Further Submission by the Franchise Council of Australia in relation to the Treasury Legislative Amendment (Small Business and Unfair Contract Terms) Bill 2015.

August 2015

Franchise Council of Australia
Level 1, 307 Wattletree Road,
Malvern East, Victoria 3145
1300 669 030

1. Executive Summary

The Franchise Council of Australia welcomes the opportunity to provide this further submission to the Federal Parliament in relation to the Treasury Legislative Amendment (Small Business and Unfair Contract Terms) Bill 2015 ("the Bill").

In our previous submissions we commented at length in relation to the policy issues and the proposed legislation.[1] We commend the detail of those submissions for your consideration, as we consider that our comments and concerns remain relevant and important. In short, we remain gravely concerned that the Bill will not achieve the desired policy objectives, and will in fact have the following negative consequences:-

1. The Bill will not provide sufficient mechanisms for business parties to contract with certainty. Without additional exemptions the party to a contract with a small business will always have a potential claim hanging over its head;

2. The Bill will make lenders less willing to deal with small business either directly, as loan documentation will be included, or indirectly when financing transactions;

3. The Bill does not take into consideration the fact that third parties frequently rely on, or are affected by, business contracts. Third parties can include financiers, landlords, suppliers, franchisees, contractors and employees.

4. The Bill will create additional disputation. Moreover, the Bill swill steer parties towards the courts rather than towards mediation and other less costly alternative dispute resolution mechanisms; and

5. The Bill will see small business excluded from business opportunities, including opportunities such as tenders and major projects which typically operate on a standard form contract basis.

In this submission we have provided more detail in relation to our concerns. Our preferred position is that Parliament not pass the Bill in its current form. At the very least the Bill should be referred to a Parliamentary Committee to further consider these concerns.

If the Parliament remains intent on introducing legislation to prohibit unfair contract terms in standard form small business contracts there must be a mechanism for the parties to a business contract, and all affected third parties, to know at or about the time of signing whether the contract is binding. Alternatively the legislation must be narrowed such that it does not apply to all small business contracts, but only to contracts that are clearly provided on a take it or leave it basis in circumstances directly comparable to consumer contracts. The current consumer definitions create uncertainty and ambiguity in business transactions.

In this submission we have provided more detail concerning changes that we consider give effect to the legislative intent, but address our concerns by providing greater certainty. We have also included some additional suggestions not canvassed in our previous submissions.

We also wish to raise our concerns in relation to compliance costs. If the Bill is enacted in its current form the compliance cost to business will run to many millions of dollars. The legislation potentially applies to almost all businesses, and a vast array of business contracts will need to be reviewed. This cost does not appear to have been factored into any consideration of the impact of the Bill or the Regulatory Impact Study.

We would welcome the opportunity to further discuss the contents of this submission with interested parties.

---

[1] Submission by the Franchise Council of Australia in relation to the Treasury Legislative Amendment (Small Business and Unfair Contract terms) Exposure Draft 2015, and submission by the Franchise Council of Australia in relation to the possible extension of unfair contract term protections to small business dated June 2014.

2. Our concerns

We remain gravely concerned that the Bill will not achieve the desired policy objectives, and will in fact have the following negative consequences:-

1. The Bill will not provide sufficient mechanisms for business parties to contract with certainty:-

    a. There is currently no way to determine with certainty whether a contract will be fully enforceable in accordance with its terms. There is no mechanism for a party to obtain a ruling or determination on a contract term from the ACCC or anyone else. A party must just form their own view, or take their chances in the context of very imprecise definitions;

    b. The list of terms that "may be unfair" is extremely broad and general. The list includes a substantial number of provisions that would be in all or most commercial contracts, and several or the words used within examples are themselves quite vague. For example:-
        i. "a term that permits … one party … to avoid or limit performance of the contract";
        ii. "a term that permits one party, but not the other, to terminate the contract";
        iii. "a term that penalizes one party … for a breach of the contract";
        iv. "a term that permits one party to renew, or not renew, the contract";
        v. "a term that permits one party unilaterally to vary the characteristics of goods or service to be supplied";

    c. Similarly the indicators of a "standard form contract" are so broad as to cover almost any situation. Many contracts are prepared before "any discussion … between the parties", and it would be very easy to argue that the terms of a contract failed to "take into account the specific characteristics of another party" or a party was not given "an effective opportunity to negotiate the terms of the contract". It is also very easy to argue that another party had "all or most of the bargaining power" or a party was "in effect required to accept or reject the terms of the contract in the form in which they were presented"

    d. Without additional exemptions the party to a contract with a small business (which of course can also itself be a small business) will always have a potential claim hanging over its head. The potential for abuse is obvious:-
        i. The legislation reverses the onus of proof, such that once an allegation is made that a provision is "unfair" a party must DISPROVE that fact. A business (including a small business attacked by another small business) will therefore be vulnerable to commercial blackmail, such as a threat of a class action (possibly even funded by a competitor) in relation to its contract terms;
        ii. The "unfairness" of a provision is likely to be universally pleaded as a defence in every situation where a party seeks to exercise its contractual rights. The Bill will almost certainly add cost and time delay to all court proceedings.
        iii. Furthermore, it would appear impossible for a court to determine an issue in relation to "fairness" without a detailed hearing. Far from giving access to justice, the Bill actually creates an environment where the principles of justice and the proper enforcement of legal rights in business dealings is able to be thwarted by vague and essentially spurious allegations.
        iv. Most small business do not have the resources to be involved in any court case. Accordingly they are at risk of being forced to settle spurious claims, particularly in the context of legislation where once an allegation is made THEY have to prove the fairness of the contract terms.

2. The Bill will make lenders less willing to deal with small business either directly, as loan documentation will be included, or indirectly when financing transactions. Lawyers are already giving advice to their clients in relation to the legislation. In essence that advice is:-
    a. The application of the legislation is uncertain;
    b. You should consider trying to avoid coming within the legislation, rather than making major adjustments to your standard form contractual processes or having to justify the "fairness" of provisions;
    c. You will avoid the legislation entirely if you do not deal with small businesses as defined;
    d. If you do deal with small businesses, it will be more costly to do so as you will lose the efficiency provided by standard form contracts, and you will need to consider the legislation and the fairness of contract terms.

    This will have an obvious impact on small business access to finance, and it will increase the cost of assessing small business loans. This is particularly the case if (as with franchise, technology, biotech and many other companies) the assets are intangible and reliant on the enforceability of contracts.

    Taking a specific example, imagine a technology contract that includes a non-compete provision. If a party were able to successfully argue (or indeed even assert) that the provision was "unfair", this could affect the underlying value of both companies. Yet this argument is eminently possible under the Bill.

3. The Bill does not take into consideration the fact that third parties frequently rely on, or are affected by, business contracts. Third parties can include financiers, landlords, suppliers, franchisees, contractors and employees. They are all able under current law to assume that if they see a contact signed by both parties, that contract is enforceable according to its terms. The Bill takes away that assurance. As a consequence these third parties will:-
    a. Be at risk should certain terms of a contract relevant to their transaction be considered "unfair";
    b. Be more nervous dealing with small businesses; and
    c. Have additional compliance costs in assessing whether they should lend, rent or deal with a small business.

4. The Bill will create additional disputation. This is obvious just from considering the comments above. "Unfairness" will become the universally pleaded defence in every legal matter, creating unnecessary cost and delay for parties seeking to enforce their legitimate rights. Moreover, the Bill swill steer parties towards the courts rather than towards mediation and other less costly alternative dispute resolution mechanisms. The fact is that the Bill gives a small business legal rights they do not otherwise have. Further, in the context of a mediation, how do parties reach agreement on what is fair? Arguably they already did that when they signed the business contract, so if one party now asserts something is "unfair" the prospects of a mediated outcome seem remote; and

5. The Bill will see small business excluded from business opportunities, including opportunities such as tenders and major projects which typically operate on a standard form contract basis.

<u>Inconsistent with global business laws</u>

We also raise the issue of international inconsistency.

As far as we could determine there is no similar legislation to the Bill anywhere else in the world. This alone should provide warning signs to Parliament. We have not considered whether Australia has any international obligations in relation to this issue, but it seems beyond rational argument that as a country seeking to transact in a global economy Australia

should not have fundamental business laws so dramatically out of step with international expectations.

Furthermore, legislation that does focus on unfair contract terms (for example the UK Unfair Contract Terms Act 1977, has very specific application as opposed to the very sweeping coverage of the Bill. The UK legislation is very relevant, as not only does it deal specifically with unfair contract terms but the English legal system has been the foundation of much Australian law.

The Unfair Contract Terms Act 1977 is an Act of Parliament of the United Kingdom which regulates contracts in essentially the same manner as the Bill. It is broader in scope than the Bill, in that it applies to nearly all forms of contracts. However it is much narrower in application. In summary, the Act renders terms excluding or limiting liability ineffective or subject to a test of reasonableness, depending on the nature of the obligation purported to be excluded.

Unlike the Bill, it is quite clear exactly what terms will be at risk. Liability for negligence occasioning death or personal injury cannot be excluded, nor liability for loss arising from (a) defective goods or (b) negligence of distributor where goods are "of a type ordinarily supplied for private use or consumption." Similarly various implied terms as to title, description, quality or sample cannot be excluded against a consumer. So in this sense the unfair contract terms goes no further than essentially replicates existing provisions of the Australian Consumer Law. It does not prohibit a broad range of unfair contract terms, let alone leave open which provisions of a contract might possibly be considered unfair.

The second part of the legislation comes closer to the Bill, but still specifies precisely what is and is not covered by the legislation. This again is in stark contrast to the Australian Bill. A contact term that purports to exclude liability for negligence other than for death or personal injury must satisfy the requirement of reasonableness. Similarly where a party that deals on standard written terms, and there is a provision purporting to exclude liability arising from a breach committed by that party under the same contract or performance under a contract which is substantially or totally different of that which is reasonably expected of him, the provision shall be void except insofar as it satisfies the requirement of reasonableness. An exclusion of liability for misrepresentation must satisfy the requirement of reasonableness. (Of course this UK provision would be more than covered by s18 of the Australian Consumer Law, which prohibits misleading or deceptive conduct.)

There are also additional provisions in the UK law that apply to consumer transactions. For example a party dealing as a consumer cannot contract to indemnify a third party on behalf of the other party, except insofar as it satisfies the requirement of reasonableness, and implied terms as to description, quality and sample may only be reasonably excluded where neither party is dealing as a consumer.

The key points to note from the UK law are:-

1. The legislation clearly specifies the types of provisions that are considered unfair, rather than providing a shopping list of possibilities;
2. The law focuses on contract terms that purport to change the legal position from what would otherwise be the case but for the contract term. As such the legislation restores the status quo, and is readily understood by all transacting parties and affected third parties. The Bill on the other hand has the potential to change the deal, and in a sense surprise transacting and affected parties;
3. The legislation makes a clear distinction between consumer and business transactions, recognizing that they are inherently different.

.

3. **Recommendations**

We have 3 alternative recommendations, which are outlined below. We have provided several options to achieve our third recommendation. We have also offered on the need for greater definitional clarity.

1. Rejection of the Bill

In our view there is a compelling case for the Bill to be rejected. The concerns we have raised are real, and fundamental. The Bill may be well intentioned, but the unintended consequences and uncertainty created will damage small business and cause substantial and unnecessary additional compliance cost to almost all businesses.

2. Exempting franchise agreements

If the Bill is enacted, our preferred position is that there be a blanket exemption from the Bill for franchise agreements in circumstances where the agreements have been provided in accordance with the requirements of the Franchising Code of Conduct. Although franchise agreements come within the current very broad definition of a standard form contract in the Bill, a contract provided under a comprehensive statutory disclosure regime that features among other things a mandatory 14 day period between when the agreement is provided and when it can be signed, as well as a 7 day cooling off period after signing, should not fairly be able to be considered “standard form” contract.

We have been advised that such a suggestion is not acceptable, or alternatively the franchise sector ought to take advantage of the provision in the Bill that facilitates the creation of specific industry exceptions. We have therefore focused in this submission upon exemptions and amendments that we consider will address the five concerns summarized above, and which can apply to all small business standard form contracts.

3. Achieving contractual certainty

The Bill must at the very least be amended to ensure contractual certainty. It is vital that the parties to a business contract know at the time of signing, or within a reasonably short period thereafter, whether a contract is fully enforceable according to all of its terms. This is also vitally important for a financier that has lent on the basis of the contract, or a supplier or a sub-contractor who has transacted on the same assumption. Landlords and other third parties have the same requirements. In the context of franchise agreements much of the value of the business of the franchisor and the franchisee rests on the enforceability of the franchise agreement.

The FCA proposes the following alternatives for your consideration:-

1. That there be a blanket exemption in the case of any agreement in respect of which the small business certifies that they have obtained legal advice. We felt this was a simple, common sense solution that was also consistent with the policy intent of the Franchising Code of Conduct; and/or

2. If any small business party considers a provision in a standard form contract to be unfair, they must object to a designated person prior to signing the contract, or within a relatively short period (say 60 days) of signing. A “designated person” would be the ACCC (which has offices in every State), a State Small Business Commissioner or the Federal Small Business and Family Enterprises Ombudsman; and/or

3. The legislation should follow the lead of UK legislation on unfair contracts, and only prohibit provisions that have the effect of limiting the liability a person might otherwise have. So, for example, provisions that purport to limit or exclude liability or prevent a party from exercising a legal right they would otherwise have would be prohibited. This restriction on unfair contract terms would preserve certainty of contract, as

parties would know that their situation is governed by the normal legal position yet would still address a fundamental concept of fairness; and/or

Greater definitional clarity

We also consider there needs to be far greater clarity around what constitutes a "standard form contract", and the definition needs to be substantially narrowed such that it refers to a contract offered in circumstances where the small business has no opportunity to negotiate, and no real commercial alternative. The indicators of a standard form contract contained in the legislation may be appropriate in the context of consumer transactions, but they create considerable uncertainty in the context of business to business transactions.

The examples in the legislation go far beyond the ACCC description of it being a contract is offered on a "take it or leave it basis". And such terminology is not really particularly helpful given the huge variety of day to day business contracts.

4. Observations concerning on the Bills Digest commentary

We note that the Parliamentary Library Bills Digest contains some information in relation to the Bill, including making reference to some comments by the Franchise Council of Australia and others. We understand that the Bill is soon to be the subject of a second reading debate, and that the policy positions of some parties may remain open. Accordingly we wished to make some policy observations, and to comment upon aspects of the Bills Digest summary:-

Does the Bill "simply extend" consumer protections to small business?

Not really.

From a purely drafting perspective it looks like a simple extension – just add the words "small business" after "consumer". But from a practical perspective it is not correct to say that the Bill simply extends the unfair contract term protections that are currently available to consumer to small businesses. This statement misunderstands, or fails to take account of, the true nature and complexity of business dealings, and the differences between a typical consumer transaction and a typical business transaction. Consider the following:-

1. A consumer transaction is typically an isolated transaction, whereas business dealings are often ongoing and integrated with other dealings;

2. Contracts in a consumer transaction focus typically on the good or service supplied, whereas business contracts are often far more complex.

3. A business contract can have a direct relationship to the profitability and value of both parties, but a consumer transaction relates simply to the value of the good or service involved;

4. A consumer transaction typically involves only the consumer and the supplier, whereas a business transaction will often involve, or have implications for, third parties - other businesses, sub-contractors, financiers, landlords, suppliers and so forth;

5. The legislation goes far beyond the types of contracts surveyed in the ACCC's review of standard form contracts. It extends far beyond airline, telecommunications, fitness and vehicle rental contracts to every type of business contract. There has been no genuine attempt to consider the potential ramifications of the Bill on business contracts generally;

6. A consumer will frequently have no realistic choice at point of transaction, or even at all. In business to business transactions (absent some monopoly or cartel) the nature of market competition is such that there is always a commercial alternative. Any Government intervention should focus on the extent of competition in the market, and

abuse of market power, rather than the provisions of a contract freely made between business parties.

Do the provisions "apply in the same way" as in relation to consumer transactions?

Not in practice.

Practically speaking the business to business extension of unfair contract terms will simply not apply "in the same way" as in relation to consumer transactions. It is essential to consider how the various provisions will work in practice. In reality the unfair contract provisions in consumer transactions address a situation where there is no negotiation opportunity. Typical consumer contracts (and good examples are the airline, telecommunications, fitness and car rental contracts examined by the ACCC in its review) are signed at point of purchase by a consumer where:-

1. often the consumer will have minimal capacity to read and understand the contract, and some consumers will be completely incapable of doing so;

2. there is no practical capacity to actually effect a change, as the person representing the supplier has no authority to agree to any change;

3. the purchase is about to immediately occur; and

4. the contract terms do not reflect what one might fairly expect to find in such a contract.

In business transactions…

Do the provisions "apply in the same way" as other key provisions in the TPA?

Practically speaking, it is also not accurate to say that the extension of unfair contract terms to small business contracts will apply "in the same way" as "other key provisions in the TPA do, such as those dealing with unconscionable conduct and misleading and deceptive conduct."[2] The unconscionable conduct and misleading conduct prohibitions apply to conduct, not contract terms. So the proposed prohibition on unfair contract terms will apply in a totally different way.

Further, the prohibitions on unconscionable conduct and misleading conduct reflect what most people would understand to be the legal position – that someone cannot act unconscionably or mislead or deceive. On the other hand most business people would assume, and indeed this is the current state of the common law, that there is no general principle that a provision in a contract must be "fair". To date the law has been that parties to a business contract are deemed to have read and understood a contract they have signed, and are bound by it absent any fundamental illegality, misleading or deceptive conduct, unconscionable conduct or bad faith.

As a consequence the legislation will not at all reflect

Is it true that the previous Government's decision not to proceed with the prohibition at the time of the introduction of the consumer law prohibition was as a result of it being subject to the outcome of reviews of both the unconscionable conduct provisions … and the Franchising Code of Conduct? If so, what flows from those reviews?

Not entirely.

We were involved with discussions with the then Small Business Minister Bowen, and would add that a key reason why the unfair contract provisions were restricted to consumer

[2] This quote is taken from the quotation on the second page of the Bills Digest under the heading "Background".

transaction in the Trade Practices Amendment (Australian Consumer Law) Bill 2009 was that the Government of the day was persuaded by the same reasoning that is contained in this submission – that it is inappropriate to extend the prohibition on unfair contract terms to business to business transactions.

However it should be noted in the context of the comment that further consideration "was subject to the outcome of reviews of both the unconscionable conduct provisions … and the Franchising Code of Conduct" that:-

a. The review of the unconscionable conduct provisions recommended strongly against any extension of unfair contract protection to business contracts; and

b. Substantial new provisions have been inserted into the Franchising Code of Conduct, including a general good faith requirement and provisions directly focused on specific provisions of franchise agreements.

Given the foregoing it is very hard to justify the inclusion of franchise agreements in the unfair contracts regime.

5. **Onus of proof**

It is a generally accepted legal principle that the onus of proof should be upon the person making any claim. In recent times there are examples where Government has chosen to reverse the onus of proof. However this is only in exceptional circumstances.

The Australian Consumer Law considers that in consumer transactions, where consumers have far less capacity to establish a position, there should be a reverse onus of proof. (See sections 24(4) and 27(1). However the reverse onus should not apply to business contracts. It should be the responsibility of the business making an allegation of unfairness in relation to a contract term to make the case and meet the normal onus of proof. It is unfair and unreasonable to reverse the onus of proof in business contracts.

Even people such as Associate Professor Elizabeth Spencer, who have zealously advocated the extension of unfair contract terms to business contracts, agree that there should not be a reverse onus of proof.

Reversal of the onus of proof will create a lawyer's paradise, and encourage spurious claims. In a business transaction it is contrary to all established legal principles that once a party merely makes an allegation, the onus of proof then shifts to the other party to disprove it. It is a fundamental principle of justice that a party making an allegation bears the obligation of making the case. The reverse onus of proof must be removed from the Bill.