businesses to resolve issues with unfair contract terms such as consideration of a dispute resolution process and a "reasonable steps" test.

If you would like clarification about this submission, please do not hesitate to contact me or our Digital Capability and Policy Lead Charles Hoang (02 9466 5462, charles.hoang@aigroup.com.au).

Yours sincerely,

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