

20 December 2018

Manager
Unfair Contract Terms Review
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: consumerlaw@treasury.gov.au

Dear Sir/Madam

Review of Unfair Contract Term Protections for Small Business

Introduction

The Law Council of Australia is the peak national body representing the legal profession in Australia.

The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) makes this submission in response to a Discussion Paper from Treasury dated November 2018 on Review of Unfair Contract Term (**UCT**) Protections for Small Business (**Discussion Paper**).

The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SMEs. This submission draws on Committee members' perspectives and experiences as advisers to SMEs.

Please note that the SME Committee's submission may differ from those made by other Committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs and other sized enterprises

Response

Thank you for the opportunity to provide a submission on the Discussion Paper. We have sought to respond below to each of the questions listed in the Discussion Paper.

The SME Committee considers it is important to recognise that both consumers and small businesses use insurance cover to manage risk. The SME Committee's responses below are made in light of the use by small businesses particularly of general insurance cover as risk management for their business activities. The Committee also provides responses in light of the use by small businesses and consumers of life insurance cover as a treatment for the risk costs of the death, trauma to, permanent disability or temporary disability (so as not to be able to be employed) of individuals upon whom others, or the business, relies. The

benefit payable under such an insurance policy is compensation for what would otherwise have been the loss suffered by the insured for an untreated risk event.

The SME Committee notes that because insurance cover is used as risk management, it is imperative that the terms of the cover and the benefit payable under the insurance policy are clear and indisputable so that the policyholder as an insured consumer or small business does not find that the insurance cover taken out fails to provide sufficient and certain risk cover.

Issues for Discussion

Thresholds

Does the headcount approach work in practice? If so, is an employee number of 20, appropriate to define a small business for the purpose of UCT protections? If not, what are alternative approaches and what would be the benefit of adopting them?

From the SME Committee's experience, a definition of small business of up to 20 employees limits the application of the extension of unfair contract terms. A major objective of extending the UCT legislation to small business was to provide a level competition playing field to provide small business with the same protections as consumers given that small business often face the same vulnerabilities and difficulties as consumers in a contractual relationship.

Consequently the Committee considers that it would be appropriate to change the definition of small business to 'up to 100 employees'.

This would also accord with both the definition applicable for the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) and the Australian Financial Complaints Authority (**AFCA**), both of which are high profile bodies that deal with small business dispute issues and would assist both small business and those who deal with them to understand when the UCT legislation applies.

Does the value threshold appropriately cover contracts that warrant UCT protections? If not, how should the thresholds be altered and why?

In the context of the Law Council's recent submission on the extension of UCT to small business,¹ the SME Committee preferred that the legislation apply to all standard form contracts, regardless of value thresholds. The Committee continues to consider that thresholds should not apply.

Although the Committee acknowledges that the inclusion in the application definition of a value threshold places the onus on small businesses to undertake due diligence for high-value transactions, thus avoiding a moral hazard situation occurring where a small business relies solely on the UCT protections without undertaking the necessary due diligence before signing a contract, the Committee continues to prefer no threshold.

From the Committee's experience, albeit due diligence would seem prudent for a high value contract, when the contract is in standard form, as noted in the discussion paper, by definition, there is no feasible opportunity for a recipient party to the contract, whether or not they are a small business, to negotiate any of the terms of the contract.

¹ Law Council of Australia, *Unfair Contract Terms - Insurance Contracts*, Submission to the Treasury, 27 August 2018.

The commercial terms are always negotiable in all standard form contracts, these being the contract party name and details, the term of the contract, the price and the subject matter of the good or service being provided. Consequently, the Committee notes that these commercial terms are, in any event, exempt from the application of the UCT legislation.

Do you have experience or are you aware of any contracting practices designed or undertaken to avoid the UCT protections?

The Committee is aware of practices by franchisees that avoid detriment to themselves, and thus would not meet the definition of an unfair contract term, but result in detriment to a third party, such as employees. Please see its response to item 7 below.

Coverage

In your experience, what factors and circumstances make it difficult to determine whether a contract is a standard form contract? What clarifications would assist with making this determination? Can you provide examples?

The Committee acknowledges that the current legislation ultimately leaves it for a court to determine whether a contract is a standard form contract, with a list of criteria to be taken into account. Commercially and legally however, what constitutes a standard form contract is fairly well understood, in particular that the body of the terms of the contract are not negotiable (that is, 'take it or leave it'), and the contract is used on a repeat basis, albeit that this is not a criteria listed in the legislation.

The Committee notes that this may be because, given the UCT legislation currently only applies to provide a remedy to a small business contract party on an individual contract basis, the need for the contract to be used on a repeat basis was not considered appropriate to be included as a criterion.

The Committee notes that without the inclusion of the repeat use criteria, the definition of a standard form contract could be applied by a court to a contract that would not generally be considered to be a standard form contract.

Consequently, the Committee considers it would provide for clearer application of the legislation if it included a definition of a 'standard form contract', rather than leaving it for a court to determine, and to include in that definition a requirement for repeat usage of the contract.

The Committee agrees that when entering into a contract, small businesses would benefit from greater certainty as to whether the contract they intend to sign is a standard form contract likely to fall within the protections of the UCT regime, rather than a contract where a claim that a contract is a standard form contract may be challenged.

The Committee observes that it is easier for either the Australian Competition and Consumer Commission or the Australian Securities and Investments Commission to determine whether a contract made with a small business is a standard form contract as they are able to assess a range of contracts used by an entity requiring the contract in the form containing the alleged unfair term.

Exemptions

Are the exemptions appropriate? Can you provide examples of where the exemptions to the UCT protections have been ineffective? Is there evidence that would justify an expansion of the exemptions, for example, as a result of regulatory overlap?

It is the SME Committee's position that the current exemptions to the UCT legislation as they apply to small business are appropriate and do not require expansion, including for reasons of regulatory overlap.

The Committee notes that in the situations that the Discussion Paper suggests should be exempted from the UCT protections, unfair terms should not exist. Situations mentioned by industry stakeholders include:

- where contracts are in a standard form, but are not used in a 'take it or leave it' fashion and are subject to individual negotiation. The Committee notes that such individual negotiation is generally to commercial terms as previously mentioned and any negotiation should not allow agreement for the inclusion of potentially unfair terms;
- where terms included in a standard form contract are drafted in line with an industry code. The Committee notes that any suggested inclusion in an industry code of a potentially unfair term should be apparent before the code is put in place and should be removed; and
- where 'minimum standards' prescribed by state and territory laws may conflict with the UCT protections or cause uncertainty for businesses. The Committee notes that there are legal interpretation rules that apply to provide Commonwealth legislation with priority over any conflicting State or territory laws.

Should industry 'minimum standards' prescribed by state and territory laws be exempt from the UCT protections? Is there data and evidence to support your opinion?

In the Committee's view, a state or territory minimum standard should not be assessed as an unfair term, even applying the Commonwealth UCT legislation as it applies to small businesses.

Consequently, although the Committee does not see the necessity to exempt such minimum standards from the UCT protections for small business, it does not disagree with doing so if it mitigates any legal debate as to legislative priority.

Overall Effect

Do you think the current UCT regime offers appropriate level of protections to small businesses?

Generally, the SME Committee acknowledges that the extension of the UCT regime to small business has provided an opportunity to seek a more level commercial and legal competition playing field for small businesses, which can only assist small businesses to prosper.

As previously noted, the Committee is of the view that the UCT regime would benefit more entities in the small business sector by increasing the definition requirement for a small business from up to 20 employees, to up to 100 employees, and from removing value thresholds for contracts to be included in the regime.

In addition, the SME Committee considers that the objectives sought to be achieved by the extension of the UCT regime to small business would better be met if a change is made to the remedial consequences of the inclusion of an unfair term in a contract. The current legislation provides for a court to determine whether or not a term is an unfair term given

the factual circumstances of the parties' relationship. Where a contract term is found to be unfair, the legislation provides for it to be void.

Whilst the Committee acknowledges that the current legislation provides that if a court makes a declaration that a term is unfair and consequently the term is thereby void, should a party subsequently seek to apply or rely upon the unfair term, it is a contravention of the Australian Consumer Law (or the *Australian Securities and Investments Commission Act 2001* (Cth)), and the court may grant one of the following remedies:

- an injunction;
- an order to provide redress to non-party small businesses; or
- any other orders the court thinks appropriate.

The Committee notes that there may be circumstances where the remedy of voiding a term may not be the preferred outcome for small business otherwise impacted by the term.

The Committee therefore notes that as an alternative to the term being void, it may be preferable that the consequence of a court determining a term to be unfair should not just be that the term is void, and the court should also have the power to make other or alternative orders if it thinks such order will provide a more appropriate and just outcome in all of the circumstances, including rewriting or varying any unfair term.

Do you think additional examples are needed to clarify unfair terms?

The SME Committee considers that as the regulators take legal action on unfair terms, each providing an additional example, the impact of the UCT regime as it applies to small business will become more widely acknowledged, recognised and applied so as to not have unfair terms included in a greater number of future contracts.

Are there any other issues relevant to the Government's review of UCT protections for small business that impact on the effectiveness of the regime?

Additional determinative bodies

The SME Committee suggests that the determinative body under the legislation should not be limited to the courts. For a small business to take action in a court to have a term in a contract assessed as void is an expensive and time-consuming exercise and unlikely to be availed of by many small businesses who could otherwise benefit from the regime.

The Committee considers that it would greatly benefit the ability of the regime to achieve its intended objectives for a small business to be able to seek a determinative outcome from a Tribunal dealing with small businesses, or in the case of financial products and services, from AFCA.

Unfair term in one, unfair in all similar terms?

The Committee is of the view that the legislation should be changed to provide that when a term in a standard form contract with one small business has been determined to be an unfair term, the same term should also be deemed to be an unfair term in all others of the same form of standard form contract subject to the UCT legislation. This should occur at the time the determination that it is unfair is made, if used by the other party with small businesses in similar circumstances to those of that one small business.

The Committee notes that it is common for an industry sector to use similar terms in standard form contracts, even if the contract for each provider differs in its other (standard) terms. Accordingly, if one business had a term declared an unfair contract term, the Committee considers it may be appropriate to deem that term as an unfair term in all standard form contracts used in the same industry sector.

Alternatively, the Committee considers that another approach to a provision that deems an unfair term to also be an unfair term in other standard form contracts that are subject to the UCT legislation used either by the same provider or by the industry sector is possible. This may be to change the legislation so that if an order that a term in a standard form small business contract is an 'unfair contract term', there is then a rebuttable presumption that in other similar contracts subject to the UCT regime (used by that business or used by other businesses in the same industry) that contain the same term, the term is an unfair contract term. In that way the term is not deemed to be void or illegal but there is a rebuttable presumption that it is an unfair term. The stronger party would then have the legal onus of proof to show it is not an unfair contract term in that contract rather than deeming every contract to contain an 'illegal' term.

Inclusion of unfair term as an offence

The SME Committee notes that there has been a suggestion that the inclusion of an unfair term in a standard form contract with small business, and that is subject to the UCT legislation, should be considered an offence subject to sanctions.

Perhaps it is that the regulators consider the inclusion of an UCT should be illegal so they can impose a fine for simply including an UCT even if it was never used or relied on. The Committee's position is that it would be concerning if the fine imposed was based on a separate fine for each contract in which the term appeared, or based on a separate fine for each term in that contract that is held to be void because when that is coupled with the provision that the Committee has suggested to consider one unfair term to also be deemed unfair in others of the same standard form used by the party with other small businesses in similar circumstances, the potential fine could be huge.

Given that under the current and any changed legislation a degree of uncertainty will exist as to whether a term is determined to be an unfair term, the Committee does not consider that the inclusion in a contract of a potentially unfair term should be an offence, nor that sanctions should be applied for such inclusion.

Further discussion

The SME Committee would be happy to discuss further any aspect of this submission. Please contact Coralie Kenny, member of the SME Committee, in the first instance on 0409 919 082 if you would like to do so.

Yours faithfully



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Chair, Business Law Section