Law Council
OF AUSTRALIA

Via email: australianconsumerlaw@treasury.gov.au

The Australian Consumer Law
Consultation on draft provisions on unfair contract terms
Competition and Consumer Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Sir,

An Australian Consumer Law – Consultation on Draft Provisions on Unfair Terms

I refer to a submission dated 21 May 2009, lodged by members of the Financial Services Committee of the Business Law Section of the Law Council of Australia in their capacity as individuals rather than as representatives of the Committee. For ease of reference, I attach a copy of the submission.

I am writing to confirm that the submission has now been endorsed by the Financial Services Committee and the Business Law Section. However, owing to time constraints imposed for the lodgement of submissions, it has not been possible to have the submission considered by the Directors of the Law Council of Australia Limited.

Yours faithfully,

W Grant

Bill Grant
Secretary-General

25 May 2009

Enc.

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The Australian Consumer Law: Consultation
on Draft Unfair Contract Terms Provisions
Competition and Consumer Policy Division
Treasury
Langton Crescent
Parkes ACT 2600

21 May 2009

Dear Sirs

Consultation on drafts unfair contracts terms provisions

Further to the request (the **Request**) for comments by Treasury in relation to the draft unfair contract terms provisions of the Australian Consumer Law (the **Proposed Laws**), we make the following submission on behalf of members of the Financial Services Committee of the Business Law Section of the Law Council of Australia (**LCA FSC**) in their capacity as individuals rather than as representatives of the LCA FSC, pending the approval of the submission by the Law Council of Australia Business Law Section Executive.

1 Do not proceed

We urge the government not to proceed with the Proposed Laws without significant further consultation and allowing a significantly longer period to comment on the proposed laws than the 11 days permitted by the Request.

2 Inadequate consultation and insufficient time

The Report refers to the history of consultation in relation to the Proposed Laws. With respect, consultation has been in the context of, and conducted under the heading of, consumer law reform. It has not previously been publicised that the Proposed Laws would extend to non-consumer transactions. The extension of these reforms into this field, requires that there be adequate consultation and sufficient time for submissions from the wider interests which would be affected by the Proposed Laws. This is likely to lead to significantly different and more diverse submissions being made and reduce the risk of the Proposed Laws creating serious unintended problems and uncertainty in non-consumer transactions.

3 Inconsistency with announced MCCA model

The Request states that the Proposed Laws are based on the Ministerial Council of Consumer Affairs (MCCA) agreed unfair contract terms model as stated in the MCCA communiqué dated 15 August 2008.

We do not believe the MCCA communiqué was generally perceived to indicate a model of the nature proposed in the Proposed Laws. We note that:

(a) the MCCA is a council of ministers of ***consumer*** affairs;

(b) the reforms were described as part of a framework of a national ***consumer*** law; and

(c) the MCCA agreed model stated that, to be treated as an unfair term, a term would have to operate to the detriment, or a substantial likelihood of detriment, to the ***consumer*** and that determining whether a term was unfair would require the taking into account of the broader interest of ***consumers*** as well as the ***particular consumers*** affected.

The term consumer was not defined but would naturally be read in the context of the communiqué from the MCCA, and was in fact read, as indicating that the terms would be confined to consumer transactions. The Proposed Laws are radically different in their scope.

4 Departures from Productivity Commission recommendations

The Proposed Laws are not consistent with the recommendations of the Productivity Commission as set out in the Productivity Commission's 2008 report in relation to the introduction of unfair contract terms regulation (**PC Report**) .

In particular:

(a) It appears that the PC Report was addressing consumer transactions – the Proposed Laws extend to all transactions.

(b) The draft legislation does not include material detriment to consumers as an element of an 'unfair term' – an 'unfair term' is defined exclusively in section 3(1) of the proposed provisions in terms that contain no reference whatsoever to any material detriment to consumers (or anybody else). What is required is only that the term would cause a 'significant imbalance' in the parties' rights and obligations and that it not be 'reasonably necessary' in order to protect the 'legitimate interests' of the party who would be advantaged by the terms. Although section 3(2) requires the court to 'take into account' the extent to which a term would cause, or there is a substantial likelihood that a term would cause, detriment to a party if it were to be applied or relied on, this is not an element of the definition and there is no reference to "material" detriment.

(c) Actual detriment – the PC Report recommended a term should be void only if there was actual detriment suffered by a party. This approach directs attention to the time at which a provision is relied upon, permitting regard to be had to the manner in which the advantaged party uses the term, and redresses the adverse impact of such reliance on the consumer. By contrast, the Proposed Laws require consideration of whether there is a substantial likelihood that a term would cause detriment ***if*** the term was relied on –there is no need to consider whether or not the term is relied upon or exercised by the advantaged party in a commercially reasonable way so as not to prejudice the other party, nor does it make any allowance for the manner in which the advantaged party would customarily exercise its contractual power (although such evidence may potentially be relevant in determining the question of likelihood). On its face the Proposed Laws are concerned with the question of the inherent fairness of a term (and not its application). This is not an inappropriate approach but it is one which is inconsistent with the PC Report and also inconsistent with the Victorian *Fair Trading Act* 1999 which defines an unfair terms as on which "causes" a significant imbalance in the parties' rights and obligations.

(d) Good faith – the abandonment of any element of good faith from the definition also radically alters its operation.

We disagree with the statement in the Request that the removal of the requirements of a lack of good faith or substantial likelihood of detriment are 'minor clarifying refinements'.

5 Inconsistencies between the Proposed Laws and the Commentary

The Commentary which was issued together with the Proposed Laws is inconsistent with the Proposed Laws. For instance:

(a) The Commentary states, at page 8, that section 2 of the Proposed Laws "will apply to all standard-form contracts entered into for the supply of goods or services or a transfer of land". However, the draft legislation does not specifically refer to such contracts.

(b) On page 9 of the Commentary, it is stated that the first element of the unfairness test "requires the court to consider whether the term has caused a significant imbalance". As already noted above, the draft legislation only refers to the significant imbalance that **would** be caused.

(c) The Commentary on page 11 states that the requirement that the court take into account detriment reflects the PC Report's recommendation "that there would need to be material detriment to consumers... in order for a remedy to be available". As already noted in section 4 above, the Proposed Laws do not refer to material detriment.

(d) On page 14 of the Commentary, it is stated that the provisions make it clear that in the context of the credit agreement, the upfront price will include the repayment of both the principal and the interest of a loan. The relevant section of the proposed legislation merely states that the upfront price includes the total amount of principal that is owed under the contract.

These inconsistencies require clarification.

6 The Upfront Price Exemption

The Proposed Laws do not apply to a term of a standard form contract that sets the "upfront price" payable under the contract. The "upfront price" is defined as the consideration that is provided, or is to be provided, for the supply, sale or grant under the contract and that is disclosed at or before the time the contract is entered into. It is further stated that the upfront price "does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event".

The Commentary issued together with the Proposed Laws stipulates further that:

- an upfront price can include payments to be made at a future time;
- the price may vary over time (for instance in the case of interest payable for credit) or be calculated according to a formula after a specified amount of time has passed or specified conditions have been met and the intention is that these would be included in the upfront price if disclosed at or before the contract is made; and
- the provisions are not intended to allow customers to challenge the payment of interest under a credit agreement, or to challenge the interest rate or variations of interest rates on the basis that they are unfair.

The exclusion of "other consideration that is contingent on the occurrence or non-occurrence of a particular event" is explained, in the Commentary, as referring to payments that are not necessary for the provision of the supply, sale or grant under the contract but are the additional to the upfront price. This would appear to be intended to apply, for instance, to fees such as break-cost fees but would also extend presumably to dishonour fees and arguably default interest.

It must surely be open to argument that, if the fee to be charged or the formula by which it is to be calculated is set out at the outset of the contract, it can be viewed as part of the price, whether or not its payment is contingent on the occurrence or non-occurrence of an event during the life of the contract. Unfair terms regulation of the United Kingdom excludes the adequacy of price or remuneration generally from an assessment of fairness, without distinguishing consideration that is contingent of the occurrence or non-occurrence of any event. This is a preferable approach. The question of the adequacy of any fee or charge is not something which can be measured sensibly with regard to issues of imbalance in the parties rights and obligations. If Parliament wishes to allow parties to be able to challenge the adequacy of fees and charges, there are other more appropriate

ways in which to do this, for example by challenging the reasonableness of the fee or charge as occurs under section 72 of the current state-based Uniform Consumer Credit Code.

7 Potential for adverse consequences

The Request notes the conclusion of the PC Report that in Victoria and countries that have enacted laws against unfair contract terms, there has been little evidence of adverse unintended commercial consequences or of significant business compliance costs.

In our view, this conclusion cannot be applied to the Proposed Laws. In particular:

(a) the proposed laws are of far wider application than the laws to which the Productivity Commission referred – both Victorian and United Kingdom laws are confined in their application to consumer transactions, whereas the proposed laws extend to all transactions;

(b) the proposed laws are in significantly different form to the laws of the jurisdictions referred to by the Productivity Commission – there are significant differences in the legislation which give rise to far greater potential uncertainty in their application; and

(c) Victorian laws are in any event only recent and provide an insufficient basis to draw conclusions as to the likely impact of unfair contract terms legislation.

8 Criminal sanctions

No justification is provided for including the option of proscribing certain terms and imposing criminal sanctions on the use of such terms. Such prohibitions will inevitably be breached inadvertently. Given the objectives of the reform, and the absence of likely 'wrongdoing' by any party, civil consequences should be an adequate sanction.

9 Unintended civil sanctions: void and illegal contracts

The legislation does not appear to give adequate consideration to the potential impact of invalidating a term of a contract on the contract as a whole.

The legislation provides for the remainder of the contract to continue to be enforceable to the extent it is capable of performance, but the test of 'capable of performance' is unclear.

The test could be construed as:

(a) on its strict terms, a requirement that the parties perform a contract notwithstanding the void term and regardless of the impact of the invalidity of the term on the contract as a whole – this could radically alter the actual obligations of the parties to a contract, particularly where the 'advantaged party' has taken on obligations in reliance on the term that has been avoided; or

(b) the provision may be intended to engage common law doctrines of severance – these doctrines are notoriously difficult to apply.

There is therefore a significant possibility that contracts will be required to be performed in circumstances when they ought not reasonably to be required, or that contracts will be entirely avoided based on technical notions of common law severance that poorly reflect the real commercial intention of the parties.

This problem is compounded in the context of the proposal to prescribe certain terms the inclusion of which in a contract would be a criminal offence. By making the term of a contract a criminal offence, the legislation raises the possibility that the entire contract could be rendered illegal. The consequence of rendering a contract illegal is that moneys paid under the contract may be wholly unrecoverable – this would be an extreme and disproportionate consequence to attach to including an 'unfair' term in, for example, a loan agreement.

A further problem is the proposed application of the Proposed Laws to contracts entered into before the implementation date where they are varied or renewed after the implementation date. Parties frequently do not obtain legal advice before varying or renewing a contract – there is therefore a material risk that parties will unknowingly attract the application of the laws to existing contracts, potentially rendering them unenforceable.

10 Inevitable period of uncertainty

Regardless of whether or not the Proposed Laws are ultimately given a workable interpretation by the courts, a long period of significant uncertainty would seem to be inevitable whilst that jurisprudence develops.

11 Implications for Australia as a financial centre

The implementation of these laws in the form proposed is likely to render Australian contract law so uncertain as to make Australian law a commercially unacceptable choice of law in any transaction in which the parties could choose another law to apply – indeed, it may even be incumbent on Australian practitioners to advise their clients not to choose it where there is an alternative choice available.

In addition, the uncertainty that the laws would create in relation to the ability of a party to enforce a foreign law contract within an Australian court will operate as a commercial disincentive to operating in Australia or dealing with Australian counterparties. Australia would be likely to be considered a high risk jurisdiction as regards enforceability of contracts, undermining a critical aspect of Australia's attractiveness to foreign investors and undermining efforts to enhance the advantages of Australian commercial courts and arbitration centres. This is likely to harm the potential for Australian legal service providers to generate income from the export of Australian legal services.

12 Ability of Australian companies to tap international capital markets

For the same reasons, implementation of the laws will likely make it more difficult for Australian companies to tap international capital markets. International investors require certainty that their contracts would be enforced. The risk that those contracts would not be enforced by an Australian court on such uncertain grounds as are reflected in the Proposed Laws would act as a disincentive for international investors to provide funding to Australian companies.

13 Potential impact on Australian financial services

It is common for financial products and lending products in Australia to rely on broad discretions on the part of the product issuer or lender. If the Proposed Laws proceed it may well be that many of those products will be withdrawn from the market because the enforceability of the discretionary terms are too uncertain. For example, banks may well seek to return to 'on demand' lending (if, indeed, such lending terms would be enforceable) rather than provide longer-term funding in reliance on unilateral powers to vary a loan agreement.

14 Inconsistency with other regulatory goals

There are a number of areas in which the draft legislation appears to run counter to other regulatory goals and reforms, being pursued by the government at the same time. For example:

(a) the Financial Stability Forum (comprising the RBA and other key central banks) recommendations in relation to the restoration and promotion of financial stability calls for increased use of industry developed standardised documents to mitigate systematic risk and the Financial Stability Forum has specifically called on governments to support standardisation initiatives – the Proposed Laws expose such documents to the risk of being found void by reason of their standardisation;

(b) the real risk that significant numbers of financial contracts could be rendered void and unenforceable, or that at a minimum there would be significant uncertainty as to their enforceability, posing a significant risk of material loss to financial institutions at a time when such institutions are already significantly stressed and further increasing the difficulty and cost for borrowers to raise debt funding;

(c) if the Proposed Laws are passed, it is unlikely that a law firm could give an opinion of sufficient certainty in relation to the enforceability of a netting agreement to satisfy APRA's requirements for an ADI to recognise netting for capital adequacy purposes, placing further strain on ADI's capital requirements;

(d) among the Proposed Laws' examples of unfair terms are terms that permit one party to assign a contract to the detriment of another party without the other party's consent – as part of the Personal Property Securities Reforms, however, the Government is proposing to effectively abrogate contractual restrictions on assignment to permit assignment even where the parties have agreed assignment was not possible;

(e) another of the Proposed Laws' examples of an unfair term is any term that limits or has the effect of limiting another party's right to sue a party – this follows years of consultation in regard to professional organisations (including law firms and barristers that comply with Professional Standards Legislation) being able to adopt limited liability regimes and the successful co-ordination of State and Federal legislation to achieve this with the added benefits for consumers of containing adverse affects of increased insurance premiums and of enhancing professional standards under Professional Standards Legislation.

15 Preliminary thoughts

We emphasise that the submissions made in this letter are our preliminary thoughts on potential problems with the Proposed Laws. The Proposed Laws may well represent the most radical incursion into contract law ever undertaken in Australia (and possibly any other significant common law jurisdiction). We doubt that the Proposed Laws are suitable in their current form, and in any event warrant far more detailed and considered debate than permitted by the 11 day period prescribed by the Request.

Yours sincerely