



Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600
Via email: economics.sen@aph.gov.au

27 August 2015

Dear Sir/Madam,

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

Introduction

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

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (SME Committee) makes this submission in response to a request from the Senate Economics Legislation Committee in relation to the Treasury Legislation Amendment (Small Business and Unfair Contracts Terms) Bill 2015.

The SME Committee has as its primary focus the consideration of legal issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership comprises legal practitioners who are extensively involved in legal advice to small businesses.

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.

Submission

The SME Committee is supportive of the Commonwealth Government's proposal to extend Unfair Contract Term (UCT) protections to small business.

The SME Committee believes that many small businesses are subject to UCT's in the standard form contracts which they enter into with larger businesses.

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone +61 2 6246 3788
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

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Background

In May 2009 the then Minister for Consumer Affairs, the Hon, Chris Bowen MP issued draft legislation to prohibit unfair contract terms.

The proposed law covered business to business and well as consumer to business contracts.

In relation to business to business contracts the then Minister said:

“Standard-form contracts are used by parties irrespective of the legal status or nature of the party to whom the contract is presented, and without any effective opportunity for that party to negotiate the term. In such cases, it would be invidious to suggest that the same term, which may be considered unfair in relation to a contract entered into by a natural person, would not be similarly unfair in relation to a business, where neither of them is in a position to negotiate the term”

The business to business dealings were to have a contract threshold of \$2 million for all contracts.

Eventually a Bill was tabled in Parliament but business to business contracts were excluded.

The present

The Coalition went to the last Election promising business to business UCT legislation for low value standard form contracts below a certain monetary threshold. The Minister for Small Business, the Hon Bruce Bilson MP, embarked on an extensive consultation process proposing an extension of the current consumer provisions to small business contracts to assist small businesses where the allocation of risk in the contract could not be fairly apportioned.

There is a general acceptance that extension of the UCT protections to small business contracts where one of the parties is a small business with fewer than 20 employees is warranted. However the critical issue is the threshold level that determines whether the law applies to the contracts of that small business.

The proposed legislation has the following thresholds:

- A business with fewer than 20 employees; and
- The **upfront price payable** under the contract does not exceed \$100,000; or
- The contract has a duration of more than 12 months and the **upfront price payable** under the contract does not exceed \$250,000.

The test does not differentiate between a contract by a small business that acquires goods for resale and a contract to acquire services or a combination of goods and services for consumption by the business.

Small businesses that acquire goods for resale (or a combination of goods and services) are more likely to quickly exceed the thresholds. Small businesses that acquire services only are more likely to fall under the proposed thresholds.

The “upfront price payable” under the contract is defined in the Australian Consumer Law as the consideration that:

- a) is provided, or is to be provided, for the supply, sale or grant under the contract; and*
- b) is disclosed at or before the time the contract is entered into,*

but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.

In the view of the SME Committee the thresholds are too low and will as a consequence automatically exclude many small business contracts, particularly those involving the main suppliers to and customers of small businesses.

Contractual terms with larger suppliers can often be the most difficult to negotiate yet due to the value they might fall outside the threshold. On the other hand smaller suppliers with less influence will fall within the threshold.

Consequently if the two categories use the same potentially unfair terms, which is quite possible, one will be struck out, the other will not.

A related issue is that to determine what constitutes an “upfront price payable” in small business contracts is problematic. The definition is taken from the business- consumer regime and not the business to business where there are a variety of fees and costs. As a result the thresholds are readily reached.

The SME Committee suggests that the Senate Committee consider whether the current monetary thresholds are appropriate for what is intended by the proposed legislation.

To assist the SME Committee lists other thresholds by way of comparison:

- The CCA collective bargaining regime has different thresholds depending on the sector starting at \$ 3 million annual dealings, then \$5 million for farmers, \$10 million for agricultural machinery, \$15 million for fuel resellers and rising up to \$20 mill for new car dealers.
- The proposed Small Business and Family Ombudsman, 100 employees.
- CCA Unconscionable conduct, none.
- CCA Unfair contract terms for consumers, none.
- CCA Small business purchases re warranty protection - \$40,000 for any individual purchase e.g. photo copier.

Impact of thresholds in relation to various businesses

- Grocery stores

A medium size independent grocery store will have many suppliers but there will be one main grocery wholesaler.

Purchases from the main grocery wholesaler will be many millions of dollars annually, no matter the size of the store. In addition, in many States, a subsidiary of the wholesaler will supply liquor products, and again in the millions of dollars annually.

Other major suppliers to grocers will be poultry suppliers, dairy products, bakers, and all will in most cases be in the millions of dollars annually, not to mention rent and utilities.

Many of the supply contracts will be for more than one year. A typical contract, for instance, is for 5 years.

- Newsagencies.

A small suburban newsagency might spend some \$250,000 annually on magazines, spread over three suppliers, but two dominate. Newspapers and phone cards will be approximately \$100,000 as will rent.

Most of the supply contracts will be for more than one year.

- Hotels.

Most will have more than 20 employees and annual contracts with suppliers such as brewers and liquor wholesalers will be over the thresholds.

- Mortgage brokers.

Many brokers would get over \$1 million dollars annually in commissions, many would get less but very few would get below \$100,000.

- Petrol.

Where the service station operator buys the fuel the annual amount will in most cases be many millions of dollars.

- New motor vehicle dealers.

Again dealers buy motor vehicles (trucks and cars) for resale and the upfront cost for goods for resupply will be many millions of dollars. Interestingly in NSW the Motor Dealers and Repairers Act does not set a monetary threshold for a new motor vehicle supply contract to be regulated by their UCT protections.

- Pharmacies

They deal with two wholesalers and annual or multiyear contracts would be well above the threshold level.

What might the transaction threshold be?

There are many options and it is not the role of the SME Committee to suggest a particular option. The SME Committee suggests that the monetary thresholds should be higher or that there be a higher threshold for contracts involving goods where they are intended for resupply.

Other issues

The SME Committee wishes to also comment on other issues as follows:

1. The definition of 'up front price payable'

The SME Committee acknowledges that the application of the UCT extension to a small business requires the contract to meet certain criteria, one being that the **upfront price payable** under the contract does not exceed \$100,000.

The SME Committee notes that the upfront price payable concept appears to have been taken from the existing consumer provisions under the ACL although there is no threshold in the ACL in relation to those provisions and the reference has a different purpose in those provisions.

As indicated, there is some concern within the SME Committee about the definition of "up front price payable" and how it that definition applies for monetary thresholds. The Committee's main concern is how the 'up front price payable' should be calculated.

The SME Committee considers that the Explanatory Memorandum and any educational material prepared by the ACCC should provide meaningful guidance.

An example of the confusion with what will form the upfront price is highlighted by the following typical payments seen in a franchise agreement (assuming it is considered to be a standard form contract):

- *An upfront fee for the grant of rights (this would be included).*
- *An ongoing franchise fee may form part of the upfront price unless it is considered "contingent". Many retail and service franchise agreements are based on a fixed percentage of gross sales (revenue or profit) for a particular trading period. Some agreements may have a minimum specified amount such as \$1,000 per month or a combination of both (e.g. the greater of 6% of Gross Sales or \$1,000). Those minimums may also be subject to review by CPI increases or another review mechanism which could be contingent.*

Other payments that typically appear in a franchise agreement include a contribution to a marketing or cooperative fund controlled by the franchisor. It is usually calculated in a

similar way to an ongoing royalty. Should a payment of that kind be included in the determination of the upfront price when it is essentially for a cooperative purpose?

Under franchise agreements there is also usually a "renewal fee" which is typically paid before the end of the term of the contract to secure a renewal, and a transfer fee (usually based on a percentage of sale price).

Many franchisors also control premises by holding the lease (or an associate holding the lease) which are leased or licensed by franchisees. Typically the rent and outgoings are "passed through" at the cost to the franchisor however those payments can be significant.

Whilst they are usually part of a separate outlet licence agreement, there is potential for a franchisor to include the obligation to pay in a franchise agreement (with the effect that the value of a good or service supplied is higher) which might have the effect of the threshold being exceeded. The same may apply to the acquisition of assets such as an existing franchise business as a going concern in concert with the supplies made under the franchise agreement. It is also not uncommon for franchisees to acquire other goods and services through the franchise agreement from a franchisor (or associate). It will be necessary to determine if those amounts form part of the upfront price.

These examples of obligations to make payments during the course of the term of the agreement can complicate the process of determining if they are considered in or out of the upfront price.

It is not clear if those payments are "contingent" because they are dependent on the sales occurring.

2. *Terms that cannot be declared 'unfair'*

The draft legislation provides that terms that define the main subject matter and upfront price payable under a contract, and terms required or expressly permitted by another law, cannot be declared unfair pursuant.

(a) The "upfront price" of the goods or service is exempt from the UCT law.

The Committee notes that the exemption from UCT law when the upfront price payable exceeds \$100,000 can have an important impact for business, especially small business. Whilst at the outset of a contract when there has been a choice whether to enter into the contract or not, such an exclusion for an upfront price may be understandable, the SME Committee considers that it is not appropriate for the exclusion to also apply upon renewal of a contract where one party is then in a captive situation.

(b) The "main subject matter" of the contract is exempt.

The SME Committee considers the same comments as those above for upfront price apply for main subject matter. In particular, with renewals what if the supplier /customer changes the main subject matter? The Committee considers that the exemption should not apply for renewals.

- (c) *Contracts prescribed by law or contracts that mirror a mandatory Code may exempted by the Minister.*

It is the SME Committee's position that there should be no such exemptions, but rather if contract terms are prescribed by law or mirror a mandatory code, this should be a defence to an action alleging unfair contract terms.

The SME Committee's view is that the alternative proposed is preferable because Codes do not prescribe an entire contract and to exclude a sector on the basis of the existence of a mandatory Code, such as, franchising, causes anomalies.

Can large businesses avail themselves of the benefit of the "small business" definition

In determining the test for a small business, a larger business (such as a public listed entity) should not be able to avail itself of these protections artificially by contracting through a subsidiary entity that has fewer than 20 employees. Similarly it should be made clear whether the protections extend to small businesses that contract with State or Commonwealth Governments (and various levels of Government entities such as GOC's who operate commercial enterprises such as Australia Post) for a supply of goods or services to or by them.

Transitional issues relating to existing contracts

Whilst most consumer contracts are not usually expressed to be assignable by a consumer, in business transactions it is common for the contract terms to allow for an assignment to occur usually when a sale of business occurs. For example a tenant wanting to assign its lease or a franchisor wanting to sell its franchise network and assign all of its franchise agreements to a new franchisor entity.

The application provisions currently are expressed in a way that the UCT protections will apply to the terms of an existing agreement on its renewal and to a specific term (as opposed to the whole existing agreement) if the term is varied.

These provisions do not make it clear whether an existing contract becomes subject to the protections if:

1. The Contract is held over on a month by month basis (such as a lease) as opposed to a renewal where it is renewed for a further fixed term on potentially different terms and conditions. Some clarity on what a renewal is considered by the SME Committee to be essential.
2. The Contract is merely assigned by one party (as opposed to novated).

It is likely that the novation of an agreement would be considered to be entering into a new agreement (but on the old terms) and then be captured.

The policy intent regarding variations and assignment should be considered and made very clear with examples given in the Explanatory Memorandum if possible.

Further discussion

The SME Committee would be happy to discuss any aspect of this submission.

Please contact Coralie Kenny, the Chair of the SME Committee, on [REDACTED] if you would like to do so.

Yours faithfully

John Keeves, Chairman
Business Law Section