FCAI Submission - Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Unfair contract terms reforms

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September 2021

Introductory Comments

1. The Federal Chamber of Automotive Industries (**FCAI)** is the peak industry body for the motor vehicle industry in Australia. Sales of new motor vehicles by FCAI members represent over 99% of all new motor vehicles sold in Australia each year. The FCAI welcomes the opportunity to make this submission on the 'Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Unfair contract terms reforms' ('**Bill**') which it does on behalf of its members. In this submission the FCAI will only address those matters which have specific relevance to its members.

2. The FCAI understands the rationale for the Bill. As the Explanatory Memorandum says, it is to:

   > '*strengthen and clarify the existing unfair contract term provisions in order to reduce the prevalence of unfair contract terms in consumer and small business standard form contracts'.*[1]

   The FCAI supports the view that 'small business' needs to be protected from exploitative behaviour of large business that use their size advantage unfairly. However, the protections offered by the unfair contract term **('UCT'**) provisions need to be limited to businesses that are genuinely 'small'. The FCAI agrees with one of the changes to the definition of 'small business': having an annual turnover of less than $10million. However, businesses that employ nearly 100 people are not small. For the reasons set out in this submission, the FCAI is of the view that the number of employees for a business to be classified as 'small' should remain as it is - less than 20. If this is not accepted then, at the very least, the number of employees should include those employed by related entities.

3. The Bill introduces pecuniary penalties for breaches of the UCT provisions. The FCAI is of the view that these are unnecessary and excessive.

[1] Paragraph 1.1 of the EM

Definition of 'Small Business'

1. As an initial point it is important to note that in addition to the UCT provisions, businesses, both big and small, have protections which, while not as far-reaching as the UCT provisions, are nonetheless similar in nature. These include the unconscionable conduct provisions in the Australian Consumer Law, unconscionable conduct at common law, the obligation to act in good faith which is contained in the Franchising Code of Conduct and the duty to act in good faith which is increasingly being implied into contracts and business relationships in general.

2. Notwithstanding these protections, the UCT provisions offer additional protections to 'small' businesses. This means that it is the size of the business that is the determining factor in the apparent need for the UCT provisions – i.e., it is because the business is 'small' which in and of itself means that it needs to have the protections contained in the UCT provisions. As pointed out in the Discussion Paper which accompanied the Regulatory Impact Statement:

   '*Like individual consumers, many small businesses lack the time, resources, legal or technical expertise and bargaining power to negotiate changes to terms specified in standard form contracts'.*

3. In other words, the criteria used in the legislation needs to accurately distinguish 'small' businesses from other businesses.

Annual Turnover is appropriate

4. The FCAI welcomes the change from 'upfront price payable' to annual turnover. It also agrees that the appropriate maximum amount for a 'small business' is $10 million. As pointed out in the Regulatory Impact Statement, this is consistent with the Australian Taxation Office, which uses an aggregated turnover of less than $10 million to categorise a small business for various tax concessions.

Number of employees in not appropriate

5. While having an annual turnover of less than $10 million is an appropriate measure for a small business, using the number of employees is not. It is not needed and should be deleted. If it is retained, it should be reduced to 20 employees and related entities should be included when calculating the number of employees.

   Too uncertain

6. The Explanatory Memorandum makes the following point (with which we agree):

   '*Under the current headcount threshold (which determines whether a business may be considered a 'small business' covered by the protections of the unfair contract term regime), it can be difficult for a contract-issuing party to determine the other party's employee numbers. The lack of clarity in the application of the test has led to uncertainty'*.

7. Unfortunately, the Bill does little to address this uncertainty. This is doubly

unfortunate because there should be even greater clarity under the Bill given that it is proposed that a contract issuing party can be subject to a significant penalty if they breach the provisions.

8. Determining the number of employees at a counter-party will not always be easy, but at least when the contract is being entered into, it is able to be verified.[2] But what if, when a standard form contract was entered into there were more than 100 employees and subsequently the contract issuing party, seeks to rely on an 'unfair' clause. If the number of employees in the other party has decreased to less than 100 the contract issuing party will have committed an offence and be subject to a substantial pecuniary penalty.[3]
9. At the very least whether or not a party is a 'small business' should be determined when the contract is entered into, and that classification should remain for the duration of the contract.

100 employees is excessive

10. A business is defined as 'small' if it satisfies either of the limbs of the definition – i.e., its turnover is less than $10 million <u>or</u> it employs less than 100 people. Having a turnover of less than $10 million does equate to a small business. However, having less than 100 employees does not. There are any number of businesses that employ less than 100 employees but which no one would consider "small". Here are just a few examples:
    - Jaguar Land Rover – 70 employees
    - Yamaha Music – 80 employees
    - Sony Interactive Entertainment Australia – 30 employees
    - Nintendo Australia - 91 people. Note that the parent company, Nintendo, had an annual revenue of 1.759 trillion yen (approx. $21.5 billion AUD) in 2021
    - Any number of new motor vehicle dealerships all owned by the ASX listed or significant family/corporate owned groups yet operating as separate companies.

11. Is it really suggested that these companies require the protections provided by the UCT provisions?

12. Clearly a threshold of 100 employees is far too high.

13. A more appropriate definition for a small business is one that employs less than 20 people, as is the case under the current provisions. Not only does this empirically make sense, but it is also consistent with the definition adopted by the Australian Bureau of Statistics.

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[2] We discuss in paragraph 26 some of the potential problems with seeking a warranty and indemnity from a counter-party

[3] s23(2C)

14. While referencing the ABS definition it is clear that the ABS is the defining authority on small business. As mentioned, the test applied by the ABS is 20 employees or less. A medium sized business is said to have between 20 and 199 employees. As of June 2021, there were 56 thousand medium sized businesses in Australia with an average employee number of 49 and average turnover of $15.6 million.

15. With a normal distribution, the measures of central tendency in the data set, that is the mean, median and mode, are equal. This would mean that the average number of employees in a medium sized business would be 109.5. However, as the average employee number is 49, this data set is highly skewed. Our analysis is that at least 50% of the 59 thousand businesses currently defined by the Government as medium sized businesses will be caught by the proposed definition within the UCT draft legislation. This is not the stated Government intent.

Related entities should be included

16. A company could by definition be a 'small' business, but nonetheless be a part of a larger group of companies which taken as whole is anything but 'small'. The 'small' business has access to the sophisticated resources and strength of the group and is, in reality, not 'small' at all. Indeed, often large groups are structured in just this way: employees are employed by a central company with the operating companies employing very few people. This is certainly the case in many automotive dealerships. In these circumstances the operating business should not be able to avail itself of the protections offered by the UCT regime. With the proposed threshold being 100 employees, this issue is even more pertinent.

17. This anomaly is recognised, at least in part, in the Privacy Act which provides in section 6D(9):

    'Despite subsection (3), a body corporate is not a small business operator if it is related to a body corporate that carries on a business that is not a small business.'

    This should be expanded to provide that, when assessing the number of employees of a body corporate, the total number of employees in the corporate group should be included.

Pecuniary Penalties

18. A person will be subject to a significant penalty (the size of which is discussed separately below) if they enter into a standard form contract with a small business which has an unfair term, or if they apply or rely on the unfair term.

Penalties are not appropriate

19. Imposing financial penalties is a serious matter and should only be done if there is a demonstrated need and it is clear that the threat of imposing a penalty will reduce the unacceptable behaviour.
20. As far as the FCAI is aware, there have been no instances where UCTs have been found to have been used in the automotive industry. More broadly, in other sectors of the economy, the FCAI accepts that there have been instances where UCTs have been used but is not aware of any evidence that:

> *'This option [imposing financial penalties] is likely to be the most significant deterrence against using UCTs in a small business standard form contract.'*[4]

21. The FCAI understands that in the current provisions, the consequences of a company being found to have used standard form contracts which contain UCTs are somewhat cumbersome. However, this is already being rectified in the Bill, with the Court being able to make orders it considers appropriate to prevent or reduce loss or damage that has or may be caused by the unfair term. These orders can be made in relation to any existing standard form contract that contains a similar term to the term that has been declared as unfair. These amendments give the Court extremely wide powers to make orders that will have a significant effect on an offending company and are a much more appropriate 'punishment'.

Maximum penalties excessive

22. The maximum penalty for breaches of the provisions is $10 million, or three times the benefit gained by the breach, or 10% of the turnover of the breaching party. This is excessive and disproportionate to the impact of the breach.
23. Penalties of up to $10 million are appropriate when the consequences of the breach are far-reaching and have a significant impact on a large section of the community. Cartel conduct is a good example where fines of this magnitude are justified. Proposing an unfair term in a standard form contract to a small business, hardly falls into the same category.
24. The excessiveness of the penalty is even more egregious when the proposed new section 12DF(2B) is considered. This provides that:

> *'A person who contravenes subsection (2A) [proposing an unfair term] commits a separate contravention of that subsection in respect of each term that is unfair and that the person proposed'.*

25. For there to be a breach of s12DF(2A), the unfair term must be contained in a "standard form contract". Standard form contracts are, by their nature, used frequently, meaning that if the term is found to be in breach of s12DF(2A), the breaching party is likely to have committed a substantial number of separate

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[4] At page 18 of the RIS

contraventions, each of which is subject to a maximum penalty of $10 million. This cannot have been intended and must be addressed.

26. It is not enough to simply say that these are maximum penalties and it is up to the Court to impose what it thinks is appropriate in the particular circumstances. If this was a valid proposition, there would be no maximum penalties for any breaches. The fact is that maximum penalties are there for a reason: they reflect the perceived seriousness of the breach.

Need clarity

27. We have already mentioned the fact that a party might find it difficult to ascertain the number of employees of a counterparty and the fact that this might change over time. It has been suggested that a party can protect itself against this by seeking a warranty and indemnity from the counterparty that they employ more than 100 people and if this reduces below 100, they will notify the other party accordingly. The problems with this are twofold:
    - It does not prevent the party from breaching the provision and being exposed to a penalty; and
    - It is unclear whether, as a matter of law, a party can be indemnified against a pecuniary penalty and, even if this is the case, the indemnifying party may not have the financial capacity to satisfy the claim.

Clarity on standard form contracts

28. Many of the submitters to the RIS (including the FCAI) made the point that it is often difficult to ascertain if a contract is a 'standard form contract'. While the Bill has sought to clarify this to an extent it has not gone far enough and uncertainty remains. With significant penalties applying for a breach, the need for clarity is magnified.

29. This is particularly the case in the automotive industry when a manufacturer wants to introduce a new dealer agreement or make significant amendments to an existing agreement. Unless the dealers choose to formally engage in collective bargaining, a manufacturer generally will engage with a representative group of dealers often under the auspices of the respective Dealer Council. These representatives don't have formal authority to bind the dealers, but they are the 'voice' of the dealers.

30. Generally, the manufacturer and the dealer representatives discuss and negotiate the draft dealer agreement, often over many meetings, with both sides being legally represented. As a result of these negotiations the manufacturer will amend, often substantially, the draft dealer agreement. At the conclusion of the process the manufacturer sends the final version of the new agreement to all dealers.

31. While this amounts to a substantial degree of negotiating on the terms of the dealer agreement, it is unclear whether, in this situation, the dealer agreement is a 'standard form contract'.

32. To address this, the FCAI suggests that the criteria for a 'standard form contract' should be amended so that it more clearly refers to prior discussions and negotiations with representatives of the other party.

Rebuttable Presumption

33. Clause 37(5)(a) of the draft regulations states that if it is established in one contract that a term is unfair, and that term also appears in another contract which a party claims is an unfair term, then the term is presumed unfair. FCAI would suggest that the wording may be strengthened through ensuring that the proceedings subject to that initial decision that the term is unfair must be proceedings taken in respect of the UCT provisions of this Act.