SENATE STANDING COMMITTEE ON ECONOMICS:

INQUIRY INTO THE TRADE PRACTICES AMENDMENT (AUSTRALIAN CONSUMER LAW) BILL 2009

SUBMISSION

1. This submission addresses 2 main issues. It suggests an alternative approach to achieving the objective of Schedule 1 of the Bill relating to unfair and prohibited contract terms. It also repeats a submission made to the Treasury (but after the very short consultation period had closed) in relation to a particular aspect of the operation of the Bill in its original exposure draft form which, the submission suggests, can have unintended consequences. In relation to the former, the suggestion made below for an alternative approach to that adopted by the Bill bears some resemblance to a proposal considered by the Productivity Commission in its report *"Review of Australia's Consumer Policy Framework"* [1] (**"PC Report"**). However, it appears that the proposal as developed below was not considered as a substantive alternative to the approach now adopted in the Bill.

2. My interest in the matter arose after the PC Report had issued and when the Bill in its original form was proposed to apply to business to business dealings. I note that the Minister's current proposal is that the Bill apply only to dealings with consumers, but that consideration may be given to its extension to businesses at some later time. The proposal in the first part of this submission is primarily concerned with the problem of standard form consumer contracts with unfair terms, since it is predicated on a lack of

[1] Volume 2, page 162

bargaining power on the part of the consumer. However it would also apply to small businesses exposed to standard form contracts.

Proposal for an Alternative Approach to Standard Form Consumer Contracts with Unfair Terms

3. The PC report makes the observation that[2]:

> *"…whilst some contract terms may be unfair in all contexts, in others bad faith is not intrinsic to the contract term, but is revealed by its inappropriate use."*

The Commission recognised that[3]:

> *"…the rationale for action principally rests on the unreasonableness of unfair terms, not their existence."*

Anecdotal experience suggests that problems most frequently arise from the mechanistic application of particular contract terms by people in businesses who either are given no discretion in the matter or, though having it, do not know how to exercise it in a common sense way. However, the Commission stated that[4] *"…robust quantitative evidence of the extent of detriment is inherently hard to gather"* and that were *"unwieldy"* aspects of using the law to declare terms of existing contracts to be void[5]. After discussion, the Commission said that it preferred *"ex post"* model[6] and it proposed the adoption of the approach introduced into the *Fair Trading Act* (Victoria) in 2003 which would allow a party to a consumer contract or the ACCC to challenge a term of a standard form contract as being unfair by reference to its propensity to cause a significant imbalance in the parties' rights and obligations, while not being reasonably necessary to protect the legitimate interests of the party who would be advantaged by its existence.

[2] At page 52
[3] At page 152
[4] At page 154
[5] At page 154
[6] At page 158

4. The “unwieldy” nature of the proposal is demonstrated by the fact that it was not until five years after the Victorian legislation was introduced that a case involving its interpretation reached the Supreme Court. That decision[7] adopted an entirely different approach to earlier decisions in the Victorian Civil and Administrative Tribunal, holding that the reference to “contrary to the requirements of good faith” in the legislation involved a separate element[8] which was required to be established before a term could be held to be unfair. The Court remitted the matter to VCAT for a rehearing. Although the reference to “good faith” has been omitted from the Bill, it includes a novel element which is concerned with whether the term is reasonably necessary to protect the interests of the party which would be advantaged by its operation. This provision, which seems to have no precedent, will introduce additional uncertainty, as well as expanding the factual inquiry, and is therefore likely to add significantly to the cost of any proceedings.

5. Although the approach adopted by the Bill is *ex post* in that depends on litigation (unless the term is a prohibited term prescribed by the Regulations), the test of unfairness is forward looking. The statutory meaning of unfair in s.3 seems to involve a suppressed minor premise, as suggested by the use of the word “*would*” in s.3(1)(a). It involves considering the effect on the bargaining power of the parties who have already entered into a contract in light of relevant circumstances, if the allegedly unfair term is then enforced. Yet this is only one aspect of the unfairness; the inequality usually already exists and is often the reason for the existence of the provision. This is in contrast to the approach which is adopted by the *Contracts Review Act, 1980* (NSW), which looks at the

[7] *Jetstar Airways Pty Limited v Free* [2008] VSC 539
[8] Ibid. [107] and [116], where the requirement was described as being “unclear”.

position when the contract is made and addresses the terms of the contract, its consequences and effects[9].

6. This approach may be well and good but it involves a way of addressing the problem which is incremental in the sense that, while some types of standard terms which may operate unfairly are identified in s.4 by way of example, the list is limited, and other terms which may operate unfairly will only be identified as the result of litigation which may take many years to accrue a relevant body of precedent. The NSW Act has been in place for nearly 30 years and "*is probably still developing"*[10]*.* This is understandable when regard is had to the fact that much of the enforcement of unfair terms has de minimis consequences, such that the party affected will be disinclined to consider the detriment sufficient to warrant the time and effort, let alone costs and risks, associated with litigation.

7. The approach taken by the Bill appears to be based on the premise that freedom to contract ought to be retained and protected except to the extent that such freedom, because of inequality of bargaining power or other reasons, leads to unfairness in particular cases. The purpose of this submission is to suggest that this approach is flawed. The average consumer (including small businesses confronted with a standard term contract of the type commonly used by telecommunications suppliers, financial institutions, airlines, suppliers of services on the internet etc) has a simple choice; they may either accept the terms of the contract and enjoy the goods or services offered, or they may decline the opportunity to enjoy them. The notion that freedom of contract has any scope in this context is fanciful. At the same time, as the Victorian Court noted in *Jetstar*, a ruling

[9] *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 at 620, per McHugh JA. See generally M.Tibbey, "*Undoing Unjust Contracts: Developments in jurisprudence under the Unjust Contracts Act 1980 (NSW)"* (2009) 32 Aust. Bar Rev., 182.
[10] Tibbey, loc. cit, 203.

that a contractual term is unfair can have "momentous consequences"[11]; all the more so if the term is one used in numerous standard term contracts.

8. A better approach therefore, rather than perpetuating the myth of freedom of contract, and waiting years fro the courts to determine, on a case by case basis, what is unfair, is to legislate for standard terms that apply to these different situations and then allow little or no deviation from them. The standard terms would be devised after taking evidence and hearing submissions from representative parties on both sides of typical transactions and would endeavour to be balanced. Terms which conflicted with the standard terms, unless they provided a more favourable outcome to the party forced to accept them, would be prohibited. The result would be much more efficient and produce much greater certainty. It would avoid the lottery of litigation and remove the information imbalance, at least for those consumers who cared to read the standard conditions. It would address the issue at the level of principle recognising that it arises out of the inequality of bargaining power of the parties at the time they enter into the contract, and is not only a consequence of certain terms producing inequality of bargaining position thereafter. It would avoid the random trial and error approach which is likely to result from adopting by the Bill. It would achieve the objective referred to by one leading contracts lawyer:

> *"…fairness in standard form contracts requires terms that are balance and transparent in their effect. Terms need not neglect the legitimate business interests of suppliers of goods and services but must be a proportionate response to the risks to which those terms are responding. Terms likely to be unfair are those that depart from established common law principles or impose excessive discretion on the supplier over the course of performance of the contract."*[12]

There is no reason to think that this task is better undertaken when parties to a contract are in dispute rather then prospectively.

---

[11] [2008] VSC 539 at [9].
[12] J.M.Paterson, "*The elements of a prohibition on unfair terms in consumer contracts"* (2009) 37 ABLR 184.

9. The legislation would require a panel of experts to be engaged to draft standard terms for a variety of frequently encountered relationships. The opposing parties would have input into the standard terms, but once the standard terms had been prescribed in regulations they would be mandatory for the given relationship. A party would be permitted to include additional terms if considered necessary but only if the additional terms were not in conflict with the standard terms, or provided a more advantageous outcome for the consumer party to the contract.

10. There is a germ of this idea in the *"safe harbour"* contracts discussion in the PC Report[13]. It appears that the ACCC in its submission was concerned about the cost of reviewing standard term contracts, and this weighed against the adoption of the proposal. The present proposal does not involve the ACCC undertaking the drafting process, although it could well be consulted. It is accepted that there would be an initial cost in undertaking the drafting, but it would be borne only once as opposed to the continuing costs which are likely to be incurred under the current Bill. There is precedent for the approach to drafting balanced standard form contracts in the building industry. Another example is the standard form of Contract for Sale of Land which has remained largely unchanged for many years and in respect of which a body of case law has been built providing greater certainty. The approach is a type of codification at the micro level of the contractual relationship of typical parties to each type of standard form contract. An indicative list of the types of clauses in standard term contracts that would not be permitted already exists in s.4 of the present Bill. Although the expert panel would be required to draft the entire set of terms or contract, the number of instances involved would be limited and there would be many terms which would be *"boiler plate"* and have application in all situations.

[13] Page 162

11. I have no idea how many sets of standard conditions would need to be drafted and made mandatory, however I suspect that it would not prove unmanageable to draft contracts covering a very large area of the activities presently the subject of standard term contracts, and the remainder could be progressed later. Once drafted and mandated by regulation, the standard term could be adopted by businesses by reference, unless they needed to modify them, which would reduce the amount of paperwork, or the equivalent, in completing many small transactions. While there would be a one-off cost for business, this would occur anyway with the adoption of the present Bill, as businesses will need to review their standard terms and obtain advice on them. An additional advantage is that the process of drafting the standard forms of contract would involve looking at those contracts as a whole, rather than focussing on individual terms, as will inevitably be the case with the Bill.

Specific Submission in Relation to the Operation of s.6

12. This submission is limited to one aspect of the exposure draft of the Bill which appears to give rise to unintended consequences. The provision is s.6 which provides that a prohibited term of a standard form contract is void. The section further provides that a person must not, under pain of a pecuniary penalty, include a prohibited term in a standard form contract and must not "apply or rely on, or purport to apply or rely on" a prohibited term.

13. A prohibited term is one prescribed by the Regulations. There is nothing in the exposure draft which provides any criteria for the proscription of such a term. Section 1 of the exposure draft defines the expression *"rely on"* as including "asserting the existence of a right conferred, or purportedly conferred", by a term. It is clear from this definition that the prohibition in s.6 would prevent a person from disputing in a court of law or elsewhere whether a particular term was a prohibited term and whether the contract in which it was included was a standard form contract. Moreover, s.7 includes a

rebuttable presumption that any contract asserted by a party to be a standard form contract is a standard form contract unless another party proves otherwise. While the question whether a particular term is a prohibited term may in many instances be beyond dispute, the question whether a particular contract is a standard form contract may well be a matter of dispute.

14. One of the consequences of s.6(3) therefore is that, once another party to at contract has made an assertion that a particular term of the contract has the characteristic of being a prohibited term of a standard form contract, regardless of whether that assertion is made genuinely or has any proper foundation, the other party will be prohibited, under pain of exposure to a pecuniary penalty (and presumably an injunction if applied for), from asserting the contrary, whether in negotiations or in a court of law. A further consequence will be that any legal representative of the party against whom such an assertion is made will be exposed to the possibility of a pecuniary penalty if that person is knowingly involved in asserting the existence of a right conferred, or purportedly conferred, under the contested term, even if appearing in court!

15. It surely was not the intention to alter the rights of parties to a contract to this extent, namely that, by mere assertion, one party can achieve the result that a particular term of a contract is automatically rendered void because the other party risks exposure to a civil penalty if that party seeks to contest the assertion.

27 July 2009 A.I.Tonking SC