Freehills

Submission to the Senate Standing Committee on Economics regarding unconscionable conduct provisions

I am pleased to make a short submission to the Senate Standing Committee on Economics (**the Committee**) on the need for a definition of the word 'unconscionable' in Part IVA of the *Trade Practices Act 1974 (Cth)* (**TPA**). My comments will be centred on s 51AC rather than on the whole of Part IVA, because s 51AC is this provision that is critical to the interest of small business and in respect of which I believe the Committee is seeking to provide some guidance in the interpretation of the relevant legislation.

I wish to thank the Committee for granting me an extension of time to make this submission.

In making this submission, I would like to repeat what I have said previously, both as Chairman of the Trade Practices Commission (the predecessor to the ACCC) and later as a practitioner and commentator, on the appropriateness of a provision such as s 51AC being included in the TPA. In my view, the TPA should focus on competition issues (see comments below regarding US law). However, this point is too late to be considered at this point in time – we have travelled too far down the road in accepting the fact that the TPA will contain both competition law provisions as well as unfair trading and related provisions.

In my view, the inclusion of such provisions as the unconscionable conduct provisions in the TPA creates an imbalance in the way in which competition law should be properly assessed (contrast the very different approach taken in the United States of America).

It is also my view that there is no reason why s 51AC of the TPA, and its equivalent provision in the *Australian Securities and Investments Commission Act 2001* should not be given a much more comprehensive and appropriate interpretation than it has been in the past by our courts. They have been, by and large, too timid in the way in which they have assessed this particular provision.

In considering how one should assess the definition of the word 'unconscionable', in the context of the TPA, I would like to refer the Committee to the important decision of the Full Federal Court in *ASIC v National Exchange Ltd* (2005) 148 FCR 132, a decision which is often overlooked.

Whilst this case considered the expression 'unconscionable conduct' in the context of corporations law, there is no reason why the interpretation adopted by the Full Federal Court in that case cannot be applied equally in competition cases under the TPA. The fact that the court did not find in favour of the regulator on this occasion was due to a technical problem in relation to whether the relevant conduct was in 'trade or commerce'. But, the Court was in no uncertain mood in interpreting the word 'unconscionable'. There is a very clear finding that the conduct engaged in by National Exchange Ltd (making offers for shares in companies which were the subject of continual takeover activity or other financial conduct) was unconscionable.

For the benefit of the Committee, I have extracted paragraphs 26 to 45 of the judgement of the Full Federal Court in the *National Exchange* case in Appendix 1 of this submission.

The thrust of the Court's decision in paragraph 30 in particular, makes it clear that were it not for the fact that some of our judges are just too timid in interpreting these provisions in an appropriate fashion, there would be many more successful decisions under s 51AC of the TPA than is currently the position.

In my view there is no need for a statutory definition to be introduced. Indeed, there is a real danger that if we introduce a statutory definition we will just create further problems in relation to the interpretation of this provision.

In addition to the *National Exchange* case may I remind the Committee of some earlier decisions in which the concept of unconscionability was considered quite robustly by the courts. In particular, I refer the Committee to the decision in *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 in which Justice John Batt of the Victorian Supreme Court made some rather far reaching findings on unconscionability in the context of a contractual dispute between two very large organisations, involving a sum of money well above the financial threshold that currently operates under the TPA. That decision was discussed in an article written by me with a former employee at a previous firm, Joel Mahemoff; Baxt and Mahemoff, *Unconscionable Conduct Under the Trade Practices Act – An Unfair Response by the Government: A Preliminary View* (1998) 26 ABLR 5. See also the paper written by me with another former employee, Edward Archibald; Baxt and Archibald, 'Consumer and Business Protection: Its Role in the Pro-competition Statute' Hanks and Williams (eds), *Trade Practices Act: A 25 Year Stocktake* (2001) Melbourne University Press.

There have also been a number of other cases (many of them are discussed in the *National Exchange* case) and articles in which the concept of unconscionability has been interpreted more broadly and effectively than is generally thought to be the case in interpreting this provision.

Any definition that is introduced into legislation will take time to be interpreted by the courts. There are always going to be judges who will be reluctant to allow a broad reading and interpretation of a clause such as s 51AC of the TPA.

I am concerned that the introduction of a new definition will slow down, rather than accelerate, the possible interpretation of s 51AC along the lines suggested by the Full Federal Court in the *National Exchange* case.

Finally, I would like to mention Justice Paul Finn, who was a member of the Full Federal Court in the *National Exchange* case. He has written a very interesting paper in which he has foreshadowed the potential use of unconscionable conduct legislation, or similar legislation, in providing appropriate relief to consumers in circumstances where the very long list of criteria that are now included in s 51AC (and in the corresponding provisions of the corporations legislation) give the court as much opportunity and encouragement to provide relief in appropriate circumstances. This paper was delivered at the University of South Australia's Trade Practices Workshop in 2006 and is entitled *Unconscionable Conduct?*. (I would be happy to forward the Committee a copy of this paper.)

Australia has a tendency of being over-prescriptive in its legislative initiatives. We tend to change our legislation too often. This tends to delay the proper and considered interpretation of the legislation that we have in place. The fact that some cases are lost when judges form a particular view is not necessarily a good reason for simply changing the legislation. Sometimes it does take a little bit of time, and a bit of imagination and 'bravery' on the part of judges, to ensure that legislation is interpreted in an effective fashion.

As noted earlier, my discussion of the meaning of unconscionability has concentrated on that term as used in s 51AC. In my view, there is no reason why that term should be read down (a different argument may possibly be made in relation to ss 51AA and AB). However, my concern that any new definition being introduced into the legislation will lead to delay in the interpretation of the legislation (as noted above) will apply equally to the interpretation of these other provisions (ie ss 51 AA and AB).

Appendix 1

Extract from the Full Court of the Federal Court of Australia decision in

ASIC v National Exchange Ltd (2005) 148 FCR 132

[26] The question of whether the conduct of National Exchange was unconscionable involves additional and different considerations. His Honour said that, under the general rule, it was not meaningful to speak of unconscionable conduct except in relation to a particular person and it was not meaningful to address the question of whether conduct is unconscionable in the abstract. His Honour noted that no claim was made by any member of Aevum that the conduct of National Exchange was unconscionable in relation to that member, and, in these circumstances, his Honour considered that it was inappropriate to make any declaration.

[27] The primary judge adverted to the standards of unconscionable conduct imposed by the unwritten law. His Honour did not consider that the conduct of Tweed in this case was unconscionable, however, his Honour said at [109] that the circumstances gave rise to "considerable disquiet". This proceeding is not brought under the unwritten law. Nor has it been bought under s 12CA of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act), which statutorily incorporates the unwritten law.

[28] The claim of ASIC is brought under a specific statutory provision, namely, s 12CC of the ASIC Act, which prohibits unconscionable conduct by a person in trade or commerce in connection with the supply of financial services. In determining whether conduct is unconscionable, the section lists a number of specific matters that may be taken into account by the Court. This does not purport to be an exhaustive list.

[29] Section 12CC can be contrasted with s 12CA, which prohibits a person from engaging in conduct in relation to financial services and in trade and commerce where the conduct is unconscionable within the meaning of the "unwritten law". Section 12CC makes no reference to the unwritten law and refers to conduct that is, in "all the circumstances", unconscionable. It is also specific in its requirement that the supply of financial services must not only be "in trade or commerce", but the acquisition of those services must also be "for the purpose of" trade or commerce: s 12CC(8).

[30] In our view, his Honour erred in approaching the question of unconscionable conduct on the basis of the limitations that the general law imposed on that concept. It is evident from [3.7] of the Explanatory Memorandum to the *Financial Services Reform (Consequential Provisions) Bill 2001* (Cth), which concerned the proposed s 12CC of the ASIC Act, that this section was intended to operate as a "mirror" provision to s 51AC of the *Trade Practices Act 1974* (Cth): see also *Debates*, vol 216, p 8,767 (Ministerial Statements) and p 8,800 (Second Reading Speech). There is no foundation in the language or purpose of s 12CC to impose limitations from the unwritten law, such as the necessity to identify a specific or particular person. Authority on s 51AC supports the proposition that the prohibition in s 12CC is not to be read down by limiting its operation only to circumstances where the common law would grant relief in respect of unconscionable conduct: *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd (No 2)* (2000) 96 FCR 491 at 502 per French J; *Australian Competition and Consumer Commission v Keshow* [2005] ATPR (Digest) 46-265 at [97] per Mansfield J and the cases and authorities there cited. It is equally clear both from the actual

language of s 51AC and of s 12CC and from the extrinsic materials relating to s 51AC that these provisions were intended to build on and not to be constrained by common law case law: see *Australian Competition and Consumer Commission v Radio Rentals Ltd* [2005] FCA 1133 at [24]; and *Debates*. The language must be given its ordinary meaning and must not be qualified by pre-existing constraints on liability: see *Australian Competition and Consumer Commission v Simply No-Knead (Franchising) Pty Ltd* (2000) 104 FCR 253 at [30] – [37]; Pearson, G, "The ambit of unconscionable conduct in relation to financial services" (2005) 23 C&SLJ 105 at 123; Bigwood, R, "Curbing Unconscionability: Berbatis in the High Court of Australia" (2004) 28(1) MULR 203.

[31] The extrinsic material before the court indicates that s 51AC was inserted into the TPA to protect persons engaged in small business.

[32] We now turn to the question of whether the conduct was unconscionable within the meaning of s 12CC.

[33] "Unconscionable conduct", on its ordinary and natural interpretation, means doing what should not be done in good conscience. In a case where the discrepancy in price and value is great, as in the present case, and the conduct is systematically and directly focused on vulnerable but unnamed members, some of whom who can be expected to accept the offers, such conduct can reasonably be described as being against good conscience. The targeted offerees in this case could reasonably be expected to include persons who are unacquainted with share values, inexperienced in trading their interests, lacking in commercial experience and some of whom act inadvertently and are elderly. The evidence shows that Tweed believed from his past experience that such persons were more likely to accept the offer.

[34] ASIC says that the unconscionable element arises from the following considerations.

[35] National Exchange is an experienced share investor that has acquired shares through the making of off-market offers for shares in demutualised companies at substantially below the value of these shares. Tweed knew that Aevum had been a mutual society, that it had recently demutualised and that, in September 2004, it was an unlisted public company with 6,255 shareholders. He was aware that Aevum had published a prospectus on 29 September 2004 and that it was the intention of Aevum to offer in the order of 11 million shares at $0.90 each and to seek listing and quotation of the shares on the Australian Stock Exchange. Tweed also knew that, when the offer document was sent to Aevum shareholders, there was no current market price for shares in Aevum.

[36] The time period for the offers was to close relatively early, either on 10 November 2004 or before that date if sufficient acceptances were received. The offer document was not sent to the shareholders as soon as practicable after the date of the offers. This delay had the effect that members receiving the offer document had no more than seven business days to consider the offer, obtain advice and post the acceptance to National Exchange for receipt by the deadline of 10 November 2004.

[37] Evidence was tendered that Tweed, the controlling mind of National Exchange, had in earlier proceedings given evidence that members of demutualised companies, having not paid for their shares, were more likely to sell them for less than their market value than were shareholders who had paid for their shares. He believed and acted on the basis that shareholders who had not paid for their shares and did not want to hold them were more likely to be prepared to sell their shares for less than half their market value. Tweed perceived that it was an advantage to make offers without the necessity of disclosing any prevailing market price for the shares that were the subject of the offers. He considered that a reasonable person would be less likely to accept

the offer if his or her attention was directed to the estimate of the value of the shares in Aevum. The offer document was therefore cast in such a way that the critical information as to the fair estimate of the value of the shares was not contained on the front page in close proximity to the consideration for the offer and nor was it linked to the consideration. The information as to the fair estimate was printed on the reverse page of the offer document.

[38] Against these considerations must be weighed the fact that there was no communication between National Exchange and the shareholders other than by the offer document. Nor was there any fiduciary relationship or evidence that any recipient was under a special disability as to age or personal circumstances. The offer document, in our view, was not misleading and contained a recommendation that the shareholders consult an adviser and read the entire document. Moreover, National Exchange disclosed its estimate of the value of the shares. The document was a short one and was not in legalistic terms.

[39] In these circumstances, the question is whether the conduct of National Exchange was "unconscionable", according to the ordinary and natural meaning of that term, having regard to the list of statutory considerations.

[40] The starting point in making this determination as to unconscionability is the list of factors to which the Court's attention is drawn by s 12CC(2). These factors should be considered and weighed as a whole. Some may weigh in favour of a characterisation of the conduct as unconscionable and others may not. It is not appropriate to approach this list as exhaustive. This list is indicative of some of "the relevant circumstances". There are several factors that clearly apply in this case to support a characterisation of the conduct as unconscionable. The first is that there must be some doubt as to whether the recipients who accepted the offers were able to understand the offer document since, on its face, it is difficult to see why or how a recipient would be persuaded to part with shares, without any bargaining, where the price offered was admitted by the offeror to be substantially less than half the offeror's estimate of the value of the shares and less than one quarter of the initial market price of the shares. There may be special factors which operate, such as the urgent need for money or the possible inability of recipients to obtain cash from any other source or to wait a few days to see what price the market indicated, however, there is no evidence to warrant this inference in the present case.

[41] The "financial service" in this case is National Exchange's offer to purchase the shares at $0.35 per share. One matter to be taken into account under s 12CC(2) is the amount and circumstances under which the recipient could have acquired an equivalent offer. While there was no equivalent offer in the present case, the fact is that, when the shares came on the market shortly after the offer closed, they sold for 440% of the price offered by Tweed. This is not a case where there was any room for negotiation between the parties.

[42] Another of the listed considerations is the extent to which the supplier acted in good faith. On the evidence and concessions before the Court as to Tweed's strategies, it cannot be suggested that the conduct of Tweed was undertaken in good faith.

[43] National Exchange set out to systematically implement a strategy to take advantage of the fact that amongst the official members there would be a group of inexperienced persons who would act irrationally from a purely commercial viewpoint and would accept the offer. They were perceived to be vulnerable targets and ripe for exploitation, as they would be likely to act inadvertently and sell their shares without obtaining proper advice, and they were a predictable class of members from whom Tweed could procure a substantial financial advantage by reason of their commercially irrational conduct. This is not a case of shrewd commercial negotiation between businesses within acceptable boundaries. The conduct can properly be described as predatory and against

good conscience. This is not a case of obtaining a low price by shrewd negotiation. It is predatory conduct designed to take advantage of inexperienced offerees. The primary emphasis is on the conduct of the offeror towards the offeree in deciding whether conduct is unconscionable. The law is not, of course, intended to protect the reckless or the unreasonable and, as Spigelman J stated in *Attorney General of New South Wales v World Best Holdings Ltd* [2005] NSWCA 261 at [121], "[u]nconscionability is a concept which requires a high level of moral obloquy". The concept of unconscionability is, however, concerned to prohibit conduct such as that of the offeror in this case, which was directed at exploiting the targeted recipients. There is a strong element of moral obloquy in this case.

[44] Section 12CC requires the Court to focus primarily on the unconscionable conduct of *the offeror* and to determine whether that conduct is contrary to the norm of conscientious behaviour. In our view, the conduct of National Exchange in this case, pursuant to its carefully formulated and systematic approach, clearly offends against basic notions of good conscience and fair play.

[45] For these reasons, we consider that the trial judge erred in finding that National Exchange did not engage in unconscionable conduct for the purposes of s 12CC. It is unnecessary to consider whether his Honour was correct in concluding that this conduct was not unconscionable for the purposes of the unwritten law. We should not be taken as concluding that where a person targets a class of persons on the assumption that there are likely to be vulnerable persons within that class who cannot protect their own interests, that person cannot be found in appropriate circumstances to have engaged in unconscionable conduct in dealing with individual members of that class…