



Australian Government  
The Treasury



# EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESSES

Consultation paper

May 2014

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## PROVIDING YOUR FEEDBACK

This consultation process is designed to allow interested parties and stakeholders to provide views on the impacts of unfair terms in standard form business contracts and options to curtail the use of unfair contract terms, including an extension of the existing Australian Consumer Law protections to small businesses. This consultation process will run for 10 weeks from 23 May 2014 to 1 August 2014.

The Commonwealth is undertaking the consultation process on behalf of Consumer Affairs Australia and New Zealand (CAANZ)<sup>1</sup>. Stakeholders can access details of the consultation process via both the consultations page of the Australian Consumer Law website – [www.consumerlaw.gov.au](http://www.consumerlaw.gov.au) and the consultations page of the Australian Treasury website – [www.treasury.gov.au/ConsultationsandReviews/Consultations](http://www.treasury.gov.au/ConsultationsandReviews/Consultations).

CAANZ value your feedback and will facilitate this through a number of channels, as outlined below.

## SUBMISSIONS TO THIS CONSULTATION PAPER

Throughout this paper there are questions to facilitate submissions. These should be used as a guide when submitting a written response. There is no limit to the length of submissions.

Submissions should be uploaded via the consultations page of the Australian Treasury website.

For accessibility reasons, please upload responses in a Word or RTF format. An additional PDF version may also be submitted.

### **Please upload submissions via the Australian Treasury Website**

Website: [www.treasury.gov.au/ConsultationsandReviews/Consultations](http://www.treasury.gov.au/ConsultationsandReviews/Consultations)

Enquiries: Can be directed to Manager, Consumer Policy Framework Unit, on 02 6263 2111, [AustralianConsumerLaw@treasury.gov.au](mailto:AustralianConsumerLaw@treasury.gov.au) or using the 'Make a comment' facility on the Treasury website.

Mail: Unfair Contract Terms Consultation Paper  
Small Business, Competition and Consumer Policy Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

The closing date for submissions is 1 August 2014.

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<sup>1</sup> Consumer Affairs Australia and New Zealand (CAANZ) consists of senior officers of the Commonwealth, State and Territory and New Zealand Government agencies responsible for consumer affairs or fair trading. The primary role of CAANZ is to support Consumer Affairs Ministers.

All information (including name and address details) contained in submissions will be made available to the public on the Australian Treasury website, unless it is indicated that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked as such in a separate document.

A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

## **BRIEF FEEDBACK**

Brief feedback can be provided through the 'Make a comment' facility on the Treasury website. This form is a useful tool to provide short and succinct feedback on the issue and is limited to 2,500 characters. Those stakeholders who have more detailed feedback are encouraged to submit a formal submission.

## **PARTICIPATION IN A SURVEY**

In order to obtain more information on the matters outlined in this paper, CAANZ has also developed an online survey on businesses experiences with contracts and unfair terms. This survey will take stakeholders around 10-15 minutes to fill out and can be found on the Treasury website.

## **STAKEHOLDER MEETINGS**

Treasury, on behalf of CAANZ, will also be holding targeted meetings with stakeholders to discuss the matters outlined in this paper. Stakeholders can contact Treasury if they are interested participating in these meetings.

## **GUIDANCE**

CAANZ has released a fact sheet, which is available on the Treasury website, to provide an overview of this project and key points on unfair contract terms.

The Australian Competition and Consumer Commission (ACCC) has published guidance and background information on unfair contract terms in consumer contracts. This can be accessed on the ACCC website.

## FOREWORD

The Australian Consumer Law<sup>2</sup> is a national, State and Territory law, which commenced in January 2011, that aims to protect consumers and ensure fair trading in Australia. It seeks to improve consumer well-being through consumer empowerment and protection, fostering effective competition and enabling confident participation of consumers in markets in which both consumers and suppliers trade fairly.

Preventing unfair practices is one of the six operational national consumer policy objectives, and in line with this, the Australian Consumer Law includes unfair contract term protections for standard form consumer contracts. These protections enable the courts to declare void a term within a standard form consumer contract that is 'unfair'. A term is 'unfair' if it: causes a significant imbalance in the parties' rights and obligations under the contract; is not reasonably necessary to protect the legitimate interests of the party advantaged by the term; and would cause detriment to a consumer if it were relied on.

The Commonwealth Government has committed to extending the consumer unfair contract term protections to the small business sector as part of the *Real Solutions Small Business Policy*. In 2013, Consumer Affairs Ministers agreed to consider such an extension through the Legislative and Governance Forum on Consumer Affairs.

Over recent years there have been recurring accounts of small business vulnerability and disadvantage arising from unfair contract terms and there is considerable support from the small business community for Government intervention in this area. Small businesses are vital to the economy in terms of employment, innovation and ultimately productivity and Australians' standard of living. Small businesses may face similar issues to consumers in relation to standard form contracts and unfair contract terms.

A national unfair contract terms law would enhance and not impede or duplicate existing industry regulatory protections and provide a flexible review of contract terms across all industries and circumstances. To help businesses reduce their compliance costs, the ACCC would initially take an educative and compliance based approach similar to that employed for the introduction of the consumer protections.

The Australian Treasury is progressing this issue on behalf of Consumer Affairs Australia and New Zealand and is undertaking an extensive consultation process to gather additional evidence on the extent of the problem and the Government's policy response.

We look forward to hearing your views.

*Consumer Affairs Australia and New Zealand*

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<sup>2</sup> *Competition and Consumer Act 2010* (Commonwealth) sch s23.



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## GLOSSARY OF TERMS

|                |   |
|----------------|---|
| ABS            | Australian Bureau of Statistics   |
| ACCC           | Australian Competition and Consumer Commission  |
| ACL            | Australian Consumer Law   |
| ASIC           | Australian Securities and Investments Commission  |
| ASIC Act       | <i>Australian Securities and Investments Commission Act 2001</i> (Commonwealth)   |
| CAF            | Legislative and Governance Forum on Consumer Affairs  |
| CCA            | <i>Competition and Consumer Act 2010</i> (Commonwealth)   |
| COAG           | Council of Australian Governments   |
| CRA            | <i>Contracts Review Act 1980</i> (NSW)  |
| IGA            | Intergovernmental Agreement for the Australian Consumer Law 2009, entered into by the Commonwealth (Cth), State and Territory governments |
| UCT provisions | The unfair contract term provisions contained in Part 2-3 of the ACL  |
| TCP Code       | Telecommunications Consumer Protection Code   |

### **Note:**

Where 'UCT' is referenced – this refers to potential unfair contract terms. Whether a term is unfair is determined by the courts, with regard to surrounding circumstances.



## EXECUTIVE SUMMARY

To save time and resources negotiating contracts, many businesses pre-prepare standard form contracts that are presented to customers on a 'take it or leave it' basis. Standard form contracts promote the smooth functioning of the economy by avoiding the transaction costs associated with negotiated contracts, particularly for transactions that are of low value and repeated with a large number of parties.

For various reasons, parties being offered standard form contracts may often not review the terms and conditions closely and may not understand the meaning of particular terms. Furthermore, parties being offered standard form contracts may not have the power to negotiate terms.

Some contract terms and conditions may unfairly advantage one party, at the expense of the other, with the potential to transfer all or much of the risk in a transaction to the other party. Other contract terms may allow the party offering the contract increased flexibility and opportunity beyond what is reasonably necessary for the protection of their legitimate interests and to the detriment of the other party. Where recipients of standard form contracts fail to understand the risks they have taken or are poorly placed to manage them, they may benefit from regulation of unfair contract terms.

Unfair contract terms in standard form consumer contracts are regulated by provisions in the Australian Consumer Law. These provisions came into effect across Australia on 1 January 2011. They render unfair terms in standard form consumer contracts void, to protect consumers from unfair contract terms, and encourage the adoption of 'fair' contract terms. This followed a 2008 Productivity Commission Review of Australia's Consumer Policy Framework, which found that unfair terms were prevalent in consumer contracts and recommended passing such a law.

Businesses, like consumers, also encounter standard form contracts and can face many of the same problems as consumers. This is likely to be particularly the case for small businesses that are commonly presented with standard form contracts and, like consumers, can lack the time and legal or technical expertise to critically analyse these contracts, and the power to negotiate. Compared to larger businesses, small businesses may also be less well placed to manage certain risks transferred to them by the other party.

For these reasons, the Commonwealth Government is committed to extending unfair contract term provisions for standard form contracts to small businesses. There is considerable support from the small business community and representative organisations based on recurring accounts of small business vulnerability and disadvantage arising from unfair contract terms. There is also the potential for underreporting of the problem at hand, with some small businesses potentially feeling powerless in the face of a contract they see as non-negotiable and the resource advantage of the other party.

Furthermore, businesses' interactions through contracts are different in a number of ways from consumer interactions, including greater diversity of transactions, increased likelihood of repeat transactions and large variation in transaction size.

Consumer Affairs Australia and New Zealand (CAANZ), on behalf of Consumer Affairs Ministers, is seeking stakeholder views on the scope of the problem and options which could address the problem, including the extension of unfair contract term provisions.

The policy options analysed in this RIS are:

- Option 1 – The status quo. No action is taken, contrary to the Commonwealth Government's policy commitment.
- Option 2 – Light touch or non-regulatory responses.
- Option 3 – Legislative amendment to extend the existing UCT provisions to contracts involving small businesses, in accordance with the Commonwealth Government's policy commitment.
- Option 4 – Legislation to require contracts with small business to be negotiated on request.

In relation to option 3, feedback is also sought from stakeholders on the design of such an extension, particularly how small business contracts would be defined and whether the provisions would apply to both the acquisition and supply of goods or services.

Legislative amendment to extend the existing unfair contract terms law is the Commonwealth Government's policy commitment and the preferred option at this time. Such an approach would use the enforcement architecture around the unfair contract terms law regarding consumer contracts. It would be relatively less complex to implement and administer given consumer agencies' and businesses' experience to date with the current provisions regarding consumer contracts. Light touch or non-regulatory responses are unlikely to adequately protect small businesses, while legislation that requires contracts to be negotiated on request would not address information failure and bargaining power issues.

Further evidence on the likely impact of all options is required to conduct an informed evaluation of the options and to determine which approach should be pursued. The views of stakeholders received throughout the CAANZ consultation will inform a final, decision-making COAG RIS.

# KEY FOCUS QUESTIONS

Throughout this consultation paper there are a number of detailed questions for stakeholders to answer to better define the problem and assess the costs and benefits of the different options. Stakeholders lodging formal submissions are encouraged to refer to these detailed questions in their submissions. For quick reference, below is an overview of some of the key questions.

## THE PROBLEM

1. How widespread is the use of standard form contracts for small business and what are their benefits and disadvantages?
2. What considerations influence the design of terms and conditions in standard form contracts?
3. To what extent are businesses reviewing standard form contracts or engaging legal services prior to signing them? Does this depend on the value or perceived exclusivity of the transaction?
4. To what degree do small businesses try to negotiate standard form contracts?
5. Is it the terms or the process by which some contracts are negotiated that is the main concern for small businesses?
6. How do small businesses differ from consumers in relation to their interaction with standard form contracts?
7. What terms are businesses encountering that might be considered 'unfair'?
8. What detriment have businesses suffered from unfair contract terms?
9. What protections do businesses currently have when they encounter unfair contract terms and are they sufficient?
10. What regulatory responses are already in place that aim to protect small business from unfair contract terms and how effective are these mechanisms?

## THE POLICY RESPONSE

11. What responses (including by government or industry) could be implemented to help businesses with ensuring contract terms respect the legitimate business objectives and interests of both big and small contracting parties?
12. Would information disclosure requirements impact on the decision to review standard form contracts and/or consider the terms included in them?
13. Given the Commonwealth Government's commitment to extend existing unfair contract term provisions to small businesses, what should be the scope of the protections?

14. Should the Australian Consumer Law UCT provisions be extended to cover small businesses defined using contracting party characteristics or transaction size? Should small business to small business contracts be included?
15. Should the extension of the UCT provisions provide protection for small business when they both acquire and supply goods or services?

# THE PROBLEM

## OVERVIEW

Contracts are a fundamental part of business, underpinning transactions made between businesses by identifying promises that parties have made to each other, allocating risk between the parties, and providing a mechanism for enforcement.

Standard form contracts are pre-prepared by one party to the transaction. The party offering the contract typically has most of the bargaining power in the transaction and makes the offer on a take it or leave it basis. Standard form contracts promote the smooth functioning of the economy by reducing the transaction cost of negotiation and allowing cheap repeated transactions without having to negotiate each time a contract is made.

For consumers, at least, there is evidence that they often do not read standard form contracts. Those consumers that do read standard form contracts may not understand or value fully the nature of all terms, and if they decide that they do not like the terms on offer they may find there to be minimal or no scope to negotiate changes.

Small businesses may experience similar situations and behaviours. Large businesses may present them with standard form contracts and, like consumers they may lack the time and legal or technical expertise to critically analyse these contracts, and the power to negotiate. In some circumstances these standard form contracts may be used to further enhance or embed the commercial advantage or dominance of the other party well beyond reasonable legitimate commercial interests.

The result may be that the party offering the standard form contract has better knowledge about its terms and conditions than the small business and so may include terms that advantage itself, at the expense of the small business. Some terms serve the legitimate business needs of the party offering the contract, for example passing risk to the small business that they can influence and manage. However, some contract terms and conditions may unfairly advantage one party, at the expense of the other, with the potential to transfer all or much of the risk in a transaction to one party. In this context, the concept of 'risk' includes all elements of the contractual arrangement, including aspects such as limitations on the parties' rights in legal proceedings against each other and the parties' rights to change the contract. The concept of a 'contract' or 'transaction' includes on-going commercial arrangements, such as leases. As further explored below, such 'unfair contract terms' have broader, undesirable economic costs.

Small businesses may consider they have little choice but to accept these terms in the belief that this is the only avenue to the commercial opportunity they are seeking, predicated on the hope that a more mutually accommodating attitude may operate between the parties in practice. To the extent that unfair contract terms are not factored into customers' decisions, they may not be a basis on which businesses seek to compete, and therefore may not be subject to the correcting forces of competition. Where recipients of standard form contracts fail to understand the risks they have taken on or are poorly placed to manage them they may benefit from a contract that sees the large business offering the contract retaining the risks. In these circumstances, some form of intervention may be warranted to encourage the adoption of 'fair' contract terms.

While there is some evidence on the extent of the problem for consumers, where intervention has occurred, further investigation is being undertaken to examine the extent to which these issues apply to small business and what proportionate response best negates the detriment and harm.

## CONTRACTS AND SMALL BUSINESSES

1. Contracts are a fundamental part of business. Contracts underpin transactions made between businesses by identifying promises that parties have made to each other, allocating risk between the parties, and providing a mechanism for enforcement.<sup>3</sup>
2. The doctrine of freedom of contract has two key aspects: that every person is free to enter into a contract with any person they choose; and to contract on any terms they want. The intent is that the voluntary wills of the parties expressed in the contract should be enforceable.
3. In practice, though, some consider this provides the more powerful party to a contract 'a freedom of manipulation and motivation, [and] a freedom from any onus of articulation ...'.<sup>4</sup> Consequently, disparities in bargaining positions between the business offering the contract and the business signing the contract may mean that the party signing the contract is not always free to negotiate terms under which they contract. This is evident in the use of standard form contracts that are offered on a take it or leave basis.
4. The businesses signing the contract may also not have the resources or skills to completely understand the implications of contractual terms they are presented, which also provides an opportunity for manipulation.
5. These circumstances may lead to the inclusion of unfair contract terms. For illustration, unfair contract terms may relate to any of the following:

### Matters that may be affected by unfair contract terms:

- Rights to avoid or limit the performance of the contract, terminate it, vary its terms or renew or not to renew the contract.
  - Rights to change the price or characteristics of the goods or services to be supplied.
  - Determining when the contract has been breached and the extent of liability for breaches.
  - Limits on the parties' right to sue each other and the evidence that can be led in proceedings on the contract.
6. Small businesses are commonly presented with standard form contracts and, like consumers, can lack the time and legal or technical expertise to critically analyse these contracts, and the power to negotiate.
  7. Over recent years there have been a number of concerns around the fairness of certain terms in contracts between big businesses and small businesses, with a number of anecdotal reports in the media and State and Territory regulators receiving a number of complaints from small businesses. While individual consumers are protected against unfair contract terms in standard form contracts under the consumer law, small businesses are not.

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3 Stone, R., Text, *Cases and Materials on Contract Law* and McGuire, B and Grasso, T, *Pre-contractual negotiations – warranties and exclusion clauses* (2001) 44 *Comp&L* 43, 43.

4 Boldeman, L., *The Cult of the Market – Economic Fundamentalism and its Discontents*. ANU E Press 2007, 254.

8. For these reasons, the Commonwealth Government has committed to extending unfair contract term protections to small businesses and State and Territory Consumer Affairs Ministers have agreed to consider the extension.
9. CAANZ wishes to investigate the extent to which small businesses are encountering unfair contract terms in more detail and the Government's response.

## **STANDARD FORM CONTRACTS ARE OFTEN OFFERED TO SMALL BUSINESS**

10. To save time and resources negotiating with each contracting party individually, many businesses pre-prepare contracts. Commonly, there is an imbalance of bargaining power and contracts are presented on a 'take it or leave it' basis to the other businesses. Such contracts are known as 'standard form contracts'.
11. Standard form contracts enable the parties to enter complex contracts quickly. For businesses offering these contracts they reduce the training costs of salespeople, who would otherwise need guidance when negotiating such agreements. From the perspective of the business entering into the contract, they allow for lengthy and detailed agreements to be executed promptly by those who may only be focused on core terms such as price, quality, product characteristics and key aspects of a commercial relationship.
12. Standard form contracts are more likely to be used for transactions that are of low value and repeated in high volume when it involves many customers. In these circumstances the costs to both contracting parties of using negotiated contracts for these transactions are likely to exceed the benefits.
13. Small businesses, like consumers, are often offered standard form contracts due to the small scale of their transactions, their lack of legal resources and bargaining power. As business size and scale of the transaction increases, professional advice is more likely to be sought and transactions may be more likely to be negotiated. However, even with larger transaction sizes, professional advice may still not be sought by smaller businesses where there is a perception of exclusiveness of opportunity or an absence of competitive alternatives.
14. In comparison to smaller businesses, bigger businesses may invest significantly in expert legal and commercial advice and embed this input into carefully calibrated contractual provisions to protect their interest or advantage their position.
15. CAANZ wishes to explore the prevalence of standard form contracts encountered by small business, particularly in different industries and for different transaction values.

### Focus questions

1. How widespread is the use of standard form contracts for agreements with small business and in what circumstances are they used?
2. What types of transactions are they commonly used for, that is for which goods and services, in which industries and over what range of transaction values?
3. What are some of the benefits and disadvantages of standard form contracts?

### SMALL BUSINESSES MAY NOT VALUE SOME TERMS AND CONDITIONS APPROPRIATELY

16. Some terms will affect a small business' decision to enter a contract. Foremost in their minds may be those terms that determine the nature of the good or service to be supplied and the upfront price.
17. Other terms may have little effect on a small business' decision as it may not be aware of their significance or may not value them appropriately. Such terms may, for example, relate to the rights of parties if certain events take place, or to the actions of parties to fulfil their obligations under the contract.
18. Research on reading rates for consumers, at least, suggests that the vast majority of people do not read standard form contracts.
  - 18.1. The type of vendor, the price of the good or service and the length of the agreement may be attributes that impact on whether a customer will read a standard form contract or not.
  - 18.2. Victorian research in 2007 found that consumers' propensity to read contracts was influenced by:
    - 18.2.1. their inclination towards wariness and attention to detail; and
    - 18.2.2. previous negative experiences with unfair contracts or the experiences of friends and family members.<sup>5</sup>

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5 Consumer Affairs Victoria (2007), Unfair Contract Terms in Victoria: Research into their Extent, Nature, Cost and Implications, Research Paper no. 12, October, 15.

### Research: reading rates of consumers

A 2006 US study found that as little as four per cent of participants reported that they read standard form contracts.

A 2009 US study found that one or two, out of every thousand retail software shoppers chose to access the license agreement (standard form contract), and those customers that did, only read a small portion of the text.

A survey by the Queensland Office of Fair Trading indicated that at least half of the respondents failed to read or understand contracts.

Consumer Affairs Victoria found that one quarter of consumers failed to read contracts at all (with another 21 per cent only giving them cursory consideration).

19. While there is limited empirical evidence on the reading rates of small businesses, anecdotal reports suggest that like consumers small businesses can lack the resources to adequately review contracts. As a result small businesses may not be aware of the significance of certain terms and conditions that are included in a contract that they sign.
20. CAANZ wishes to explore the reading rates of business, particularly small business, through the consultation process. CAANZ will be exploring this issue further through the online business survey released as part of this consultation.

### Focus question

4. To what extent are businesses reviewing standard form contracts or engaging legal services prior to signing them? Does this depend on the value or perceived exclusivity of the transaction?
21. There are a number of reasons why small businesses may not review standard form contracts closely. Perfectly informed decisions are often not possible in practice because of the limited time and resources available for making them.<sup>6</sup> For a number of reasons, small businesses may decide that there is little benefit, and significant cost, in spending the time reviewing and understanding each contract.
  - 21.1. Standard form contracts may be long and confusing to small businesses, often using legal terminology. Small businesses may arrive at the conclusion that it is not worth their time reviewing a contract that they do not understand, or that it is not worth the cost of legal advice.
  - 21.2. Small businesses may consider that even if they do not wish to agree to all the terms, they will be unable to negotiate with the bigger business that drafted the standard form contract, and which may have all or most of the bargaining power, and therefore that it is not worth reviewing the contract in the first place.

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6 On the topic of bounded rationality see Ariely, D., (2008) *Predictably Irrational: The Hidden Forces That Shape Our Decisions*; Kahneman, D., (2011) *Thinking Fast and Slow*; and Thaler R. and Sunstein, (2008) C., *Nudge: Improving Decisions about Health, Wealth and Happiness*.

- 21.3. Smaller businesses may consider that standard form contracts are generally standardised across an industry, as competitors borrow each other's terms (in order to save on contract formation costs and to ensure they compete on even terms with their rivals), and therefore that there is no point in 'shopping around' for better contract terms.
- 21.4. Smaller businesses may consider that, given the standard nature of the contract, countless other businesses would have agreed to exactly the same terms. As a result, if there had been any issues with these terms in the past, they would have been resolved.
- 21.5. Smaller businesses may choose to focus on what appears to be the cost of the good or service or commercial opportunity fundamentals, on the expectation that the other party will make their money from the upfront contractual provisions and not from impositions or variations that emerge later under the agreement.
22. In other cases, it may be that small businesses review and understand terms, but may undervalue the risk of certain low probability events.
23. Many of these issues that apply to small businesses are similar to the issues faced by consumers. However compared to consumers, small businesses may have somewhat greater incentive and capacity to review and interpret accurately terms in unfair contracts where:
  - 23.1. the upfront value of contracts and costs of associated risks are substantially larger than for the typical consumer;
  - 23.2. they have existing relationships with lawyers, accountants and other professionals they may draw on for advice; or
  - 23.3. there are repeated transactions with the same counterparty.

### Focus question

5. To what degree do small businesses try to negotiate contracts that are presented on a 'take it or leave it' basis? Are there types of goods and services where small businesses are more likely to try to negotiate contracts?

## IMPERFECT INFORMATION AND THE POSSIBILITY OF UNFAIR CONTRACT TERMS IN STANDARD FORM CONTRACTS

24. Where small businesses do not review terms closely or understand fully the risks involved, they will have less information about the nature of the contract on offer than the party that drafted the standard form contract. In such situations of 'asymmetric information', a contract that shifts risks onto the small business may be cheaper for the supplier to provide, and many customers may choose this cheaper contract if price is a priority. As such, businesses may choose to enter into contracts containing unfair terms.
25. It should be recognised that some terms in standard form contracts serve the legitimate business needs of the party offering the contract. They may pass risk to the small

business for events that are within their ability to influence, providing, for example, the supplier with a contractual basis for seeking redress from counterparties that act in bad faith and allowing supply to other parties at a lower price. They may also allow businesses to manage commercial risks associated with catastrophic events affecting small businesses.

26. However, other terms may give rise to potential small business and social detriment. Small business may mistakenly enter contracts they should not have because they undervalued contractual obligations they were unaware of, or where they tended to underestimate the cost and incidence of the risks they took on. Some risks may also be better managed by the supplier or a larger business, for example: where their likelihood or cost can be influenced by the supplier; or where it is possible for the supplier to diversify the risk across the pool of customers. Certain terms may also be perceived to be inherently unfair, violating a highly valued ethical norm.
27. In this context, the concept of 'risk' includes all elements of the contractual arrangement, including aspects such as limitations on the parties' rights in legal proceedings against each other and the parties' rights to change the contract. Relevant contracts include on-going commercial arrangements, such as leases. Unfair contract terms (UCTs) are those conditions that disadvantage one party, but that are not reasonably necessary for the protection of the legitimate interests of the other.
28. Under current UCT protections for consumer standard form contracts (under the Australian Consumer Law), a term in a consumer contract is *unfair* if it:
  - 28.1. causes a significant imbalance in the parties' rights and obligations under the contract;
  - 28.2. it would cause detriment (whether financial or otherwise) to a party if it were to be relied on; and
  - 28.3. the term is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term.
29. There are a number of factors to consider when deciding whether a term is potentially unfair, with the final decision on whether a term is unfair made by a court. In determining whether a term is unfair, the court is required to take into account:
  - 29.1. the extent to which the contract is transparent – that is, if the term is expressed in reasonably plain language, legible and presented clearly and readily to the party affected by it; and
  - 29.2. the contract as a whole.

30. Below are some common examples of terms that may be regarded as unfair if they are included in standard form consumer contracts:

**Terms that may be regarded as unfair in consumer standard form contracts include terms that:**

- Permit the supplier but not the customer to avoid or limit the performance of the contract, terminate it, vary its terms or renew or not to renew the contract.
- Permit the supplier to:
  - change prices without the customer's right to terminate the contract (lock in terms);
  - unilaterally determine when the contract has been breached;
  - unilaterally vary the characteristics of the goods or services to be supplied; and
  - assign the contract to the customer's detriment without the customer's consent.
- Penalise the customer but not the supplier, for breach or termination of contract.
- Limit the customer's right to sue the supplier.
- Limit the supplier's explicit liability for its agents.
- Limit the evidence the consumer can lead in proceedings on the contract.
- Impose the evidentiary burden on the customer in proceedings on the contract.

**Focus questions**

6. What considerations influence the design of terms and conditions in standard form contracts?
7. What terms are businesses encountering that might be considered 'unfair'?
8. Do these terms relate to the operation of the contract or to remedies available under the contract?
9. What detriment have businesses suffered from UCTs and are there examples of business sectors where detriment is particularly prevalent?

**COMPETITION MAY NOT ELIMINATE UNFAIR TERMS**

31. If small businesses had perfect information about the terms of the contracts that they were signing and a sufficient choice of counterparties, competitive forces should drive all players in the market towards offering contracts that include only fair terms. For example, a large business could offer a standard form contract to a small business at a lower upfront price but that includes a term that shifts a key risk to a small business counterparty that the large business could more readily have managed itself. The larger business may lose business to other companies that offer contracts at a higher upfront price but that see those companies maintain the risk themselves.

32. In practice, small businesses often have imperfect information and so may not fully value the risks transferred to them in the contract. For a given price, businesses that offer more favourable terms may be unable to compete with businesses that offer contracts containing UCTs. If it imposes greater costs on a large business to supply the goods with favourable terms, and small businesses do not generally review the terms closely, the incentives for offering fair terms would be low. In such circumstances, competition would tend to see large businesses offer contracts that include unfair terms.
33. CAANZ wishes to explore through consultation who is including 'unfair' terms in contracts. In particular, larger businesses that have access to legal resources and greater bargaining power may be more likely to include unfair terms in contracts to small businesses than businesses of similar size. In some instances unfair terms could be included by a third party who draws up the contract (such as a lawyer) and seeks to minimise legal risks for their clients.

### Focus questions

10. How do unfair terms in standard form small business contracts impact on confidence and trust in the market?
11. Who is including 'unfair' terms in contracts to small businesses? Is it larger business and/or a third party (such as a lawyer) drawing up the contract?
12. Is it the terms or the process by which some contracts are negotiated between small business and business to be the primary issue for small businesses?

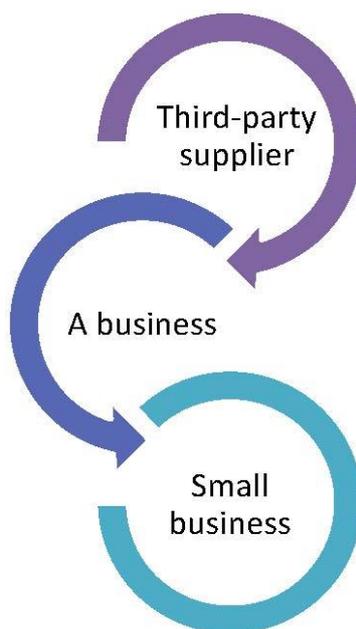
## THE COSTS ARISING FROM UNFAIR CONTRACT TERMS

### Increased cost of risk

34. Unfair terms may shift the management of risks to small businesses, even if the businesses they are contracting with would be able to better manage those risks. The businesses offering the contract are usually better informed about, and may be able to control to a reasonable extent, the risks associated with the quality, timeliness and continuity of supply.
35. Such re-distribution of risk may reduce incentives for the business offering the standard form contract to manage risks efficiently.

### Example:

A business may stipulate a term in a standard form contract disclaiming liability from a third party supplier causing loss. This business may be less likely to shop around for the most dependable third party supplier, or even for the supplier that offers the best reliability/price trade off. The business might simply choose the supplier that offers the lowest price because the customer, not the business will bear the cost if the third party fails to perform. This can push the risk onto customers, who have no choice as to the third party supplier. On the other hand, repeat commercial relationships and customer referrals could provide some incentive for businesses to curtail this behaviour.



36. It may also mean that, when adverse outcomes occur, the cost of dealing with them is higher, if the small business is less well-placed to manage the impact. For example, UCTs may result in the small business bearing the risk of high cost, low probability events. While this may result in customers receiving lower priced goods or services, they may be taking on risks that they are not well placed to manage.<sup>7</sup>
37. Small businesses are likely to be less well placed than larger businesses to manage risks when they occur given they are likely to have less resources. Larger businesses are more likely to have robust risk management procedures and policies in place, as well as a better ability to absorb the costs if something goes wrong due to their size.

### Transaction costs associated with avoiding unfair contract terms

38. Small businesses seeking to avoid the risks associated with signing contracts that include unfair terms may incur substantial additional transaction costs.
39. *Ex-ante* (transaction) costs are costs incurred by a business before a contract is signed. These costs include search and information costs, such as internal resources or legal fees for contract review and examination. Once the information searching is completed, the decision on whether or not to place trust with the potential contracting party will be made.
40. The relative costs of gaining information necessary to assess whether UCTs are present in standard form contracts are likely to be higher for smaller businesses, due to smaller transactions and lower technical and legal expertise. As a result it may not be worthwhile for small businesses to seek to gain additional information.
41. That said, these costs relative to the transaction size may be lower for small businesses undertaking repeat transactions, and/or larger dollar value transactions. This is

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<sup>7</sup> Productivity Commission (2008), *Review of Australia's Policy Framework*, 418.

because the cost of reviewing the contract closely, assessing risk and obtaining legal advice (when done so) will be spread over many transactions and/or reflect a smaller proportion of the monetary value of the transaction.

42. Alternatively, small businesses may not always have the power to renegotiate terms. In this case, the increase in transaction costs is reflected by the small business taking on more of the risk in the contract than they would prefer. To the extent the small business is more poorly placed to manage the risk, this represents a social cost.
43. The presence of UCTs may also lessen the ability of small businesses to compete with large businesses. It is likely that the costs associated with reviewing contracts relative to transaction size are higher for small businesses that can lack the resources to assess contracts. For larger businesses engaging in typically larger transactions the cost of properly assessing contracts is likely to be lower (relative to the transaction size) and they are more likely to have the necessary resources available.
44. Quantification of the cost of ensuring that there are no UCTs in a contract is difficult, if not impossible, given that any resources (internal or legal) spent are likely to reflect a review of the contract more broadly – that is, the contract will be assessed not just for unfair terms, but whether the contract is generally desirable and should be entered into by the business.
45. Lastly, a perception of ‘exclusivity’ to the commercial opportunity conveyed by a contract containing a UCT may lead a small business to proceed with a potentially risky or exploitive contract, perhaps in the hope that the operation of the commercial relationship may be more mutually accommodating.

#### **Other costs of unfair contract terms**

46. The presence of UCTs may also weaken small business confidence in contracting and may be considered undesirable on ethical grounds.
47. While there is little evidence of the effects on small business confidence, a 2007 Victorian study found that consumers believed that previous experiences with UCTs impacted significantly on their confidence when entering future contracts.<sup>8</sup> This finding may be instructive to the experience of small businesses with UCTs.
48. A further cost of UCTs is that they violate the principle of fairness, which is a highly valued ethical norm. In consultation on the Australian consumer policy framework in 2007 and 2008, the Productivity Commission found that this appeared to be the main basis for participants in their inquiry supporting action on unfair contract terms, though they also noted that while many ethical norms are valued, not all are enforced legally.<sup>9</sup>

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8 Consumer Affairs Victoria (2007), *Unfair Contract Terms in Victoria: Research into their Extent, Nature, Cost and Implications*, Research Paper no. 12, October, 23.

9 Productivity Commission (2008), *Review of Australia’s Consumer Policy Framework*, 413.

### **Increased small business confidence and trust in markets**

A legal framework that appropriately addresses unfair contracts terms should ensure that businesses that supply small business compete with each other on price and quality without passing inappropriate levels and types of risk to their small business counterparties. Businesses contracting with small businesses would then have a clear commercial imperative to efficiently and effectively manage risks that they are best-placed to manage. In turn, this should stimulate innovation and growth by efficient small businesses that would then be able to compete with larger businesses on a level playing field. This will promote small business confidence and trust in markets, along with greater investment in the long term.

### **Focus questions**

13. To what extent do small businesses engage legal services prior to signing standard form contracts? What transaction value does a contract need to have for businesses to engage legal advice? Are there any other factors that would influence a business' decision to engage in legal advice prior to signing a standard form contract?
14. Are there examples of instances where risks have been unfairly shifted to small businesses in contracts?

### **Extent of the problem and costs arising from unfair contract terms**

49. Two key factors are likely to influence the extent of the problem of UCTs – their current prevalence in standard form contracts and the extent to which (if present) they are relied upon by the business offering them.
50. There is limited literature on the current prevalence of UCTs in standard form contracts offered to small businesses and the extent to which they are applied or relied upon. Complaints addressed to the ACCC (see below) provide some insights into the issue, but they are likely to underestimate the amount of formal complaints as they are likely to have been directed through other mechanisms such as State and Territory consumer bodies.
51. Furthermore, some UCT issues are likely to be settled by business through informal negotiations and through formal mechanisms such as assisted dispute resolution.
52. Lastly if some businesses feel that there is no legal redress for UCTs they may not seek to escalate the issue through both informal and formal channels.

### **Australian Competition and Consumer Commission complaint data**

53. The ACCC received 894 complaints related to UCTs and small business since commencement of the consumer ACL UCT provisions on 1 January 2011 to 25 November 2013.

**Table 1: Australian Competition and Consumer Commission unfair contract term and small business complaints 1 January 2011–25 November 2013**

| Category  | Complaints* | Percentage          |
|---|-------------|---------------------|
| Automatic Rollover — a subset of termination complaints in which the contract automatically rolls over for excessive periods for example five years or more.  | 148         | 17 per cent         |
| Termination — clauses that unfairly restrict the small businesses right to terminate the contract.  | 136         | 15 per cent         |
| Restricting Rights and Liability — clauses that unfairly limit the other party's liability under the contract or restrict the ability of the small business to enforce their rights under the contract.                   | 85          | 10 per cent         |
| Unilateral Contract Variation — clauses that allow the other party to change the contract without the consent of the small business.  | 91          | 10 per cent         |
| Cancellation fees — a subset of termination complaints in which the small business is required to pay excessive cancellation fees for example in excess of \$25,000 for a contract worth substantially less than the fee. | 61          | 7 per cent          |
| Retrospective Variation — a subset of unilateral variation complaints in which the contract contains clauses that allow for retrospective variation of terms and conditions.  | 60          | 7 per cent          |
| Unfairly assigning risk — contracts that place unfair requirements on the small business for things outside of their control for example payment for damage by a third party to equipment.                                | 19          | 2 per cent          |
| UCT — Other   | 63          | 7 per cent          |
| Franchising (not Franchising Code related) — exclusive supply contracts.  | 22          | 2 per cent          |
| Franchising (not Franchising Code related) — geographical clauses.  | 18          | 2 per cent          |
| Franchising (not Franchising Code related) — other.   | 191         | 21 per cent         |
| <b>Total</b>  | <b>894</b>  | <b>100 per cent</b> |

Source: Australian Competition and Consumer Commission

54. Complaints relating to automatic rollover (17 per cent), termination (15 per cent), restricting rights and liability (10 per cent), and clauses allowing unilateral contract variation (10 per cent) were the main types of complaints received by the ACCC during the relevant period. Other franchising related complaints accounted for the largest proportion of complaints to the ACCC (21 per cent).

### Focus question

15. How are small businesses currently addressing issues with respect to UCTs? Are they resolving complaints informally or addressing complaints through more formal channels such as regulators?

### The prevalence of unfair terms in small business standard form contracts

55. CAANZ wishes to explore through consultation the extent to which standard form contracts offered to small businesses include UCTs.
56. The ACL currently prohibits businesses from seeking to rely on UCTs in consumer contracts.<sup>10</sup> In practice, many businesses may have already removed unfair terms from their consumer contracts and may not differentiate between consumers and small businesses when offering standard form contracts for particular types of goods and services.

<sup>10</sup> Section 23 of the Australian Consumer Law.

57. It is unclear how many standard form contracts are being offered to small business that are not otherwise already captured under the existing UCT provisions. CAANZ wishes to explore this as part of the consultation process.
58. If, as a result of the introduction of the ACL UCT provisions for consumers, many contracts now offered to small businesses do not contain UCTs, the magnitude of the problem may not be great. However, if this is the case, the costs associated with any government action to address the problem (such as extending the ACL provisions to small business), could be nominal. This is explored under Option 3 below.
59. It is also important to note that while some consumer standard form contracts may be offered to small business, and therefore are required to comply with the existing UCT law, small businesses currently have no recourse in the event they wish to challenge such terms. This is particularly relevant given that a court may only declare a term unfair and therefore void. Unfair terms are not prohibited outright under the ACL.

### Focus questions

16. How many businesses offer goods and services to small businesses via standard form contracts?
17. How many of these contracts treat business customers and consumers differently?

### How often businesses act on or enforce unfair contract terms

60. The existence of UCTs does not necessarily mean that such terms are always being enforced or relied upon by businesses that offer the contract. Costs arise where UCTs are applied, or at least where there is a concern they will be applied. Reasons why UCTs may not be enforced or relied upon include:
  - 60.1. unfair non-core terms are triggered by events that may or may not occur – such as defaults or failure to provide a service (that is, they may be low probability, high cost events);
  - 60.2. a business may not choose to act on a UCT if they consider that loss of reputation from acting on the term is greater than what the gain would be for the business if the term was enforced;
  - 60.3. while it may be claimed that competitive processes do not eliminate the existence of UCTs, there may be competitive forces restraining their use.<sup>11</sup>
61. On the other hand, smaller businesses may be persuaded by assertions from their larger business counterparty that ‘freedom to contract’ concepts mean that they have ‘signed on’ for all the contract terms regardless of their fairness.
62. There is though a question of whether any detriment arises merely from the existence of UCTs (even if never relied upon), for example, in reducing small businesses’ willingness to contract on the basis of standard form contracts.

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11 Productivity Commission (2008), *Review of Australia’s Policy Framework*, 426.

63. CAANZ wishes to explore through consultation how often businesses act on, or enforce UCTs. Evidence relating to the extent of reliance on or enforcement of UCTs in small business contracts by business would assist in quantifying the detriment UCTs may cause small business.
64. However, CAANZ recognises that there may be practical issues in attempting to measure the extent of detriment arising from a particular UCT. For example, a UCT may be an exorbitantly high cancellation fee. The extent to which this term is stifling competition would not be easy to measure, for example how many businesses would have cancelled a particular contract and moved to a competitor if not for the term.

### Focus question

18. To what extent are businesses relying on/enforcing unfair contract terms?

## CONCLUSIONS

65. The CAANZ consultation process is seeking evidence about the use of standard form contracts, the extent to which they are reviewed by small business, the ability of small businesses to renegotiate terms, and the existence, use and detriment caused by UCTs in such contracts.
66. In general terms, customer trust in and use of standard form contracts can result in efficient markets, because standard form contracts promote the smooth functioning of the economy by reducing the transaction cost of negotiation and allow cheap repeated transactions without having to negotiate again each time a contract is made. Small businesses, like consumers, are often offered standard form contracts.
67. The detriment caused by UCTs in standard form contracts arises in a number of ways. A lack of understanding of terms may result in small businesses entering contracts they would have preferred not to enter, had they understood the terms, or raise transaction costs in seeking legal or technical advice in order to understand the nature of contract terms. UCTs may also result in the inefficient passing of all or most of the risk in a transaction to a small business that may not be well placed to manage this risk. The presence of UCTs may also weaken small business confidence in contracting.



# POLICY OBJECTIVE

## OVERVIEW

The policy objective is to help to provide a level playing field for small businesses when interacting with other businesses through standard form contracts. This will enhance the welfare of Australians by increasing small business certainty and confidence. Small business customers interacting with other businesses through standard form contracts should have confidence that the contract they have entered into is fair and reasonable and that risks are allocated efficiently.

The options to address the identified problem would seek to improve incentives for businesses to offer fair contract terms and reduce the incidence of terms in standard form contracts offered to small business that are unfair.

The options for addressing the problem will enhance, not impede or duplicate existing enforceable mechanisms that achieve the equivalent policy outcomes.

68. Standard form contracts involving small businesses should generally allocate risks to the party best able to manage them, and not result in a significant imbalance in the parties' rights and obligations arising under the contract. Small business customers interacting with other businesses through standard form contracts should have confidence that the terms of the contract they have entered into are fair and reasonable and that small businesses are protected from suffering detriment as a result of unfair terms.
69. In achieving this objective, it is important that benefits should exceed costs.
70. In addition, options for addressing the problem identified would seek to:
  - 70.1. provide certainty to businesses as to the application of any laws from the outset of contract formation;
  - 70.2. provide appropriate avenues of timely recourse from consumer agencies for small business against UCTs; and
  - 70.3. maintain, to the maximum extent possible, the 'sanctity of contract'.<sup>12</sup>

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<sup>12</sup> The ideal of sanctity of contract emphasises that parties are to be held to the agreements that they have freely made. The ideal ensures that both parties in a contract honour and respect the terms and conditions agreed upon in a contract, where goods and services are traded and exchanged for consideration.



# STATEMENT OF THE OPTIONS AND IMPACT ANALYSIS OF EACH OPTION

## OVERVIEW

There are a number of tools available to address problems with unfair contract terms. These range from those that focus on customer empowerment (demand side measures), such as enhancing the quality or type of information provided for products, to those that focus on modifying supplier behaviour (supply side measures), such as mandating product standards or encouraging the development of codes of conduct.

To address the problem defined, this RIS explores four main options:

- Option 1 – the status quo. No government action is taken contrary to the Commonwealth Government policy commitment.
- Option 2 – light touch or non-regulatory responses.
- Option 3 – legislative amendment to extend the existing UCT provisions to standard form contracts involving small businesses. This is the Commonwealth Government's policy commitment and the preferred option at this time.
- Option 4 – legislation to require small business standard form contracts to be negotiated on request.

The options explored do not seek to change the bargaining power of parties that may be present in the contract formation stage. Rather, they seek to address the imbalance of information about contract terms or alleviate the detrimental effects of enforcement of unfair contract terms against small business.

## OPTION 1 — THE STATUS QUO

71. Under this option, current and existing laws (to the extent that they could apply to UCTs offered to small business) would continue to operate. Market incentives would be relied upon to address the identified problem and to partly or wholly achieve the stated objectives.
72. This option is inconsistent with the Commonwealth Government's policy commitment.

### Relying on current laws

73. The consumer law and the common law enshrine the concept of fairness in contractual dealings in certain ways. Small businesses receive a number of protections afforded to individual consumers under the ACL, which may provide some protection from UCTs (see Background).
74. Primarily, the existing UCT provisions for consumer standard form contracts may provide protection to small business. To the extent that a good or service could be both for domestic use and business use (for example, computer spyware software), and the business offering a standard form contract for that good or service does not distinguish between individual consumers and small businesses, small businesses may benefit from the existing ACL UCT provisions. However, as stated above, small businesses

themselves have no redress under these laws and they may not be readily applicable to contracts for a commercial relationship rather than a single transaction or service.

75. In addition, under the ACL a person must not engage in conduct that is, in all the circumstances, unconscionable. In some limited circumstances, these laws could protect small businesses from UCTs. However, CAANZ notes that:

75.1. The ability for the unconscionable conduct provisions to deal with particular contractual *terms* is often questioned. While the ACL now clarifies that the court can examine the terms of a contract in determining unconscionability.

75.2. The courts have stated that 'unfair conduct' does not necessarily equal 'unconscionable conduct'.<sup>13</sup>

76. Furthermore, under the ACL, a person must not engage in misleading or deceptive conduct, or make certain kinds of false or misleading representations with respect to goods or services.<sup>14</sup> However, CAANZ notes that a contract term can be unfair without necessarily being misleading or deceptive.

77. Suppliers of goods and services must also adhere to the specified consumer guarantees in the ACL, which cannot be excluded, modified or limited by contract. However, there are a number of features of these provisions which limit their application to UCTs encountered by small business:

77.1. Consumer guarantees primarily apply to core terms about the nature and quality of the product or service, rather than other terms relating to issues such as dispute resolution or terms which lock-in the customer.

77.2. In broad terms, these provisions offer protection to small businesses for transactions under \$40,000 or if the goods were of a kind ordinarily acquired for personal, domestic or household use or consumption, provided that the goods are not purchased for resupply, or transformation in the course of production or manufacture.

77.3. In relation to services, these provisions protect small businesses if the transactions are under \$40,000 or if the services were of a kind ordinarily acquired for personal, domestic or household use or consumption.

77.4. A number of exceptions, particularly relevant for small business customers apply. Exceptions relate to insurance contracts; or contracts for the transportation or storage of goods for the business, trade, profession or occupation of the person for whom the goods are transported or stored.

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13 As Spigelman CJ noted in *Attorney-General (NSW) v World Best Holdings Ltd* (2005) 63 NSWLR 557: 'Unconscionability is a concept which requires a high level of moral obloquy. If it were to be applied as if it were equivalent to what was 'fair' or 'just', it could transform commercial relationships ... The principle of 'unconscionability' would not be a doctrine of occasional application, when the circumstances were highly unethical, it would be transformed into the first and easiest port of call when any dispute ... arises'.

14 Section 18 of the ACL.

78. In addition, the *Competition and Consumer Act 2010* (CCA) prohibits a corporation with a substantial degree of market power from taking advantage of that power for a proscribed anti-competitive purpose. CAANZ notes that a contract term can be unfair without having an anti-competitive purpose.
79. As outlined in further detail in Background, there are also a range of industry specific measures which may provide varying degrees of protection for small businesses from UCTs. There are four mandatory industry codes under the CCA – the Franchising Code, the Unit Pricing Code, the Horticulture Code and the Oilcode and other specific industry protections including the Telecommunications Consumer Protection Code and the *Independent Contractors Act 2006*.
80. The focus of these codes is largely on unfair contracting practices that have been identified as particularly problematic in the sector and not on unfair contract terms. Where there is a focus on unfair contract terms they relate to narrow circumstances and therefore the codes may not provide effective safeguards against unfair terms more broadly.
81. In addition, state legislation may provide some degree of protection against unfair contract terms, in some cases limited to particular industry sectors.
82. The options for extending UCT protections will enhance, not impede or duplicate existing enforceable mechanisms that achieve the equivalent policy outcomes.

### Focus questions

19. Do existing regulatory mechanisms provide comparable protection for small businesses from the inclusion of unfair contract terms in standard form contracts? Do they achieve the overall policy objective of helping to provide a level playing field for small business customers when interacting with other businesses through standard form contracts?
20. What is the extent of any overlap between the proposed UCT law for small businesses and existing regulatory mechanisms?
21. Do existing enforceable regulatory mechanisms provide adequate, accessible and timely avenues for redress?

### Relying on market forces

83. In the absence of government intervention, market forces – including awareness of small businesses as to the risk of UCTs in standard form contracts, reputational concerns and a desire for customer loyalty – may play a role in disciplining businesses' inclusion and/or exercise of UCTs in standard form contracts.
  - 83.1. Businesses that are unable to respond appropriately and in a timely manner to small business concerns, or that behave in a manner that appears contrary to general small business interests, may experience damage to their reputation and a decline in their customer base.
84. However, not all markets are highly competitive and, hence, subject to these disciplines. The greater the imbalance of bargaining power, the greater the larger

business's ability to offer a standard form contract on a 'take it or leave it' basis and the lower the likelihood that market forces will influence the inclusion of unfair terms.

- 84.1. For example, if the customer has few alternative parties to contract with, or if the loss of any individual small business' custom creates little incentive for the business to change the terms in its contracts, market forces such as those described may not prove to be a reliable mechanism.
85. Further, even in highly competitive markets, and as outlined in the Problem section above, competitive forces only discipline those terms in standard form contracts which customers, as a group, are aware of and value appropriately. Where customers have imperfect information, they may choose contracts which appear more favourable in their more visible terms, like the upfront price, and place lower weight on contingent terms even where they are unfair. In such an environment, if inclusion of a UCT allows a supplier to offer a better price by re-distributing risk away to the customer, it is likely to attract customers, while suppliers that offer less favourable prices for contracts without unfair terms may find it difficult to attract customers.
86. It is not clear that competitive forces create powerful enough incentives for businesses to exclude UCTs from their standard form contracts.

### Focus question

22. What role do market forces play in reducing the incidence of UCTs and are they sufficient to address the problem?

### Impact analysis

87. Benefits of maintaining the status quo include the following:
  - 87.1. There would be no change to current levels of litigation and subsequent certainty around contract enforceability, or to current incentives to adopt standard form contracts.
  - 87.2. It is likely that there would be fewer direct costs for businesses than would be incurred (at least in the short term) if any other policy option considered in this RIS were adopted. As a consequence, there would also be no increased prospect of higher prices faced by small businesses, or ultimately consumers, due to any increase in compliance costs being passed on by businesses.
  - 87.3. There would also be no increase in prices faced by small businesses or ultimately consumers due to any increased costs to businesses associated with supplying 'fairer' terms.
    - 87.3.1. Note though that while suppliers may charge lower prices under the status quo, small businesses may be better off paying a higher price for a contract that sees more of the risk in the transaction remaining with the supplier. Put another way, lower prices would not be of benefit to small businesses if the benefit of those lower prices is more than offset by the cost of lower quality contract terms.

88. The 'costs' associated with the status quo would derive from the aforementioned policy objectives not being met. The policy objectives may not be met if existing laws and market forces responses do not provide a sufficient constraint on businesses' inclusion of UCTs in standard form contracts offered and agreed to by small businesses. This option is inconsistent with the Commonwealth Government's policy commitment.
89. The policy objectives not being met could result in the following costs:
  - 89.1. a lower number of contracts with 'fair' terms on offer to small businesses, resulting in risk being taken on by small businesses that the counterparty would be better placed to manage, in turn reducing overall economic welfare;
  - 89.2. a lessened ability for small business to compete with large businesses, to the extent that costs from UCTs fall disproportionately on the former; and
  - 89.3. diminished preparedness of small businesses to invest, innovate and engage in economic and employment growth opportunities.
90. Further costs would continue to be borne by government and regulatory agencies in responding to any disputes and/or complaints from small business about UCTs.

### Focus question

23. Do UCTs impact upon competition between businesses, particularly by increasing the cost and risk of doing business for small businesses more than for large businesses? Is there scope for greater competition between businesses in the absence of UCTs?

## OPTION 2 — LIGHT TOUCH OR NON-REGULATORY RESPONSES

91. Under this option, light-touch government or industry-led actions could be taken which do not involve legislation to invalidate UCTs (option 3) or require standard form contracts to be negotiated (option 4). These actions include:
  - 91.1. industry-led initiatives to curtail the presence of UCTs;
  - 91.2. government awareness and information campaigns for small business;
  - 91.3. information disclosure requirements for standard form contracts (this may also be a regulatory option); or
  - 91.4. guidance for business and/or a 'list' of what may be seen as an unfair term (this may also be a regulatory option).
92. This option does not impede or displace existing Commonwealth, State and Territory regulatory intervention in areas characterised by an imbalance in power and resources between the parties such as in the franchising sector or with respect to retail tenancies. Any additional actions would seek to enhance existing arrangements in these areas.

## Industry-led initiatives

93. In response to concerns from government and small business about the inclusion of UCTs in standard form contracts, businesses could collectively develop industry-led responses to the problem.
94. Industry-led responses could include, for example, voluntary standards or a voluntary code of practice setting out the types of terms and conditions that will not be included in standard form contracts offered to small business.

## Impact analysis

95. This option would aim to decrease any detriment borne by small businesses as a result of information failures arising in markets with standard form contracts by reducing the existence and use of UCTs, rather than seeking to correct the information failure itself by providing more information to small business.
96. CAANZ notes governments would have little control over the content of these standards or codes, or the extent to which businesses chose to comply with them.
97. This option would likely result in different approaches taken in different industries rather than a blanket solution for the whole economy and could arguably therefore allow the response to be better tailored to the requirements of a given industry.
98. It is also arguable that the self-regulatory option, by giving industry the lead role, would result in industry taking a more positive and pro-active role in ensuring compliance with codes. Industry bodies would need to develop monitoring and enforcement arrangements in order to ensure that the code achieved acceptable levels of effectiveness and credibility, as continued failure would inevitably pose the risk of a more regulatory solution being substituted in the future.
99. However, costs can arise from a sector-by-sector approach. As self-regulatory or co-regulatory initiatives are developed at the level of individual industries they are likely to vary significantly. As a result, this may generate a greater compliance burden through the prescription of multiple rules, instead of one broad obligation. This may be particularly problematic for businesses who find they are covered by multiple codes. From the perspective of small business, a self-regulatory option could be costly, since there would be greater difficulties in identifying the relevant code/standard and determining its specific provisions. An added layer of complexity arises with the existing UCT requirements for standard form consumer contracts in the ACL.
100. An ad-hoc response to unfair contract term protections across industries could leave small businesses in some industries protected for very specific types of unfair contract terms but exposed to other types of unfair contract terms that other industries may be protected against.
101. In addition, it is likely that some industries may not voluntarily develop codes or standards, and that some industry participants may not agree to be bound by any voluntary code or standard. Achieving broad consensus when negotiating the content of codes and standards can be difficult.

102. Aside from the costs arising from an industry driven sector-by-sector approach, where voluntary compliance fell short, governments would be limited in their ability to act.
103. Such an option would seek to support, strengthen and enhance existing industry arrangements and not seek to displace or impede them. As discussed above, the existing industry arrangements currently largely focus on unfair practices and not the actual unfairness of the contract terms themselves. There is a focus only on very specific unfair contract terms, leaving businesses exposed to unfair contract terms more broadly.

### Focus questions

24. Are there any industry led responses that currently address the identified problem, and have they been effective or ineffective?
25. Are future industry led responses a viable approach to addressing the problem?
26. Are existing regulatory interventions and mechanisms effective?

### Increasing awareness and information campaigns

104. Governments could embark on information campaigns to raise small business awareness of the issue of UCTs in standard form contracts. Small businesses may be more likely to review standard form contracts closely if they have greater awareness of the possibilities of UCTs in standard form contracts, what they may look like, what potential costs may arise if the contract is agreed and what avenues are available to them in the event they are presented with a UCT.
105. This option would seek to reduce information failures in markets where standard form contracts are offered by improving the understanding of information received by small businesses when entering into standard form contracts.

### Impact analysis

106. If such campaigns are effective, to educate small business about the possibility of UCTs, and increase small businesses identification of UCTs, this initiative may see small business invest more resources in reviewing and understanding contracts, which may in turn result in fewer small businesses encountering, or being bound by UCTs.
107. However, there are reasons to believe that such a campaign is likely to be ineffective. Despite an awareness of the issue of unfair contract terms, the time and technical and legal expertise necessary to understand fully standard form contracts may continue to be unwarranted for low value transactions. This will particularly be the case where small business are unable to negotiate terms with a business offering a standard form contract. Moreover, customers may continue to find it difficult to value accurately less salient features of contracts, particularly associated with the costs of low probability risks.
108. In addition, there may be limited avenues for small businesses presently available in the event they have agreed to a standard form contract containing a UCT.

## Information disclosure arrangements

109. This option would aim to ensure that small businesses have a minimum level of information about the contracts they are entering into before signing, by businesses providing to prospective contracting parties a high level summary of the key terms in a contract or a 'key facts sheet'.
110. Again, this option would seek to reduce information failures in markets where standard form contracts are offered by improving the quality of information received and considered by small businesses when deciding to enter into standard form contracts.
111. Such initiatives may be led through industry associations, given that key terms are likely to vary across industries; however, it could also be achieved by regulation if industry was unwilling to do so. Regulatory disclosure regimes have been adopted in a wide range of customer contexts, from food nutrition to home loans.<sup>15</sup>
112. Research suggests that to be effective, regulation of disclosure must adopt one of two strategies:
  - 112.1. Simple disclosures, to target imperfectly rational purchasers. These would be aggregated, one-dimensional disclosures of product-attribute and product-use information that facilitate comparison between competing products.
  - 112.2. More comprehensive and complex disclosure, aimed at sophisticated intermediaries.
113. Disclosure regimes are likely to be more effective when they take into consideration customers' cognitive biases.<sup>16</sup>

## Impact analysis

114. A benefit of this approach is that it would not impact upon the 'sanctity of contract'.
115. A further potential benefit of this approach is that it may facilitate competition in standard form contracts due to a higher level of awareness, and in turn could lead to improved quality and increased variety of terms.<sup>17</sup> This option could create incentives for businesses to offer fairer terms (because they can be distinguished from unfair terms) and lead to a more efficient allocation of risk between parties to standard form contracts.
116. However, this option may not achieve fully the stated objectives. This is because, as outlined in the Problem section, even if all the necessary information is available (through information disclosure requirements) small businesses may not have the time

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15 For example the *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011* requires lenders to provide consumers with personalised Key Facts Sheets for home loans.

16 Florencia Marotta-Wurgler (2010) *Does Disclosure Matter?* New York University School of Law at 9.

17 Bar-Grill, O., (2012) *Seduction by Contract: Law, Economics, and Psychology in Consumer Markets*, Oxford University Press.

or expertise to process it accurately and so may disregard the information,<sup>18</sup> particularly for transactions that are individually of low value or where they are unable to negotiate with the other party if they do not wish to agree to the standard terms.

117. The costs associated with this option would be those incurred by business in complying with disclosure obligations imposed by regulation, or if industry-led, the costs of complying with industry requirements, if such a business chose to comply.

### Focus questions

27. Would information disclosure requirements impact the decision of small businesses to review standard form contracts and/or consider the terms included in standard form contracts?
28. What are the costs to business in complying with disclosure obligations relating to other types of information?

### Guidance for business and/or a list of unfair terms

118. A 'list of unfair terms' and/or guidelines on what unfair terms are or a suggested set of default rules or templates of standard form contracts for a variety of different types of transactions could be developed for business, through non-regulatory efforts by businesses and industry associations.

118.1. Alternatively, this guidance or list could be developed through government initiatives (such as ACCC and State and Territory consumer agencies) or legislation.

119. This option would be a supply-side measure, aimed at changing the behaviour of businesses preparing standard form contracts (not the small business customers being offered the contracts), which would go to alleviating any detriment to small businesses caused by the problem identified.

### Impact Analysis

120. While this option may reduce the prevalence of UCTs, it would be inflexible and would limit the ability of suppliers and customers to include terms that may be unfair in some instances, but are not unfair when applied to their particular circumstances. In general, it is not possible to determine whether a term is unfair without regard to surrounding circumstance. If legislated, such inflexible regulation would also encroach heavily on the doctrine of freedom of contract.
121. Further, any list of unfair terms could create an incentive to develop unfair terms with substantially the same effect but that are not on the list. It may also not be practicable to identify a comprehensive list of unfair terms up front, and the list would likely need to be added to over time.

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<sup>18</sup> Disclosure regulation has been criticised as ineffective due to a belief that disclosure is unlikely to affect purchasing behaviour, either because most consumers will still not read or because they will not understand terms.

122. There will also be costs to the government or regulatory bodies associated with developing and maintaining the lists or default templates.

### Focus questions

29. Would a list of unfair terms or a default template created by the government, or by industry, assist small businesses in considering whether to sign a standard form contract?
30. Would these approaches reduce the incidence of unfair terms in standard form contracts?
31. How would these approaches impact on the flexibility of businesses to include terms that may be unfair in some instances, but are not unfair when applied to their particular circumstances?

## OPTION 3 — LEGISLATIVE AMENDMENT TO EXTEND THE EXISTING UNFAIR CONTRACT TERM PROVISIONS TO SMALL BUSINESS CONTRACTS (PREFERRED OPTION)

123. This option would be a legislative amendment to the existing UCT provisions in the ACL, to provide that a term of a standard form contract offered to small business is void if it is unfair. This reflects the Commonwealth Government's policy commitment.
- 123.1. As outlined in *Background*, the ACL currently provides UCT protection for standard form consumer contracts. Broadly, consumer contracts are those for a supply of goods or services to an individual, whose acquisition of the goods or services is wholly or predominantly for personal, domestic or household use or consumption.
124. Consistent with the existing ACL provisions, this option would permit the ACCC, State and Territory consumer agencies or private parties to apply to a court for a declaration that a term of a standard form contract is unfair. Where a court has made such a declaration, then it would be a contravention for a person to apply, or rely on, that term.
125. This option may reduce the flexibility of businesses to offset the existence of UCTs with other terms such as a lower price. It may be argued that this option could reduce the flexibility for businesses to provide contracts that provide overall benefits to customers. However, this would depend on whether the benefit received from the UCT protections under this option outweighs the benefits received from other offsetting contract terms (such as price).

### Scope of legislation

126. CAANZ would value stakeholder feedback on sub-options, in terms of the types of contracts and businesses to which UCT provisions would apply, that go to the scope of this option. **Attachment A** outlines in greater detail the various implementation issues for stakeholder consideration that are summarised here.

127. An issue is how small businesses or small business transactions should be defined. Four options include extending UCT provisions to:
  - 127.1. businesses that are not publicly listed companies;
  - 127.2. transactions that are below a certain threshold;
  - 127.3. businesses that have an annual turnover below a certain threshold; or
  - 127.4. businesses that employ less than a certain number of employees.
128. Another issue is whether to extend UCT provisions to all contracts involving either supply or acquisition of goods and services by small businesses, or only contracts involving acquisition of goods and services by small businesses.
129. A further issue is whether to extend UCT provisions only to large business contracts with small businesses, or to also include small business to small business contracts.
130. A final issue is whether to extend UCT provisions to contracts for financial products and services.
131. In deciding which contracts would be included, the benefits need to be weighed against the costs. The more businesses that are captured the higher the compliance costs. The smaller the business the higher the likely benefit from UCT protections as they may be more likely to transact using standard form contracts, have a smaller capacity to review/negotiate these contracts and be less well placed to manage risks.
  - 131.1. When determining which contracts will be captured, it would be desirable that businesses seeking to contract with another business be able to identify readily whether or not the UCT provisions would apply to a particular contract.
132. CAANZ also wishes to explore which types of terms are more likely to be considered to be unfair by small business (see Problem section). Presently, the ACL provides examples of terms that courts may have regard to in order to determine whether a particular term is unfair.<sup>19</sup>
  - 132.1. For example, unfair terms could be categorised as remedial terms (terms that relate to the rights of parties in the event that certain events take place) or operative (terms that relate to the actions of parties to fulfil their obligations under the contract). It may be the case that one category may be of more concern to small business than the other.
  - 132.2. While CAANZ acknowledges focusing on those terms that are of most concern to small business (by considering complaints data and/or evidence provided as part of this consultation process) and this may provide a targeted government response, there may be a number of disadvantages of this approach.

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<sup>19</sup> Section 25 of the ACL.

- 132.3. What is an 'unfair' term is defined in the ACL UCT provisions where three requirements must be satisfied.<sup>20</sup> It could be argued, including on ethical grounds, that any term that satisfies this three limbed test, and is therefore 'unfair' should be addressed by government action.
- 132.4. Targeting specific types of terms may create a 'running list' of terms that may be considered to be deemed unfair by the courts, creating incentives for businesses to simply shift from one type of unfair term, to another term – which may also be unfair under the existing ACL UCT laws.
- 132.5. It would create a different legislative regime for businesses to comply with dependent on the contracting parties. That is, there would be different compliance requirements from the consumer UCT framework and the small business UCT framework.
133. Such provisions would seek to complement and reinforce existing industry arrangements and not displace them. Current industry arrangements largely focus on the fairness of negotiating practices rather than matters of substantive fairness relating to the actual terms in the contract. Where there are protections for unfair contract terms in existing industry arrangements such protections relate only to very narrow circumstances and do not offer effective safeguards against unfair terms more broadly. A national UCT law would reinforce these specific arrangements and provide a flexible review of contract terms across all industries and circumstances.

### Focus questions

32. Would the benefits of a targeted legislative response (such as only deeming specific unfair terms offered to small business as void) outweigh the costs of such an approach?
33. How would such an approach interact with existing regulatory protections?
34. Are particular types of terms in standard form contracts (such as unilateral contract variation, or termination rights) more likely to be considered 'unfair' by small businesses?

### Impact analysis

134. Option 3 would not seek to address the information failure issue directly, but would seek to alleviate the detrimental effects of this failure encountered by small business by seeking to decrease the existence of, and ability to use, UCTs.

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<sup>20</sup> Section 24 of the ACL.

135. Before proceeding with this option it would be important to consider whether there would be any unintended consequences. For example, it could be argued that suppliers may respond by avoiding supplying particular goods or services to small businesses (or acquired from small businesses) rather than comply with the legislative extension. Some businesses may also move to negotiated contracts for some transactions. However:

135.1. In the consumer space it appears that standard form contracts continue to be used widely, and there is no evidence to suggest that a significant number of businesses ceased to supply consumers following the introduction of the ACL UCT provisions.

135.2. In addition, it is arguable that a contract that exists today that hinges on a term that would be deemed to be unfair, and would not exist if this option was implemented, may be undesirable from a policy perspective.

### More efficient contract terms

136. If it can be assumed that legislation would reduce the use of UCTs, such a reduction may result in a more efficient allocation of risk, reducing total costs of production and raising economy-wide productivity.

137. This would also be supported by the ACCC undertaking an information campaign on the new reforms and initially taking a collaborative, compliance based approach to ensuring businesses conformed to the laws similar to the activities following the introduction of the consumer ACL UCT provisions.

137.1. In March 2013, the ACCC released an Industry Report on the initiatives of the ACCC following the introduction of the consumer UCT provisions. The report indicated that since 2011 there has been a decreased prevalence of UCTs in consumer contracts:

*The ACCC achieved significant improvements to standard form consumer contracts in a number of industries following the introduction of new protections and enforcement tools under the ACL ...*

*This process has enabled the ACCC to identify problematic contract terms and related practices in the airline, online retail, telecommunications and vehicle rental sectors; and with some prominent travel agents, online traders and businesses in the fitness industry.<sup>21</sup>*

138. If there are businesses that offer UCTs and cannot compete without such terms, such regulation may drive them out of the market as they find it more difficult to compete with businesses that offer only fair terms.<sup>22</sup> This may increase the effectiveness and efficiency of the economy as only the more efficient businesses (including risk management efficiency) survive.

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21 ACCC (2013), Unfair Contract Terms, Industry review outcomes, March 2013, 5.

22 Productivity Commission (2008), *Review of Australia's Consumer Policy Framework*.

139. This option may also reduce signalling costs and reputation costs such as branding in the market, which may lead to lower prices.

### **Reducing unfair conduct**

140. Unfairness can undermine trust and a preparedness to invest, and increase transaction costs as customers and businesses are more wary of dealing with unfamiliar counterparties, and will engage in more research and information gathering before doing so.
141. A generally fairer society and economy would lead to increased confidence in the system, and may lead consumers and businesses to engage in more transactions with unfamiliar businesses. This should increase competition and economic activity.
142. Stronger adherence to the ethical principle of fairness may also be considered a social good in its own right.

### **Costs of enforcing contracts and litigation**

143. The evidence from the introduction of UCT provisions to consumers in Victoria and the UK<sup>23</sup> suggests that such laws do not result in significant increases in litigation and difficulty in enforcing contracts.
144. Retailers have accepted some level of UCT protection in the UK grocery code and Australia's proposed Grocery Code; and it has been judged that the benefits of these codes outweigh any associated implementation costs.

### **Compliance costs for business**

145. Prior to the implementation of the ACL, the Productivity Commission noted that there was little evidence in Victoria or in the countries that have enacted laws against UCTs, of significant business compliance costs or adverse unintended commercial consequences.<sup>24</sup>
146. Furthermore, similar to when the consumer UCT protections were implemented, the ACCC would embark on an information campaign to inform businesses of the new protections and expectations of businesses as they transition to the new laws helping reduce compliance costs.

### **How many businesses would incur costs?**

147. There are approximately 2.14 million Australian businesses. Under this option compliance costs would be incurred predominantly by the subset of businesses that currently offer standard form contracts, including to small businesses, that include unfair terms, and which have not already ensured that their contracts comply with UCT requirements.

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23 Productivity Commission (2008), *Review of Australia's Consumer Policy Framework* vol 1, 34.

24 Ibid.

148. At least before the introduction of the ACL and the national UCT regime, it is highly probable that businesses who offered standard form contracts would offer them to both individuals and businesses alike. Today, with the existing UCT protection for consumer contracts, it is not known the extent to which businesses that offer standard form contracts discriminate between different prospective contracting parties.

148.1. A study conducted in the United States in 2007 found that businesses do not vary their contracts to discriminate between businesses and consumers.<sup>25</sup>

149. The extent businesses would incur costs will depend on how many business-to-business contracts are captured by the provisions (*see Attachment A* for a further discussion of the different options). The more businesses that are captured by the reforms, the higher the compliance costs.

### **What costs, and how much would be incurred by these businesses?**

150. The transition costs incurred by business from this option would include:

150.1. familiarisation costs (businesses educating themselves of the new law);

150.2. the costs of ensuring terms are compliant and revising terms (if necessary); and

150.3. the costs associated with change in business processes if contracts are amended.

### **Familiarisation costs**

151. It would be anticipated that all businesses (2.14 million) would incur familiarisation costs from the legislative change, but these costs would be relatively small given the option would extend the existing ACL laws, not create a new prohibition or framework.

152. As with the consumer UCT provisions, the ACCC would undertake an information campaign to inform businesses of the changes and provide detailed guidance material.

### **Costs of revising terms or ensuring terms are compliant**

153. Some businesses may incur costs to ensure terms are compliant with the legislation. This impact can be assessed in two ways; costs of reviewing terms and the costs of changing terms.

154. It is noted that, consistent with the existing consumer UCT provisions, this legislative option would make UCTs void. It would not prohibit the existence of UCTs outright. As a consequence, some businesses may decide (risk assessment) not to review terms, or alter existing contracts, given the legislation would not penalise a business for mere inclusion of the term. Penalties may only apply if that business sought to rely on an unfair term.

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25 Marotta-Wurgler, F., (2007), 'What's in a Standard Form Contract? An Empirical Analysis of Software Licence Agreements', *Journal of Empirical Legal Studies*, 4(4): 677-713.

155. Businesses that review terms and determine that existing contracts are compliant will incur fewer costs than those businesses which determine that contracts are required to be amended.
- 155.1. A 2013 UK survey conducted regarding consumer rights legislation indicated that there was a significant difference between the cost to business of reviewing contract terms and the combined cost of reviewing and changing.<sup>26</sup>
156. The cost incurred by each individual business of reviewing and changing terms will be dependent on a number of factors:
- 156.1. the size of the business;<sup>27</sup> and
- 156.2. how often contracts are changed.<sup>28</sup>
157. While the ACCC will provide general guidance to those subject to the new provisions, it will develop more detailed guidance for those sectors where small business concerns about unfair contract terms are most prevalent. This is consistent with the ACCC's approach to the introduction of the consumer ACL UCT provisions in which it worked with businesses to remove or change unfair terms in standard form contracts and address identified issues, rather than moving immediately to an enforcement approach.
158. The ACCC indicated that overall, there was a good level of cooperation from businesses during the consumer UCT review phase, leading to substantial changes in some standard form contracts. Many businesses chose to delete or amend problematic terms. The ACCC has also indicated that these changes also led to some broader improvements to the general business practices in these sectors.<sup>29</sup>

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26 Consumer Rights Bill: Proposals on Unfair Contract Terms Impact Assessment: Final (June 2013), 17.

27 Based on survey responses, the UK Department for Business Innovation and Skills has estimated that the average annual cost of changing terms and conditions is £83 for micro businesses and £331 for larger businesses. See Consumer Rights Bill: Proposals on Unfair Contract Terms Impact Assessment: Final (June 2013).

28 Based on survey responses, the UK Department for Business Innovation and Skills has estimated that 26 per cent of businesses change their terms and conditions at least yearly, 30 per cent changing terms and conditions every 1 to 2 years, 30 per cent only change terms and conditions less often or on an ad hoc basis, and 14 per cent do not change terms and conditions.

29 ACCC (2013), Unfair Contract Terms, Industry review outcomes, March 2013.

### **Case study — Implementation of the Australian Consumer Law’s Unfair Contract Term provisions: Terms that allow the business to change the contract without consent from the consumer**

In the industries reviewed, the ACCC found this issue most prominently in telecommunications standard form contracts. Of 11 telecommunications standard form contracts reviewed, six included terms that purported to allow the businesses to vary the contract unilaterally.

TPG’s standard form consumer contract included a term enabling it to vary the subscription fees charged to consumers for a service, without providing notice. The term was worded as follows:

*You must pay all subscription fees applicable to the plan for which you have registered. You understand that all fees and charges may be altered from time to time by us without notice; however, we will not increase the subscription fee for your plan until the end of the Minimum Contract Term.*

This term was problematic because it had the effect of permitting TPG to change subscription fees payable under the contract during the life of the agreement, without notice to the consumer or adequate balancing provisions being included.

Following direct engagement with the ACCC as part of these reviews, TPG agreed to delete the section of the term allowing for unilateral variation of subscription charges. The amended term now reads:

*You must pay all subscription fees applicable to the plan for which you have registered. Failure to pay subscription or usage charges will result in the suspension or termination of your service.*

### **Costs associated with change in business processes (if contracts are amended)**

159. If contracts are amended in response to the legislation, costs arising from the following may also be incurred by business (the amount of which is likely to vary significantly from business to business):

159.1. modifying processes and systems;

159.2. modifying business rules and operating practices; and

159.3. modifying staff education and training.

160. Depending on the scope of the legislation, small businesses themselves may incur compliance costs if the standard form contracts they offer to other businesses are captured under the extension.

### **Administrative costs for government**

161. Such an approach would utilise the existing implementation and enforcement architecture around the UCT law regarding consumer contracts, lessening the one-off set up costs and some of the ongoing costs incurred by government as a result of implementation. ACCC guidance for small businesses could be based on consumer UCT experiences, helping to decrease the cost.

162. The ongoing administrative burden will also depend on the design of legislation (Attachment A) and how many transactions are captured.
163. Policing of UCTs requires regulatory resources, including time used in the court system.
164. It is difficult to estimate the costs of any litigation since the intent of the option is to decrease any detriment incurred by small business from the use (and existence) of UCTs *from the outset* and the *threat* of legal action when UCTs are used against small businesses.
165. It is noted that in terms of the existing UCT laws, at the early stages, the ACCC primarily targeted efforts towards a compliance regime, with businesses reviewing terms with the assistance of the ACCC. Given the laws have now been in place for some time, the ACCC is now moving from a compliance to an enforcement response to resolve any outstanding issues.<sup>30</sup>

### Unfair terms found in a consumer internet services contract

In July 2013, the ACCC successfully litigated its first UCT matter under the ACL – *Australian Competition and Consumer Commission v Bytecard Pty Ltd*. In this matter, the Federal Court declared (by consent) that a number of terms in an internet services contract were unfair.

Under the now void terms, used between 1 January 2011 to April 2013, NetSpeed (Bytecard) was able to:

- unilaterally vary the amount payable under its contracts without prior notice, however, it did not have to allow consumers to terminate to avoid the obligation to pay the varied amount or an opportunity to negotiate;
- require the consumer to insure NetSpeed in any circumstances (including where the consumer was not in breach of the contract and any loss may have been caused by NetSpeed's breach and even deliberate misconduct) yet there was no corresponding term applicable to NetSpeed; and
- terminate its contracts at any time without cause, while the consumer's right to terminate was subject to conditions.

### Quantification

166. Just as it is difficult to quantify the extent of the problem or the detriment caused by UCTs, it is difficult to quantify the net benefits and costs of this option.

166.1. The 2008 Productivity Commission Review noted, there are also significant problems in quantifying the net benefits of prohibitions against false, misleading, deceptive or unconscionable conduct, yet these prohibitions are now widely acceptable as being in the public interest.<sup>31</sup>

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<sup>30</sup> Ibid.

<sup>31</sup> Productivity Commission (2008), *Review of Australia's Consumer Policy Framework*, 431.

167. CAANZ considers that if the costs associated with the introduction of a law against UCTs in small business contracts are likely to be low (given for example, the number of standard form contracts that would be required to be changed), then the indeterminacy of benefits associated with the introduction of a new law is less likely to be a major concern.<sup>32</sup> Furthermore, as the 2008 Productivity Commission Review noted there were sound in-principle rationales for proscribing UCTs that cause consumer detriment that go beyond a simple cost / benefit analysis. Such rationales were that given consumers may not read contracts inefficient risk bearing can result by businesses and consumers, and that fairness in contracts is a valued ethical principle.
168. Consultation will assist to provide a high-level quantification of potential costs for business under this option.

### Focus questions

35. Does this option reduce flexibility for businesses to provide contracts which provide overall benefits to consumers? Would some businesses move to negotiated contracts?
36. Are there any unintended consequences that could arise from this option?
37. If businesses were unable to include UCTs in their agreements, would small businesses be able to better compare the value of competing offers to supply/acquire?
38. To what extent will contracts be reviewed if these new laws were implemented?
39. For businesses who offered standard form contracts to consumers prior to the introduction of the ACL, what was the estimated compliance cost from adapting to the ACL UCT laws?

## OPTION 4 — LEGISLATION TO REQUIRE STANDARD FORM CONTRACTS WITH SMALL BUSINESSES TO BE NEGOTIATED ON REQUEST

169. This option would involve legislation to require businesses to negotiate, on request, the terms of all standard form contracts they offer to small businesses.

### Impact analysis

170. Under this option, if a small business is able to request that a standard form contract be negotiated, when they identify a UCT they would be able to negotiate with the party offering the contract to modify/eliminate this term. The contract would no longer be a 'standard form contract' (as it is no longer offered on a 'take it or leave it' basis) and would become a negotiated contract.
171. However, this may still not solve the information failure issues associated with standard form contracts as the small business would still need to identify that there is a UCT in the first instance, and be willing to incur the cost of renegotiating the contract, which may be significant, particularly for low value contracts. In addition, the ability to require negotiation – with no actual protections from unfair terms – may be of little value because small businesses that are vulnerable to unfair contract terms are more

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32 Ibid.

likely to lack bargaining power and therefore be unable to negotiate changes to unfair terms.

172. If the small business does not have time and technical or legal resources to adequately review the contract they may not identify the UCT, which if enacted could still unfairly shift risk onto the small business that is not well placed to manage this risk. In these circumstances the small business would also not be able to seek redress through the legal system.
173. The costs of requiring contracts to be negotiated on request would:
  - 173.1. preclude the significant efficiency benefits that standard form contracts deliver – it would be costly and impractical for all businesses to negotiate contracts in some circumstances, particularly for transactions that are individually of low value and repeated with a large number of parties; and
  - 173.2. be prohibitively expensive and impractical to enforce.
174. Given that this option would still not address the information failure and bargaining power issues around standard form contracts and UCTs and the substantial additional transaction costs associated with this option, it is not considered further.

#### **Focus question**

40. Are there other options not considered in this paper that would effectively address the problem?

# CONSULTATION

## Overview

CAANZ aims to use methods to receive submissions and feedback from the public that are user friendly and effective. CAANZ will also seek to engage groups who may have difficulty in communicating with the government for a variety of reasons such as isolation and language barriers.

Outlined below is a consultation strategy based on consultation principles recommended by the Office of Best Practice Regulation (OBPR). It is designed to ensure maximum input is received from the small and large business communities, and other interested stakeholders.

## CONTINUITY

175. The consultation process will begin in conjunction with the release of this paper over a 10-week period.
176. It is early in the policy development process and various options will be explored to address the problem. Once this process is concluded, further targeted consultation may be necessary to clarify any issues or questions that arise from the initial consultation period. If legislation is subsequently prepared, further targeted consultation with key stakeholders may take place on draft legislation.

## TARGETING

177. Given the wide ranging implications of any regulation in this area, a multi-faceted approach is proposed.
178. This Consultation Paper has been released on the Australian Consumer Law website – [www.consumerlaw.gov.au](http://www.consumerlaw.gov.au) and the consultations page of the Australian Treasury website-[www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Small-Business-and-Unfair-Contract-Terms](http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Small-Business-and-Unfair-Contract-Terms).
179. Individuals are able to lodge questions via the ‘make a comment’ facility on the Australian Treasury website or via email to [AustralianConsumerLaw@treasury.gov.au](mailto:AustralianConsumerLaw@treasury.gov.au), which will be responded to in a timely fashion. If submitters wish to provide a submission via mail, they may do so through the Australian Treasury address outlined in the ‘Providing your feedback’ section of this Paper.
180. In addition to this Consultation Paper, CAANZ has prepared a short fact sheet on some of the key issues raised by the proposed extension of unfair contract protections to small business.
181. An online survey, has been released on [www.consumerlaw.gov.au](http://www.consumerlaw.gov.au). This aims to capture as many responses as possible and provides another way for stakeholders to provide feedback. Those who provide written submissions are also welcome to participate in the survey.

182. Business.gov.au is also promoting the release of the survey and the Consultation Paper. It has a wide reaching social media presence on Twitter and Facebook. Additionally, it manages the business consultation portal which informs registered businesses when the Government proposes policy changes.
183. CAANZ will hold a number of targeted meetings with stakeholders who would be impacted by the introduction of unfair contract protections for small business.

## APPROPRIATE TIMELINES

184. The initial consultation period will run for 10 weeks to facilitate comprehensive consultation with businesses.

## ACCESSIBILITY

185. CAANZ intends to reach a broad cross-section of stakeholders. It will be important to assess the impact of unfair contracts on those in regional areas. Approximately 35 per cent of small businesses are based in regional areas. Treasury has developed a list of small business stakeholders in regional areas who will be provided with the details of the consultation process.
186. CAANZ will ensure Indigenous stakeholder groups are particularly consulted through this consultation process.
187. Nearly 30 per cent of small business owners in Australia have culturally and linguistically diverse backgrounds.
- 187.1. In 2013 the Retail Food Group, which owns a number of franchises, estimated that 'more than 50 per cent of its successful franchise applicants over the last six months spoke English as a second language'.<sup>33</sup> The Treasury has also developed a list of contacts which will be used to disseminate information.
188. As outlined above under Targeting, various stakeholder groups will be contacted via different channels to ensure the communication method is most appropriate and convenient for them.

## TRANSPARENCY

189. CAANZ will work to ensure there is sufficient time for feedback on the options outlined in this Consultation Paper.
190. Once the initial consultation process has concluded, a final or decision-making RIS will be produced to discuss the results of the consultation process, the evidence that has been gathered and how the conclusion is reached. Both the Consultation Paper and the decision-making RIS will be published on OBPR's website.

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33 Smartcompany (2013), *How well do you need to speak English to run a business in Australia*, available at: [www.smartcompany.com.au/growth/franchising/30220-how-well-do-you-need-to-speak-english-to-run-a-business-in-australia-franchise-report.html](http://www.smartcompany.com.au/growth/franchising/30220-how-well-do-you-need-to-speak-english-to-run-a-business-in-australia-franchise-report.html).

191. All submissions to the consultation process will be published on the Australian Treasury website, unless authors have indicated that they would like all or part of their submission to remain in confidence.

## **CONSISTENCY AND FLEXIBILITY**

192. CAANZ has consistently designed the consultation procedures in line with OBPR consultation principles and has ensured that there is flexibility to maximise stakeholder participation in the consultation process.

- 192.1. Stakeholders can participate in the consultation through a number of means, including: a feedback form, an online survey, formal submission and targeted meetings.

## **EVALUATION AND REVIEW**

193. Once the initial consultation period has concluded, outcomes of the stakeholder consultation will be conveyed by CAANZ to Consumer Affairs Ministers through the Legislative and Governance Forum on Consumer Affairs (CAF). Feedback from stakeholder consultation will inform the final, decision-making RIS.
194. Specific questions are likely to arise from the Consultation Paper which may not have been considered at the time of drafting. CAANZ may conduct further targeted consultation with key stakeholders, if necessary.



## CONCLUSION

195. Customers, including small businesses, may not always adequately review standard form contracts before agreeing to them and, where they do, may not have the power to negotiate terms. Businesses, knowing this, may include unfair terms that shift all or most of the risk in the transaction onto the customer. UCTs in standard form consumer contracts are rendered void by the ACL.
196. In many circumstances, small businesses may act in a similar fashion to consumers when engaging in contracts with other businesses. Small businesses may encounter the same lack of scope for negotiation, may have a lack of time and access to technical or legal advice and may have difficulty managing risks.
197. The economic case for intervening rests on the range of costs associated with unfair contract terms in standard form contracts. They may lead to a higher social cost of managing the risk of adverse events, particularly where the party drafting the contract can influence their likelihood or cost, or can diversify the risk across a pool of customers. Small businesses seeking to avoid UCTs may incur additional costs in analysing contracts, either internally or through fees for legal services. The presence of UCTs may also reduce small business confidence in contracting and violate the ethical norm of fairness.
198. The policy objective is to help to provide a level playing field for small business customers when interacting with other businesses through standard form contracts. This will enhance the welfare of Australians by increasing small business certainty and confidence.
199. This paper has outlined a number of options, both legislative and non-legislative, that could be pursued in order to achieve the stated objectives. The options explored either seek to address the problem itself, that is the information failure and lack of bargaining power, or they seek to alleviate the detrimental effects of the market failure for small business. At present there is limited empirical evidence to illustrate the problem in question, and the benefits and costs of any options to address the problem are difficult to measure in practice.
200. Option 1 describes no new government action, where small businesses would continue to rely on existing laws and market forces to provide protection from UCTs and associated conduct by businesses. This is inconsistent with the Commonwealth Government's policy commitment.
201. A number of forms of redress exist for small business, at least in some contexts, where businesses seek to enforce UCTs, including other legislation, whether of general or specific application. However, there are features of the different types of redress which limit their application to UCTs encountered by small business. The result of Option 1 would be a less efficient allocation of risk across parties to contracts and a higher cost of doing business for small businesses.
202. Option 2 outlines that light touch or non-regulatory options could be taken such as industry-led initiatives to curtail the use of UCTs, improve small business awareness

and information campaigns, information disclosure requirements and the development of guidance material for businesses.

203. It is considered that as self-regulatory or co-regulatory initiatives are developed at the level of individual industries, they are likely to vary significantly and therefore may not be appropriate to wholly address the problem at hand. Furthermore, although increasing awareness and information campaigns could be cost effective and may address the problem to a limited extent; this is unlikely to be an adequate solution by itself. In particular, it may not lead to businesses providing only fair terms and it would not provide appropriate remedies to small businesses who suffer detriment as a result of a UCT.
204. Option 3 (the preferred option) outlines that the existing UCT provisions in the ACL could be extended to protect small business from UCTs. This is the Commonwealth Government's policy commitment. Attachment A also discusses the possible scope of such a legislative extension.
205. Just as the introduction of the UCT regime for consumer contracts has reduced the existence of UCTs in the marketplace,<sup>34</sup> a reduction of UCTs offered to small businesses would result in fairer contract terms and a more appropriate distribution of risk, which should increase the overall efficiency of the economy.
206. While it is hard to estimate accurately the costs of extending the UCT regime to small business, experiences in Victoria (prior to the ACL) and abroad suggest implementation of UCT laws has not significantly increased compliance costs or resulted in unintended consequences for business.
207. Option 4 proposes legislation requiring that business be willing to negotiate terms in all contracts. Given the substantial costs associated with this option, it is not considered further.
208. Further evidence on the likely impact of these options is required to conduct an informed evaluation of the options and to determine which approach should be pursued. Each option presents benefits and costs that may be experienced differently by different stakeholders.
209. CAANZ invites stakeholders to provide further evidence and information on the problem outlined, and the benefits and costs of each option. This evidence (in addition to the evidence gathered through the survey and meetings with stakeholders) will be used to inform the final decision-making Regulation Impact Statement for consideration by Consumer Affairs Ministers.

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34 See ACCC (2013), *Unfair Contract Terms, Industry review outcomes*, March 2013.

# BACKGROUND

## SMALL BUSINESS

210. Small business is a disparate group. Small businesses can take on all legal forms, straddle all industry sectors, buy and sell in markets of varying degrees of concentration and range in size from micro businesses working from home to businesses verging on becoming large enterprises. They are made up of people from diverse backgrounds. This includes non-English speaking groups, people from regional areas, Indigenous Australians, stay-at-home mothers and young entrepreneurs (to name a few).
211. Typically, the main features of small businesses are that:
- 211.1. revenue is generally lower than businesses that operate on a larger scale;
  - 211.2. they have fewer employees than businesses that operate on larger scales;
  - 211.3. they are organised to provide a greater degree of managerial control for owners (such as sole proprietorships, partnerships or limited liability companies); and
  - 211.4. they typically operate in a limited geographic area and are not likely to operate in multiple locations.
212. There are many definitions applied to small business in Australia. For example the Australian Bureau of Statistics (ABS) defines a small business as having 0-19 employees. The ABS defines a micro business as having 0-4 employees.
213. Businesses with less than 20 employees make up over 95 per cent of businesses in Australia according to the most recent publication on key small business statistics by the Department of Industry.<sup>35</sup> Of these, approximately 84 per cent are in the services sector.
214. Another common definition for small business is 'an entity that operates a business with an aggregated turnover of less than \$2 million'. This is the definition used by the Australian Taxation Office.
215. Over 45 per cent of private sector employees in the Australian economy are employed in the small business sector, with small business making up 34 per cent of the private sector's contribution to Australia's gross domestic product.<sup>36</sup>
216. Although the majority of small business is in the services sector, they make up the majority of business in all sectors measured by the ABS. Their share as a proportion of the market in the agriculture, construction, transport, postal and warehousing, financial and insurance services and rental, hiring and real estate services sectors is well above

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35 Department of Industry (2012), *Australian Small Business Key Statistics and Analysis*, available at: [www.innovation.gov.au/smallbusiness/keyfacts/Documents/AustralianSmallBusinessKeyStatisticsAndAnalysis.pdf](http://www.innovation.gov.au/smallbusiness/keyfacts/Documents/AustralianSmallBusinessKeyStatisticsAndAnalysis.pdf).

36 The definition of small business for this statistic is a business with 0-19 employees.

95 per cent. Their share as a proportion of the market in the accommodation and food sector is still above 80 per cent.

## THE 2008 PRODUCTIVITY COMMISSION RECOMMENDATION

217. The Productivity Commission, in its *2008 Review of Australia's Consumer Policy Framework*, recommended that a new generic, national consumer law should apply in all sectors of the economy.
218. The Productivity Commission recommended on balance, that this generic law include national UCT laws.
- 218.1. The Productivity Commission recognised that there were sound in-principle rationales for proscribing UCTs that cause consumer detriment. Such rationales were that fairness in contracts is a valued ethical principle; and given consumers may not read contracts, inefficient risk bearing can result by businesses and consumers.
- 218.2. The Productivity Commission considered that a clear, nationally consistent approach would also provide some benefits and that there was a lack of clarity about how the unconscionability provisions applied to contractual terms.
- 218.3. It was acknowledged, however, that these reasons alone were not a sufficient reason for proactive intervention and it was hard to accurately estimate the benefits and costs of introducing UCT laws.
219. The Productivity Commission broadly defined 'unfair contract terms' as terms 'that disadvantage consumers, but ... are not reasonably necessary for the protection of the legitimate interests of suppliers'. The scope of what was meant by 'consumer' was not explicitly discussed.
220. The Productivity Commission's UCT recommendation was made notwithstanding that consumer provisions in the *Trade Practices Act 1974* included protection from unconscionable conduct.

## AGREEMENT BY CONSUMER AFFAIRS MINISTERS TO IMPLEMENT A NATIONAL UNFAIR CONTRACTS LAW

221. On 2 October 2008, COAG agreed to establish a national law addressing unfair contract terms, as proposed by the Ministerial Council on Consumer Affairs (MCCA)<sup>37</sup> on 15 August 2008. The MCCA model adopted many recommended features of the UCT law outlined by the Productivity Commission in its Review.
222. This MCCA model, which COAG ultimately agreed, did not outline the scope, or provide an outline of the definition of 'consumer' for the purpose of the proposed UCT protections.

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<sup>37</sup> MCCA is now CAF.

## The existing legislative provisions

223. The Productivity Commission's UCT recommendation was largely implemented as laws of the Commonwealth, Victoria and New South Wales on 1 July 2010 and then extended to apply in all other States and Territories on 1 January 2011.
224. While the 2009 exposure draft legislation was expressed as capable of applying to business-to-business contracts, the final form of the UCT provisions, which are in place today, are expressed to apply to all businesses which use standard form contracts in their dealings with *consumers*.
225. A 'consumer contract' is defined for this purpose as a contract for a supply of goods or services or sale or grant of an interest in land '*to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption*'.<sup>38</sup>
226. In broad terms, a standard form contract will typically be one that has been prepared by one party to the contract (most commonly the supplier) and is not subject to negotiation between the parties. Ultimately, this is a matter for the court to determine.<sup>39</sup>
227. A term is 'unfair' if it:
- 227.1. would cause a significant imbalance in the parties' rights and obligations;
  - 227.2. is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
  - 227.3. would cause detriment (financial or otherwise) to a party if relied upon.<sup>40</sup>
228. In determining whether a term is unfair, the court is required to take into account:
- 228.1. the extent to which the contract is transparent – that is, if the term is expressed in reasonably plain language, legible and presented clearly and readily to the party affected by it; and
  - 228.2. the contract as a whole.<sup>41</sup>
229. There are a number of exceptions to the application of the UCT provisions. For example, the provisions do not apply to terms that:
- 229.1. define the main subject matter of the contract; or
  - 229.2. set the upfront price payable under the contract.<sup>42</sup>

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38 Section 23 of the ACL.

39 Section 27 of the ACL.

40 Section 24 of the ACL.

41 Section 24 of the ACL.

42 Section 26 of the ACL.

230. The UCT laws apply to most financial products and financial services purchased by consumers through the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

### Enforcement

231. Enforcement of the UCT provisions is shared between the ACCC, ASIC and the State and Territory consumer protection agencies. Individual consumers can also seek to enforce their rights under the law.

232. The role of the courts is to determine whether a term in a standard form consumer contract is unfair and to make orders which remedy any breach of the UCT provisions. It is not the role of any regulator to endorse contract terms or to state categorically that they are unfair.

233. If a court finds a contract term to be unfair, it can make orders such as: an order declaring all or part of the contract to be void; an order varying a contract or arrangement as the court sees fit; or an order directing the respondent to repair or provide parts for a product provided under a contract at their expense. Civil pecuniary penalties are not available in the event that a court declares a term unfair and void.

234. Just because a contract contains an unfair term, does not automatically mean the whole contract is void. A contract containing a void term will be valid unless it cannot operate without the unfair term.<sup>43</sup>

## EXISTING SMALL BUSINESS PROTECTION UNDER THE COMPETITION AND CONSUMER ACT 2010

235. Small businesses have a dual role in Australia's competition and consumer policy framework as both consumers and suppliers of goods and services.

236. The ACL provides both:

236.1. general protections, which create standards of business conduct; and

236.2. specific protections, which address identified forms of business conduct (provisions dealing with consumer transactions and the safety of consumer goods).

237. There are three general protections within the ACL. Two of these protections regulate procedural unfairness in business dealings – misleading and deceptive conduct and unconscionable conduct, while the third regulates substantive unfairness through the unfair contract term provisions.

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<sup>43</sup> Section 23 of the ACL.

**Substantive unfairness** is concerned with the outcome or result of a contract or agreement. The unfairness is not a consequence of the circumstances surrounding or the process leading up to the formation of the contract. Rather, the unfairness results from the actual wording of the contract term.

**Procedural unfairness** is concerned with the circumstances surrounding or the process leading up to the formation of a contract. It is those circumstances that can result in unconscionable conduct. Procedural fairness is also an important concept in relation to unjust contracts.

## Unconscionable conduct

238. The ACL prohibits unconscionable conduct. It states that a person must not, in trade or commerce, in connection with the supply or possible supply of goods or services of a kind to a person (other than a publicly listed company) engage in conduct that is, in all the circumstances unconscionable.<sup>44</sup>
239. The unconscionable conduct provisions provide some protection to small business as it is not limited to conduct in connection with the supply of goods and services of a kind ordinarily acquired for personal, domestic or household use or consumption as it is not subject to the 'consumer contract' definition.
240. A court will determine on a case-by-case basis what is unconscionable. However, the court may take into account a number of matters to determine whether or not there has been a breach of this section. This includes:
- 240.1. the relative strength of the bargaining positions between the parties;
  - 240.2. the extent to which the supplier was willing to negotiate the terms and conditions of any contract with the customer;
  - 240.3. the terms and conditions of the contract;
  - 240.4. whether, as a result of conduct engaged in by the business, the customer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier;
  - 240.5. whether the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the customer for the supply of goods or services; and
  - 240.6. the extent to which the supplier and the customer acted in good faith.<sup>45</sup>
241. The ability for the unconscionable conduct provisions to deal with particular UCTs is often questioned. Generally, courts have not found contract terms, by themselves, to be unfair ('substantive' unconscionability) and rather have taken into account the surrounding circumstances ('procedural' unconscionability).

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<sup>44</sup> Section 21 of the ACL.

<sup>45</sup> Section 22 of the ACL.

242. The ACL clarifies that the prohibition on unconscionable conduct<sup>46</sup> is not intended to be limited to equitable or common law doctrines of unconscionable conduct, and that the court can examine the terms and the manner and extent to which a contract is carried out. However, this is yet to be tested in court.
243. The protections do not apply to publicly listed companies.
244. Relief from unconscionable conduct is also available under the equitable doctrine of unconscionable conduct.<sup>47</sup>

### False, misleading and deceptive conduct

245. Under the ACL, a person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.<sup>48</sup> There is also a prohibition on making certain kinds of false or misleading representations with respect to goods or services.
246. These protections apply to benefit both individuals and business. However, a contract term can be unfair without necessarily being misleading or deceptive.

### Consumer guarantees

247. Suppliers of goods and services must adhere to the specified consumer guarantees in the ACL, which cannot be excluded, modified or limited by contract. They provide a minimum acceptable standard for terms in consumer contracts.
- 247.1. In relation to goods, the guarantees include that the goods supplied are of acceptable quality,<sup>49</sup> goods supplied by description correspond with the description<sup>50</sup> and that goods are reasonably fit for the purpose represented by the supplier or disclosed by the consumer (whether expressly or by implication).<sup>51</sup>
- 247.2. In relation to services, the guarantees include that the services will be rendered with due care and skill,<sup>52</sup> within a reasonable time.<sup>53</sup>
248. In relation to the scope of the consumer guarantee protection, the provisions apply to 'consumer transactions' and by doing so, adopt the definition of 'consumer' provided in section 3 of the ACL.
- 248.1. The definition of 'consumer' in section 3 of the ACL captures transactions involving acquisition of goods that would ordinarily be acquired for personal, domestic, or household use or consumption and are not acquired for the purpose of re-supply, as well as all transactions under \$40,000.

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46 And the equivalent ASIC Act provision, section 22CB.

47 Equity may grant relief for unconscionable conduct where one party is in a position of special disadvantage and the other party knows or ought to know of that special disadvantage and takes unfair advantage of his or her position. See *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 462 and 474.

48 Section 18 of the ACL.

49 Other than by auction. Section 54(1) of the ACL.

50 Other than by auction. Section 56 of the ACL.

51 Section 55(1) of the ACL.

52 Section 60 of the ACL.

53 Section 62 of the ACL.

249. Given this definition, small businesses are protected under the consumer guarantee provisions for transactions under \$40,000, unless they are purchasing goods for resale.
250. However, the guarantees do not apply to all transactions under \$40,000, given that the consumer guarantee provisions do not apply to:
- 250.1. contracts of insurance; or
  - 250.2. contracts for the transportation or storage of goods for the business, trade, profession or occupation of the person for whom the goods are transported or stored.
251. Consumer guarantees primarily apply to core terms regarding the nature and quality of the product or service, rather than other terms relating to issues such as dispute resolution or lock-in.

### Misuse of market power

252. The CCA prohibits a corporation with a substantial degree of market power from taking advantage of that power for a proscribed anti-competitive purpose.<sup>54</sup>
- 252.1. The proscribed purposes listed in the CCA include eliminating or substantially damaging a competitor, preventing entry of a person in a market, and deterring or preventing a person from engaging in competitive conduct in a market.
253. The objective of the misuse of market power prohibition is not to protect individual competitors. The purpose of the provision 'is to distinguish between vigorous competitive activity, which is desirable, and economically inefficient, monopolistic practices, which are undesirable'.<sup>55</sup>

### Codes of conduct

254. A code of conduct is a set of guidelines that outline an acceptable standard of behaviour. They are designed to supplement primary legislation (such as the CCA) to achieve minimum standards of conduct in an industry where there is an identifiable problem to address.
255. There are numerous codes of conduct that seek to establish appropriate behaviour between participants in particular sectors or industry. Administration and enforcement of codes may be bestowed on an industry body or by a government authority (if underpinned by regulation).
256. It is not possible to provide a comprehensive list of industry codes that may provide some protection to small business in relation to contractual terms.

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<sup>54</sup> Section 46, Part IV of the *Competition and Consumer Act 2010*.

<sup>55</sup> Commonwealth of Australia (1993), *National Competition Review*, August 1993, available at: [www.australiancompetitionlaw.org/reports/1993hilmer.html](http://www.australiancompetitionlaw.org/reports/1993hilmer.html).

- 256.1. Examples of codes not underpinned by government regulation include the Wine Industry Code of Conduct,<sup>56</sup> and the Code of Banking Practice.<sup>57</sup>
- 256.2. The Code of Banking Practice establishes the banking industry's key commitments and obligations to individual or small business (less than 20 full time employees, or less than 100 full time employees if the business is or includes the manufacture of goods) actual or prospective customers involved in retail banking transactions.
- 256.3. An example of an industry code that is underpinned by regulation is the Telecommunications Consumer Protection Code (TCP Code).
- 256.4. The TCP Code is a code for the telecommunications industry in Australia. The TCP Code, enforced by the Australian Communications and Media Authority (ACMA) provides safeguards to customers in the areas of sales, service and contracts, billing and complaint handling.
- 256.5. Under the TCP Code a supplier must not 'include terms which would be unfair in its standard form customer contracts under the law'.<sup>58</sup> A 'customer' can be a business or non-profit organisation which acquires products that are not for resale, which does not have a reasonable opportunity to negotiate the terms of a contract, and will have an annual spend of less than \$20,000 with the provider.<sup>59</sup>
- 256.6. The TCP Code applies to all carriage service providers (whether they offer fixed, mobile or internet services) that provide services to residential or small business customers.
- 256.7. Small businesses therefore receive some protection from UCTs in relation to telecommunications contracts.

### Codes of conduct under the *Competition and Consumer Act 2010*

257. Codes of conduct can be prescribed under the CCA and are enforced by the ACCC.
258. There are currently four mandatory industry codes under the CCA – the Franchising Code, the Unit Pricing Code, the Horticulture Code and the Oilcode. Except for the Unit Pricing Code, all seek to establish acceptable behaviours between participants within those sectors. Some aspects of the codes seek to address procedural fairness concerns in that sector.
259. The Oilcode regulates the conduct of suppliers, distributors and retailers in the petroleum retail industry in Australia. Among other things, the code requires any changes to terms and conditions of a proposed renewed fuel re-selling agreement to be

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56 Australian Wine Industry Code of Conduct, available at: [www.wineindustrycode.org/](http://www.wineindustrycode.org/).

57 Australian Bankers' Association (2013), *Code of Banking Practice 2013*, available at: [www.bankers.asn.au/Industry-Standards/ABAs-Code-of-Banking-Practice/Code-of-Banking-Practice-2013--Online-Version](http://www.bankers.asn.au/Industry-Standards/ABAs-Code-of-Banking-Practice/Code-of-Banking-Practice-2013--Online-Version).

58 Clause 4.5.3. Unfair has the same meaning as the ACL.

59 Clause 2.1.

made in good faith. That is, it seeks to minimise or eliminate procedural unfairness relating to contract formation between industry participants.

260. The Horticulture Code deals with trade between growers and traders to improve clarity and transparency of transactions between growers and wholesalers of fresh fruit and vegetables.
261. The Franchising Code contains a number of protection and disclosure requirements, including for example:
  - 261.1. a statutory cooling off period of seven days for franchisees when they first enter into a franchise agreement;
  - 261.2. a requirement that a franchise agreement must not contain, or require a franchisee to sign, a general release of the franchisor from liability towards the franchisee;
  - 261.3. a franchisor must not unreasonably withhold consent to the transfer or novation of a franchise agreement;
  - 261.4. a requirement for six months' notice of the franchisor's decision to renew or not review a franchise agreement at the end of the term of the franchise agreement; and
  - 261.5. a number of disclosure requirements, covering behaviours which could possibly be considered unfair in certain contexts, including: unilateral contract variation; onerous confidentiality obligations; end of term arrangements; changes to a franchise agreement upon sale; attribution of legal costs; and unforeseen capital expenditure requirements.
262. The Commonwealth Government is currently in the process of introducing reforms to the Franchising Code to strengthen its effectiveness and improve its responsiveness to the sector's unique commercial characteristics and tensions.
  - 262.1. This includes: introducing a general duty on franchisors and franchisees to act in good faith during their dealings with each other; providing extra protections to franchisees against unfair practices – such as franchisors imposing significant capital expenditure or unreasonable restraint of trade clauses; requiring additional disclosure on the franchisor's management of marketing funds; and introducing civil pecuniary penalties and infringement notices to enhance the enforcement tools available to the ACCC.
263. A code of conduct for the grocery sector has been proposed by Coles, Woolworths and the Australian Food and Grocery Council. The proposed Code aims to regulate standards of business conduct in the grocery supply chain and to ensure transparency and certainty in commercial transactions, and requires retailers to deal with all of their suppliers in accordance with the Code. The Code also sets out avenues for suppliers to raise complaints with retailers in relation to conduct covered by the Code, and provides mechanisms for dispute resolution. The Commonwealth Government is currently considering whether to prescribe the Grocery Code as an industry code under the *Competition and Consumer Act 2010*.

263.1. The draft Grocery Code prescribes some issues that must and must not be included in contracts between grocery retailers and suppliers. For instance, it allows retailers to make unilateral changes to contracts only if there is a provision for such changes in the original contract, the change is due to circumstances beyond the retailer's control, and the retailer provides written notice of the change.

### Other Industry specific protections

264. The below are by no means an exhaustive account of existing industry protections that may provide protection to small business from unfair terms.

### Independent Contractors

265. The *Independent Contractors Act 2006* (Cth) allows for a judicial review by the Federal Court, or the Federal Circuit Court, of a services contract – on the grounds that the contract is unfair and/or harsh.

266. Judicial reviews of services contracts are limited to circumstances where the contracted work is performed by either a natural person who is an independent contractor or, where an independent contractor is a body corporate, a director or family member of a director, of the body corporate. There are relatively limited remedies available if a term of a contract is found to be unjust or harsh.

### Financial Services

267. An Australian Financial Services Licence (AFSL) is required to provide financial advice and to offer certain types of financial products.

268. Under section 912A of the *Corporations Act 2001* (Cth), a person with an AFSL must do all things necessary to ensure that financial services offered are provided 'efficiently, honestly and fairly'.

### The duty to act in good faith in contractual performance and enforcement

269. There appears to be consensus in Australian case law, and in our partner economies, that the obligation to act in 'good faith' requires parties to a contract to:

269.1. perform all things necessary to enable other party/s to a contract to enjoy the benefits of the contract;<sup>60</sup> and

269.2. act reasonably or not arbitrarily or capriciously in exercising any discretionary powers under the contract.<sup>61</sup>

### The duty imposed by legislation

270. It is noted that Commonwealth legislation imposes good faith obligations in relation to insurance contracts. The *Insurance Contracts Act 1984* (Cth) prevents a party from

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<sup>60</sup> See e.g. *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596.

<sup>61</sup> See e.g. *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234.

relying on a provision of an insurance contract if to do so would be to fail to act with the ‘utmost good faith’.

271. Furthermore, as outlined above, in determining whether a party has acted unconscionably under the CCA, the court may take into account the extent to which the supplier and the customer acted in good faith. Other remedies under the Act may also be available.

## New South Wales legislation — Contracts Review Act

272. State legislation particularly relevant to this Consultation Paper is the New South Wales *Contracts Review Act 1980* (NSW) (CRA). In general, the CRA provides that a court can grant relief in relation to a consumer contract if it finds the contract or a provision of the contract to have been ‘unjust’ in the circumstances relating to the contract at the time it was made. ‘Unjust’ is defined as including unconscionable, harsh or oppressive behaviour, and the CRA is not limited to ‘standard terms’.
273. In general, the CRA does not provide protection to small business. Subject to some limited qualifications, the CRA does not apply where the contract was entered into in the course of or for the purpose of a trade; business or profession carried on by the person or proposed to be carried on by the person.<sup>62</sup>

## OVERSEAS EXPERIENCE

274. In many jurisdictions, like many of the laws in Australia, small businesses are often indirectly included in UCT legislation that is predominantly aimed at protecting consumers. In addition, some European economies protect small businesses under their UCT laws.

## The European Council Unfair Terms in Consumer Contract Directive 1993

275. In 1993 the European Union (then the European Economic Community) adopted *Council Directive 93/13/EEC*, which required its member states to implement regulations on unfair terms in business to consumer contracts. Article 3(1) of the directive stated that:

*A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer. Where a consumer is defined as:*

*Any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession.*<sup>63</sup>

276. Some member states, such as Germany and the Netherlands, have applied their domestic laws implementing this Directive to include businesses in certain circumstances.

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<sup>62</sup> Section 6(2).

<sup>63</sup> European Union (1993), *Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts*, available at: [www.eu-consumer-law.org/directive3\\_en.pdf](http://www.eu-consumer-law.org/directive3_en.pdf).

277. Germany and the Netherlands have implemented *Council Directive 93/13/EEC* through their Civil Codes, the *Bürgerlichen Gesetzbuches* (BGB) and *Burgerlijk Wetboek* (BW), respectively.<sup>64</sup>

277.1. For example, Article 307 of the BGB provides that standard form contract terms are ineffective or void insofar as they unreasonably disadvantage a contracting part, contrary to the requirements of good faith.

277.2. These Codes do not generally distinguish between the type of contracting party, though some types of contracts or businesses are excluded from some of these requirements. For example, some of the requirements in Division 2 of Book 2 of the BGB do not apply to employment contracts, or under family law.

## The United Kingdom

278. The UK has provided a level of scrutiny of UCTs since 1977.<sup>65</sup> In 2001, the English and Scottish Law Reform Commissions were requested to review the regulation of UCTs in the UK.

279. The English and Scottish Law Reform Commissions finalised their joint report in 2005, and made a number of recommendations, including to extend scrutiny of UCTs to most “micro” businesses (e.g. businesses with fewer than nine employees). While the Government accepted the joint report in principle, it was not implemented.

## The Nordic States (Denmark, Finland and Sweden)

280. The Nordic states have had laws in place since around 1915 that permit contract terms to be modified or set aside where they are unfair in the circumstances, even if they are individually negotiated.<sup>66</sup> These laws apply to contracts in general, including business-to-business contracts.

## The United States of America

281. Provisions for unconscionable terms are contained in the Uniform Commercial Code (s 2-302) which is used in all States except Louisiana.

282. If a court finds a contract or any clause of a contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

283. The provisions refer to unconscionable rather than unfair terms, and the provisions are not limited to consumers. However, when applied to business-to-business contracts a stricter and more rigorous approach is taken. The courts examine the relative strengths and vulnerabilities of the parties, finding unconscionability only when one party is in a

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<sup>64</sup> Division 2 of Book 2 of the BGB provides these requirements in Germany, and Division 3 of Title 5 of Book 6 of the BW, which is based on the BGB, provides these requirements in the Netherlands.

<sup>65</sup> Through the *Unfair Contract Terms Act 1997* and the *Unfair Terms in Consumer Contracts Regulations 1999*.

<sup>66</sup> Jan Bryme, Mats Eskils and Emil Odling, ‘*Benchmarking of existing national legal e-business practices: country report - Sweden*’ (Paper No DG ENTR/04/68, European Commission’s Directorate-General for Enterprise and Industry, 2006) 10.

position of weakness such as when a party is inexperienced within the industry or lack any realistic alternatives.

284. The *Restatement (Second) of Contracts*, a influential treatise on the American contract law, published by the American Law Institute, also explains that where a party includes terms in a standard form contract which they have reasons to believe the other party would not agree to if they knew of the terms, those terms are taken to not be part of the contract.



# ATTACHMENT A: OPTIONS FOR LEGISLATIVE AMENDMENT

1. CAANZ is seeking stakeholder views on specific options arising from option 3 – legislative amendment to extend the existing UCT provisions. This approach is the Commonwealth Government’s policy commitment.
2. Given that the impact of option 3 is dependent on how any legislative extension of the UCT regime is devised, this Consultation Paper seeks stakeholder views on ways to extend the law.

## A DEFINING ‘SMALL BUSINESS’ FOR THE PURPOSE OF THE UNFAIR CONTRACT TERM PROVISIONS

3. Under the existing UCT provisions, a term can only be unfair if it is in a standard form consumer contract.
4. Broadly, a ‘consumer contract’ is defined in section 23(3) as a contract for a supply of goods or services, where that good or service is wholly or predominantly for personal, domestic or household use or consumption.
5. A contract concerning a business purchasing a good or service from a business predominantly for commercial reasons or entering into a commercial relationship is not captured by the UCT provisions.
  - 5.1. A small business may currently receive some limited protection under the UCT laws if they purchase a good or service partly for a commercial purpose, so long as it was predominantly for personal use.
    - 5.1.1. An example may be the purchase of internet for personal use in the home, which is used by a sole trader for a number of business purposes.
6. There is no existing definition of ‘small business’ in the ACL, nor is there a standard definition of ‘consumer’, given the different policy underpinnings of the provisions.

### Issue A

7. To extend the UCT protections to small business, an amendment to the ACL will be required to broaden the provision to capture small business contracts in addition to consumer contracts.
8. The definition of small business will establish the scope of regulatory cover for small business under the UCT provisions.

### Objectives

9. In deciding which businesses would be included with such a reform the benefits need to be weighed against the costs. The more businesses that are captured by the reforms the higher the compliance costs.

10. The smaller the business the higher the likely benefit from UCT provisions as they are more likely to transact using standard form contracts, have a smaller capacity to review/negotiate these contracts and less well placed to manage large risks which could be borne on them if an unfair term is enacted.
11. UCT provisions for larger businesses are likely to reap lower benefits as the scale of transactions are more likely to lend themselves to larger negotiated transactions and they are more likely to have the resources and bargaining power to negotiate. Furthermore, they are more likely to be able to manage and diversify the risks from transactions.
12. When considering an appropriate definition, businesses seeking to contract with another business should be able to readily identify whether or not the UCT provisions would apply to a particular contract.
13. The following options present various possibilities for extending the UCT laws, in order to facilitate the consultation process. Each option presents benefits and limitations. Alternative suggestions from stakeholders are welcomed.

**Option A.1: Apply to all business-to-business standard form contracts with an exception that a publicly listed company cannot rely on the provisions**

14. The option would require the amendment or repeal of the term and definition of 'consumer contract' to incorporate contracts where one party is not a listed public company.
  - 14.1. A listed public company is defined in section 2 of the ACL as having the same meaning given by section 995-1(1) of the *Income Tax Assessment Act 1997* (Cth).
15. Exempting listed public companies from the UCT protections would be consistent with the approach taken under the unconscionable conduct provision in the ACL,<sup>67</sup> where a person is only prohibited from engaging in unconscionable conduct towards an unlisted public company.
16. Under this option, at the time of entering into a contract, parties would be certain as to whether or not the UCT provisions apply to that contract given that listed public companies are readily identifiable.
17. Listed public companies are not small businesses. Listed public companies are large businesses that have a separate legal identity from its owners. Publicly listed companies are headed by a board of directors and shareholder liability for the losses of the company is limited to their share contribution only. Publicly listed companies should have the resources available and bargaining power to negotiate risks and manage the risks associated with them.
18. Given corporate governance requirements imposed on publicly owned entities, the Australian Securities and Investments Commission (ASIC) is required to keep a register

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<sup>67</sup> Section 21 of the ACL.

of all listed public companies in Australia. Currently, there are approximately 2000 publicly listed companies (out of approximately 2.14 million Australian businesses).

### Option A.2: Define on the basis of a transaction threshold

19. Under this option, the UCT provisions would be extended to cover business-to-business transactions for less than a prescribed amount. This option would define the scope of the UCT laws based on the nature of the transaction rather than the nature of the contracting parties. An appropriate transaction threshold would need to be specified.
20. This approach would be similar to that taken in the definition of ‘consumer’ for the purposes of consumer guarantees under section 3 of the ACL.
  - 20.1. Section 3 of the ACL defines ‘consumer’ for the purposes of the consumer guarantee, unsolicited consumer agreements and pyramid selling provisions of the ACL. To fall within this definition, a person must satisfy one of the three listed categories. One category is that the amount payable (for example, the total consideration) for the goods or services did not exceed \$40,000.
  - 20.2. The section provides a number of caveats, for example, a person does not acquire goods as a consumer if the goods were acquired for the purpose of re-supply or using them in the course of a process of production or manufacture.<sup>68</sup>
    - 20.2.1. Given the number of caveats contained within section 3 that would eliminate many transactions engaged in by business, this existing definition is not likely to meet the stated objectives.
21. Under this option, at the time of entering into a contract, parties would be certain as to whether or not the UCT provisions apply to that contract given that the contract amount that is the subject of the agreement determines whether or not it falls within the UCT regime.
22. The smaller the size of a transaction the less likely businesses are going to devote resources to reviewing standard form contracts, particularly if they consider them to be standard in nature, and therefore the higher likelihood that any UCTs would go unnoticed. This could be further exacerbated for a small business which also has limited resources/expertise to review contracts compared to a large business. Small businesses are unlikely to employ legal expertise for small transactions as the costs would likely far outweigh the benefits.
23. This option may result in some small business transactions which exceed the threshold falling outside the scope of the UCT law, such as mortgages, some financial transactions, or large acquisition or supply contracts for input products to be used in a process or manufacture by the small business. Given that higher dollar values would be involved in these transactions, the detriment from a UCT which disproportionately transfers risk to a small business could be high.

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<sup>68</sup> By virtue of section 3(2).

24. However, on the other hand it could be argued that businesses (small or large) dealing in large commercial transactions have a responsibility to engage the required legal resources to ensure there are no UCTs in the contracts for these transactions. Businesses engaging in larger transactions should have the legal resources to deal with these transactions, otherwise they should not be entering into them.
25. Given this option is based on a transaction threshold, the provisions would still apply to large businesses and publicly listed companies and it could be argued that they should be excluded due to their resources and greater bargaining power and their ability to manage risk (Option A.1).
  - 25.1. An alternative would be for the option to be coupled with an exclusion to be available for publicly listed companies, as in Option A1, or with a requirement that the business has less than a specified level of revenue (see Option A3) or less than a specified number of employees (see Option A4).
26. Further research would need to be undertaken to determine the appropriate monetary threshold based on the vulnerabilities of small businesses and the different types of contracts they enter into. For example it might be important to distinguish between contracts pertaining to the purchase of general goods and services and those that relate to more substantive commercial relationships such as franchising and retail tenancy.

#### **Option A.3: Define on the basis of annual turnover**

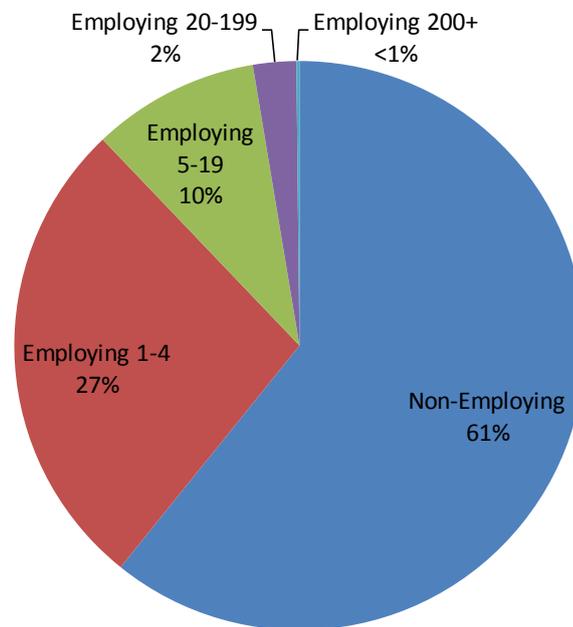
27. Small businesses typically generate lower revenue amounts than larger entities.
28. The UCT laws could be extended by drawing on the *Income Tax Assessment Act 1997* definition of 'small business entity', which is based on a \$2 million aggregated turnover test. This option would require the amendment or repeal of the term and definition of 'consumer contract' to incorporate contracts where one party has an aggregate turnover for the previous year of less than \$2 million.
29. This option would capture approximately 94 per cent of all businesses in Australia (over two million Australian businesses meet this definition).
30. A business contracting with the small business entity may not know at the time of the contractual dealings that the other business qualifies for UCT protection.
31. Further, for businesses with low margins that rely on high turnover, turnover may not be an accurate representation of their bargaining power or resources.

#### **Option A.4: Define on basis of the number of employees**

32. A small business typically employs less people than a large business in the same industry. This option would require the amendment or repeal of the term and definition of 'consumer contract' to incorporate contracts where one party employs fewer than a specified number of employees at a particular time.
33. Broadly, the *Fair Work Act 2009* (Cth) (FWA) defines a 'small business employer' as a national system employer that employs fewer than 15 employees at a particular time.

34. While the ABS does not use the FWA definition of small business, according to ABS data, in June 2013 there were approximately two million businesses, or approximately 97 per cent of total businesses, that employed less than 20 people.<sup>69</sup>

### Businesses by employment size ranges 2012-13



Source: ABS Counts of Australian Businesses, Including Entries and Exits June 2009 to June 2013

35. The *Corporations Act 2001* (Cth) includes a definition of a 'small proprietary company' based on the number of employees. Under this Act, a proprietary company is defined as small for a financial year if it satisfies at least two of the following:
- 35.1. the consolidated revenue for the financial year of the company and any entities it controls is less than \$25 million;
  - 35.2. the value of the consolidated gross assets at the end of the financial year of the company and any entities it controls is less than \$12.5 million; and
  - 35.3. the company and any entities it controls have fewer than 50 employees at the end of the financial year.<sup>70</sup>
36. The *Corporations Act 2001* (Cth) also defines a 'large proprietary company'.<sup>71</sup>
37. The UK and Scottish Law Commission 2005 paper on UCTs recommended that the definition of business size comes down to its number of employees, with nine or fewer to be classified as a small business.<sup>72</sup>

<sup>69</sup> Australian Bureau of Statistics, Cat. No. 8165.0, *Counts of Australian Businesses, Including Entries and Exits* – June 2009 to June 2013.

<sup>70</sup> Section 45A *Corporations Act 2001*.

<sup>71</sup> Section 45A *Corporations Act 2001*.

38. An issue with this option is that a contracting party may not know at the time of the contract how many employees a prospective contracting party has at the time, and therefore whether or not the UCT provisions apply to the contract at hand.

**Table 2: Defining ‘small business’ for the purpose of the unfair contract term provisions**

|                   |  |
|-------------------|--|
| <b>Issue A</b>    | To extend the provisions to small business, an amendment will be required to repeal the term ‘consumer contract’ so that small business standard form contracts, where goods and services are not purchased for personal consumption, are also captured by the provisions. |
| <b>Option A.1</b> | Define on the basis of whether a business is publicly listed.  |
| <b>Option A.2</b> | Define on the basis of a transaction threshold.  |
| <b>Option A.3</b> | Define on the basis of annual turnover.  |
| <b>Option A.4</b> | Define on basis of the number of employees.  |

### Focus questions

41. What are the benefits and disadvantages of each definition option?
42. What option is the most appropriate definition for extending the UCT laws? Should it be defined by business or transaction size?

## **B SHOULD THE EXTENSION TO CAPTURE A CONTRACT WHERE A SMALL BUSINESS EITHER ACQUIRES OR SUPPLIES GOODS OR SERVICES?**

39. Currently, the UCT provisions apply where a consumer *acquires* goods or services. A consumer does not supply goods or services to a business.

### Issue B

40. Small businesses play a dual role in the consumer policy space – they acquire goods and services from businesses for the purpose of using them or transforming them in the process of production or manufacture, and they supply goods and services to businesses and consumers.
41. Increasingly today, some large businesses are opting to contract with smaller businesses to acquire goods rather than with wholesalers.
- 41.1. Historically, supermarkets have purchased fresh produce from wholesalers and processors. However, primary producers are increasingly by-passing wholesalers

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72 The Law Commission and Scottish Law Commission (2005), *Unfair Terms in Contracts*, Law Com No.292, Scot Law Com No. 199.

and entering into direct supply arrangements with supermarkets.<sup>73</sup> In many instances, standard form contracts may be insisted on.

42. If a transaction threshold is used to apply the UCT laws to small business, the UCT laws would instinctively apply to circumstances where a small business either supplies or acquires goods or services. In other words, if Option A.2 is adopted, Option B.1 would automatically result.

**Table 3: Extending the law to capture a contract where a small business either acquires or supplies goods or services**

|                   |   |
|-------------------|---|
| <b>Issue B</b>    | Currently, the UCT provisions only apply where a consumer acquires goods or services.<br><br>Small businesses play a dual role in the consumer policy space – they acquire goods and services from businesses for the purpose of using them or transforming them in the process of production or manufacture, and they supply goods and services to businesses. |
| <b>Option B.1</b> | The amendments could capture small business contracts involving supply or acquisition of goods or services with another business.   |
| <b>Option B.2</b> | The amendments could capture small business contracts only involving the acquisition of goods or services from another business.  |

**Focus question**

43. Should the extension of the UCT provisions provide protection for small business when they acquire and supply goods or services?

**C SHOULD THE EXTENSION ALLOW SMALL BUSINESS TO SMALL BUSINESS CONTRACTS TO BE CAPTURED?**

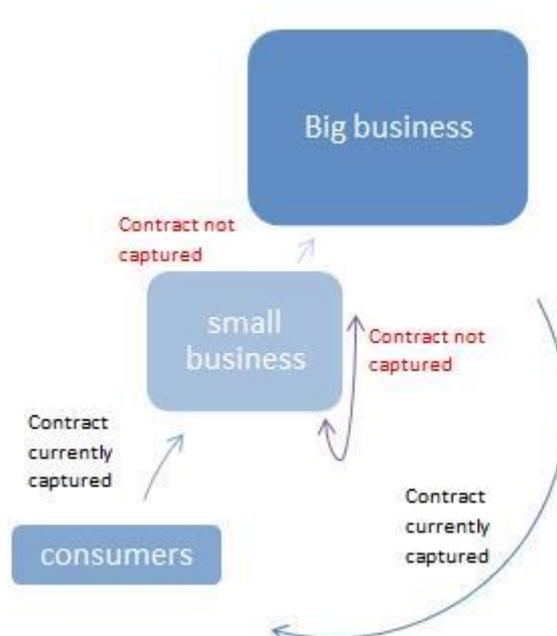
43. The UCT provisions are founded on the rationale that consumers, relative to businesses are limited in their capacity/resources to negotiate or challenge terms in standard form contracts and that in some circumstances they are not best placed to manage certain risks associated with UCTs in these contracts.

**Issue C**

44. By extending the UCT laws to small business, there is a question whether the laws should be able to capture unfair terms in a contract between two small businesses.

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<sup>73</sup> For example, in 2008, the ACCC reported that up to 80 per cent of fruit and vegetables purchased by Coles and Woolworths came directly from primary producers.



45. On the one hand, it could be argued that both businesses could lack the resources to deal effectively with standard form contracts. On the other hand, the small business offering the contract could still be best placed to manage certain risks attached to the contract as they may have more information about these risks compared to the receiving party. As a result it would still be unfair for the supplier to disproportionately shift these risks on to the customer.
46. If the 'small business definition' under Option A.2 (above) was adopted, this issue would not arise as the definition is a transaction-based threshold and does not take into consideration the characteristics of the contracting parties.

**Table 4: Extending the law to capture small business to small business contracts**

|                   |  |
|-------------------|--|
| <b>Issue C</b>    | There is a question whether the UCT extension should cover contracts between two small businesses (however defined). |
| <b>Option C.1</b> | The extension could allow for a contract between two small businesses to be captured by the laws.                    |
| <b>Option C.2</b> | The UCT provisions could be restricted to where there is one small business (however defined) to the transaction.    |

**Focus question**

44. Should any extension void unfair terms in a small business to small business contract?

**D Should the extension capture financial services and products?**

47. The UCT provisions in the ACL are substantially replicated in the ASIC Act, as they apply to financial services and credit.

48. In the context of the ASIC Act, a consumer contract is defined as a standard form contract that is a financial product or a contract for the supply, or possible supply, of services that are financial services.
49. The 'upfront price' of a contract falls outside of the UCT provisions. The ASIC Act UCT provisions clarify that the total amount of the principle and interest payable under a credit agreement forms part of the 'upfront price'.
50. Insurance contracts are excluded from the operation of the UCT provisions in the ASIC Act by the *Insurance Contracts Act 1984* (IC Act).<sup>74</sup> This is due to a general exclusion of remedies under other Acts on the basis that the IC Act consumer protections should be the sole source of remedies in relation to insurance contracts.
51. UCT provisions are enforced under a shared enforcement model, with the ACCC responsible for UCT provisions under the ACL and ASIC responsible for UCT provisions under the ASIC Act.

#### Issue D

52. There is a question whether the extension should cover financial products and services.

#### Option D.1

53. The UCT provisions in the ASIC Act could be extended to cover small business contracts (however defined) in relation to the supply/acquisition of financial products and services. This would mean that ASIC Act UCT provisions remain consistent with the ACL UCT provisions. It would also mean that insurance contracts provided to small business (however defined) would not be covered to the extent that the IC Act excludes insurance contracts from the UCT provisions of the ASIC Act.
54. This would seek to ensure that consistent approaches to dealing with UCTs were adopted in relation to financial services and credit, and the range of goods and services otherwise covered by the ACL provisions.

#### Option D.2

55. Alternatively, the UCT provisions in the ASIC Act could remain, and be limited to, consumer contracts. A small business would therefore only be covered by the UCT provisions if they acquire a consumer contract covered by the UCT provisions (for example a consumer contract that is partly used for small business purposes).

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<sup>74</sup> Section 15 of the *Insurance Contracts Act 1984* (Cth).

**Table 5: Extending the law to capture financial products and services**

|                   |   |
|-------------------|---|
| <b>Issue D</b>    | <p>The UCT provisions in the ACL are substantially replicated in the Australian Securities and Investments Commission Act 2001 (ASIC Act), as they apply to financial services and credit.</p> <p>In the context of the ASIC Act, a consumer contract is defined as a standard form contract that is a financial product or a contract for the supply, or possible supply, of services that are financial services.</p> |
| <b>Option D.1</b> | <p>The extension of the UCT provisions could also cover financial products and services provided to small business so that the ASIC Act provisions remain consistent with equivalent ACL provisions.</p>  |
| <b>Option D.2</b> | <p>The UCT provisions in the ASIC Act could remain and be limited to standard form consumer contracts.</p>  |

**Focus question**

45. Do you consider that the UCT laws within the ASIC Act should be extended to apply to small business contracts?