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Inquiry into the Trade Practices Amendment (Australian Consumer Law) Bill 2009

Submission
by

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The need for an effective legal framework for dealing with unfair contract terms: The compelling case for fine-tuning the unfair contract proposals and reinstating business to business contracts involving small businesses

After extensive research and consultation on the issue of unfair contract terms spanning over 15 years, it would be submitted that an effective legal framework for dealing with unfair contract terms is an essential feature of a world's best competition and consumer law framework.

Unfortunately, the unfair contract proposals included in the *Trade Practices Amendment (Australian Consumer Law) Bill 2009* fall short of a world's best legal framework for dealing with unfair contract terms.

In particular, it would be submitted that a number of omissions from the unfair contract proposals, as well as the inclusion of unnecessary impediments in the proposals will undermine the effectiveness of the unfair contract proposals in the *Trade Practices Amendment (Australian Consumer Law) Bill 2009*.

These omissions and unnecessary impediments include:

- Minister Emerson's reversal of the previous Minister's and Federal Cabinet's endorsement of the need to include small businesses in the unfair contracts proposals;
- Placing undue and inappropriate emphasis on questions of "detriment" and "transparency;" and
- A failure to provide for "safe harbours" as mechanisms for ensuring additional business certainty as to the operation of the unfair contracts proposals.

Each of these omissions and unnecessary impediments will be considered in this submission with appropriate recommendations included to deal with the issues raised. Also, to assist the Committee on these issues, I have included my extensive research in relation to unfair contracts terms as appendices to this submission.

Minister Emerson's reversal of the previous Minister's and Federal Cabinet's endorsement of the need to include small businesses in the unfair contract proposals

A major omission from and, therefore, a major flaw in the unfair contracts proposals currently before Federal Parliament relate to Minister Emerson's decision, upon becoming Minister for Competition Policy and Consumer Affairs, to reverse the previous Minister's (Chris Bowen) position regarding the application of the Federal Government's new unfair contracts proposals to small business. In effect, Minister Emerson has decided to exclude small businesses altogether from the protection to be given to consumers under the Government's unfair contracts proposals.

The following is a summary of the issues in relation to unfair contract terms in business to business contracts involving small businesses.

Under Minister Bowen's proposals, small businesses would have been included in the unfair contracts proposals if the standard form contract was for $2 million or less. Importantly, Minister Bowen's proposals were intended to provide both "consumers and small businesses" with protection from unfair contract terms.

In his media release of 5 June 2009 Minister Bowen stated:

> "Last year, COAG agreed that Australia should have a national unfair contract terms law and the Government is committed to ensuring that consumers and small businesses can access protection from unfair contract terms," Mr Bowen said."[1]

Minister Bowen's proposals would have excluded standard form contracts above $2 million. This was noted by Minister Bowen in his media release where the Minister stated that his unfair contract proposals would include:

> "…an exclusion of a standard-form contract where the upfront price payable for the services (including financial services), good or land supplied under the contract exceeds $2 million;"[2]

However, on becoming Minister for Competition Policy and Consumers Affairs, Craig Emerson announced that small businesses would be excluded altogether from the unfair contract proposals to be introduced into Federal Parliament. In his media release dated 24 June 2009 Minister Emerson stated:

> "The Bill will also introduce a national unfair contract terms law that will apply to standard form business-to-consumer contracts.

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[1] Minister Bowen's media release can be accessed at: http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/060.htm&pageID=003&min=ceb&Year=&DocType=

[2] Ibid

> In relation to business-to-business contracts, the Government is currently reviewing both the unconscionable conduct provisions of the Trade Practices Act and also the Franchising Code of Conduct.
>
> Since these reviews relate to business-to-business contracts, the Government will consider the issue of business-to-business standard form contracts when these reviews are complete."[3]

By applying the unfair contract proposals only to business to consumer contracts, Minister Emerson has changed the Federal Government's previous position and excluded small businesses altogether from the unfair contract proposals.

Minister Emerson's decision to remove small businesses from the unfair contracts proposals is extremely disappointing given Federal Cabinet's previous endorsement of Minister Bowen's decision to apply the unfair contract proposals to both consumers and small businesses.

With all due respect, Minister Emerson's change of position is particularly troubling for a number of reasons. First, and most importantly, Minister Emerson's decision runs directly contrary to the position of the previous Minister (Chris Bowen), as well as the Federal Cabinet, who had all agreed that the unfair contract proposals needed to apply to both consumers and small businesses.

The position of the previous Minister and the Federal Cabinet to include small businesses in the unfair contracts proposals was reached after extensive consultation, but sadly was reversed by Minister Emerson within only 3 weeks in circumstances where the level of consultation by Minister Emerson, if any, could have only have been a very small fraction of the very extensive consultation undertaken to reach the previous Federal Cabinet-endorsed decision to include small businesses in the unfair contracts proposals.

Second, Minister Emerson's decision to exclude small businesses from the unfair contracts proposals on the basis that Minister Emerson is awaiting the completion of reviews of the unconscionable conduct provisions of the Trade Practices Act and the Franchising Code of Conduct is also troubling given that such reviews are not only progressing very slowly, but such reviews have essentially been confined to standards of conduct or what is described as "procedural unconscionability." While procedural unconscionability is concerned with the surrounding conduct rather than solely the terms of the contract, the unfair contracts proposals are concerned with the issue of "substantive unconscionability" which is solely concerned with the fairness of the contract terms. Significantly, the unfair contracts proposals in the Bill are designed to specifically address the issue of substantive unconscionability.

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[3] Minister Emerson's media release can be accessed at:http://minister.innovation.gov.au/Emerson/Pages/ONENATIONALCONSUMERLAWFORAUSTRALIA.aspx

So while there is undoubtedly a need to strengthen the unconscionable conduct provisions of the Trade Practices Act as well as strengthening the Franchising Code of Conduct to deal with unethical conduct within the Australian franchising sector, such strengthening in relation to procedural unconscionability cannot be considered a substitute for the need to deal with the issue of substantive unconscionability through the inclusion of small businesses in the unfair contract terms.

In fact, an effective legal framework for dealing with unfair contract terms in a business to business context involving small businesses is an essential adjunct to effective laws dealing with procedural unconscionability. Since currently there are no Federal laws dealing with unfair contract terms in business to business context involving small businesses, it is clear that the previous Minister and Federal Cabinet recognised the pressing need to close that gap which has long disadvantaged small businesses by denying them an avenue for challenging unfair terms in their contracts with larger businesses.

Within this context, a clear flaw of the *Trade Practices Amendment (Australian Consumer Law) Bill 2009* as introduced into Federal Parliament is that the proposed new unfair contract provisions of the Bill will only apply to a "consumer contract:"

> **2 Unfair terms of consumer contracts**
>
> (1) A term of a consumer contract is void if:
> (a) the term is unfair; and
> (b) the contract is a standard form contract.

A consumer contract is defined in the following terms in the Bill:

> (3) A ***consumer contract*** is a contract for:
> (a) a supply of goods or services; or
> (b) a sale or grant of an interest in land;
> to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.

This definition of a consumer contract makes it clear that business to business contracts involving small businesses are excluded from the unfair contract provisions of the Bill.

Again with all due respect, there is no justification for Minister Emerson's decision to exclude small businesses as there are more than enough safeguards in the unfair contract proposals to maintain business certainty, while still giving small businesses a new and effective avenue to be able to challenge unfair contract terms.

There are ample safeguards in the unfair contract proposals to strike an appropriate and objective balance between the ability of larger businesses to

protect their legitimate business interests and the ability of small businesses to challenge unfair contract terms. These safeguards include:

(i) a term is 'unfair' only when it causes a significant imbalance in the parties' rights and obligations arising under the contract and it **is not reasonably necessary to protect the legitimate interests** of the larger business. The unfair contract proposals do not prevent a larger business from protecting its legitimate business interests. This is the most important safeguard as the larger business is able to protect it legitimate interests. It is only when the larger business goes beyond what is reasonably necessary to protect its legitimate interests that the term becomes unfair. This safeguard alone is more than sufficient to allay the ill-conceived and irrational fears by larger businesses and their legal advisers regarding the unfair contract proposals in the Bill;

(ii) the proposals only relate to standard form contracts. These are offered on a take-it-or-leave-it basis. If the contract is not a standard form contract it will not be covered by the proposals.

(iii) some terms will not be able to be challenged under these provisions. These relate to:

- the main subject matter of the standard-form contract;
- the upfront price payable under the standard-form contract;

(iv) the proposals only operate in relation to contracts entered into or varied after the commencement of the proposals.

When these safeguards are all considered together they enable larger businesses to protect their legitimate business interests while allowing small businesses the ability to challenge only those terms that go beyond what is reasonably necessary to protect the legitimate business interests of the larger business.

RECOMMENDATION

That business to business contracts involving small businesses be reinstated in the unfair contracts proposals contained in the Bill in accordance with the previous Minister’s and Federal Cabinet’s endorsement of the need to include small businesses in the unfair contract proposals.

Placing undue and inappropriate emphasis on questions of "detriment" and "transparency"

Under the Bill as currently drafted, a court is required to take into account questions of "detriment" and "transparency" in determining whether a term is unfair:

> **3 Meaning of *unfair***
>
> …
>
> (2) In determining whether a term of a consumer contract is unfair under subsection (1), a court may take into account such matters as it thinks relevant, but must take into account the following:
>
> (a) the extent to which the term would cause, or there is a substantial likelihood that it would cause, detriment (whether financial or otherwise) to a party if it were to be applied or relied on;
>
> (b) the extent to which the term is transparent;
>
> (c) the contract as a whole.
>
> (3) A term is ***transparent*** if the term is:
>
> (a) expressed in reasonably plain language; and
>
> (b) legible; and
>
> (c) presented clearly; and
>
> (d) readily available to any party affected by the term.

The specific reference to and mandatory requirement for a court to take into account questions of "detriment" and "transparency" is unwarranted and has the effect of elevating these "factors" to a point where there is a real risk that court's interpretation of these concepts will undermine the effectiveness of the unfair contracts proposals.

In short, the mandatory requirements for a court to take into account questions of "detriment" and "transparency" as provided for in the Bill as currently drafted place undue and inappropriate emphasis on these two issues in a way that detracts from the 2 central questions under a framework dealing with unfair contract terms.

These 2 central questions are found in Bill's definition of "unfair:"

> **3 Meaning of *unfair***
>
> (1) A term of a consumer contract is ***unfair*** if:
>
> (a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
>
> (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term.

These 2 central questions relate to (i) the presence of a significant imbalance in the contractual rights and obligations between the parties; and (ii) whether

or not the term is reasonably necessary in order to protect the legitimate interests of the larger party.

These 2 central questions provide an objective framework for assessing the unfairness of the contract term. These 2 central questions also clearly express the public policy objective and market failure that is being sought to be corrected by the unfair contracts proposals. More importantly, answering these 2 central questions is sufficient to answer the question of whether a contract term is unfair. In this sense, the 2 central questions provide a self contained and definitive test of what is an unfair contract term without the need to provide for additional questions to be asked.

Indeed, providing for additional questions as the Bill proposes to do in relation to "detriment" and "transparency" is to confuse the consequences or symptoms of unfairness with the fundamental question of whether or not a contract term is unfair.

Misplaced emphasis on questions of "detriment"

Clearly, "detriment" is a possible consequence of unfairness and, therefore, is only relevant to questions of damages or compensation that may flow from an unfair contract term. So while questions of "detriment" are certainly relevant to remedies that may flow from the contract term being unfair, it is inappropriate to pursue such questions when considering whether or not the contract term is unfair.

It needs to be remembered that the "evil" sought to be corrected by unfair contract proposals is the inclusion of unfair contract terms in the first place. The damage or "detriment" that may flow from the inclusion of the unfair contract term is a separate and distinct question from whether or not the contract term is unfair. With all due respect to the drafters of the Bill in its current form, the Bill's attempt to raise questions of "detriment" in determining whether or not the contract term is unfair is to confuse questions relating to the evil sought to be corrected with questions relating to the remedy that may flow from that evil.

Accordingly, the Bill's reference to "detriment" as a factor in determining whether or not a contract term is unfair should be deleted from the Bill.

Misplaced emphasis on questions of "transparency"

Similarly, the Bill's reference to whether or not a contract term is "transparent" when determining whether or not a contract term is unfair should be deleted. Once again references to transparency detract from the 2 central questions under an unfair contract proposal relating to (i) the presence of a significant imbalance in the contractual rights and obligations between the parties; and (ii) whether or not the term is reasonably necessary in order to protect the legitimate interests of the larger party. Those 2 central questions are distinct questions to whether or not the term was "transparent."

Indeed, the drafting style of a contract or the “transparency” surrounding the contract are questions relating to a party’s comprehension or understanding of the contract. Even then, irrespective of how “transparent” or “comprehensible“ a contract term may be, it is clear that a contract term can still be drafted by the larger party in such a way as to (i) represent a significant imbalance in the contractual rights and obligations in favour of the larger party; and (ii) in a manner that that goes beyond what is reasonably necessary in order to protect the legitimate interests of the larger party.

In fact, a term can be “transparent” but still be unfair on the simple, but objective basis that the larger party’s bargaining power allows the larger party to draft and impose a contract term in such a way as to (i) represent a significant imbalance in the contractual rights and obligations in larger party’s favour; and (ii) in a manner that that goes beyond what is reasonably necessary in order to protect the legitimate interests of the larger party.

RECOMMENDATION

The Bill’s references to “detriment” and “transparency” as mandatory factors to be taken into account by a Court in determining whether or not a contract term is unfair should be deleted from the Bill.

A failure to provide for "safe harbours" as mechanisms for ensuring additional business certainty as to the operation of the unfair contracts proposals

While there is considerable business certainty built into the unfair contracts proposals in the Bill, there are addition mechanisms that could quite easily be incorporated into the proposals to provide even more business certainty. For example, the Bill could provide a mechanism under which a business could apply for a binding opinion or authorisation from the ACCC. Similarly, the Bill could provide a mechanism for a business or industry associations to develop "model contracts" containing "fair" terms that could be authorised by the ACCC for voluntary adoption by an industry or businesses.

Advisory opinions or Authorisations by the ACCC

The ability of a business or industry association to approach the ACCC under the Bill to seek an opinion in relation to particular contract terms would be a useful way to not only promote greater fairness in contracts, but to also provide businesses with additional confidence that the contract terms in question will not be considered to be unfair under the Bill.

In doing so, businesses can be proactive in seeking guidance and approval from the ACCC on the use of particular contract terms. A business can approach the ACCC and secure an opinion or Authorisation from it that the terms will not be considered to be unfair. Such an opinion or Authorisation could be sought on either an informal or formal basis, and should give the business sufficient comfort that the term can be legitimately used.

Of course, an advisory opinion or Authorisation by the ACCC must only be issued after an open and transparent process has been followed whereby the particular term is closely scrutinized. The process must be a public one and allow all interested parties the opportunity to either support or challenge the particular term. Such a process would strike an appropriate balance between safeguarding the public interest in not allowing the use of unfair terms in contracts, and providing businesses with upfront advice on the use of particular contract terms.

Use of model contracts

The ability to seek an advisory opinion on particular contract terms can be complemented by allowing the opportunity for model contracts or model contract terms to be approved by the ACCC for use in a particular industry. Such model contracts or model contract terms could be approved following a formal review process in which all interested parties have the opportunity to either support or challenge the contract. Once approved, the terms of the model contract cannot be challenged as unfair. Importantly, an approved model contract would provide a template of "fair" contract terms that can be legitimately used in consumer contracts within a particular industry.

RECOMMENDATION

Amend the Bill to provide for “safe harbours” as mechanisms for providing additional business certainty as to the operation of the unfair contracts proposals.

APPENDIX 1

Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: Is Australia Falling Behind?" *Trade Practices Law Journal*, Vol. 13, pp. 70-89.

APPENDIX 2

Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: The search for a new regulatory model," *Trade Practices Law Journal*, Vol. 13, pp. 194-213.

APPENDIX 3

Zumbo, F., (2007), "Promoting Fairer Consumer Contracts: Lessons from the United Kingdom and Victoria" *Trade Practices Law Journal*, Vol. 15, pp. 84-95.

APPENDIX 4

Zumbo, F., (2006), "Promoting Fairer Franchise Agreements: A Way Forward?" *Competition and Consumer Law Journal*, Vol. 14, pp. 127-145.