

Senate Economics Committee

***Inquiry into the statutory definition of Unconscionable Conduct***

Submission from Liam Brown

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I enclose for the Committee's reference a copy of an article written by me and published in the *Melbourne University Law Review* in 2004. The article is entitled "The Impact of Section 51AC of the *Trade Practices Act 1974* (Cth) on Commercial Certainty" and it deals with the interpretation and effect of s 51AC.

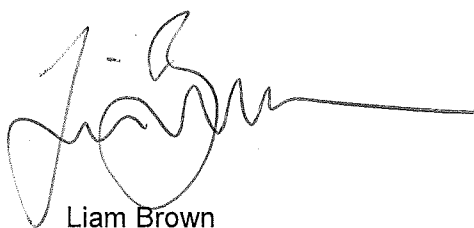
Whilst the research for this article was completed in 2003 and 2004, I have conducted a brief review of subsequent case law and judicial treatment of the provision seems to have progressed consistently with the central theses of the article. That is, there has been a cautious judicial response to s 51AC, such that a court will only find a contravention in cases that demonstrate 'serious misconduct' during contractual formation or performance, or 'bad faith' in the exercise of contractual rights.

I do not know what led to this inquiry, but it would seem there is a certain level of dissatisfaction within the small business sector with the effectiveness of the Part IVA at preventing exploitative conduct by large businesses in their dealings with small businesses. It is interesting to note that much of the early academic commentary about s 51AC suggested the provision tipped the balance too far in favor of small business plaintiffs. Much of this criticism centered on the ability of a court to scrutinize a voluntary transaction on the basis of what appeared to be vague normative behavioral standards. These standards, it was said, were not clear rules of rational application, but vague concepts imbued with ideas of fairness.

It is clear from s 51AC and its 'shopping list' of factors that might indicate the presence unconscionability that the provision goes well beyond the doctrine of unconscionable bargains in equity. One of the theses of my article was that, notwithstanding the difficulty in defining a concept like unconscionability, the judicial treatment of the s 51AC would be cautious and principled so that the type of conduct caught by the provision was capable of being defined with adequate certainty. Accordingly, I hypothesized, there would not be a 'flood' of aggrieved small business litigants seeking to use the section to unwind their unfavorable transactions with larger companies.

It is very difficult for the legislature to define with precision normative behavioral standards like 'unconscionability' and 'good faith' because these standards rely on the application of an objective judicial conscience to the facts of a case. Parliament attempted to address this difficulty, in the case of Part IVA, by directing the judicial mind towards matters that might indicate the presence of unconscionable conduct. However, the legislature left the ultimate decision with the judiciary as to how much weight should be given to each or any of the factors in any particular case.

In my view, empirical work should be undertaken to assess the extent to which the public policy objectives of Part IVA have been achieved and if they have not been achieved why this is the case. If Part IVA has not succeeded in changing business behavior and protecting small business and consumers from exploitation, are there other measures that could be used to achieve its purposes beyond a probably elusive search for a rigid statutory definition of unconscionable conduct? The failure of the Part to provide sufficient protection for small businesses and consumers, if this found to be the case, might have nothing to do with the words of the Act. Such a failure could be due to insufficient education of consumers and the business community, inadequate government support services for consumers and small business or complicated and difficult enforcement and enforcement mechanisms under the Act.



Liam Brown

21 October 2008

# THE IMPACT OF SECTION 51AC OF THE *TRADE PRACTICES ACT 1974 (CTH)* ON COMMERCIAL CERTAINTY

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*[Section 51AC of the Trade Practices Act 1974 (Cth) was introduced in 1998 to protect small business from unconscionable conduct. This initiative was taken following a number of government reports that highlighted the exploitation some small businesses suffer at the hands of larger businesses. This article argues that legislative intervention in this context is justified and that the mechanism adopted by s 51AC is appropriate. Indeed, the provision is neither likely to undermine commercial certainty nor have a significant impact on business activity. The Australian judiciary has thus far been cautious in its approach to the interpretation of obligations contained in the provision, limiting its use to cases that satisfy a threshold test of demonstrated 'serious misconduct' during contractual formation or performance, or 'bad faith' in the exercise of contractual rights. This balanced approach accords with nearly 50 years of experience with a comparable statutory commercial unconscionability provision in the United States.]*

## CONTENTS

I	Introduction.....	590
II	Classical Contract Theory and General Law Unconscionability.....	592
	A Classical Contract Theory and Economic Background.....	592
	B General Law Unconscionability.....	594
III	The Protection of Small Business and Statutory Unconscionability .....	595
IV	The Legislative Provisions — Expanding Unconscionability .....	600
	A The Protection Offered by Section 51AA.....	601
	B The Protection Offered by Section 51AC .....	602
V	Good Faith and Its Impact on Certainty .....	604
VI	The United States Experience.....	607
	A Comparing Contract Law in Australia and the United States .....	607
	B Unconscionability under the Uniform Commercial Code .....	607
	C Good Faith and Unconscionability in the United States .....	609
	D Parallels between Unconscionability in Australia and the United States... ..	611
VII	Judicial Caution with Section 51AC.....	612
	A Trickle or Flood? .....	612
	B The Scope of Section 51AC.....	613
	1 <i>Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd</i> .....	613
	2 <i>Hurley v McDonald's Australia Ltd</i> .....	614
	3 <i>Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd</i> .....	616
	4 Summary of the Case Law .....	617
	C Good Faith? .....	617
	1 <i>Automasters Australia Pty Ltd v Bruness Pty Ltd</i> .....	617
	2 <i>Boral Formwork &amp; Scaffolding Pty Ltd v Action Makers Ltd</i> .....	618

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D The Direction of Australian Case Law .....	620
VIII Conclusion.....	620

## I INTRODUCTION

Part IVA of the *Trade Practices Act 1974* (Cth) ('TPA') contains three sections that prohibit corporations from engaging in unconscionable conduct: ss 51AA, 51AB and 51AC. Section 51AC was added to the TPA in 1998 following concerns that existing statutory and common law causes of action did not adequately protect small businesses against unfair or exploitative conduct. To achieve this protection, s 51AC proscribes 'conduct that is, in all the circumstances, unconscionable'<sup>1</sup> in connection with dealings with small businesses. Some commentators view this legislatively-imposed standard of business behaviour as an affront to the fundamental legal and economic need for commercial certainty.<sup>2</sup> Uncertainty is said to arise because s 51AC empowers courts to review contractual dealings not according to rational rules of coherent application, but against nebulous behavioural standards based on fairness. This article will show, however, that the extent of commercial uncertainty is well controlled by the provisions of s 51AC, where the content of business conduct proscribed can be ascertained with adequate clarity. This has been evinced by a developing jurisprudence that requires satisfaction of a threshold before the section will apply. This threshold has been articulated as the existence of 'serious misconduct or something clearly unfair or unreasonable'<sup>3</sup> on the part of the defendant. Serious misconduct involves pre-contractual misbehaviour or an absence of good faith or other abuses during contractual performance.

Section 51AC forms part of a modern trend in the law towards legal evaluation of the normative conduct of commercial dealings, and attempts to free such transactions from morally reprehensible conduct.<sup>4</sup> Some commentators have argued that allowing the court to inquire into a business relationship on the basis of unconscionability causes such a degree of commercial uncertainty that large businesses would be loathe to deal with small businesses. Further, overall transaction costs would rise and there would be an explosion of litigation.<sup>5</sup> On the other hand, it has been suggested that the small business sector is such an

<sup>1</sup> TPA s 51AC(1), (2).

<sup>2</sup> See, eg, Anne Finlay, 'Unconscionable Conduct and the Business Plaintiff: Has Australia Gone Too Far?' (1999) 28 *Anglo-American Law Review* 470, 500-2; Robert Baxt and Joel Mahemoff, 'Unconscionable Conduct under the *Trade Practices Act* — An Unfair Response by the Government: A Preliminary View' (1998) 26 *Australian Business Law Review* 5, 7, 18; Ross Buckley, 'Unconscionability Amok, or Two Readily Distinguishable Cases?' (1998) 26 *Australian Business Law Review* 323, 323; Peter van den Dungen, 'Good Faith, Unconscionable Conduct and Imaginary Community Standards — Section 51AC of the *Trade Practices Act* and the Insurance Industry' (1998) 10 *Insurance Law Journal* 1, 17.

<sup>3</sup> *Hurley v McDonald's Australia Ltd* (2000) 22 ATPR ¶41-741, 40 585 (Heerey, Drummond and Emmett JJ) ('*Hurley*'); *Automasters Australia Pty Ltd v Brumess Pty Ltd* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [361], [395] ('*Automasters*').

<sup>4</sup> See Paul Finn, 'Commerce, the Common Law and Morality' (1989) 17 *Melbourne University Law Review* 87; Vivien Goldwasser and Tony Ciro, 'Standards of Behaviour in Commercial Contracting' (2002) 30 *Australian Business Law Review* 369.

<sup>5</sup> Finlay, above n 2, 502; Baxt and Mahemoff, above n 2, 9; van den Dungen, above n 2, 18.

important part of the economy that providing protection from exploitation is essential to prevent unfair hardship and maintain market integrity.<sup>6</sup>

It has been over five years since the commencement of s 51AC, but the existence of a broad judicial discretion to review commercial contracts according to their fairness continues to cause controversy. This article shows that the effect of s 51AC on commerce is likely to be minimal because the behavioural obligations imposed by s 51AC can be defined with sufficient clarity and the judiciary has exhibited caution in the use of the section. This observation is supported by an examination of the United States experience with a comparable statutory commercial unconscionability provision. Recent case law indicates that s 51AC undoubtedly has the potential to erode commercial certainty in some areas,<sup>7</sup> but counterbalancing this is a desire to increase contractual fairness. Moreover, a generally restrained judicial response is likely to ensure that this delicate balance is not tipped too far in either direction.

Part II of this article examines the economic background against which classical contract theory developed, and the socioeconomic changes tied to a subsequent shift towards individualised fairness. It also considers the equitable doctrine of unconscionability. Part III examines the legislative and political history of s 51AC to identify the problem that the provision was intended to remedy and the controversy surrounding its implementation. Part IV discusses the structure and operation of the section in order to identify the legislative tools used to achieve the policy aims outlined in Part III, the expanded notion of unconscionability embodied in s 51AC, the sources of the uncertainty thereby created and the mechanisms used to resolve it. Part V investigates the potential for s 51AC to undermine fundamental contractual principles and increase uncertainty during business dealings. Part VI compares the operation of the section with statutory unconscionability in the US. Finally, Part VII analyses litigation involving s 51AC to ascertain current judicial trends and the effect that this litigation has had on certainty and commercial obligations.

This article concludes by demonstrating that the legislative response embodied in s 51AC to the problem of unfair commercial practices was justified and will not cause disastrous commercial ramifications. Although s 51AC involves the imposition of broad and seemingly ill-defined obligations, this protection is essential to ensure the vitality of small business and healthy market competition. Experience with statutory standards of business conduct in the US shows that, with cautious judicial application, the business community has little to worry about in this regard. In any case, the standard of behaviour demanded should not be difficult to meet as it accords with traditional relational contracting standards of honesty and fairness in business dealings.<sup>8</sup>

<sup>6</sup> See, eg, Brian Johns, Winston Dunlop and William Sheehan, *Small Business in Australia: Problems and Prospects* (1978) 15; Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, 8802 (Peter Reith, Minister for Workplace Relations and Small Business).

<sup>7</sup> See, eg, *Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd* [2003] NSWSC 713 (Unreported, Austin J, 5 August 2003) (*'Boral'*), where s 51AC was used to undermine the principle of autonomy relating to stand-by letters of credit.

<sup>8</sup> Goldwasser and Ciro, above n 4.

## II CLASSICAL CONTRACT THEORY AND GENERAL LAW UNCONSCIONABILITY

### A. Classical Contract Theory and Economic Background

It is instructive to evaluate s 51AC against the background of classical contract theory and economic efficiency. Indeed, the legislative history of the section is linked to both of these concepts. Economic efficiency is enhanced to some extent by principles of classical contract theory,<sup>9</sup> which enables businesspeople to plan their transactions and allocate the risks of their business relationship to those willing and best able to accept them.<sup>10</sup> This is achieved by holding people to the bargains that they have made. However, absolute rules of strict application can lead to harsh outcomes, especially where the contractual relationship involves parties of unequal power and resources. At general law, courts developed principles which recognised that, in certain circumstances, contractual promises should not be enforced because of the existence of exploitative or unfair circumstances.<sup>11</sup>

By the 19<sup>th</sup> century, western society had undergone a substantial transformation from an economy dominated by village markets and farm-based industry to 'global' markets and factory-based production. This social and economic change coexisted with, and was to a large extent dependent upon, laissez-faire ideology.<sup>12</sup> Laissez-faire economic philosophy attributed the advancement of society to the self-interested struggle of the individual within a market free from government interference.<sup>13</sup> This, in turn, relied on secure and certain transactions provided by robust and predictable rules of commercial behaviour, which were contradictorily enforced by the non-interfering state.<sup>14</sup>

It was in the crucible of the 19<sup>th</sup> century free market that contract law as we know it took shape. It was supported by the tenets of caveat emptor, freedom to contract and the sanctity of the contract.<sup>15</sup> The maxim 'caveat emptor' was based on the idea that the individual is in the best position to judge his or her own interests. Consequently, it was left to individuals to protect their own interests when entering contracts. Freedom and certainty of contract were based on the ideas that efficient market transactions require commercial players to have the

<sup>9</sup> Blake Morant, 'Contracts Limiting Liability: A Paradox with Tacit Solutions' (1995) 69 *Tulane Law Review* 715, 761-2; Paula Baron, 'Shells of Steel and Bodies of Pulp: Commercial Man, Commercial Morality' (1993) 11 *Law in Context* 3, 11; P S Atiyah, *An Introduction to the Law of Contract* (5<sup>th</sup> ed, 1995) 7-15.

<sup>10</sup> Richard Posner, *Economic Analysis of Law* (4<sup>th</sup> ed, 1992) 89-96; Raymond Mulholland, 'The Shifting Sands of Contract Law' (1994) *New Zealand Law Journal* 216, 217; Morant, above n 9, 761-71.

<sup>11</sup> John Adams and Roger Brownsword, 'The Ideologies of Contract' (1987) 7 *Legal Studies* 205, 210. See also *Errington v Errington* [1952] 1 KB 290; *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130; *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 71.

<sup>12</sup> See, eg, Nicholas Seddon and Manfred Ellinghaus, *Cheshire & Fifoot's Law of Contract* (8<sup>th</sup> ed, 2002) 1107-15; Donald Greig and Jim Davis, *The Law of Contract* (1987) 13-26.

<sup>13</sup> See Seddon and Ellinghaus, above n 12, 1108-9.

<sup>14</sup> Baron, above n 9, 11-12.

<sup>15</sup> Greig and Davis, above n 12, 13-26.

liberty to contract with whoever is willing, and that once promises are made they must be kept. Effectively, the state delegated law-making power to the parties involved that could, by mutual agreement, formulate the precise rules regulating their relationship. This was premised on a 'concurrence of intention'<sup>16</sup> or 'meeting of the minds' and involved little state intervention within the confines of the relationship. Jessel MR said:

If there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice.<sup>17</sup>

Inability to predict the future or the behaviour of others means that commercial relationships necessarily involve business risks. Contractual 'certainty' is the vehicle provided by classical contract theory to minimise, and, where necessary, allocate risk. It is axiomatic that where parties are able to determine and allocate risks with certainty, transaction costs accounting for uncertainty are reduced and consequently economic efficiency is promoted. Therefore, by providing contractual certainty, the law creates a mechanism for effective risk allocation within the business relationship that functions to reduce transaction costs and promote economic efficiency.

However, the idea of certainty has often proved an illusory aspiration<sup>18</sup> and the sanctity of contracts has never been absolute. Encroaching on contractual relationships are many long-established rules designed to protect vulnerable parties, promote fairness and maintain the competitive integrity of the market. Prohibitions on the enforcement of contracts with minors, and the concepts of undue influence and unconscionable bargains, exemplify the preparedness of the law to interfere with contracts in the pursuit of fairness. Rules designed to promote fair contractual conduct have increased in prominence since the early 20<sup>th</sup> century as the courts and legislature have been influenced by what John Adams and Roger Brownsword call 'consumer-welfarist' ideology.<sup>19</sup> Changes in the sophistication and size of corporations and the use of standard form 'contracts of adhesion' have allowed companies to manipulate the principles of freedom and sanctity of contract for their own commercial expediency.<sup>20</sup>

In the 20<sup>th</sup> century, it became increasingly apparent that traditional causes of action were not sufficient to control exploitative market practices and facilitate fairness between all commercial participants.<sup>21</sup> The rapid and substantial growth in size and sophistication of corporate organisations following the industrial revolution, and particularly after World War II, meant that the difference in commercial strength between large and small business enterprises had in-

<sup>16</sup> *Foster v Wheeler* (1887) 36 Ch D 695, 698 (Kekewich J).

<sup>17</sup> *Printing & Numerical Registering Co v Sampson* (1875) LR 19 Eq 462, 465.

<sup>18</sup> Sir Anthony Mason, 'Contract, Good Faith and Equitable Standards in Fair Dealing' (2000) 116 *Law Quarterly Review* 66, 70.

<sup>19</sup> Adams and Brownsword, above n 11.

<sup>20</sup> See, eg, Greig and Davis, above n 12, 47-74; Seddon and Ellinghaus, above n 12, 1112-13.

<sup>21</sup> Greig and Davis, above n 12, 27-39.

creased.<sup>22</sup> Embedded ideals of laissez-faire regulation and freedom of contract allowed market manipulation by powerful corporations. Further, unfair practices such as the formation of cartels and monopolies and the use of standard form contracts reduced competition, compromised the integrity of the economy and often meant weaker parties had little prospect of justice.<sup>23</sup>

The last century saw an increasing shift towards individualised fairness in contracting, even in the context of what appeared on the surface to be voluntarily assumed contractual obligations.<sup>24</sup> This reflects the general law principles that were imposed upon classical contract theory, to prevent enforcement of a contract in unfair circumstances. The issue is how far notions of fairness should be allowed to impact on the predictability and certainty attributed to the traditional laws of contract. This quandary is a manifestation of a continuing tension between the fundamental pillars of contract: on the one hand, caveat emptor, freedom, sanctity and certainty; and on the other, the relatively new notion of individualised fairness between the parties. Some commentators have characterised this battle as a diametrically opposed struggle between the application of flexible, generalised standards and the use of rigid but certain rules.<sup>25</sup>

It is said that one of the most fundamental functions of the law of contracts is to enforce the parties' agreed allocation of risk in their relationship.<sup>26</sup> Parties to a contract will be unable to allocate risks accurately if the content of their obligations within the relationship cannot be described with certainty. The cost of this uncertainty may be that it is no longer attractive to pursue the relationship. Alternatively, there is an added 'cost' of vigilance to ensure the satisfaction of uncertain obligations. Where the standard of behaviour expected of a party is uncertain, vigilance is difficult and there is a risk that these obligations will require judicial clarification. In this way, legal expenses and the potential loss of contractual benefits are factored into the bargain, resulting in an overall increase in the price of the transaction.<sup>27</sup>

### B General Law Unconscionability

At general law, bargains wrought in unfair circumstances were ameliorated to some degree by the development in equity of the doctrine of unconscionable bargains. Statutory unconscionability in the *TPA* is a descendant of this equitable

<sup>22</sup> Ibid.

<sup>23</sup> Ibid; Commonwealth, *Parliamentary Debates*, House of Representatives, 16 July 1974, 225–6 (Keppel Enderby, Minister for Manufacturing Industry).

<sup>24</sup> See generally Adams and Brownsword, above n 11.

<sup>25</sup> See, eg, Mason, above n 18, 94; Gino dal Pont, 'The Varying Shades of "Unconscionable" Conduct — Same Term, Different Meaning' (2000) 19 *Australian Bar Review* 135, 136–7, 165–6; Hossein Abedian and Michael Furmston, 'Relief against Forfeiture after Breach of an Essential Time Stipulation in the Light of *Union Eagle Ltd v Golden Achievements Ltd*' (1998) 12 *Journal of Contract Law* 189, 192–6; Tania Voon, '*Roxborough v Rothmans of Pall Mall Australia Ltd*: Contractual Fallout from Tobacco Franchise Licence Fees' (1999) 15 *Journal of Contract Law* 81, 92–3; Andrew Phang, 'Security of Contract and the Pursuit of Fairness' (2000) 16 *Journal of Contract Law* 158.

<sup>26</sup> Anthony Kronman and Richard Posner, 'Introduction: Economic Theory and Contract Law' in Anthony Kronman and Richard Posner (eds), *The Economics of Contract Law* (1979) 1, 4.

<sup>27</sup> Finn, above n 4, 98.



doctrine, which was most famously explained by Mason J in *Commercial Bank of Australia Ltd v Amadio*.<sup>28</sup> Mason J explained that a court would grant relief 'whenever one party by reason of some condition or circumstance is placed at a special disadvantage vis-à-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created.'<sup>29</sup> By this analysis, the Court carefully limited the application of the doctrine to those plaintiffs able to establish that they were under a 'special disadvantage' when the contract was made. This limitation owed inspiration to the judgment of Fullagar J in *Blomley v Ryan*:

The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-à-vis the other.<sup>30</sup>

When explicating the equitable doctrine of unconscionable bargains in *Amadio*, the High Court clearly stated that it was only the setting in which a contract is made that is relevant to a finding of unconscionability.<sup>31</sup> Where there is no problem with the manner in which the contract was formed, a contract that turns out to be harsh in its operation cannot be impeached on the grounds of unconscionability. It must be noted, however, that unduly harsh terms may form part of the factual matrix used to infer unconscionable conduct in the formation of the contract.<sup>32</sup> This dichotomy between the circumstances of formation and the actual operation of a contract provides the basis for the distinction between procedural and substantive unconscionability.

### III THE PROTECTION OF SMALL BUSINESS AND STATUTORY UNCONSCIONABILITY

Increased recognition of the need to protect small businesses — and the failure of the general law to do so adequately — led to several lacklustre attempts at government intervention in Australia in the first half of the 20<sup>th</sup> century.<sup>33</sup> The arrival of the *TPA*, however, had a significant impact on exploitative market conduct. The *TPA* set out to prevent anti-competitive practices and abuse of power by prohibiting certain conduct, allowing private enforcement and estab-

<sup>28</sup> (1983) 151 CLR 447 (*'Amadio'*).

<sup>29</sup> *Ibid* 462.

<sup>30</sup> (1956) 99 CLR 362, 405.

<sup>31</sup> *Amadio* (1983) 151 CLR 447, 459 (Gibbs CJ), 466 (Mason J), 474 (Deane J).

<sup>32</sup> Daniel Clough, 'Trends in the Law of Unconscionability' (1999) 18 *Australian Bar Review* 34, 37-8; Mario Sindone, 'The Doctrine of Economic Duress — Part 1' (1996) 14 *Australian Bar Review* 34.

<sup>33</sup> For example, in 1906 the Commonwealth Parliament enacted the *Australian Industries Preservation Act 1906* (Cth), aimed at prohibiting certain monopolies and restraints of trade deemed to be detrimental to the public. However, several restrictive judicial decisions based on the *Constitution* and freedom of contract ideals prevented this Act from having any substantial effect: see *A-G (Cth) v Adelaide Steamship Co Ltd* [1913] AC 781.

lishing a commission to administer the scheme.<sup>34</sup> The *TPA* reflected the idea that a healthy market relies on healthy competition and that this in turn demands fairness in the interaction between market participants. That said, the early versions of the *TPA* did not address unconscionable conduct, which remained purely within the confines of equity. Successful application of the doctrine in a commercial setting remained rare, due to the need for the plaintiff to establish the existence of a 'special disadvantage'.<sup>35</sup>

The introduction of the *TPA* coincided with a growing awareness of the pivotal role played by small business in the Australian economy and society.<sup>36</sup> Accordingly, the particular needs of this sector of the economy were gradually being represented with greater volume and effect.<sup>37</sup> Some commentators feared that an unprotected and weak small-business sector could have serious economic ramifications, such as a reduction in market competition and reduced entrepreneurial activity.<sup>38</sup> These fears led to two important outcomes. First, a number of government-initiated inquiries, with mandates to examine the special needs of small business, identified contexts in which small businesses were routinely the victims of harsh or unfair commercial practices.<sup>39</sup> Second, successive governments became more responsive to policy suggestions aimed at providing a remedy for perceived abuses of power in relationships between small and large businesses.<sup>40</sup>

<sup>34</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 16 July 1974, 225–8 (Keppel Enderby, Minister for Manufacturing Industry). The commission was originally called the Trade Practices Commission under the *TPA*. However, s 39 of the *Competition Policy Reform Act 1995* (Cth) changed the name to the Australian Competition and Consumer Commission ('ACCC').

<sup>35</sup> *Amadio* (1983) 151 CLR 447, 462 (Mason J).

<sup>36</sup> Johns, Dunlop and Sheehan, above n 6. The authors cite a census by the Australian Bureau of Statistics which shows that in 1969, 41 per cent of people were employed in small businesses. Further, these entities accounted for nearly 32 per cent of the 'total value added by the private sector': at 11. See also Phil Ruthven, 'Small Business in the Australian Economy, 1984 and Beyond' (Paper presented at the National Small Business Conference, Sydney, 8–9 August 1984) 164; House of Representatives Standing Committee on Industry, Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) xi.

<sup>37</sup> See, eg, Small Business Research Unit, Bureau of Industry Economics, *Small Business Review 1984* (1985); Peter Charlton and Clinton Porteous, 'Coalition Blueprint Excites Business', *The Courier Mail* (Brisbane), 19 February 1996, 21; Ian Henderson, 'Opposition Tackles the Big Issue of Small Fry', *The Australian* (Sydney), 21 August 1996, 56; Natasha Bitá, 'MPs Back Protection for Small Business', *The Australian* (Sydney), 27 May 1997, 2; Peter Switzer, 'Leveling the Playing Field', *The Australian* (Sydney), 1 October 1997, 28.

<sup>38</sup> Johns, Dunlop and Sheehan, above n 6, 15; United Kingdom, *Report of the Committee of Inquiry on Small Firms*, Cmnd 4811 (1972) 28–31.

<sup>39</sup> See, eg, Trade Practices Review Committee, Parliament of Australia, *Trade Practices Review Committee Report: Report to the Minister for Business and Consumer Affairs* (1976); House of Representatives Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Takeovers and Monopolies: Profiting from Competition?* (1989); House of Representatives Standing Committee on Industry, Science and Technology, *Small Business in Australia*, above n 36; Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Mergers, Monopolies & Acquisitions: Adequacy of Existing Legislative Controls* (1991); House of Representatives Standing Committee on Industry, Science and Technology, Parliament of Australia, *Finding a Balance: Towards Fair Trading in Australia* (1997) ('Reid Report').

<sup>40</sup> See, eg, below nn 50–8 and accompanying text.

In 1976, the Trade Practices Review Committee reported following the first major inquiry into the operation of the TPA.<sup>41</sup> The committee felt that the inflexibility of equitable relief against unconscionable conduct, and its inapplicability to commercial dealings, could and should be overcome by including a provision in the TPA to deal with unconscionability.<sup>42</sup> This suggestion was not immediately followed. It proved controversial with industry groups and other commentators, who expressed fears about the effect of such a provision on contractual certainty.<sup>43</sup> Due to these concerns and the ongoing political debate surrounding the issue, it was not until 1986 that the first of the TPA unconscionability provisions appeared — s 52A.<sup>44</sup>

Significantly, the type of conduct proscribed by this section appeared more expansive than that contained in the equitable unconscionability doctrine. This was because the legislature refused to define unconscionability, instead providing a non-mandatory, non-exhaustive list of criteria for judicial consideration.<sup>45</sup> This list included 'principled discretion',<sup>46</sup> helping to reduce fears of judicial subjectivity and at the same time allowing the court flexibility in decision-making. The section was nevertheless limited to transactions between consumers and corporations, leaving small business with no such legislative protection.<sup>47</sup>

The failure to include small business transactions within the new statutory unconscionability scheme was a source of debate and political lobbying. Several government-commissioned reports, academics and small business groups indicated the desirability of extending the s 52A prohibition to all commercial transactions.<sup>48</sup> Other commentators and corporate groups met this suggestion with protests about the potentially deleterious impact of such legislative interference in contractual processes on commercial dealings.<sup>49</sup>

<sup>41</sup> Trade Practices Review Committee, above n 39.

<sup>42</sup> *Ibid* [1.3].

<sup>43</sup> It was not long after this that the first serious effort at tackling unconscionable contracts was introduced in New South Wales with the *Contracts Review Act 1980* (NSW). To some, this was a momentous legislative development. As McHugh JA remarked in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, 621:

The *Contracts Review Act 1980* is revolutionary legislation whose evident purpose is to overcome the common law's failure to provide a comprehensive doctrinal framework to deal with 'unjust' contracts. Very likely its provisions signal the end of much of classical contractual theory in New South Wales.

<sup>44</sup> Section 52A of the TPA was renumbered as s 51AB by s 8(2) of the *Trade Practices Legislation Amendment Act 1992* (Cth).

<sup>45</sup> See TPA s 51AB(2)(a)-(e).

<sup>46</sup> Matthew Lees, 'Contract, Conscience, Communitarian Conspiracies and Confucius: Normativism through the Looking Glass of Relational Contract Theory' (2001) 25 *Melbourne University Law Review* 82, 113-14. Lees describes 'principled discretion' as the method by which the court can be granted extensive discretion, confined by a guiding principle as to how the discretion is exercised. In the case of s 51AB, the listing of the criteria and the words of the section serve to assert the principle that consumers should be protected from unfair conduct perpetrated by larger businesses because of their superior bargaining power. It is according to this principle that judicial discretion can be exercised.

<sup>47</sup> TPA s 51AC(1), (5), (6).

<sup>48</sup> See, eg, House of Representatives Standing Committee on Industry, Science and Technology, *Small Business in Australia*, above n 36; Senate Standing Committee on Legal and Constitutional Affairs, *Mergers, Monopolies & Acquisitions*, above n 39.

<sup>49</sup> See, eg, Robert Baxt, 'Commercial Law: Better Protection of Small Businesses — The Beddall Committee's Recommendations for the Widening of s 52A of the *Trade Practices Act 1974*'

In response to this controversy, the government enacted s 51AA as a compromise.<sup>50</sup> In theory, this section would provide some protection to small businesses because it prohibited corporations from engaging 'in conduct that is unconscionable within the meaning of the unwritten law'.<sup>51</sup> This formulation meant that s 51AA did not create any new substantive rights, but merely declared the existing equitable doctrine. In effect, the only benefit to a victim of unconscionable conduct was the availability of the flexible remedies provided by the *TPA* and the opportunity for representative proceedings to be brought by the Trade Practices Commission.<sup>52</sup>

Section 51AA proved to be of limited benefit to small business plaintiffs. The problem of high equitable threshold requirements remained unchanged — few commercial parties could realistically claim to be labouring under a 'special disadvantage'. Consequently, although the Commission continued to receive a 'stream of complaints',<sup>53</sup> most of these cases were not appropriate for litigation under the *TPA*.<sup>54</sup>

In 1997, *Finding a Balance: Towards Fair Trading in Australia* ('*Reid Report*'), commissioned by the Howard government, concluded that there were many areas in which small businesses were vulnerable to exploitation.<sup>55</sup> Overall, small businesses seemed to suffer similar disadvantages to ordinary consumers. Since s 51AA was unable to provide a satisfactory level of protection for small businesses in their dealings with large businesses,<sup>56</sup> the authors of the *Reid Report* recommended that the unconscionability protection enjoyed by consumers under s 51AB be extended to small business.

The government formed the view that there was a defect in the law and responded with a package of measures given the wistful epithet 'New Deal: Fair Deal — Giving Small Business a Fair Go'.<sup>57</sup> At the heart of the package was a new legislative weapon — s 51AC — which added what has been described as an 'exocet missile' to the defensive armoury of small business.<sup>58</sup> Although similar in form to s 51AB, s 51AC went much further by including an additional

(1990) 64 *Australian Law Journal* 425; House of Representatives Standing Committee on Legal and Constitutional Affairs, *Mergers, Takeovers & Monopolies*, above n 39, [4.6.31].

<sup>50</sup> The *Trade Practices Legislation Amendment Act 1992* (Cth) ss 8–9 introduced s 51AA, renumbered s 52A as s 51AB, and placed both ss 51AA and 51AB in a new pt IVA of the *TPA* entitled 'Part IVA — Unconscionable Conduct'.

<sup>51</sup> *TPA* s 51AA(1).

<sup>52</sup> The Trade Practices Commission is now the Australian Competition and Consumer Commission: see above n 34; *TPA* ss 80, 87. See also *Australian Competition and Consumer Commission v C G Berbatis Holdings Pty Ltd* (2003) 214 CLR 51, 81 (Kirby J) ('*Berbatis*').

<sup>53</sup> Trade Practices Commission, *Unconscionable Conduct in Commercial Dealings — A Guide to s 51AA of the Trade Practices Act* (1993) 8.

<sup>54</sup> Finlay, above n 2, 482, 489.

<sup>55</sup> *Reid Report*, above n 39, xv.

<sup>56</sup> *Ibid* xv–xxix.

<sup>57</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, 8799 (Peter Reith, Minister for Workplace Relations and Small Business). Access to s 51AC is reserved to small businesses, as it cannot be used by listed companies (*TPA* s 51AC(1)–(2)) or where the transaction in question involves more than \$3 million (*TPA* s 51AC(9)).

<sup>58</sup> William Duncan and Sharon Christensen, 'Section 51AC of the *Trade Practices Act 1974*: An "Exocet" in Retail Leasing' (1999) 27 *Australian Business Law Review* 280, 280.

six criteria to direct judicial decision-making.<sup>59</sup> Amongst other adaptations, this provision allowed the court to refer to the controversial notion of good faith.<sup>60</sup> Given that good faith in contracting had never been relevant to a finding of unconscionable conduct in equity, this clearly indicated that s 51AC had moved away from traditional doctrine.

When Peter Reith, the Minister for Workplace Relations and Small Business, introduced the package, he acknowledged the policy tension that was being created between the protection of small business and the preservation of commercial contractual certainty.<sup>61</sup> The concern of many commentators was that s 51AC tipped the balance too far in favour of small business,<sup>62</sup> since the court was now able to review freely-made commercial contracts on the basis of a concept that had once been available only in equity in clearly limited circumstances. The legislative prohibition of unconscionable conduct was significantly expanded, yet of uncertain scope in its substantive operation.

Although its development was problematic, s 51AC was introduced as a response to an empirically-identified problem, in a statutory form that involved an attempt to both utilise and expand existing principles of equity and trade practices law. While the equitable doctrine of unconscionability was readily amenable to precise definition, its 'parasitic'<sup>63</sup> use in the TPA had never been defined with satisfactory clarity. This problem was compounded by the use in s 51AC of an expanded concept of unconscionability with additional criteria for judicial reference, such as good faith<sup>64</sup> and industry codes.<sup>65</sup>

Section 51AC does not define the term 'unconscionable', but it is clear that it is not limited by the notion of special disadvantage, or any other equitable doctrine.<sup>66</sup> Although s 51AC targets similar contractual misconduct and bears a similar name to its equitable ancestor, the new cause of action is greatly expanded in scope.

Hasluck J recently considered the scant authority on the interpretation of s 51AC. In his Honour's opinion, the words of s 51AC, when considered in the context of the TPA as a whole, clearly define a prohibition 'beyond the usual bounds of the concept of equity'.<sup>67</sup> While general law notions inform the concept, it could not be so limited because it was clearly intended to establish a broad prohibition on unconscionable conduct.<sup>68</sup> In the opinion of Sundberg J, the

<sup>59</sup> TPA s 51AC(3)(f)-(k), (4)(f)-(k).

<sup>60</sup> TPA s 51AC(3)(k), (4)(k). See discussion in below Part V.

<sup>61</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, 8800 (Peter Reith, Minister for Workplace Relations and Small Business).

<sup>62</sup> See, eg, Finlay, above n 2; Baxt and Mahemoff, above n 2; Buckley, 'Unconscionability Amok', above n 2; van den Dungen, above n 2.

<sup>63</sup> This description is used in Law Book Company, *Trade Practices Law*, vol 2 (at 16-3051) [16.80.2].

<sup>64</sup> TPA s 51AC(3)(k), (4)(k).

<sup>65</sup> TPA s 51AC(3)(g), (4)(g).

<sup>66</sup> See above nn 59-60 and accompanying text; *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253, 265 (Sundberg J) ('*Simply No-Knead*').

<sup>67</sup> *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [361].

<sup>68</sup> *Ibid.*

principal pointer to an enlarged notion of unconscionability in s 51AC lies in the factors to which subs (3) permits the Court to have regard. Some of them describe conduct that goes beyond what would constitute unconscionability in equity.<sup>69</sup>

These judgments reflect an interpretation that the court has been vested with substantial discretion to make a determination based on the individual facts of a case. Although this only reflects the opinion of two single judges of the Federal Court, this position is likely to meet with continued judicial approval. This interpretation is further supported by the second reading speech for the Bill that became the *Trade Practices Amendment (Fair Trading) Act 1998* (Cth), where it was said that s 51AC 'will extend the common law doctrine of unconscionability expressed in the existing s 51AA'.<sup>70</sup> The meaning of what conduct is unconscionable is 'at large'<sup>71</sup> and is discussed below in Part IV(B).

#### IV THE LEGISLATIVE PROVISIONS — EXPANDING UNCONSCIONABILITY

Much of the criticism of s 51AC is predicated upon a perception that it introduces ill-defined concepts and allows wide-ranging judicial discretion leading to decreased commercial certainty.<sup>72</sup> However, despite s 51AC providing a more expanded scope for protection from unconscionable conduct for small businesses than was available in equity or under s 51AA,<sup>73</sup> it is submitted that s 51AC represents a workable approach to the prevention of unconscionable conduct because its scope may be articulated with precision.

In sub-ss (3) and (4), s 51AC provides a list of factors to which the court may have regard for the purposes of determining whether the imputed conduct contravenes the section. This list makes it clear that s 51AC is based on a notion of unconscionability that is more expansive than that at general law as expressed in s 51AA.<sup>74</sup> First, several of the paragraphs allow the court to consider matters not relevant to the equitable doctrine. Second, the paragraphs contain both procedural and substantive elements, which allow the court to look at both bargaining practices and outcomes. Finally, the list might in effect impose a duty of good faith in contracting.

Increased protection does not of itself lead to reduced contractual certainty if the scope of the behavioural duty created can be adequately ascertained. There are two ways the provision arguably achieves this result. First, by the use of the term 'unconscionable' as a method of circumscribing the type of conduct caught by the prohibition. This term effectively excludes from the operation of the provision conduct that is not unconscionable as the word is ordinarily defined. In this way a threshold requirement of conduct that is unconscionable is imposed

<sup>69</sup> *Simply No-Knead* (2000) 104 FCR 253, 265.

<sup>70</sup> *Ibid*, citing Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, 8800 (Peter Reith, Minister for Workplace Relations and Small Business).

<sup>71</sup> *Simply No-Knead* (2000) 104 FCR 253, 267 (Sundberg J).

<sup>72</sup> See, eg, Finlay, above n 2, 501; Baxt and Mahemoff, above n 2, 22-3.

<sup>73</sup> See above nn 60-70 and accompanying text.

<sup>74</sup> See above nn 50-6.

prior to judicial reference to the specific list of factors. Second, if a duty to contract in good faith has been created then this could be the concept used to confine the reach of the section and Parliament may have inadvertently used s 51AC to impose the 'good faith' standard on commercial relationships to which the placitum is applicable.

#### A The Protection Offered by Section 51AA

Although s 51AC expands the scope of protection offered by s 51AA to small business, the precise behavioural prescription of s 51AA remains unsettled. Initially, the courts restricted the reach of the section to facts that fitted within the narrow 'unconscionable bargains' doctrine as articulated in *Amadio*.<sup>75</sup> Many commentators argued that this approach was consistent with both the wording of the section and the intention of Parliament.<sup>76</sup> Others felt that s 51AA should not be so confined. Some thought that the conduct proscribed potentially extends to any attempt to create or enforce 'harsh or oppressive' contractual rights.<sup>77</sup> Still others felt that the section extends to conduct that fits within any of the equitable doctrines that are underpinned by the concept of unconscionability, such as estoppel and undue influence.<sup>78</sup> Although the High Court recently had the opportunity to examine this debate in *Australian Competition and Consumer Commission v C G Berbatis Holdings Pty Ltd*,<sup>79</sup> the issue on appeal did not relate to the scope of the section and only Kirby J, who dissented, chose to discuss this matter. His Honour acknowledged that the best view of the section was that expounded by French J at first instance.<sup>80</sup> Kirby J looked at the legislative history of s 51AA, and the purposes of both the TPA generally and Part IVA in particular, and concluded that the section should extend to conduct beyond *Amadio*-style unconscionability.<sup>81</sup>

Therefore, the breadth of s 51AA remains unsettled: if s 51AA is found to extend to any conduct deemed unfair or contrary to conscience, then it might render s 51AC otiose. However, if s 51AA covers all such conduct, then logically there would be little room in which s 51AC could operate. Given that s 51AA

<sup>75</sup> (1983) 151 CLR 447, 462 (Mason J). See *Australian Consolidated Investments Ltd v England* (1995) 183 LSJS 408; *Leitch v Natwest Australia Bank Ltd* (Unreported, Federal Court of Australia, Cooper J, 12 October 1995); *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246; *Australian Competition and Consumer Commission v Chats House Investments Pty Ltd* (1996) 71 FCR 250.

<sup>76</sup> See, eg, Buckley, 'Unconscionability Amok', above n 2; Finlay, above n 2; Baxt and Mahemoff, above n 2; Phillip Tucker, 'Unconscionability: The Hegemony of the Narrow Doctrine under the Trade Practices Act' (2003) 11 *Trade Practices Law Journal* 78; Ross Buckley, 'Sections 51AA and 51AC of the Trade Practices Act 1974: The Need for Reform' (2000) 8 *Trade Practices Law Journal* 5. See also *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd* (2001) 117 FCR 23, 77 (Gyles J).

<sup>77</sup> *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, 402-3 (Batt J) ('*Olex Focas*'), citing Law Book Company, *Laws of Australia*, vol 35 (at 13 September 2004) 35 Unfair Dealing, '35.5 The Notion of Unconscionability' [2], [5].

<sup>78</sup> See, eg, *Australian Competition and Consumer Commission v C G Berbatis Holdings Pty Ltd* (2000) 96 FCR 492, 503-4 (French J).

<sup>79</sup> (2003) 214 CLR 51, 85, 98 (Kirby J).

<sup>80</sup> *Ibid* 85.

<sup>81</sup> *Ibid* 81-4, 94-6.

was not designed to create any new substantive rights, a better view is that shared by French and Kirby JJ — that it is limited to facts that would fall within existing equitable doctrines underpinned by unconscionability.

### B *The Protection Offered by Section 51AC*

The intention that s 51AC should extend the general law as encapsulated by s 51AA is evinced by the long and varied list of criteria provided to guide judicial decision-making. This 'shopping list', as it has been facetiously described,<sup>82</sup> provides 11 criteria to which the court may have regard when determining whether the conduct in question contravenes the provision.<sup>83</sup> Sundberg J recently pointed out that some of these elements allow the court to have reference to matters clearly beyond those that would constitute unconscionability in equity.<sup>84</sup>

A good example is found in sub-ss (3)(g)–(h) and (4)(g)–(h), where a court is allowed to consider the requirements of industry codes. Part IVB of the *TPA* deals with industry codes and was enacted at the same time as s 51AC. This allows industries to develop mandatory or voluntary standards of conduct to be observed by all industry participants. It is likely that such codes will contain prescriptive norms of commercial behaviour unrelated to traditional unconscionability requirements.<sup>85</sup> Sub-sections (3)(a) and (4)(a) of s 51AC, which allow consideration of 'the relative strengths of the bargaining positions' of the parties, provide another example of the move beyond existing law. In equity, reference purely to a lack of bargaining strength has never been sufficient to constitute the 'special disadvantage' necessary to activate the unconscionability doctrine.<sup>86</sup>

It is not just the paragraphs in the list that provide expanded protection. Since s 51AC(2) explicitly provides that the list is not exhaustive, the matters that may potentially guide judicial discretion in an individual case are infinitely wide and varied. This unbridled discretion is central to the claims of uncertainty in the administration of justice according to individual judicial consciences.

In *Amadio*, the High Court emphasised that the equitable doctrine is concerned with procedural rather than substantive unconscionability.<sup>87</sup> However, unconscionability under s 51AC goes beyond this, and allows consideration of both procedural and substantive components. The two most obvious references to substantive unconscionability elements are in paras (b) and (e) of the 'shopping list'. Under para (b), the court may consider whether the small business was 'required to comply with conditions that were not reasonably necessary for the

<sup>82</sup> See, eg, Frank Zumbo, 'Unconscionability within a Commercial Setting: An Australian Perspective' (1995) 3 *Trade Practices Law Journal* 183, 199; Eileen Webb, 'Section 51AC and Retail Leasing — A False Start but Some Guidelines for the Future' (2000) 8 *Australian Property Law Journal* 135, 137.

<sup>83</sup> *TPA* s 51AC(3)(a)–(k), (4)(a)–(k). The criteria are identical in both sub-ss (3) and (4).

<sup>84</sup> *Simply No-Knead* (2000) 104 FCR 253, 265.

<sup>85</sup> Philip Tucker, 'Too Much Concern Too Soon? Rationalising the Elements of Section 51AC of the *Trade Practices Act*' (2001) 17 *Journal of Contract Law* 120, 143.

<sup>86</sup> See, eg, *Amadio* (1983) 151 CLR 447, 462 (Mason J); *Berbatis* (2003) 214 CLR 51, 64 (Gleeson CJ), 77 (Gummow and Hayne JJ).

<sup>87</sup> *Amadio* (1983) 151 CLR 447, 462 (Mason J), 474 (Deane J).



protection of the legitimate interests'<sup>88</sup> of the large business. This effectively allows the court to consider whether the terms of the contract are unduly harsh in their operation. Paragraph (e) allows the court to consider 'the amount for which and circumstances in which' the parties contracted.<sup>89</sup> Thus the court is able to consider the substantive operation of the contract to see whether the small business has been forced to give excessive consideration or submit to excessive demands.

Potentially the most compelling indication of an expanded notion of unconscionability is the imposition of what might amount to a duty to negotiate, perform and enforce contractual rights in good faith. This obligation arises from reading paras (i), (j) and (k) of the 'shopping list' together. First, para (j) allows the court to consider 'the extent to which the [large business] was willing to negotiate the terms and conditions of any contract'.<sup>90</sup> This element is not derived from equitable doctrine and was clearly added to address 'contracts of adhesion'.<sup>91</sup> Second, para (i) allows the court to consider the extent to which the large business disclosed pertinent information to the small business during negotiations.<sup>92</sup> Third, para (k) invites the court to have regard to 'the extent to which [the parties] acted in good faith'.<sup>93</sup> As a consequence of reading these paragraphs together, a large company is obliged not only to act in good faith but also to negotiate in good faith. The potential scope and significance of this implication is discussed below in Part V.

It has been suggested that because the elements of the 'shopping list' are not mandatory, normative obligations cannot arise from their inclusion in the *TPA*.<sup>94</sup> However, a behavioural duty is created because a court can be invited by counsel to consider any of the elements provided.<sup>95</sup> In its discretion a court can disregard these criteria. Nevertheless, it is unlikely that this would be done without sound reason, because it is doubtful that Parliament would allow reference to indicia of expected standards of conduct and yet not require that these be observed in the marketplace. For example, it is unlikely that Parliament would allow a court to consider whether a party has acted in good faith and yet not require parties to act in good faith.<sup>96</sup> Therefore, the practical effect of the criteria provided by the 'shopping list' in sub-ss (3) and (4) is to impose a duty on commercial participants, the content of which is determined by viewing the list as a whole. The problem with this is how such a broad impost can be defined with sufficient clarity to ensure commercial certainty. One way, described above, is to use the term 'unconscionable' in its ordinary sense as a threshold to application of the

<sup>88</sup> *TPA* s 51AC(3)(b), (4)(b).

<sup>89</sup> *TPA* s 51AC(3)(e), (4)(e).

<sup>90</sup> *TPA* s 51AC(3)(j), (4)(j).

<sup>91</sup> These contracts present a small business with two options: to sign a standard term contract with harsh terms or to not sign a contract at all.

<sup>92</sup> *TPA* s 51AC(3)(i), (4)(i).

<sup>93</sup> *TPA* s 51AC(3)(k), (4)(k).

<sup>94</sup> See, eg, Stephen Corones, 'Does "Good Faith" in s 51AC of the *Trade Practices Act* Deny Self-Interest?' (1999) 27 *Australian Business Law Review* 414, 415.

<sup>95</sup> Heather King, *Statutory Unconscionability* (2003) 8 (Unpublished manuscript, School of Law and Legal Studies, La Trobe University).

<sup>96</sup> *Ibid.*

English authority<sup>125</sup> that described unconscionability in similar terms to the High Court's pronouncement in *Amadio*.<sup>126</sup> However, as was seen in other common law jurisdictions, the availability of this cause of action in a commercial setting was severely restricted.

The development of commercial norms throughout the 20<sup>th</sup> century towards honesty and fair dealing led to the incorporation of a prohibition on unconscionable commercial conduct into the UCC. Section 2-302 of the UCC provides that '[i]f the court as a matter of law finds the contract or any term of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract'.<sup>127</sup>

Like the *TPA*, § 2-302 of the UCC does not contain a definition of unconscionability, nor does it describe the parameters of its operation. This grants the courts substantial discretion in determining the quality of a bargain according to the context of the case. This discretion has attracted criticism from some commentators,<sup>128</sup> while others have felt that it is part of the strength of the section.<sup>129</sup>

The Official Comments accompanying the UCC are useful aids in interpretation. While these Comments are not legally binding, they have frequently proven to be both illuminating and persuasive.<sup>130</sup> The first Official Comment to § 2-302 states:

The principle is one of prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power. The basic test is whether, in the light of the general commercial background ... the term or contract involved is so one-sided as to be unconscionable ...<sup>131</sup>

The Official Comment indicates that unconscionability is very context dependent — conduct that in one context is unconscionable may not be unconscionable in another. It is also apparent that an imbalance in bargaining power alone would be insufficient to found a claim. However, 'unfair surprise' and 'oppression' are sufficient. Case law has demonstrated that 'unfair surprise' indicates that a term or the operation of a term was unfairly concealed from a party until the contract was concluded.<sup>132</sup> This implies deception during the formation of the contract by, for example, hiding important terms in fine print or complicated legal language.<sup>133</sup> 'Oppression' involves the abuse of an inequality of bargaining power such that the contract causes great hardship to the oppressed party. This implies that the victimised party had no realistic choice about the

<sup>125</sup> *Earl of Chesterfield v Janssen* (1751) 2 Ves Sen 125, 155; 28 ER 82, 100 (Hardwicke LC).

<sup>126</sup> (1983) 151 CLR 447. See above nn 28–31 and accompanying text.

<sup>127</sup> UCC § 2-302(1) (2004).

<sup>128</sup> See, eg, Leff, above n 120.

<sup>129</sup> See, eg, Manfred Ellinghaus, 'In Defense of Unconscionability' (1969) 78 *Yale Law Journal* 757.

<sup>130</sup> Joseph Perillo, *Corbin on Contracts* (revised ed, 1993) vol 1, 78.

<sup>131</sup> UCC § 2-302 cmt (2004).

<sup>132</sup> *Williams v Walker-Thomas Furniture Co*, 350 F 2d 445, 449 (DC Cir, 1965) (Skelly Wright J) ('*Williams*').

<sup>133</sup> *Ibid*.

terms — for example, where a party's ignorance or naiveté is exploited to drive a hard bargain, or where contracts of adhesion are used.<sup>134</sup>

It was initially suspected that § 2-302 would be inapplicable in commercial disputes where parties are expected to protect their own interests.<sup>135</sup> It was soon clear, however, that as small businesses could be victimised by unconscionable contracts, they should also receive protection under the provision.<sup>136</sup>

Courts and academics came to identify both procedural and substantive unconscionability as relevant to § 2-302.<sup>137</sup> Generally, for a finding of behaviour contrary to § 2-302, there must be both 'bargaining naughtiness' (procedural unconscionability such as unfair surprise and oppression) and 'evils in the resulting contract' (substantive unconscionability such as unduly harsh contractual terms).<sup>138</sup> Although, on occasions, particularly egregious contractual terms alone have been sufficient for a finding of unconscionability,<sup>139</sup> it would be rare for a contract to be so one-sided as to be substantively unfair in the absence of evidence of unfair surprise or abuse of unequal bargaining power during contract formation.<sup>140</sup> That is, as a general rule, for a finding of unconscionability under the UCC a plaintiff must demonstrate the existence of both procedural and substantive unconscionability.

#### *C Good Faith and Unconscionability in the United States*

It has been suggested both judicially and academically that the standard of conduct demanded by § 2-302 can be measured against the concept of good faith. The initial exponent of this view was Professor Karl Llewellyn, an architect of the UCC, who argued that § 2-302 should not be considered in a vacuum.<sup>141</sup> Since § 1-203 of the UCC also 'imposes an obligation of good faith in ... performance or enforcement' of every contract,<sup>142</sup> this must inform the standard expected under § 2-302. The UCC defines 'good faith' as 'honesty in fact'<sup>143</sup> and, in the case of a merchant,<sup>144</sup> 'the observance of reasonable commer-

<sup>134</sup> *Re Elkins-Dell Manufacturing Co.*, 253 F Supp 864, 871 (Lord J) (ED Pa, 1966).

<sup>135</sup> *Vitex Manufacturing Corp Ltd v Caribtex Corp*, 377 F 2d 795, 799 (Staley CJ) (3d Cir, 1967).

<sup>136</sup> *Luick v Graybar Electric Co*, 473 F 2d 1360 (8<sup>th</sup> Cir, 1973); *Fairfield Lease Corporation v Pratt*, 278 A 2d 154 (1971); John Calamari and Joseph Perillo, *The Law of Contracts* (3<sup>rd</sup> ed, 1987) 404.

<sup>137</sup> See, eg, *Williams*, 350 F 2d 445 (DC Cir, 1965). See also Leff, above n 120, 487.

<sup>138</sup> Leff, above n 120, 487. See also *Kohl v Bay Colony Club Condominium Inc*, 398 So 2d 865 (Fla Dist Ct App, 1981).

<sup>139</sup> See, eg, *Resource Management Co v Weston Ranch & Livestock Co*, 706 P 2d 1028 (Utah, 1985).

<sup>140</sup> Richard Hunter, 'Unconscionability Revisited: A Comparative Approach' (1992) 68 *North Dakota Law Review* 145, 169.

<sup>141</sup> Karl Llewellyn, *The Common Law Tradition: Deciding Appeals* (1960) 369.

<sup>142</sup> UCC § 1-203 (2004).

<sup>143</sup> UCC § 1-201(20) (2004).

<sup>144</sup> The term 'merchant' is defined in § 2-104 of the UCC:

'Merchant' means a person that deals in goods of the kind or otherwise holds himself out by occupation as having knowledge or skill peculiar to the practices or goods involved in the transaction or to which the knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that holds himself out by occupation as having the knowledge or skill.

cial standards of fair dealing'.<sup>145</sup> Despite the fact that § 2-302 specifically mentions the time of formation and § 1-203 describes performance or enforcement, there have been many instances of judges applying a finding of fact that indicated a lack of 'good faith' in performance as a means of finding conduct contrary to § 2-302 — even though § 2-302 is ostensibly only concerned with the time of formation.<sup>146</sup> For example, the New Jersey Supreme Court in *Kugler v Romain* noted that '[t]he standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing'.<sup>147</sup>

Since it seems that the 'good faith' standard informs the unconscionability provision, it is necessary to examine briefly what this standard entails in the context of US contract law. It is clear that good faith under the UCC encompasses subjective and objective tests.<sup>148</sup> 'Honesty in fact' under § 1 requires subjective honesty, often described as the 'pure heart and empty head' standard, or an absence of dishonesty, deceit or improper purposes, whilst 'reasonable standards' under § 2 requires conduct measured against objective standards of commercial reasonableness and trade practices and customs.<sup>149</sup>

A source of persuasive influence when interpreting the UCC is the American Law Institute's *Restatement (Second) of Contracts* ('*Restatement (Second)*').<sup>150</sup> The current version of the document provides that there is a prohibition against unconscionability in *all* contracts, couched in almost identical terms to that found in the UCC. It too contains no definition of unconscionability.<sup>151</sup> To the extent that it represents the law, § 205 of the *Restatement (Second)* codifies an obligation on *all* contracts identical to a merchant's obligation under the UCC. The Official Comment to § 205 is quite illuminating:

Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness.<sup>152</sup>

<sup>145</sup> UCC § 2-103(1)(b) (2004).

<sup>146</sup> See, eg, *Flash v Powers*, 99 NYS 2d 765 (1950); *Dow Corning Corp v Capitol Aviation Inc*, 411 F 2d 622 (7<sup>th</sup> Cir, 1969).

<sup>147</sup> 279 A 2d 640, 652 (NJ, 1971); *Meshinsky v Nichols Yacht Sales*, 541 A 2d 1063, 1067 (NJ, 1988).

<sup>148</sup> Cole, above n 98, 24.

<sup>149</sup> See, eg, Thomas Diamond and Howard Foss, 'Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery' (1996) 47 *Hastings Law Journal* 585, 598-600; Harry Flechtner, 'Comparing the General Good Faith Provisions of the PECL and the UCC: Appearance and Reality' (2001) 13 *Pace International Law Review* 295, 302-3; William Hawkland, *Hawkland's Uniform Commercial Code Series* (at October 2002) § 1-203:1, 'Good Faith Performance and Enforcement'; Mark Snyderman, 'What's So Good about Good Faith? The Good Faith Performance Obligation in Commercial Lending' (1988) 55 *University of Chicago Law Review* 1335, 1340-1.

<sup>150</sup> The original *Restatements* drafted by the American Law Institute restate the common law into black-letter rules, and provide recommendations of policy. The *Restatement (Second)* updates the original, in light of new authorities and updated concepts. Therefore, the *Restatement (Second)* is highly regarded and is thus persuasive in interpreting the UCC.

<sup>151</sup> *Restatement (Second)* § 208 (1981).

<sup>152</sup> *Restatement (Second)* § 205 cmt (1981).

This definition supports Professor Steven Burton's thesis that standards of good faith protect the reasonable expectations of the contracting parties by inhibiting the subsequent discretion that they enjoy once in a contractual relationship.<sup>153</sup> The Appellate Court of Illinois in *Carrico v Delp* adopted this approach:

Good faith between the contracting parties requires the party vested with contractual discretion to exercise it reasonably and he may not do so arbitrarily, capriciously or in a manner inconsistent with the reasonable expectations of the parties.<sup>154</sup>

An alternative but compatible view of the standard required by good faith is provided by Professor Robert Summers, who indicated that it might be more appropriate to describe what is *not* good faith.<sup>155</sup> The standard required simply excludes conduct in bad faith. This approach has been incorporated into the Official Comment to § 205 of the *Restatement (Second)*:

A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.

Neither the UCC nor the *Restatement (Second)* directly import the good faith standard to contractual formation. American law is limited to, inter alia, duties to act honestly, diligently, and in the spirit of the bargain, but not necessarily to bargain in good faith. Further, the *Restatement (Second)* makes no specific reference to good faith in the bargaining process. However, the Official Comment to § 205 of the *Restatement (Second)* indicates that there are many existing rules, such as fraud and duress, to deal with particular forms of bad faith conduct during negotiations.

Although 'good faith' has been important in defining the scope and content of 'unconscionability' during contractual performance under s 51AC,<sup>156</sup> this might be one source of divergence between the Australian and US commercial unconscionability standards. Section 51AC appears to include a duty to negotiate in good faith — a requirement that is beyond the US standard.

#### D *Parallels between Unconscionability in Australia and the United States*

Many commentators consider that § 2-302 has been applied with adequate judicial caution,<sup>157</sup> particularly in disputes between merchants where classical

<sup>153</sup> Steven Burton, 'Good Faith Performance of a Contract within Article 2 of the Uniform Commercial Code' (1981) 67 *Iowa Law Review* 1, 6.

<sup>154</sup> 141 Ill App 3d 684 (1986).

<sup>155</sup> Robert Summers, "'Good Faith" in General Contract Law and the Sale Provisions of the Uniform Commercial Code' (1968) 54 *Virginia Law Review* 195, 232-3.

<sup>156</sup> *Flash v Powers*, 99 NYS 2d 765 (1950); *Dow Corning Corp v Capitol Aviation Inc*, 411 F 2d 622 (7<sup>th</sup> Cir, 1969); *Kugler v Romain*, 279 A 2d 640, 652 (NJ, 1971).

<sup>157</sup> A H Angelo and E P Ellinger, 'Unconscionable Contracts: A Comparative Study of the Approaches in England, France, Germany, and the United States' (1992) 14 *Loyola of Los Angeles International and Comparative Law Journal* 455, 504-5; Frank Zumbo, 'Unconscionability and Commercial Transactions: Exploring the Need for Further Reform under the *Trade Practices Act*' (1994) 22 *Australian Business Law Review* 323, 341-2.

notions of protecting one's own interests have stood firm.<sup>158</sup> However, some commentators argue that there has recently been a gradual retreat from the high-water mark set during the 1960s and 1970s, when fairness standards dominated judicial decision-making. This has involved a subtle reversion towards the ideals of commercial certainty and freedom of contract, which has served to recalibrate the judicial balance.<sup>159</sup> In considering these trends, the words of Arthur Leff should be remembered:

The world is not going to come to an end. The courts will most likely adjust, encrusting the irritating aspects of the section with a smoothing nacre of more or less reasonable applications ... Commerce in any event is not going to grind to a halt because of the weaknesses in 2-302.<sup>160</sup>

Part VI of this article has shown that there are certain similarities in the obligations imposed by § 2-302 of the UCC and s 51AC of the *TPA*. Both statutory instruments prohibit unconscionable conduct in business transactions, but refrain from defining unconscionability. Both instruments also allow unconscionability to be assessed by reference to good faith, albeit a potentially attenuated referential capacity in the US. Judges have found that § 2-302 generally requires the existence of both procedural and substantive elements of unconscionability. This is not required by s 51AC, which simply provides reference to indicia of both forms of unconscionability. However, as suggested earlier, substantive unconscionability is more likely to exist in the presence of procedural unconscionability. Under the UCC, the requirement for both procedural and substantive unconscionability acts as a threshold requirement before a finding of unconscionability will be made. Section 51AC also has a threshold — the need for the conduct complained of to be unconscionable in the ordinary sense of the word and the developing requirement of 'serious misconduct or something clearly unfair or unreasonable'. It is these similarities that make it reasonable to look to the US experience for comfort, where the adoption of a broad statutory commercial unconscionability provision has not proved disastrous for commercial certainty.

## VII JUDICIAL CAUTION WITH SECTION 51AC

### *A Trickle or Flood?*

Section 51AC came into operation more than five years ago. In this time there has been relatively little opportunity for judicial inquiry into the scope of its operation. The trickle of cases which has reached the courts is at odds with the predictions of a flood of litigation,<sup>161</sup> despite an extensive educational campaign

<sup>158</sup> Luke Nottage, 'Form and Substance in US, English, New Zealand and Japanese Law: A Framework for Better Comparisons of Developments in the Law of Unfair Contracts' (1996) 26 *Victoria University of Wellington Law Review* 247, 258; Hunter, above n 140, 159; Zumbo, 'Unconscionability and Commercial Transactions', above n 157.

<sup>159</sup> See, eg, Ralph Mooney, 'Hands across the Water: The Continuing Convergence of American and Australian Contract Law' (2000) 23 *University of New South Wales Law Journal* 1, 31-7.

<sup>160</sup> Leff, above n 120, 558-9.

<sup>161</sup> See, eg, Baxt and Mahemoff, above n 2, 9.

run by the ACCC to inform small businesses of their rights under s 51AC, and the fact that nearly \$500 000 was made available by the government for the ACCC to take action under the *TPA* on matters of specific relevance to small businesses.<sup>162</sup>

The cases involving s 51AC can be divided into two broad categories. First, there are those matters where a contractual dispute has arisen between the parties and, as part of a 'scatter-gun' approach, a small business plaintiff has alleged unconscionable conduct contrary to s 51AC as one of a number of causes of action.<sup>163</sup> The pleadings and evidence relating to unconscionability in these cases have tended to be flimsy and lacking in cogency.<sup>164</sup> Not surprisingly, the s 51AC claims in these cases have rarely succeeded. The other category of case is where the large business defendant's conduct has been simply so deplorable that it would be an affront to the conscience of even the most opportunistic commercial participant.<sup>165</sup> In these latter cases, the provision of relief is hardly controversial. Thus, very few cases have tested the margins of the conduct proscribed by the section. Still, there have been several cases allowing the opportunity for judicial examination of the requirements of s 51AC. These cases demonstrate that concerns regarding the application of s 51AC are ill-founded and it appears that a well-balanced jurisprudence concerning the obligations under the section is beginning to emerge. A court will not find conduct that is contrary to s 51AC unless a threshold requirement of serious misconduct is satisfied. Serious misconduct will often be conduct that would satisfy traditional procedural unconscionability or conduct that evinces a want of good faith.

### B *The Scope of Section 51AC*

#### 1 *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd*<sup>166</sup>

In *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd*, Subaru (Aust) Pty Ltd ('Subaru') appointed Garry Rogers Motors (Aust) Pty Ltd ('Garry Rogers') as its authorised dealer in 1991. In 1997, Subaru introduced the 'six-star' program of service enhancement. Garry Rogers indicated that it was not

<sup>162</sup> The ACCC published a number of pamphlets that were provided to small businesses to inform them of the operation of s 51AC: see, eg, ACCC, *Fair Game or Fair Go? Avoiding and Dealing with a Hard Bargain* (1999). The government provided \$480 000 for the ACCC to take action under the *TPA*: ACCC, *Small Business and the Trade Practices Act: A Practical Guide for Australian Small Business* (1999) 14.

<sup>163</sup> See, eg, *Commonwealth Bank of Australia v McArthur* [2003] VSC 31 (Unreported, Dodds-Streeton J, 21 February 2003) ('*McArthur*'); *Australian Competition and Consumer Commission v 4WD Systems Pty Ltd* (2003) 200 ALR 491; *Australia China Business Bureau Pty Ltd v MCP Australia Pty Ltd* [2003] FCA 934 (Unreported, Hely J, 5 September 2003) ('*Australia China*'); *Monroe Topple & Associates Pty Ltd v Institute of Chartered Accountants in Australia* [2001] FCA 1056 (Unreported, Lindgren J, 6 August 2001); *Overlook v Foxtel* [2002] NSWSC 17 (Unreported, Barrett J, 31 January 2002) ('*Overlook*').

<sup>164</sup> See, eg, *McArthur* [2003] VSC 31 (Unreported, Dodds-Streeton J, 21 February 2003); *Australia China* [2003] FCA 934 (Unreported, Hely J, 5 September 2003); *Overlook* [2002] NSWSC 17 (Unreported, Barrett J, 31 January 2002).

<sup>165</sup> See, eg, *Simply No-Knead* (2000) 104 FCR 253; *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002).

<sup>166</sup> (1999) 21 ATPR ¶41-703 ('*Garry Rogers*').

willing to comply with all parts of the program.<sup>167</sup> Subsequently, Subaru gave notice of termination of the agreement. Subaru refused to revoke this notice despite several attempts by Garry Rogers to show that it had changed its mind and would comply with the program.<sup>168</sup> Garry Rogers alleged that the termination of the dealership was unconscionable and contrary to s 51AC.<sup>169</sup>

Under the *Franchising Code of Conduct*,<sup>170</sup> which Finkelstein J assumed to be applicable,<sup>171</sup> prior to termination of a franchise agreement a franchisor 'must give reasonable written notice of the proposed termination and the reasons for it to the franchisee'.<sup>172</sup> On the facts, the first element had been satisfied but not the second. Subaru was thus in breach of the applicable industry code (para (g) of the 'shopping list'). In the circumstances, however, Finkelstein J held that a failure to meet this requirement would not amount to unconscionable conduct because the applicant was aware of the main factor motivating the termination: namely its failure to adopt the 'six-star' program. Since Garry Rogers' behaviour indicated general disdain for the program, it was understandable that a breakdown in mutual trust and confidence had occurred, despite the change of attitude. Once such a breakdown occurred it would not be unconscionable to terminate the relationship for legitimate purposes.<sup>173</sup>

The behaviour of Subaru lacked the necessary threshold requirement for s 51AC of serious misconduct — that is, the conduct complained of was not, in all the circumstances, unconscionable. On the facts there had certainly been no procedural unconscionability, and in enforcing a contractual right Subaru had merely acted to protect its commercial interest.<sup>174</sup> The decision in *Garry Rogers* laid the foundation for the balanced judicial approach to s 51AC. Accordingly, a court will refuse to give relief simply for harsh contractual terms when the circumstances of the case indicate that the defendant has not behaved in a particularly reprehensible or exploitative way either during contractual formation or performance.

## 2 *Hurley v McDonald's Australia Ltd*

*Garry Rogers* indicates that the unconscionability doctrine can be circumscribed by requiring that, before a finding contrary to s 51AC can be made, there must have been 'unconscionability' on the part of the defendant.<sup>175</sup> While this seems to beg the question, this concept has been framed by reference to its ordinary or dictionary meaning and not its peculiar legal usage.<sup>176</sup> In *Hur-*

<sup>167</sup> Ibid 43 011.

<sup>168</sup> Ibid 43 012–13.

<sup>169</sup> Ibid 43 013.

<sup>170</sup> The *Trade Practices (Industry Codes — Franchising) Regulations 1998* (Cth) prescribe the *Franchising Code of Conduct*, as set out in the Schedule to the Regulations, as a mandatory industry code.

<sup>171</sup> *Garry Rogers* (1999) 21 ATPR ¶41-703, 43 015.

<sup>172</sup> *Franchising Code of Conduct* cl 22(3).

<sup>173</sup> *Garry Rogers* (1999) 21 ATPR ¶41-703, 43 016.

<sup>174</sup> Ibid.

<sup>175</sup> See, eg, *Hurley* (2000) 22 ATPR ¶41-741, 40 585 (Heerey, Drummond and Emmett JJ); *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [395].

<sup>176</sup> As discussed in Part V.



*Iley v McDonald's Australia Ltd*, the Full Federal Court prefaced its discussion of the matter with an approving synopsis of the conclusions on unconscionable conduct reached in the *Cameron v Qantas Airways Ltd*<sup>177</sup> cases:

For conduct to be regarded as unconscionable, serious misconduct or something *clearly unfair or unreasonable*, must be demonstrated ... Whatever 'unconscionable' means in sections 51AB and 51AC, the term carries the meaning given by the Shorter Oxford English Dictionary, namely, actions *showing no regard for conscience*, or that are *irreconcilable with what is right or reasonable* ... The various synonyms used in relation to the term 'unconscionable' import a *pejorative moral judgment* ...<sup>178</sup>

In this case, Hurley had participated in a promotional game run by McDonald's where participants collected tokens with their fast food purchases. Particular sequences of tokens represented particular prizes. Hurley claimed a prize by mixing a token from the previous year with tokens from the current year. Relying on a clause in the conditions of entry that granted sweeping discretion to reject claims, McDonald's rejected Hurley's claim. Among Hurley's several legal challenges was that in order to reject her claim McDonald's had acted unconscionably in breach of s 51AB by relying on a contractual provision to deny Hurley her prize. In its discussion of the case the Court indicated that, despite the different list of criteria provided in ss 51AB and 51AC, a common feature of the two provisions was a threshold requirement of 'serious misconduct or something clearly unfair or unreasonable' beyond the terms of the contract.<sup>179</sup>

This analysis of s 51AC bears similarities to the US position where, except for exceptional circumstances, a plaintiff must establish both procedural and substantive unconscionability before statutory unconscionability is established. However, in the Australian context it is likely that this threshold will involve unconscionable conduct in its ordinary sense. In *Hurley* this was framed as a requirement of demonstrated 'serious misconduct or something clearly unfair or unreasonable' on the part of the defendant.<sup>180</sup>

Logically, the threshold to s 51AC might often involve procedural unconscionability in fact, such that in a case like *Hurley* the terms of the contract must be substantively harsh or unfair and imposed on the plaintiff due to the defendant's pre-contractual misconduct. Thus, whilst McDonald's had a very broad discretion under the contract to reject applications by participants, it could not be said that the rejection resulted from serious misconduct because there was nothing clearly unfair and it was not unreasonable in the circumstances.<sup>181</sup> The Court in *Hurley* expanded the idea expressed by Finkelstein J in *Garry Rogers* that for a finding of conduct contrary to s 51AC there must be seriously improper behaviour on the part of the defendant. In effect, both courts were supporting the existence of a threshold to the operation of the section, which amounted to

<sup>177</sup> See *Cameron v Qantas Airways Ltd* (1995) 55 FCR 147, 178-81.

<sup>178</sup> *Hurley* (2000) 22 ATPR ¶41-741, 40 585 (Heerey, Drummond and Emmett JJ) (emphasis in original) (citations omitted).

<sup>179</sup> *Ibid.*

<sup>180</sup> *Ibid.*

<sup>181</sup> *Ibid.*

unconscionability in its natural sense and was articulated as 'serious misconduct or something clearly unfair or unreasonable'.<sup>182</sup> The courts were thus limiting the utility of the section to cases of particularly harsh or unfair behaviour. In this way, s 51AC was prevented from being used simply to complain about a contract that is harsh in its operation.

3 *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd*

*Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* involved a dispute between a franchisor, Simply No-Knead (Franchising) Pty Ltd ('SNK'), and a number of franchisees. The franchisees complained, inter alia, that SNK withheld orders of supplies to pressure franchisees to comply with its demands, and that when the franchisees requested a meeting to discuss their concerns, SNK refused to participate in any negotiations.<sup>183</sup> SNK actively operated in competition with the franchisees and refused to provide a 'disclosure document',<sup>184</sup> and distributed promotional materials which omitted the franchisees' names.<sup>185</sup>

After analysis of the circumstances of the case and the applicable matters in s 51AC(3), Sundberg J felt that the matter was 'an overwhelming case of unreasonable, unfair, bullying, and thuggish behaviour in relation to each franchisee that amounts to unconscionable conduct by SNK for the purposes of s 51AC(1)'.<sup>186</sup> SNK's refusal to deliver goods in order to pressure the franchisees amounted to unfair tactics (para (d) of the 'shopping list'); the refusal to provide a disclosure document breached the applicable industry code (para (g)); and the refusal to negotiate (para (j)), refusal to supply and unilateral imposition of new conditions and action in competition showed a want of good faith (para (k)). Further, the distribution of promotional materials which omitted the franchisees' names was not 'reasonably necessary for the legitimate business interests' of SNK (para (b)). Whilst Sundberg J felt a broad discretion had been given to the Court by s 51AC,<sup>187</sup> this was a case of obvious application. The business conduct of SNK had simply been so bad that it clearly fell within the parameters of the new section.

*Simply No-Knead* demonstrates how the threshold of conduct contravening s 51AC is not confined to traditional procedural unconscionability. In this case, all of the misconduct occurred after the formation of the contract. However, on the facts, Sundberg J was satisfied that the conduct of the defendant attracted the application of s 51AC. In so doing, his Honour seemed to state that the post-formation conduct of SNK warranted the epithet of 'serious misconduct or something clearly unfair or unreasonable' used to delimit the application of s 51AC in *Hurley*.<sup>188</sup> That is, the threshold of serious misconduct need not occur

<sup>182</sup> *Ibid.*

<sup>183</sup> *Simply No-Knead* (2000) 104 FCR 253, 260-2 (Sundberg J).

<sup>184</sup> *Ibid* 263-4 (Sundberg J).

<sup>185</sup> *Ibid* 262-3 (Sundberg J).

<sup>186</sup> *Ibid* 270.

<sup>187</sup> *Ibid* 265-7.

<sup>188</sup> *Hurley* (2000) 22 ATPR ¶41-741, 40 585-6 (Heerey, Drummond and Emmett JJ).

prior to contractual formation, but can also apply to particularly egregious behaviour during contractual performance. It is also possible that the misbehaviour of SNK could be equated with a lack of good faith, given that his Honour explicitly found conduct contrary to para (k).<sup>189</sup> In other words, the threshold of serious misconduct might be met not only by procedural misbehaviour but also by an absence of good faith in contractual performance, identified in this case by the particularly egregious behaviour of the defendant.

#### 4 Summary of the Case Law

The three cases examined above demonstrate a well-balanced approach by the Australian judiciary to the interpretation and application of s 51AC. Relief will not be provided by a court simply where a contract turns out to be harsh in its operation.<sup>190</sup> There is a threshold that a plaintiff must overcome before the section will apply: this has been articulated in *Hurley* as requiring 'serious misconduct or something clearly unfair or unreasonable'.<sup>191</sup> Whilst such conduct might often amount to procedural unconscionability, it is not necessarily so limited, as demonstrated in *Simply No-Knead* where the post-contractual conduct of the defendant was simply so bad that it met the threshold requirement.

If accepted, such a threshold will decrease the utility of the provision for a small business facing onerous contracts or contractual outcomes. In effect, this creates a similar hurdle as the requirement in the US for the presence of both procedural and substantive unconscionability.

#### C Good Faith?

In Part V, it was postulated that the margins of conduct prescribed by s 51AC can be measured by notions of good faith. Two recent cases provide support for the idea that the threshold requirement of 'serious misconduct or something clearly unfair or unreasonable'<sup>192</sup> may also be satisfied by a lack of good faith on the part of the defendant during contractual performance.<sup>193</sup>

#### 1 *Automasters Australia Pty Ltd v Bruness Pty Ltd*

Automasters Australia Pty Ltd ('Automasters') entered into a franchise agreement with Bruness Pty Ltd ('Bruness') in 1997. In 1999, against the background of a number of ongoing disputes and recriminations, Automasters purported to terminate the relationship, alleging a number of contractual breaches by Bruness. Bruness counterclaimed that the termination by Automasters constituted, *inter alia*, unconscionable conduct prohibited by s 51AC.

Hasluck J reiterated that before a finding of unconscionability can be made, 'serious misconduct or something clearly unfair or unreasonable must be

<sup>189</sup> *Simply No-Knead* (2000) 104 FCR 253, 270.

<sup>190</sup> *Hurley* (2000) 22 ATPR ¶41-741, 40 586 (Heerey, Drummond and Emmett JJ).

<sup>191</sup> *Ibid* 40 585.

<sup>192</sup> *Ibid*.

<sup>193</sup> *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002); *Boral* [2003] NSWSC 713 (Unreported, Austin J, 5 August 2003).

D *The Direction of Australian Case Law*

A small number of cases alleging conduct contrary to s 51AC have reached the courts. Of these, only a few have resulted in a finding of unconscionability. The Australian judiciary, like its US counterpart, has predominantly adopted a balanced approach to explain the content of behavioural requirements under s 51AC. A consistent line of reasoning shows that before a contract with harsh terms will be impeached there must be 'serious misconduct or something clearly unfair or unreasonable'.<sup>206</sup> This 'serious misconduct' has involved procedural misbehaviour in contract formation, an absence of good faith, or other gross abuses in the exercise of contractual rights.

In general, the impact of s 51AC appears to be minor, with only a small number of actions under the section to date. There are many possible reasons for this. Possibly, the problem identified in the various government studies was not as intractable as originally suggested. Conversely, the section may have been successful in meeting the government's objective to 'induce behavioural change',<sup>207</sup> resulting in improved standards of commercial conduct and less need for litigation. Alternatively, commercial parties might have resorted to traditional relational means of contracting and resolving disputes.<sup>208</sup> Small businesses may now be more successful at using these traditional methods when armed with the threat of s 51AC litigation. Without detailed empirical study, the actual reasons are uncertain.

## VIII CONCLUSION

The principles of classical contract theory that provide the framework for certainty during commercial dealings are undermined by externally-imposed behavioural norms that allow a court to review contracts according to vague standards rather than coherent rules. However, present interpretations of s 51AC largely limit any negative effects it may have upon contractual certainty or autonomy, while imposing minimum standards of fairness upon commercial dealings involving small business.

Over the last 25 years, the Australian government received a number of representations and empirical reports establishing that small businesses are frequently the victims of unfair commercial practices, resulting in individual hardship and reduced competitive market forces. The problem for the government was the ubiquitous tension between fairness and certainty. Section 51AC was the government's answer, allowing courts to review transactions tainted by unconscionable conduct involving small business. However, rather than defining unconscionability explicitly, the legislature provided a non-compulsory, non-exhaustive 'shopping list' of criteria for judicial reference. The list and the paragraphs contained therein make it clear that s 51AC moves well beyond the

<sup>206</sup> *Hurley* (2000) 22 ATPR ¶41-741, 40 585; *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [362].

<sup>207</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, 8801 (Peter Reith, Minister for Workplace Relations and Small Business).

<sup>208</sup> Goldwasser and Ciro, above n 4, 394.

equitable notion of unconscionability, granting a sweeping discretion to inquire into allegations of unconscionable conduct. The nebulous term 'unconscionability', combined with wide judicial discretion, has led to strident criticism from some commentators concerning the potential for the section to erode commercial certainty, with serious economic consequences.

This article has shown that these fears are largely misplaced. The application of s 51AC is limited by a requirement for the conduct complained of to be unconscionable in the ordinary sense of the word. In effect, this creates a threshold for the application of the provision. This threshold has been judicially articulated as demanding serious misconduct before a small business plaintiff is able to avail itself of the benefits flowing from s 51AC. 'Serious misconduct' will often equate to traditional procedural unconscionability. However, it is broader in scope and includes a want of good faith during contractual performance. It is arguable that, at its most expansive, the conduct prescribed by the provision is in fact a duty to negotiate, perform and act in good faith. While this clearly moves beyond the current state of general law unconscionability, the content of such a duty has been the subject of extensive judicial and academic analysis and can arguably be defined within the context of a commercial relationship with satisfactory certainty.

The threshold requirement of s 51AC and its judicial treatment bears some similarity to the US statutory commercial unconscionability provision in the UCC. As in Australia, this term is undefined, informed by 'good faith' and initially suffered from criticisms regarding commercial uncertainty.<sup>209</sup> However, because the section has been interpreted by the judiciary with adequate clarity and caution,<sup>210</sup> it is generally accepted that these principles have been applied without serious commercial ramifications.

Arguably, the Australian business community should not be concerned. The normative standard of behaviour prescribed by s 51AC should not be difficult to meet because honesty and fair dealing have always been necessary commercial requirements of business practice.<sup>211</sup>

Commercial certainty under s 51AC is enhanced by a developing jurisprudence that relates to the articulated threshold requirement of 'serious misconduct or something clearly unfair or unreasonable' before unconscionability is found.<sup>212</sup> This 'misconduct' requirement appears to involve procedural misbehaviour in contract formation or an absence of good faith during contractual performance.<sup>213</sup> The presence of a threshold requirement bears comparison to the US experience, where the courts have required the existence of both procedural and substantive unconscionability before making a finding of unconscionability under the UCC.<sup>214</sup> The reasoning of the Australian judiciary has not yet been

<sup>209</sup> See above n 120 and accompanying text.

<sup>210</sup> See generally above n 157 and accompanying text.

<sup>211</sup> Goldwasser and Ciro, above n 4.

<sup>212</sup> *Hurley* (2000) 22 ATPR ¶41-741, 40 585 (Heerey, Drummond and Emmett JJ); *Automasters* [2002] WASC 286 (Unreported, Hasluck J, 4 December 2002) [361], [365].

<sup>213</sup> See, eg, *Boral* [2003] NSWSC 713 (Unreported, Austin J, 5 August 2003).

<sup>214</sup> See, eg, above n 138 and accompanying text.

fully developed, with few cases examining the 'good faith' issue. However, the careful and well-balanced use by the courts of a threshold requirement before s 51AC unconscionability will be found ought to at least allay some fears regarding the extent of contractual uncertainty created. Current treatments of s 51AC point towards the continued and incremental development of a balanced and sufficiently precise concept of statutory unconscionability in Australia.