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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LEGISLATION AMENDMENT (SMALL BUSINESS AND UNFAIR
CONTRACT TERMS) BILL 2015

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Minister for Small Business,
the Hon Bruce Billson MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
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>
CAF	Legislative and Governance Forum on Consumer Affairs
CC Act	<i>Competition and Consumer Act 2010</i>
IC Act	<i>Insurance Contracts Act 1984</i>
IGA	<i>Intergovernmental Agreement for the Australian Consumer Law 2009</i>
RIS	regulation impact statement
SBDC	Small Business Development Corporation of Western Australia
SME	Small to Medium Enterprise
TPA Bill 2010 explanatory memorandum	explanatory memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No. 1) 2010
VSBC	Victorian Small Business Commissioner

General outline and financial impact

Extending unfair contract term protections to small businesses

This Bill amends the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and the Australian Consumer Law (ACL), which is set out in the *Competition and Consumer Act 2010*, to extend the unfair contract term protections currently available to consumers to cover businesses with less than 20 employees agreeing to standard form contracts valued at less than a prescribed threshold.

The ASIC Act and the ACL currently contain mirror consumer unfair contract term protections. The ASIC Act's requirements apply to financial services and products and the ACL applies to the supply of goods or services other than financial services or products and the sale or grant of an interest in land.

This Bill:

- extends the consumer unfair contract term protections in the ASIC Act and the ACL to small business contracts that meet the prescribed criteria; and
- makes provision for exempting small business contracts that are subject to prescribed laws that are deemed equivalent to the unfair contract term protections in the ASIC Act or the ACL, and which are enforceable.

The measures outlined in this Bill have been developed in consultation with a range of stakeholders, including the general public, businesses, industry groups and Commonwealth, state and territory consumer agencies, regulators and Small Business Commissioners. An extensive public consultation process was held from 23 May to 1 August 2014 on the design of the protections and a public consultation on the Exposure Draft legislation was held in May 2015.

Measures relating to the ASIC Act were agreed to by the Assistant Treasurer, and states and territories were notified of the amendments to the ASIC Act as required under the *Corporations Agreement 2002*. Measures relating to the ACL were agreed to by a majority of states and territories as required under the *Intergovernmental Agreement for the Australian Consumer Law*.

Date of effect: The Bill will commence six months after the date it receives Royal Assent.

Proposal announced: This proposal was announced in the Coalition's Policy for Small Business released in August 2013, as an election commitment.

Financial impact: The Australian Competition and Consumer Commission was provided \$1.4 million in the 2014-15 Budget to support the implementation of this Bill. The enforcement of the unfair contract terms law may require regulatory resources, including use of the court system, however it is expected that the majority of complaints will be resolved administratively and not through litigation.

Human rights implications: This Bill does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 4, paragraphs 4.1 to 4.4.

Compliance cost impact: Medium. Persons who offer contracts to small businesses may incur a once-off transitional cost (including seeking legal expertise) to implement any system changes and ensure contract terms comply with the unfair contract terms law. This cost is estimated to be \$50 million in the first year, with no ongoing costs. To help reduce compliance costs, the Australian Competition and Consumer Commission will undertake an educative and compliance-based approach similar to when the consumer unfair contract terms law was introduced.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure will affect persons that enter into standard form contracts valued less than a prescribed amount with a business with less than 20 employees.

Main points:

- The extension of the consumer unfair contract term protections to small business contracts will allow unfair contract terms to be declared void and for the contract to continue to bind the parties if it can operate without the unfair term.
- This will reduce the incentive to include and enforce unfair terms in small business contracts, providing a more efficient

allocation of risk in these contracts and supporting small business' confidence in agreeing to contracts.

- Businesses that offer low-value standard form contracts to small businesses may need to review and amend their contracts to ensure they are compliant with the new protections.

Chapter 1

Amendments to the Australian Securities and Investments Commission Act 2001

Outline of chapter

1.1 Schedule 1 to this Bill contains amendments to extend the consumer unfair contract term protection in the *Australian Securities and Investment Commission Act 2001* (ASIC Act) to businesses with less than 20 employees agreeing to standard form contracts valued at less than a prescribed threshold.

Context of amendments

1.2 Small businesses, like consumers, are vulnerable to unfair terms in standard form contracts as they are often offered contracts on a 'take it or leave it' basis and lack the resources to understand and negotiate contract terms. There is potential for small business detriment where these unfair contract terms are enforced.

1.3 Consultations indicated that unfair contract terms often allocate contract risks to the party that is less able to manage them (usually small businesses). Small businesses are less likely to have robust risk management policies or be in a position to absorb the costs associated with a risk if it eventuates.

1.4 Small businesses often lack in-house legal expertise and the cost of obtaining legal advice, particularly for low-value contracts, can be disproportionate to the potential benefits of entering into such contracts. Where small businesses decide to not enter into contracts due to their lack of confidence in understanding and negotiating terms or the cost of obtaining legal advice, they may miss out on market opportunities.

1.5 Existing laws largely address 'unfair' behaviour in business dealings, rather than unfair contract terms. Moreover, the protections available under the ASIC Act for unfair contract terms are currently only afforded to consumers and not businesses.

1.6 The extension of the unfair contract term protection to cover small business contracts will address this vulnerability by allowing unfair contract terms to be declared void, providing a remedy for small

businesses. This will reduce the incentive to include and enforce unfair terms in small business contracts, providing for a more efficient allocation of risk in these contracts and supporting small business' confidence in agreeing to contracts.

1.7 Small businesses differ from consumers in that they also engage in high-value commercial transactions that are fundamental to their business and where it may be reasonable to expect that they undertake appropriate due diligence (such as seeking legal advice). Limiting the extension of the unfair contract term protection to low-value, standard form small business contracts will support time-poor small businesses entering into contracts for day-to-day transactions, while maintaining the onus on small businesses to undertake due diligence when entering into high-value contracts.

Summary of new law

- 1.8 This Bill amends the ASIC Act to:
- extend the consumer unfair contract term protection in the ASIC Act to cover businesses with less than 20 employees agreeing to standard form contracts valued at less than a prescribed threshold ('small business contract'); and
 - allow for the exemption of small business contracts that are subject to prescribed laws deemed equivalent to the unfair contract term protection in the ASIC Act, and which are enforceable.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The unfair contract term protection in Subdivision BA of Division 2 of Part 2 of the ASIC Act protects consumers and those businesses with less than 20 employees who agree to standard form contracts valued less than a prescribed threshold.	The unfair contract term protection in Subdivision BA of Division 2 of Part 2 of the ASIC Act protect consumers only.

<i>New law</i>	<i>Current law</i>
The Commonwealth Minister has the power to specify another law deemed equivalent and enforceable to the unfair contract term protections. Contracts subject to that law will be exempt from the unfair contract term protection contained in Subdivision BA of Division 2 of Part 2 of the ASIC Act.	No equivalent.

Detailed explanation of new law

1.9 Part 2 of the ASIC Act contains provisions that protect consumers from unfair contract terms. This Chapter extends these provisions to also cover small business contracts.

1.10 Specifically, section 12BF of the ASIC Act provides that an unfair contract term in a standard form, consumer contract will be void. The Bill amends section 12BF to provide that an unfair contract term in a standard form, small business contract will also be void. [*Schedule 1, item 7, subsection 12BF(1) of Division 2 of Part 2*]

1.11 The extension of section 12BF to small business contracts does not impact the availability of the existing protection for consumers, including where there is any overlap (for instance, if the parties to a contract include a consumer and a small business).

Existing concepts of the consumer unfair contract term protection to be applied to the small business protection

1.12 The small business unfair contract term protection will utilise existing concepts of ‘unfair’ and ‘standard form contract’ in sections 12BG and 12BK of the ASIC Act.

1.13 In determining whether a contract term is unfair, a court may take into account the extent to which the term is transparent, and the contract as a whole.

1.14 The meaning of the terms ‘unfair’, ‘detriment’ and ‘transparent’ are explained to some extent in the legislation, with further guidance available from paragraphs 2.30 to 2.48 of the explanatory memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No. 1) 2010 (TPA Bill 2010 explanatory memorandum). Paragraphs 2.49 through to 2.62 of the TPA Bill 2010 explanatory memorandum also provide further guidance on the examples contained in section 12BH of

the ASIC Act of unfair terms, which depending on the context and contract as a whole, could be considered as unfair.

1.15 A contract is presumed to be standard form unless otherwise proven. This concept of ‘standard form contract’ is defined, together with a list of matters that a court may find relevant in considering whether a contract is a standard form contract, in section 12BK of the ASIC Act.

1.16 Terms that define the main subject matter and upfront price payable under a contract, and terms required or expressly permitted by another law, cannot be declared unfair pursuant to subsection 12BI(1) of the ASIC Act. More information on the exemption of these types of terms can be found in paragraphs 2.63 to 2.77 of the TPA Bill 2010 explanatory memorandum.

Meaning of small business contract

1.17 A contract is a small business contract if, at the time it is entered into, at least one party to the contract is a business that employs fewer than 20 persons, and the upfront price under the contract does not exceed either \$100,000, or \$250,000 if its duration is more than 12 months.
[Schedule 1, item 8, subsection 12BF(4) of Division 2 of Part 2]

1.18 The threshold places the onus on small businesses to undertake due diligence for high-value transactions. A two-tiered transaction value threshold is used to account for multi-year contracts. The consultation process undertaken in 2014 indicated the transaction value threshold would encompass most small business transactions.

1.19 The upfront price is defined in subsection 12BI(2) of the ASIC Act as the consideration that is provided, or is to be provided, under a contract; disclosed at or before the time the contract is entered into.

1.20 Further clarification of this is provided in the TPA Bill 2010 explanatory memorandum, at paragraph 2.68:

‘Consideration includes any amount or thing provided as consideration for the supply of a good, service, financial service, financial product or a grant of land. It would also include any interest payable under a consumer contract.’

1.21 Paragraphs 2.72 and 2.73 of the TPA Bill 2010 explanatory memorandum also provided that:

‘The definition also requires that the upfront price must be disclosed at or before the time the contract was entered into by the parties. In the case of most transactions this is reasonably

straightforward, as a key pre-condition of the transaction occurring is an understanding of the price to be paid.

A key consideration for a Court in considering whether a future payment, or a series of future payments, forms the upfront price may be the transparency of the disclosure of such a payment, or the basis on which such payments may be determined, at or before the time the contract is made.’

1.22 As with consumer contracts, there could be instances where a small business contract sets out the basis on which some payments are to be determined after the contract has been entered into. Whether payments that result from such variations are part of the upfront price may depend on the transparency of the disclosure of such payments or the basis on which such payments will be determined.

1.23 The upfront price also applies to the totality of the consideration that is paid for a supply, sale or grant under a contract. For example, where a contract provides for the supply of multiple goods or services, the upfront price will be the consideration for the total supply under the contract. Although the upfront price is defined in subsection 12BI(2) as the ‘consideration’ that is paid for a supply, sale or grant, subsection 23(b) of the *Acts Interpretation Act 1901* provides that in any law, words in the singular number include the plural, and vice versa.

1.24 The upfront price also excludes ‘other consideration’ that is contingent on the occurrence or non-occurrence of a particular event. This is intended to exclude payments which do not relate to the supply under the contract, for example, payments associated with non-price terms such as termination fees, or late payment fees.

1.25 The upfront price concept applies to all contracts in the same way, except for credit contracts. For the purpose of working out whether a credit contract falls under the transaction value threshold, the upfront price does not include any interest payable under the contract. [*Schedule 1, item 8, subsection 12BF(6) of Division 2 of Part 2*]

1.26 This approach for credit contracts will ensure that small business contracts of the same value are treated equally and that movements in interest rates do not affect the scope of the protection. It will also allow businesses to calculate a contract’s value more easily when determining whether they can rely on the protection.

1.27 A threshold of less than 20 employees has been chosen as it is a commonly used head count measure and has been found by the Australian Bureau of Statistics to provide a good proxy for a small business.

1.28 In calculating the number of persons a business employs, a head count approach (regardless of an employee's hours or workload) is used. Casual employees are to be counted only if they are employed on a regular or systematic basis, to account for seasonal variations. This is the approach used in the *Fair Work Act 2009*. [Schedule 1, item 8, subsection 12BF(5) of Division 2 of Part 2]

Contracts exempted from the small business unfair contract term protection

Exempting contracts subject to industry-specific legislation and regulation that are deemed enforceable and equivalent

1.29 A contract will not be covered by the ASIC Act's unfair contract term protection where it is subject to an industry-specific law (legislation or regulation of the Commonwealth, a state or a territory) that has been deemed enforceable and equivalent and thereby exempted from the protection. Industry self-regulation cannot be exempted as these are not enforceable. [Schedule 1, item 14, subsection 12BL(2) and paragraph 12BL(3)(a) of Division 2 of Part 2]

1.30 This regulation-making power allows the Government to limit the operation of the ASIC Act to ensure that the unfair contract term protection does not duplicate protections contained in another law.

1.31 Before a law is prescribed as equivalent and enforceable, the Commonwealth Minister must consider the public interest, the overall impact of providing the exemption, and the impact on small businesses of prescribing the law. [Schedule 1, item 14, paragraph 12BL(3)(b) of Division 2 of Part 2]

1.32 The Minister must also comply with any applicable requirements stipulated by the *Corporations Agreement 2002*.

1.33 This is intended to provide a robust framework for the exercise of the regulation-making power.

Exemptions already specified in the ASIC Act

1.34 Section 12BL of the ASIC Act excludes constitutions of a company, managed investment scheme or other kind of body from coverage of the unfair contracts law. Further information on this can be found in paragraphs 2.98 and 2.99 of the explanatory memorandum to the TPA Bill 2010 explanatory memorandum.

Effect of the Insurance Contracts Act 1984 on contracts

1.35 Section 15 of the *Insurance Contracts Act 1984* (IC Act) excludes relief in respect of such contracts under any other law of the Commonwealth, a state or territory, including through a judicial review of a contract on the ground that it is harsh, oppressive, unconscionable, unjust, unfair or inequitable.

1.36 In accordance with section 15 of the IC Act, the small business unfair contract term protection will not apply to insurance contracts to the extent that they are covered by the IC Act.

1.37 The current application of section 15 to insurance contracts that are covered by the IC Act is appropriate given the current level of protections provided to parties to an insurance contract. In particular, the current operation of the ‘utmost good faith’ provisions (sections 13 and 14 of the IC Act) require parties to an insurance contract to act with the ‘utmost good faith’ otherwise, any clause or term that were to be considered unfair would be void and could not be relied upon.

Consequential amendments

1.38 In extending the consumer unfair contract term protection to small business contracts, references to consumer contracts have been modified to also refer to small business contracts. This includes:

- In the interpretation section, section 12BA, the definition of a number of terms used in the ASIC Act’s unfair contract terms law: non-party consumer, rely on, small business contract, transparent and unfair [*Schedule 1, items 1 to 5, subsection 12BA(1) of Division 2 of Part 2*].
- To insert into the interpretation section, section 12BA, a referral to section 12BK for the meaning of standard form contract [*Schedule 1, item 3, subsection 12BA(1) of Division 2 of Part 2*].
- The headings of the unfair contract term provisions of the ASIC Act [*Schedule 1, items 6 and 11, sections 12BF and 12BI of Division 2 of Part 2*].
- The reference to contracts in Subdivision BA of Part 2 of the ASIC Act [*Schedule 1, items 9, 12 and 13, subsections 12BG(1) to (2) and (4), 12BH(1) and 12BI(1) to (3) of Division 2 of Part 2*].

- To insert a requirement for the detriment to small business of prescribing a term under paragraph 12BH(1)(n) to be considered in the same way as the detriment to consumers from prescribing such terms *[Schedule 1, item 10, paragraph 12BH(2)(aa) of Division 2 of Part 2]*.
- Consequential amendments to Subdivision G of Division 2 of Part 2 of the ASIC Act, which outline the enforcement and remedy provisions for unfair contract terms *[Schedule 1, items 15 to 17, subsections 12GD(9), 12GM(10), 12GN(9), 12GND(2) to (5) and paragraph 12GNB(1)(a)(ii) of Division 2 of Part 2]*.

Application and transitional provisions

1.39 These amendments apply to varied terms, and contracts entered into or renewed on or after the day the legislation comes into effect. This will occur the day after the end of the period of six months beginning on the day this legislation receives Royal Assent. The amendments do not apply to a contract or term of a contract if it would result in the acquisition of property otherwise than on just terms pursuant to paragraph 51(xxxi) of the Commonwealth Constitution. *[Schedule 1, item 18]*

Chapter 2

Amendments to the Competition and Consumer Act 2010

Outline of chapter

2.1 Schedule 1 to this Bill contains amendments to extend the consumer unfair contract term protection in the Australian Consumer Law (ACL), which is set out in the *Competition and Consumer Act 2010* (CC Act), to businesses with less than 20 employees agreeing to standard form contracts valued at less than a prescribed threshold.

Context of amendments

2.2 Small businesses, like consumers, are vulnerable to unfair terms in standard form contracts, as they are often offered contracts on a ‘take it or leave it’ basis and lack the resources to understand and negotiate contract terms. There is potential for small business detriment where these unfair contract terms are enforced.

2.3 Consultations indicated that unfair contract terms often allocate contract risks to the party that is less able to manage them (usually small businesses). Small businesses are less likely to have robust risk management policies or be in a position to absorb the costs associated with a risk if it eventuates.

2.4 Small businesses often lack in-house legal expertise and the cost of obtaining legal advice, particularly for low-value contracts, can be disproportionate to the potential benefits of entering into such contracts. Where small businesses decide to not enter into contracts due to their lack of confidence in understanding and negotiating terms or the cost of obtaining legal advice, they may miss out on market opportunities.

2.5 Existing laws largely address ‘unfair’ behaviour in business dealings, rather than unfair contract terms. Moreover, the protections available under the ACL for unfair contract terms are currently only afforded to consumers and not businesses.

2.6 The extension of the unfair contract terms protection to cover small business contracts will address this vulnerability by allowing unfair contract terms to be declared void, providing a remedy for small

businesses. This will reduce the incentive to include and enforce unfair terms in small business contracts, providing for a more efficient allocation of risk in these contracts and supporting small business' confidence in agreeing to contracts.

2.7 Small businesses differ from consumers in that they also engage in high-value commercial transactions that are fundamental to their business and where it may be reasonable to expect that they undertake appropriate due diligence (such as seeking legal advice). Limiting the extension of the unfair contract term protection to low-value, standard form small business contracts will support time-poor small businesses entering into contracts for day-to-day transactions, while maintaining the onus on small businesses to undertake due diligence when entering into high-value contracts.

2.8 The Legislative and Governance Forum on Consumer Affairs agreed in November 2013 to consider an extension to small businesses of the consumer unfair contract term protection in the ACL, and on 13 April 2015 agreed to the amendments in accordance with the *Intergovernmental Agreement for the Australian Consumer Law*.

Summary of new law

2.9 This Bill amends the ACL to:

- extend the consumer unfair contract term protection in the ACL to cover small businesses with less than 20 employees agreeing to standard form contracts valued at less than a prescribed threshold; and
- allow for the exemption of small business contracts that are subject to prescribed laws deemed equivalent to the unfair contract term protection in the ACL, and which are enforceable.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The unfair contract term protection in Part 2-3 of the ACL protects consumers and those businesses with less than 20 employees that agree to standard form contracts valued less than a prescribed threshold.	The unfair contract term protection in Part 2-3 of the ACL protects consumers only.
The Commonwealth Minister has the power to specify another law deemed equivalent and enforceable to the unfair contract term protections. Contracts subject to that law will be exempt from the unfair contract term protection contained in Part 2-3 of the ACL.	No equivalent.

Detailed explanation of new law

2.10 Schedule 2 of the CC Act sets out the ACL. Part 2-3 of the ACL contains the consumer unfair contract term protection. This chapter extends these provisions to also cover small business contracts.

2.11 Specifically, section 23 of the ACL provides that an unfair contract term in a standard form, consumer contract will be void.

2.12 This Bill amends section 23 to provide that an unfair contract term contained in a standard form, small business contract will also be void. *[Schedule 1, item 30, subsection 23(1) of Part 2-3 of Schedule 2]*

2.13 The extension of section 23 to standard form, small business contracts does not impact the availability of the existing protection for consumers, including where there is any overlap (for instance, if the parties to a contract include a consumer and a small business).

Existing concepts of the consumer unfair contract term protection to be applied to the small business protection

2.14 Sections 24 and 27 of the ACL relate to the already existing concepts of ‘unfair’ and ‘standard form contract’ respectively, and these concepts will remain for the small business unfair contract term protection.

2.15 In determining whether a contract term is unfair, a court may take into account the extent to which the term is transparent, and the contract as a whole.

2.16 The meaning of the terms ‘unfair’, ‘detriment’ and ‘transparent’ are explained to some extent in the legislation, with further guidance available from paragraphs 2.30 to 2.48 of the explanatory memorandum to the Trade Practices Amendment (Australian Consumer Law) Bill (No. 1) 2010 (TPA Bill 2010 explanatory memorandum). Paragraphs 2.49 through to 2.62 of the TPA Bill 2010 Explanatory Memorandum also provide further guidance on the examples contained in section 25 of the ACL of unfair terms, which depending on the context and contract as a whole, could be considered as unfair.

2.17 A contract is presumed to be standard form unless otherwise proven. This concept of ‘standard form contract’ is, together with a list of matters that a court may find relevant in considering whether a contract is a standard form contract, defined in section 27 of the ACL.

2.18 Terms that define the main subject matter and upfront price payable under a contract, and terms required or expressly permitted by another law, cannot be declared unfair pursuant to subsection 26(1) of the ACL. More information on the exemption of these types of terms can be found in paragraphs 2.63 to 2.77 of the TPA Bill 2010 explanatory memorandum.

Meaning of small business contract

2.19 A contract is a small business contract if, at the time it is entered into, at least one party to the contract is a business that employs fewer than 20 persons; the contract relates to the supply of goods or services or sale or grant of an interest in land; and the upfront price under the contract does not exceed either \$100,000, or \$250,000 if its duration is more than 12 months. *[Schedule 1, item 31, subsection 23(4) of Part 2-3 of Schedule 2]*

2.20 The threshold places the onus on small businesses to undertake due diligence for high-value transactions. A two-tiered transaction value threshold is used to account for multi-year contracts. The consultation process undertaken in 2014 indicated the transaction value threshold would encompass most small business transactions.

2.21 The upfront price is defined in subsection 26(2) of the ACL as the consideration that is provided, or is to be provided, under a contract; disclosed at or before the time the contract is entered into.

2.22 Further clarification of this is provided in the TPA Bill 2010 explanatory memorandum, at paragraph 2.68:

‘Consideration includes any amount or thing provided as consideration for the supply of a good, service, financial service, financial product or a grant of land. It would also include any interest payable under a consumer contract.’

2.23 Paragraphs 2.72 and 2.73 of the TPA Bill 2010 explanatory memorandum also provided that:

‘The definition also requires that the upfront price must be disclosed at or before the time the contract was entered into by the parties. In the case of most transactions this is reasonably straightforward, as a key pre-condition of the transaction occurring is an understanding of the price to be paid.

A key consideration for a Court in considering whether a future payment, or a series of future payments, forms the upfront price may be the transparency of the disclosure of such a payment, or the basis on which such payments may be determined, at or before the time the contract is made.’

2.24 As with consumer contracts, there could be instances where a small business contract sets out the basis on which some payments are to be determined after the contract has been entered into.

2.25 An example of this is a building contract that provides the option to choose the quality of a particular material (at different prices) used in the construction process, during the life of the contract. The payments under a contract could also be subject to change over time, for example, to account for inflation. Whether payments that result from such variations are part of the upfront price may depend on the transparency of the disclosure of such payments or the basis on which such payments will be determined.

2.26 The upfront price also applies to the totality of the consideration that is paid for a supply, sale or grant under a contract. For example, where a contract provides for the supply of multiple goods or services, the upfront price will be the consideration for the total supply under the contract. Although the upfront price is defined in subsection 26(2) of the ACL as the ‘consideration’ that is paid for a supply, sale or grant, subsection 23(b) of the *Acts Interpretation Act 1901* provides that in any law, words in the singular number include the plural, and vice versa.

2.27 A threshold of less than 20 employees has been chosen for this definition, as it is a commonly used head count measure and has been found by the Australian Bureau of Statistics to provide a good proxy for a small business.

2.28 In calculating the number of persons a business employs, a head count approach (regardless of an employee's hours or workload) is used. Casual employees are to be counted only if they are employed on a regular or systematic basis, to account for seasonal variations. This is the approach used in the *Fair Work Act 2009*. [Schedule 1, item 31, subsection 23(5) of Part 2-3 of Schedule 2]

Contracts exempted from the small business unfair contract term protection

Exempting contracts subject to industry-specific legislation and regulation that are deemed enforceable and equivalent

2.29 A contract will not be covered by the ACL's unfair contract term protection where it is subject to an industry-specific law (legislation or regulation of the Commonwealth, a state or a territory) that has been deemed enforceable and equivalent and thereby exempted from the protection. Industry self-regulation cannot be exempted as these are not enforceable. [Schedule 1, item 40, subsection 28(4) of Part 2-3 of Schedule 2]

2.30 This regulation-making power allows the Government to limit the operation of the ACL to ensure that the unfair contract term protection does not duplicate protections contained in another law.

2.31 Before a law is prescribed as an equivalent and enforceable measure, the Commonwealth Minister must consider the public interest, the overall impact of providing the exemption, and the impact on small businesses of prescribing the law. [Schedule 1, item 23, subsection 139G(2A) of Division 9 of Part XI]

2.32 The Minister must also comply with any applicable requirements stipulated by the *Intergovernmental Agreement for the Australian Consumer Law*.

2.33 This is intended to provide a robust framework for the exercise of the regulation-making power.

Exemptions already specified in the ACL

2.34 Section 28 of the ACL excludes shipping contracts and company constitutions from coverage of the unfair contracts law. Further information on this can be found in paragraphs 2.91 to 2.99 of the TPA Bill 2010 explanatory memorandum.

Consequential amendments

2.35 In extending the consumer unfair contract term protection to small business contracts, references to consumer contracts have been modified to also refer to small business contracts. This includes:

- In the definitions section, section 2 of the ACL, the definition of a number of terms used in the ACL's unfair contract terms law: non-party consumer, rely on, small business contract, transparent and unfair [*Schedule 1, items 24 to 28, subsection 2(1) of Chapter 1 of Schedule 2*].
- To insert into the interpretation section, section 2, a referral to section 27 for the meaning of standard form contract [*Schedule 1, item 26, subsection 2(1) of Chapter 1 of Schedule 2*].
- The headings of the unfair contract term provisions of the ACL [*Schedule 1, items 29 and 37, sections 23 and 26 of Part 2-3 of Schedule 2*].
- To insert a requirement for the detriment to small business of prescribing a term under paragraph 25(n) to be considered in the same way as the detriment to consumers from prescribing such terms [*Schedule 1, item 22, subsection 139G(2)(aa) of Division 9 of Subdivision G*].
- The reference to contracts in Part 2-3 of Schedule 2 of the ACL [*Schedule 1, items 32 to 36 and 38 to 39, subsections 24(1) to (2) and (4), 26(1) to (2) and section 25 of Part 2-3 of Schedule 2*].
- Consequential amendments to Division 7 of Part XI and Part 5-2 of Schedule 2, which outline the declaration, enforcement and remedy provisions for unfair contract terms [*Schedule 1, items 19 to 21, paragraph 137D(b) and subparagraphs 137F(2)(b)(ii) and (d)(ii) of Division 7 of Part XI and subsection 139G(2) of Division 9 of Part XI; Schedule 1, items 41 to 47, subsections 232(3), 242(1), 250(2) to (5), paragraph 238(1)(b) and subparagraphs 237(1)(a)(ii), 239(1)(a)(ii) of Part 5-2 of Schedule 2*].

Application and transitional provisions

2.36 These amendments apply to varied terms, and contracts entered into or renewed on or after the day the legislation comes into effect. This will occur the day after the end of the period of six months beginning on the day this legislation receives Royal Assent. The amendments do not apply to a contract or term of a contract if it would result in the acquisition of property otherwise than on just terms pursuant to paragraph 51(xxxi) of the Commonwealth Constitution. *[Schedule 1, item 48]*

Chapter 3

Regulation impact statement

About this Decision Regulation Impact Statement

3.1 The purpose of this Decision Regulation Impact Statement (RIS) is to recommend a preferred policy option for dealing with the existence of unfair terms in standard form contracts being offered to small businesses. This RIS follows stakeholder comment on the Consultation RIS.

3.2 This Decision RIS identifies the nature of the problem to be solved, outlines the alternative policy options considered and explains the rationale for selecting the preferred option. It also assesses the costs and benefits of the preferred option compared with the other options identified.

3.3 This Decision RIS has been provided to the Legislative and Governance Forum on Consumer Affairs, who have endorsed the Commonwealth's preferred option to extend consumer unfair contract term protections to small businesses.¹

3.4 This Decision RIS follows the guidelines of the Council of Australian Governments in the Best Practice Regulation Guide (2007). It has been certified by the Office of Best Practice Regulation as meeting the Council of Australian Governments' best practice regulation requirements.

Foreword

3.5 The Australian Consumer Law (ACL), a national, state and territory law which commenced on 1 January 2011, aims to protect consumers and ensure fair trading in Australia.² It seeks to improve consumer well-being through consumer empowerment and protection,

1 CAF consists of all Commonwealth, state, territory and New Zealand ministers responsible for fair trading and consumer protection laws. CAF was formerly known as the Ministerial Council on Consumer Affairs.

2 *Competition and Consumer Act 2010* (Cth), Schedule 2.

fostering effective competition and enabling confident participation of consumers in markets where both consumers and suppliers trade fairly.

3.6 Preventing unfair practices is one of the six operational national consumer policy objectives, and in line with this, the ACL includes unfair contract term protections for consumers entering into standard form 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 unfair contract term protections are also replicated in the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to provide protections in financial product and service contracts.

3.7 The Commonwealth Government has committed to extending the consumer unfair contract term protections to small businesses as part of its *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 (CAF).

3.8 Small businesses are vital to the economy, generating employment, innovation and productivity – factors that support Australians’ standard of living. Small businesses are commonly presented with standard form contracts on a ‘take it or leave it’ basis and, like consumers, can lack the time and legal or technical expertise to understand or critically analyse these contracts, and the bargaining power to negotiate terms or resist their enforcement. Like consumers, they can be particularly vulnerable to the detriment that arises when an unfair contract term is relied upon. Where small businesses decide to not enter into contracts due to their lack of confidence in understanding and negotiating terms or due to the cost of obtaining legal advice, they may miss out on market opportunities.

3.9 An extensive consultation process was conducted from 23 May to 1 August 2014 to gather information on the extent of the problem and views from stakeholders on policy options. The consultation suggested that there is concern with unfair contract terms in small business contracts across a wide range of industries and circumstances.

3.10 A national unfair contract terms law for small business would be designed to enhance rather than impede or duplicate existing industry regulatory protections. To help businesses reduce their compliance costs, the Australian Competition and Consumer Commission (ACCC) would initially take an educative and compliance based approach similar to that employed for the introduction of the consumer protections. It is expected

that the Australian Securities and Investments Commission (ASIC) would also play a role.

*Consumer Affairs Australia and New Zealand*³

Executive Summary

3.11 Standard form contracts are a commonly used and cost effective option when conducting business, as they avoid the transaction costs associated with negotiated contracts. Nonetheless, standard form contracts are often offered on a ‘take it or leave it’ basis can be one-sided and have terms that are embedded in fine print. As some parties can lack the resources or skills to fully understand the implications of contract terms, businesses that offer standard form contracts have an incentive to include ‘unfair’ terms, that is, terms that advantage their position beyond their legitimate business interest and, if exercised, can cause detriment to the other party.

3.12 Action has already been taken with regard to consumer standard form contracts. In 2011, legislative protections against unfair contract terms were introduced into the ACL and mirrored in the ASIC Act for financial products and services.

3.13 Findings from an extensive public consultation process in 2014 indicated that small businesses, like consumers, are vulnerable to the inclusion of unfair terms in standard form contracts. Like consumers, they can lack the time and legal or technical expertise to understand or critically analyse such contracts and the bargaining power to negotiate terms. Compared to larger businesses, small businesses often have a more limited capacity to manage certain risks when transferred to them by the other party.

3.14 The consultation also found there are small business concerns with unfair contract terms across a wide range of industries, and that small businesses can suffer financial or other detriment when these terms are exercised. Detailed information of the consultation process can be found in the *Consultation* section of this document.

3 Consumer Affairs Australia and New Zealand is the pre-eminent sub-committee of CAF. Consumer Affairs Australia and New Zealand comprises the most relevant senior officer from consumer affairs or fair trading jurisdictions in each State and Territory, as well as the Australian Government and New Zealand.

3.15 Currently, small businesses are not protected against unfair contract terms. While the ACL provides a range of protections against unfair business practices, these go to the circumstances surrounding, or the process leading up to, the formation of a contract (procedural fairness), not to the unfairness of particular terms. Industry mechanisms, while offering some protections, do not provide for a general review of unfair contract terms in standard form contracts. To deal with the identified problem of unfair terms in standard form contracts with small business, this Regulation Impact Statement (RIS) explored four options:

- 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 (preferred option) — Legislative amendment to extend the existing unfair contract term provisions to low value contracts involving small businesses.
- Option 4 — Legislation to require contracts with small business to be negotiated on request.

3.16 The status quo does not appear to directly address the problem, with stakeholder feedback suggesting that there are widespread concerns with unfair terms in small business standard form contracts. Further, current laws and regulations do not provide adequate protections against the enforcement of unfair contract terms and there are clear incentives for businesses to include unfair terms in small business contracts.

3.17 Adopting light-touch, non-regulatory responses or introducing legislation that requires contracts with small business to be negotiated on request, is not expected to adequately and systematically address the identified problem and could impose significant compliance costs.

3.18 The preferred option is a legislative extension of consumer unfair contract term protections to include low-value contracts involving small businesses. This approach is expected to most substantially address the identified problem by enabling unfair terms in these contracts to be declared void, significantly reducing the incentive to include and rely on unfair terms. The Commonwealth recommends the legislative extension:

- apply a small business size threshold of fewer than 20 employees, combined with a transaction value threshold of \$100,000 (and \$250,000 for contracts of more than 12 months) to target low value small business transactions; and

- allow for the exemption of enforceable and equivalent legislation and regulation.

3.19 This approach achieves an appropriate balance between protecting those businesses most likely to lack sufficient resources and bargaining power, while preserving contractual freedom and certainty, and encouraging businesses to take reasonable steps to protect their interests.

The problem

3.20 The problem that has been identified is that standard form contracts being offered to small businesses often include unfair terms that, if relied on, can cause significant detriment.

Standard form contracts

3.21 Standard form contracts are pre-prepared contracts typically offered on a ‘take it or leave it’ basis by a party with greater bargaining power. Generally, a contract is considered to be standard form if one of the parties has not had the opportunity to negotiate or change the terms of the contract when agreeing to it.

3.22 As indicated in the recent consultation process, standard form contracts are widely used in Australia when businesses and consumers purchase goods and services.

- In the survey conducted as part of the public consultations process (see Attachment A: *Survey results*), 80 per cent of respondents indicated they were offered a standard form contract within the last 12 months.
- The survey indicated that standard form contracts are used in a wide range of industries, including: telecommunications, insurance, banking and financial products, utilities, and supply agreements.

3.23 Stakeholders have suggested that there are a number of benefits of standard form contracts, as they save businesses time and resources, particularly for repeated transactions. Lower costs associated with using standard form contracts can enable businesses to offer more competitive pricing on goods and services than if individual terms were negotiated with each customer.

3.24 However, stakeholders also suggested that there are a number of drawbacks associated with the use of standard form contracts, particularly

that they are not negotiated, often one-sided and include terms that are embedded in fine print.⁴ Further, some consumers and businesses signing the contract may not have the resources or skills to fully understand the implications of the terms they are presented. These factors can provide an incentive for the inclusion of unfair terms.

The inclusion of unfair terms in standard form contracts

3.25 The survey indicated that most businesses mainly focus on the price and quality of the good or service they are purchasing and not the terms and conditions in the contract (see Attachment A: *Survey Results*). Further, small businesses indicated that they lacked the resources to negotiate standard form contracts.

- Around 65 per cent of small business respondents in the survey agreed or strongly agreed that their business lacks the resources to negotiate standard form contracts.

3.26 As a result, businesses offering standard form contracts often compete on the price and the quality of the good or service and not on the terms and conditions in the contract.

3.27 This provides incentives for those businesses offering standard form contracts to include terms that advantage their position beyond their legitimate business interest and could be considered ‘unfair’. Businesses can invest significantly in expert legal and commercial advice to carefully calibrate contractual provisions to shift certain risks onto business signing the contract.

- There may also be a tendency for large businesses to base new versions of their standard form contracts on those currently being used by their competitors. This practice can result in poorly drafted and unfair contract terms being duplicated and multiplied across entire industries.⁵

3.28 Where a business can supply goods or services at a lower price by including ‘unfair’ terms (for example, by shifting certain risks onto the other party), businesses that offer more favourable terms may be unable to compete with those that offer contracts with unfair terms.⁶

4 See, for example, submission by Law Council of Australia SME Committee.

5 See, for example, submission by Law Council of Australia SME Committee.

6 In this context, the concept of ‘risk’ can include a range of contractual arrangements, for example, limitations on the parties’ rights in legal proceedings against each other and the

3.29 While business will understand and appreciate the significance of terms in contracts that they negotiate individually, some businesses signing standard form contracts are not aware of the presence of ‘unfair’ terms. Some businesses may decide not to expend the necessary resources to understand the terms where they lack the bargaining power to negotiate, or they may consider the costs disproportionate to the perceived risk of detriment that might result from entering into the contract.

3.30 Even if some customers have the resources and bargaining power to negotiate away unfair terms or resist their enforcement, if a majority of customers do not there would still be an incentive to include them.

- Competitive forces may restrain the incentive for businesses to offer contracts with unfair terms, particularly where a large number of businesses have a good understanding of the terms and/or have significant bargaining power, and where loss of reputation and potential market share is a consideration.

What is an unfair term?

3.31 The current consumer protections for unfair contract terms define an unfair term as a term that:

- causes a significant imbalance in the parties’ rights and obligations under the contract;
- would cause detriment (whether financial or otherwise) to a party if it were to be relied on; and
- is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term.⁷

3.32 This definition of unfairness recognises that while some contract terms may be perceived as ‘unfair’ by some parties, they may serve legitimate business interests and as a result should not be considered unfair.

parties’ rights to change the contract. Relevant contracts include on-going commercial arrangements, such as leases.

7 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 the transparency of the term and the contract as a whole. See Attachment B: *Consumer unfair contract terms protections in the Australian Consumer Law*.

- Some level of flexibility and uncertainty may be necessary in some types of contracts. For example, a supplier may legitimately use contract terms to pass risk to another business for events that they are able to influence, therefore providing 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.

3.33 The focus of this RIS is on substantive as opposed to procedural unfairness; that is the actual wording of the contract rather than the circumstances surrounding or the process leading up to the formation of a contract.

Small business vulnerability to unfair terms

3.34 Findings from the recent consultation process suggest that like consumers, small businesses are vulnerable to the inclusion of unfair terms in standard form contracts as they often lack:

- the resources to identify unfair terms, appreciate their significance and determine whether they can manage the associated risks;
- the resources to engage in negotiations over the terms of a contract;
- the bargaining power to successfully negotiate the terms of a contract; and/or
- the resources and bargaining power to resist the enforcement of unfair contract terms.

3.35 Responses to the consultation survey⁸ indicated that small businesses⁹ are more likely to lack resources and bargaining power than medium and large businesses. They:

- are less likely to have in-house legal expertise (8 per cent of respondents), seek legal advice on contracts (8 per cent often or always seek legal advice)¹⁰ and be able to afford legal or

8 See the summary of results in Attachment A: *Survey results*.

9 Small business respondents are defined as those with fewer than 20 employees for the purposes of the survey.

10 In the survey conducted by Consult Australia of its members, it was found that just under half of respondents did not seek professional legal advice, while those respondents who

financial advice for every contract they sign (82 per cent agree or strongly agree);

- generally have less understanding of the common terms and conditions found in standard form contracts; and
- are more likely to feel that their business does not have the resources to negotiate a better deal (65 per cent) or that standard form contracts are offered on a 'take it or leave it basis' with terms that cannot be negotiated (69 per cent).

3.36 Similar findings were reported by the Small Business Development Corporation of Western Australia (SBDC) which conducted a short survey of small businesses to support its submission to the consultation.¹¹ It reported that small business respondents were likely to believe that the other party would not negotiate contract terms and 69 per cent reported being offered contracts on a 'take it or leave it' basis. In addition, 40 per cent of respondents reported not having the power to negotiate.

3.37 While some medium and large businesses can also lack legal resources and bargaining power, larger businesses generally dedicate more time and resources to reading and understanding standard form contracts than small businesses.

3.38 Additionally, stakeholder submissions suggested that standard form contracts are often offered in situations where there is not sufficient time to review the terms of the contract.

- For instance, where a term may be questioned, not all business representatives/sales people presenting the contract have the authority to make changes to the contract.

3.39 Businesses of all sizes indicated that when purchasing a good or service using a standard form contract, the main focus was on the price and quality of the goods or services they were purchasing or supplying, not the terms of the contract.

- While most respondents indicated that they often or always reviewed standard form contracts, the majority of

indicated they did obtain professional legal advice overwhelmingly only used this advice sparingly, with more than half of respondents answering that they only obtained that advice for less than 20 per cent of contracts. See Consult Australia submission.

11 See Attachment A: *Survey results*.

respondents in the survey indicated that they were less likely to review contracts when the transaction value is low, the contracts are perceived as low risk or the contract is a renewal.

The inclusion of unfair terms in small business contracts

3.40 Feedback from the survey, submissions and stakeholder meetings indicate that unfair terms in standard form contracts are being experienced by small businesses across a wide range of industries.¹²

- Of the small business survey respondents who reported being offered standard form contracts, 60 per cent claimed to have experienced unfair terms with a wide range of goods and services identified.¹³ The most common concerns cited were in relation to automatic rollovers and termination.

3.41 Industries where unfair terms were reported in stakeholder submissions included: telecommunications, financial products and services, franchising, retail tenancy, waste management, architecture, independent contractors and advertising (see the *Consultation* section for further information).¹⁴

3.42 More generally, there was concern with a wide range of contract terms, such as those that permit one party to unilaterally vary terms, limit their obligations, terminate or renew the contract, levy excessive fees or usurious interest rates on outstanding monies, or affect the availability of redress. A number of stakeholders provided specific examples of unfair terms.¹⁵

12 See consultation section for further information.

13 Respondents were informed that the ACL contains provisions to protect consumers against unfair terms in standard form contracts and were given examples of terms that may be considered unfair. Some stakeholders did raise examples that were more related to procedural unfairness, while others raised issues with the fairness of the upfront price (currently not captured by consumer unfair contract terms protections).

14 See, for example, the anonymous submission to the review, which noted that their use is widespread; for example, employee contracts, contracts for outsourced cleaning, rubbish removal, and financial and accounting services. Other submissions supporting this notion include those by: Australian Automotive Dealer Association; DM Lock; Footscray Community Legal centre; Independent Contractors Australia; and Victorian Small Business Commissioner.

15 See, for example, submissions by the Victorian Small Business Commissioner, Small Business Development Corporation of Western Australia and the Telecommunications Industry Ombudsman.

3.43 With over two million small businesses in the Australian economy and the consultation survey suggesting that a high proportion of small businesses experience unfair terms, it is likely that a significant number of businesses in the economy are being impacted by unfair contract terms, particularly with small businesses engaging, on average, in several standard form contracts per year.¹⁶

Small business concerns about unfair contract terms in standard form contracts

3.44 The consultation suggested that small businesses are at times willingly agreeing to contracts that contain potential unfair terms. This could reflect the lack of competition for businesses to offer ‘fair’ contract terms, for example, where there are no viable alternative sources of supply.

- Some stakeholder submissions indicated that, when faced with a contract with an unfair term, small businesses can feel they have little choice but to accept the contract 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.
- Small business survey respondents who had identified an unfair term in a standard form contract were more likely to do nothing compared to medium and large business respondents, as they did not feel like they were able to negotiate (42 per cent of small business respondents compared with 26 per cent of medium and large business respondents). Medium and large business respondents were more likely to look for an alternative provider (41 per cent of medium and large business respondents compared with 28 per cent of those from small businesses).

3.45 The survey indicated that respondents who thought they had experienced an unfair term were most likely to seek resolution through informal channels. A minority of respondents indicated that they tried to resolve issues through formal channels such as complaining to a regulator (such as the ACCC or ASIC), participating in dispute resolution (including through a state Small Business Commissioner) or by pursuing legal action.

¹⁶ Respondents to the survey reported a median of five standard form contracts being offered in the previous 12 months.

- While there are currently no legislative protections for small businesses, the ACCC received 1375 small business complaints relating to unfair contract terms between the commencement of the consumer protections on 1 January 2011 and 31 December 2014 (see Table 3.1 below). The complaints made to the ACCC related to a wide range of terms, with the most common concerns being about terms relating to automatic rollover, termination, restricting rights and liability and franchising.

3.46 Small businesses have also directed complaints to state and territory fair trading bodies, state small business commissioners and industry ombudsman. Data collected from state small business commissioners suggest that complaints around potential unfair contract terms represent a significant amount of their total complaints:¹⁷

- The Victorian Small Business Commissioner (VSBC) reported receiving between 300 and 400 complaints per annum between mid-2012 and February 2015. Of these, they estimate that approximately 10 per cent concern potential unfair contract terms.

3.47 Complaints through these formal channels are likely to represent a very small share of small business concerns around unfair contract terms over this period. The consultation survey showed that of the small business respondents who reported experiencing unfair contract terms in the last 12 months only 12 per cent stated that they had pursued formal resolution, including making a complaint to a regulator (such as the ACCC, ASIC or relevant fair trading office), participating in dispute resolution (such as through a state small business commissioner) or pursuing legal action.

- The VSBC have also suggested that the number of complaints they have received relating to potential unfair contract terms likely reflect only a very small proportion of the issue. The VSBC noted that research by ORIMA¹⁸ reported that between three and five per cent of Small to Medium Enterprises (SMEs) experience a significant commercial business-to-business dispute per year. The VSBC state that, if 10 per cent of these disputes related to unfair contract terms in line with their experience, it would

17 For example, see submissions by the Victorian Small Business Commissioner, New South Wales Small Business Commissioner and Telecommunications Industry Ombudsman.

18 ORIMA Research, 2010, *Small Business Dispute Resolution*.

be expected that between 16,000 and 26,000 SMEs would experience such a dispute.

- Some small businesses may not be making formal complaints given that there are currently no legislative protections in place.

3.48 Based on the complaints data available, combined with results from the survey around small business complaint behaviour, it is therefore likely that this issue is impacting on a significant proportion of Australia's over two million small businesses.

Table 3.1: ACCC unfair contract term and small business complaints:

<i>Category</i>	<i>Number</i>
Franchising (not Franchising Code related) — other.	260
Automatic Rollover — a subset of termination complaints in which the contract automatically rolls over for excessive periods for example five years or more.	252
Termination — clauses that unfairly restrict the small businesses right to terminate the contract.	235
Unilateral Contract Variation — clauses that allow the other party to change the contract without the consent of the small business.	141
Unfair contract terms — other.	129
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.	115
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.	99
Retrospective Variation — a subset of unilateral variation complaints in which the contract contains clauses that allow for retrospective variation of terms and conditions.	65
Franchising (not Franchising Code related) — exclusive supply contracts.	33
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.	24
Franchising (not Franchising Code related) — geographical clauses.	22
Total	1,375

Source: ACCC

Small business detriment due to unfair contract terms

3.49 The existence of unfair contract terms does not necessarily mean that such terms will be enforced or relied upon by the business that offers the contract. Reasons why unfair contract terms may not be enforced include:

- where they are triggered by events that may not occur — such as defaults or failure to provide a service (that is, they may be low probability, high cost events); and
- where a business does not choose to enforce the term if they consider that the cost (for example, loss of reputation or loss of future business of the affected customer) is greater than the anticipated benefit.¹⁹

3.50 Detriment arises where unfair contract terms are enforced (or at least where there is an expectation they will be enforced).

3.51 The consultations indicated that detriment is being suffered by small businesses, who often have limited ability to resist the enforcement of unfair terms. Of the survey respondents who experienced unfair contract terms, almost half incurred some harm or loss.

- Of the 58 survey respondents who reported incurring losses in the survey, 76 per cent of these respondents undertook informal negotiations with the other party to address the unfair contract term and 28 per cent sought resolution through formal channels (some used both formal and informal methods). Of those using formal negotiations, three quarters indicated that they incurred additional costs to their business.
- Losses generally ranged from \$1,200 to \$20,000 (although one respondent claimed a loss of \$2 million).²⁰
- Examples listed by respondents included: loss of clients due to a failure to back a product, a significant amount of management time and legal advice and paying a high termination fee.

¹⁹ While it may be claimed that competitive processes do not eliminate the existence of unfair contract terms, there may be competitive forces restraining their use. See Productivity Commission, 2008, *Review of Australia's Policy Framework*, page 426.

²⁰ Note: only a small number of respondents answered this question.

3.52 The SBDC contends that many small businesses in Australia have suffered detriment as a result of an unfair contract term being enforced against them. Their submission to the consultation process provided evidence and case studies to highlight the extent of this detriment not only to the small business but to its owner and their family.

- The SBDC reported that financial loss was the most commonly mentioned detriment in their survey (30 per cent of respondents), followed by loss of business opportunity (16 per cent); the creation of compliance obligations that required unreasonable time and effort to address (16 per cent) and reputational damage (13 per cent).

Inefficient allocation of risk

3.53 The consultations indicated that an unfair contract term can shift risks to the party that is less able to manage them effectively.²¹ In many cases, this can be a small business that is less likely than the other party to have robust risk management procedures and policies in place and is less able to absorb the detriment if an unfair term is enforced.

- For example, an unfair contract term may require the small business to bear the risk of a high cost, low probability event. While this may result in a lower contract price, the small business may be taking on risks they are unable to effectively manage.
- In its submission, the Association of Consulting Architects indicated that for contracts governing architectural services there is a ‘developing tendency for clients to seek to transfer an unreasonable amount of risk to the architectural team, without appropriate compensation for bearing this risk, or to transfer risk for items that are outside the architect’s control.’²²

21 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. Such redistribution of risk may reduce incentives for the business offering the standard form contract to manage risks efficiently.

22 See page 2 of the Association of Consulting Architects’ submission.

Transaction costs

3.54 A business seeking to avoid signing a contract that includes unfair terms may incur substantial costs in gaining the necessary information to assess whether they are present.²³

- As small businesses often lack in-house legal expertise,²⁴ the cost of gaining this information, even for a simple standard form contract (one to two pages), can cost several thousand dollars.²⁵ For low value contracts this can be viewed as disproportionately high and, therefore, not worth undertaking.

Other costs

3.55 With concerns about potential detriment, the presence of unfair contract terms can weaken small business' confidence in contracting. This can have negative impacts on the broader economy as small businesses account for 97 per cent of all businesses and generate a large share of total employment.²⁶

- As one stakeholder noted: 'The direct cost of unfair contract terms is borne by the contracted party, and affects their ability to run a successful business, to produce work of high quality, to offer good employment conditions and to grow the business.'²⁷

3.56 Unfair contract terms can also entrench unequal bargaining power. In submissions to the consultation process, some stakeholders noted that businesses with strong bargaining power (and at times their affiliated partnering organisations) can offer contracts that include terms that further displace the balance of power between the parties.

3.57 Unfair contract terms also violate the ethical principle of fairness in contracts. In its 2008 report, the Productivity Commission found this to be the strongest argument for acting on unfair contract terms, though they

23 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.

24 Only eight per cent of respondents to the survey with less than 20 employees reported they had in-house legal advice. See Attachment A: *Survey results*.

25 Estimates were provided for the Law Council of Australia Competition and Consumer Committee.

26 ABS catalogue no. 8165.0.

27 See page 1 of the Association of Consulting Architects' submission.

also noted that while many ethical norms are valued, not all are legally enforceable.²⁸

Can existing laws and industry mechanisms address the problem?

3.58 The ACL, the ASIC Act and the common law enshrine the concept of fairness in contractual dealings in a number of ways. Businesses can receive a number of protections under the ACL and ASIC Act that are also afforded to consumers and which may provide some level of indirect protection from unfair contract terms in specific circumstances. However, there are currently no legislative protections or other dispute resolution mechanisms that specifically address unfair contract terms in contractual dealings between businesses.

3.59 This is because the protections are designed to address issues of ‘unfair’ behaviour in business-to-business or business-to-consumer dealings, not the unfairness of terms themselves. Where there are protections against unfair terms, these are only in relation to consumers.

3.60 While there are currently some industry-specific legislation or regulation, which can provide protection against unfair contract terms, these are generally limited in application and do not provide the level and scope of protection that is considered necessary to address the identified problem.

3.61 As a result there is a regulatory gap and small businesses remain vulnerable to unfair contract terms across a wide range of circumstances.

3.62 This issue is discussed further in the *Status Quo* section and at Attachment C: *Existing laws and regulations*.

Is there a role for Government intervention?

3.63 In the absence of adequate protections, and given small businesses generally lack the resources and bargaining power to effectively review and negotiate terms or resist their enforcement, there is currently an incentive for businesses to include unfair terms in standard form contracts offered to small businesses. This can result in an inefficient allocation of risk, with small businesses often not appreciating the risks they are taking on and being poorly placed to manage them effectively

28 Productivity Commission, 2008, *Review of Australia’s Consumer Policy Framework*, page 151.

and, when unfair terms are enforced, they can cause significant business detriment.

3.64 Therefore, there is a clear policy case for intervening to protect small businesses against unfair terms in standard form contracts.

3.65 In designing an intervention, it is important that there is an appropriate balance between contractual freedom and certainty and protection for small business. To the maximum extent possible, the intervention should not interfere in the conduct of commercial dealings nor undermine the ‘sanctity of contract’ principle.²⁹ To achieve this, the intervention should target standard form contracts entered into by those businesses most likely to lack sufficient resources and bargaining power. It will also be important to consider whether the intervention should not apply to contracts where it would be reasonable for a business to undertake appropriate due diligence before signing (that is, standard form contracts where the cost of obtaining legal advice is likely to be proportionate to the contract value).

Objective of reform

3.66 The objective of this reform is to promote fairness in contractual dealings with small businesses with regard to standard form contracts. This will reduce small business detriment and have positive impacts on the broader economy by increasing small business certainty and confidence, and providing for a more efficient allocation of risk. Small businesses, in dealing with other businesses through standard form contracts, should have confidence that the contract they are offered is fair and reasonable and that the risks are allocated efficiently.

3.67 In achieving this, it is important that the benefits of the chosen intervention exceed the costs. This includes providing, to the maximum extent possible, business certainty as to the application of the protections and providing affected businesses with timely and affordable access to justice.

²⁹ The ‘sanctity of contract’ principle 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.

Policy options

3.68 There are a several possible interventions, ranging from a focus on customer empowerment (demand-side measures) through enhancing the quality or type of information available, to a focus on modifying the behaviour of those businesses offering standard form contracts (supply-side measures) and through encouraging the development of industry self-regulation which protects against or mandates certain practices.

3.69 This RIS identifies four main options:

- Option 1 — the status quo;
- Option 2 — light touch or non-regulatory responses;
- Option 3 (preferred) — extend the current consumer unfair contract term protections to small businesses; and
- Option 4 — legislate to require small business standard form contracts to be negotiated on request.

3.70 These options do not change the relative bargaining power of parties that is present at the contract formation stage. Rather, they seek to either address the imbalance of information available about contract terms and/or protect against the enforcement of unfair contract terms in small business standard form contracts.

Option 1 – Status Quo

3.71 Under this option, there would be no intervention with existing regulations and market forces relied upon to address the identified problem.

3.72 This option is inconsistent with the Commonwealth Government’s policy commitment and CAF’s agreement to explore unfair contract terms protections for small businesses.

3.73 As highlighted in previous sections, relying on the status quo will not address the problem as under current arrangements there are clear incentives for businesses to include unfair terms in the standard form contracts they offer to other businesses and there are no protections against their enforcement.

3.74 Submissions to the consultation process broadly acknowledged that there is a systemic problem with unfair terms in standard form contracts across a wide range of business sizes and industries, although

some stakeholders expressed the view that certain industries already had adequate protections against unfair contract terms.³⁰

Relying on current laws and regulations

3.75 The common law the ACL and the ASIC Act enshrine the concept of fairness in contractual dealings in a number of ways.

The common law

3.76 The doctrine of freedom of contract under the common law 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.

3.77 In practice though, some consider this provides the more powerful party to a contract with ‘a freedom of manipulation and motivation, [and] a freedom from any onus of articulation ...’³¹ Consequently, disparities in bargaining positions between the business offering the contract and the business agreeing to the contract may mean that the party agreeing to the contract is not always free to negotiate the terms under which they contract.

3.78 Manipulation may also occur where a business signing a contract does not have the resources or skills to completely understand the implications of the contractual terms they are offered. As raised earlier, this is particularly a concern for contracts involving small businesses.

The ACL

3.79 There are a number of consumer protections under the ACL that may indirectly discourage the inclusion of unfair terms in small business contracts and/or provide a level of indirect protection for small businesses from unfair contract terms in limited circumstances.³² Some of these include:

- consumer unfair contract term protections;

30 It should be noted that the majority of submissions did not refer to the status quo option and only a few submissions (e.g. Federal Chamber of Automobile Industries) had it as their preferred option.

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

32 These protections, to a large extent, are mirrored in the ASIC Act. The equivalent provisions in the ASIC Act apply to most financial products and services purchased by consumers.

- prohibitions against unconscionable conduct;
- consumer guarantees; and
- misleading or deceptive conduct.

3.80 These protections have been designed to not specifically deal with the fairness of contractual terms but rather matters of ‘procedural unfairness’ – the unfairness of the circumstances surrounding, or the process leading up to, the formation of a contract.

3.81 As a result, they do not provide direct protection for small businesses against unfair contract terms across the wide range of circumstances that have been identified as problematic, leaving a significant gap in protection for small businesses.

3.82 Further, based on the way these protections are designed, they are unlikely to sufficiently deter the inclusion of unfair terms in contracts, particularly where a term can be unfair regardless of any procedural unfairness.

Consumer unfair contract term protections

3.83 The existing unfair contract term provisions for consumer standard form contracts in the ACL may reduce the inclusion of unfair terms in contracts being offered to small businesses, where businesses offer the same contracts to both consumers and small businesses, and choose to comply with the consumer unfair contract term provisions. However, small businesses have no legislative protection where unfair terms are present or enforced.

3.84 It is likely that only a small proportion of small business contracts would be indirectly impacted by these provisions, with businesses only offering the same consumer contracts to small businesses in particular circumstances. The survey results showed only 15 per cent of respondents offer contracts to both small businesses and consumers.

Prohibitions against unconscionable conduct

3.85 The ACL prohibits unconscionable conduct in trade or commerce in connection with the supply of goods or services to a person (other than a publicly listed company), which includes small businesses.³³ In considering whether there has been unconscionable conduct, a court

33 See section 21 of the ACL. See also section 12CB of the ASIC Act, which includes equivalent protections for the provision of financial products and services.

may, but is not required to, consider the terms of a contract, amongst a range of other factors. Therefore, in some circumstances a court may consider the fairness of the terms of the contract as part of a broader assessment of whether there has been unconscionable conduct.

3.86 In practice, statutory unconscionable conduct provisions are not used to find a contract term unfair. Consequently, it is not clear whether statutory unconscionable conduct provisions can deal with unfair contract terms in themselves. As a result, it is unlikely that these provisions provide businesses offering contracts to small businesses with sufficient disincentives to not include unfair terms in contracts.

Consumer guarantees

3.87 Under the ACL, suppliers of goods and services must adhere to the specified consumer guarantees which cannot be excluded, modified or limited by contract. Consumer guarantees primarily apply to core terms regarding the nature and quality of the good or service, rather than terms relating to matters such as dispute resolution or in the length of the contract. Consequently, consumer guarantees do not directly address unfair contract terms.

Misleading or deceptive conduct

3.88 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.³⁴ These protections are unlikely to directly address unfairness of contract terms, as a contract term can be unfair without necessarily being misleading or deceptive.

3.89 There could be some protections for small businesses where disclosure of a contract term is found to constitute misleading or deceptive conduct. However, the Law Council of Australia SME Committee suggested in their submission that small businesses have not been successful in the past in arguing that a failure of a large company to disclose an unfair term constituted misleading or deceptive conduct. They suggest that these arguments have generally not been successful mainly because it is difficult to argue that a particular unfair contract term is 'unusual' when it appears in virtually every standard contract used in a particular industry.

34 Section 18 of the ACL.

Industry-specific mechanisms

3.90 There are some industry-specific mechanisms that explicitly prohibit the use of unfair contract terms in standard form contracts offered to business, such as the *Independent Contractors Act 2006* (Cth) and the *Motor Vehicle Dealers and Repairers Act 2013* (NSW). However, these are limited to those specific sectors.

- The *Motor Vehicle Dealers and Repairers Act 2013* (NSW) provides unfair contract term protections for the supply of motor vehicles between motor dealers and manufacturers. The *Independent Contractors Act 2006* (Cth) also allows independent contractors to seek judicial review of a services contract on the grounds that the contract is 'unfair' or 'harsh'.

3.91 Some industry mechanisms, such as the Franchising Code, are focused on dealing with specific industry characteristics which drive the need for special protection. For example, the Franchising Code addresses issues that can arise from the imbalance in bargaining power and dependence of a franchisee on a franchisor. In the absence of regulation, franchisees may be vulnerable to opportunistic conduct and abuse of power by franchisors.

3.92 These industry mechanisms can provide requirements for specific contract terms and may therefore go some way to addressing a limited amount of specific unfair contract term issues in these sectors.

- For example, the Franchising Code sets out a number of protections and disclosure requirements, including cooling off rights, and was recently strengthened by the introduction of a general duty on the parties to act in good faith. It also limits the enforceability of certain terms, such as a restraint of trade clause, if certain conditions are met on conclusion of the agreement.

3.93 However, mechanisms do not provide for a general review of unfair contract terms in standard form contracts, which was an issue raised in the consultation process. For further information on these protections see Attachment C: *Existing laws and regulations*.

Relying on market forces

3.94 As discussed in *The Problem* section, the evidence suggests that market forces create incentives for businesses to include unfair terms in standard form contracts, particularly where businesses tend to focus on price and quality, and do not fully understand or value the meaning of

contract terms. These pressures are only partially ameliorated by concern about reputation or customer loyalty that may discourage businesses from enforcing unfair terms in some circumstances.

Impact Analysis

3.95 Benefits of maintaining the status quo include:

- no interference in contractual dealings, including affecting current incentives to adopt standard form contracts;
- businesses not being subject to additional compliance costs; and
- no impact on the price of goods and services, which may occur if the intervention to remove unfair terms from standard form contracts results in an increase in costs.³⁵

3.96 Costs associated with maintaining the status quo include:

- the continued inefficient allocation of risk in many standard form contracts, where risk is allocated to the party less able to manage it effectively, reducing overall economic welfare;
- the continued incidence of small business detriment resulting from the enforcement of unfair contract terms;
- a sub-optimal level of small business confidence in contracting, leading to lower investment, innovation and engagement in economic and employment growth opportunities; and
- regulatory agencies continuing to incur costs in handling disputes and/or complaints from small business about unfair contract terms but remaining unable to take action.

Option 2 — Light touch or non-regulatory responses

3.97 Under this option, a range of light touch, industry self-regulation or non-regulatory measures could be adopted or promoted to address the identified problem and complement existing measures. These include:

35 Note though that while suppliers may charge lower prices under the status quo, small businesses would be better off paying a higher price for a contract that sees more of the risk in the transaction remaining with the supplier where they are best place to manage that risk.

- industry initiatives to discourage the use of, and/or increase transparency and understanding with regard to, unfair terms in standard form contracts (for example, voluntary industry code of conduct);
- awareness and information campaigns targeted at small businesses, for example, guidance on what may constitute an unfair term and the possible implications of agreeing to them; and
- information disclosure requirements regarding the use of unfair terms in standard form contracts.

3.98 Only a few submissions to the consultation expressed a preference for such an approach (for example, Australian Industry Group (Ai Group), Business Council of Australia (BCA)).

Industry initiatives

3.99 Industry could develop self-regulation measures such as voluntary standards or a voluntary code of practice that sets out the types of terms that should not be included in standard form contracts offered to small businesses.

- In their submission, Ai Group³⁶ suggested the use of a voluntary ‘fair contract’ mark (or label) for standard form contracts that meet an agreed standard.³⁷

Impact Analysis

3.100 Such measures would see industry taking a proactive role in reducing the incidence of unfair terms in standard form contracts and providing more information to small businesses. It would likely result in different approaches being adopted which would arguably allow for responses tailored to the particular circumstances of a given industry.

3.101 However, the presence of multiple industry-specific rules may increase the compliance burden and uncertainty in business dealings,

36 They suggest that ‘fair contract principles’ could be developed through a consensus process managed by a reputable standards organisation with a committee made up of representatives that included legal experts, relevant federal, state and territory agencies and small and large businesses.

37 The Business Council of Australia suggested that there could be more effective implementation of existing industry codes.

particularly for businesses that operate across industries. Small businesses with limited resources are likely to face particular challenges.

3.102 Differential treatment across industries could also leave a small business protected from particular unfair contract terms in some circumstances but not in others, and there may be an incentive for businesses offering standard form contracts to adjust their contracting practices to avoid being captured by an industry initiative.

3.103 In addition, this option relies on industry players reaching agreement on the self-regulation measure. Where this is not achieved, small businesses remain vulnerable to unfair contract terms and governments may have limited scope to respond where voluntary compliance proves inadequate.

3.104 For these reasons it is unclear whether this approach would adequately address the identified problem throughout the economy without generating significant uncertainty and compliance costs for businesses.

Awareness and information campaigns

3.105 An awareness and information campaign would involve measures to improve small business' awareness and understanding of unfair terms in standard form contracts and could be implemented by governments or as part of an industry initiative. Guidance on what unfair terms could be included, together with a 'list of common unfair terms' and/or a suggested set of default rules or templates for standard form contracts for a variety of transaction types.

3.106 Information campaigns can raise awareness regarding the nature and potential impact of unfair terms in standard form contracts and the rights and protections available under existing laws.³⁸ This may encourage small businesses to review standard form contracts more closely and be more prepared to negotiate terms, as well as discourage businesses from including unfair terms in the standard form contracts they offer. This could be regarded as promoting 'best practice' in contracting with small businesses.

38 The issue of improved information was raised in the submission by the Business Council of Australia which suggested that 'better information for business about their protections under the prohibition of unconscionable, misleading or deceptive conduct provisions of the [*Competition and Consumer Act 2010* (Cth)]. This would include more accessible information and guidance on unfair standard contract terms, industry codes of conduct and existing legal protections', at page 8.

- In their submission, the BCA suggested that more accessible information and guidance could be provided on unfair terms in standard form contracts, industry codes of conduct and existing legal protections.³⁹ Consult Australia suggested that small business commissioners or equivalent offices around Australia could be strengthened to undertake educational activities targeted at small businesses and their clients to enhance understanding of unfair contract terms and their impact.
- The Association of Consulting Architects suggested the creation of a list of non-negotiable content for contracts.

Impact Analysis

3.107 Key benefits of this approach are that it would not impact upon the ‘sanctity of contract’ and greater awareness may facilitate competition in the use of standard form contracts, which in turn could lead to improved quality and increased variety of terms.⁴⁰ It could also increase small business confidence in contracting.

3.108 However, there is a risk the approach will not address the identified problem as small businesses may lack the resources to seek out and absorb the available information or may disregard its value, particularly where they commonly engage in low-value standard form contracts or undervalue less salient features of contracts (for example, costs associated with low probability risks). Also, even if small businesses become better at identifying unfair contract terms they may still lack the bargaining power to effectively negotiate their removal and if they agree to the contract they have no protection against its unfair terms.

- Given the meaning of ‘unfair’ is contextual, there are risks with characterising a particular term as ‘unfair’ where it may not be in all circumstances. This could impose inflexibility on contracting practices and create an incentive for ‘gaming’ by using terms with substantially the same effect but that are not described exactly as those on the list. It may also be impracticable to identify a comprehensive list front and it

39 For example the Business Council of Australia suggested this more information on unfair contract terms could be provided through regular publication of small business unfair standard contract term complaint outcomes and their resolution by businesses, ombudsmen and the ACCC.

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

would likely need to be continually updated, adding to implementation costs.

Information disclosure requirements

3.109 Information disclosure requirements would involve measures to improve the transparency of terms in standard form contracts, helping increase the information available to small businesses offered standard form contracts. For example, a minimum level of information could be required through the provision of a high level summary of the key terms in a contract, or a ‘key facts sheet’. Such a document would need to be carefully designed and targeted.⁴¹

3.110 Such initiatives could be industry-led (for example, by a representative body) and comprise key terms likely to vary across industries. They could also be imposed by regulation, similar to the disclosure regimes already adopted by a range of customer contexts, including for food nutrition and home loans.⁴²

Impact Analysis

3.111 Similar to information campaigns, an effective disclosure requirement should make it easier for small businesses to identify unfair terms. It would not impact upon the ‘sanctity of contract’ and may facilitate greater competition in standard form contracts due to a higher level of awareness. In turn, this could lead to improved quality and increased variety of terms.⁴³

3.112 However, it too risks not addressing the identified problem as even if all the necessary information is made available, small businesses may not have the resources to absorb it or may disregard its value, particularly for low-value transactions.

- In its submission, the Law Council of Australia SME Committee suggested that: ‘Information disclosure

41 Research suggests disclosure requirements are likely to be more effective when they take into consideration a customer’s tendency to think in certain ways (cognitive biases). See Marotta-Wurgler, F 2010, *Does Disclosure Matter?*, New York University School of Law, page 9.

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

43 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.

requirements are unlikely to be an adequate response to [Unfair Contract Terms] in small business contracts...because there is no guarantee that information disclosure requirements will be read by time-poor small business operators. In addition, product and service disclosure statements have a tendency over time to become just as lengthy, convoluted and complex as the contracts which they are seeking to explain.⁴⁴

3.113 Even where small businesses are able to identify unfair contract terms, they may lack the bargaining power to effectively negotiate terms and if they agree to the contract, may have no protection against its unfair terms. Also, they may continue to underestimate the value of less salient features of contracts, including the costs associated with low probability risks.

3.114 Lastly, whether disclosure obligations are imposed by regulation or are industry-led, they can impose compliance costs on businesses who offer standard form contracts.

Conclusion

3.115 While a range of light touch, industry self-regulation or non-regulatory measures are available, their effectiveness in addressing the identified problem and adequately supporting the stated policy objective is limited, whilst having the potential to impose compliance costs on business.

Option 3 — Extend unfair contract term protections to small businesses (preferred option)

3.116 Extending the consumer unfair contract term protections to small businesses would involve a legislative amendment to the ACL and the ASIC Act. This would render void a term in a standard form contract offered to a small business that a court deems unfair.⁴⁵ This would give direct effect to the Commonwealth Government's policy commitment and CAF's agreement to explore unfair contract term protections for small business.

44 See page 9.

45 As outlined in Attachment B: *Consumer unfair contract terms protections in the Australian Consumer Law*, the ACL currently provides unfair contract terms protection for standard form consumer contracts.

3.117 A legislative protection against unfair contract terms is expected to bring the greatest net benefit and is the preferred option.

Scope of legislative protections

3.118 As outlined in the public consultation paper *Extending Unfair Contract Term Protections to Small Businesses*⁴⁶ there are a number of issues to consider when designing the protections:

- What measure should be used to define a small business transaction?
- Should any industries be exempt from the protections?
- Should protections cover both the acquisition and supply of goods and services?
- Should protections cover small business to small business contracts?

Defining a small business transaction

3.119 Several options for defining small business transactions were raised in the consultation with no clear consensus on the best approach (see Consultation section). The two approaches most commonly referred to were a business size threshold and a transaction value threshold.

A business size threshold

3.120 A business size threshold would be used to limit protections to those businesses considered most vulnerable to unfair contract terms ('inclusive' approach). This approach recognises that in general, as the size of a business increases so does its resources and bargaining power.⁴⁷

3.121 As was found in the consultation process, small businesses are more likely than larger businesses to lack the resources and bargaining power to review contracts for unfair terms. A small business definition provides a clear and simple proxy for these businesses.

46 The Treasury and Consumer Affairs Australia and New Zealand, May 2014, *Extending Unfair Contract Term Protections to Small Businesses: Consultation Paper*, <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Small-Business-and-Unfair-Contract-Terms>>.

47 For example, a desire to maintain customer loyalty is more likely to discourage enforcement of unfair terms against medium and large businesses.

3.122 The term ‘small business’ is commonly defined using an employee headcount. This provides a proxy as to business size, including the extent of human resources capacity within the business.

3.123 For instance, the Australian Bureau of Statistics (ABS) defines a small business as any business with less than 20 employees, the ASIC Act defines a small business as any business having less than 20 employees (with an exception of less than 100 employees for manufacturing businesses), and the *Fair Work Act 2009* (Cth) defines a small business as any business with fewer than 15 employees.⁴⁸

- An alternative definition of small business considers annual business turnover. For instance, the Australian Tax Office defines a small business as a business with an annual turnover (excluding GST) less than \$2 million. A business turnover definition is not preferred as it is a less clear indicator of human resources capacity and could exclude small businesses in low margin and high turnover sectors (for example, petrol retailers).

3.124 It is possible that using a headcount approach for characterising a business as a small business may cause uncertainty, particularly where a party may not, on face value, be able to determine if a party they are contracting with is a small business. Nonetheless, the consultation indicated that this would not be a significant issue given that businesses who offer standard form contracts generally offer the same standard form contract to all businesses with whom they contract, regardless of business size. This suggests that the uncertainty may only arise at the time a business seeks to enforce the unfair terms, and that the onus would be on the small business to demonstrate they were a small business at the time they agreed to the contract, and are therefore covered by the protection they are seeking to enforce.⁴⁹ There will also be a requirement on regulators to establish whether a business meets the definition.

3.125 One drawback of using a small business definition is it may exclude some businesses who are also vulnerable to unfair terms but who just fall outside the threshold. An alternative is to exclude larger businesses that are well-resourced and have sufficient bargaining power from the coverage of the protection (‘by exclusion’ approach).

48 The ABS conducted research on small business definitions in 1999. It examined the accuracy and coverage of numerous definitions including turnover and employee count. The report is available at <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/1321.0>>.

49 It will therefore be important to ensure that small businesses are well educated of their rights under unfair contract term protections.

- For example, publicly-listed companies, large proprietary companies, and their subsidiaries could be excluded from the protections.

3.126 Although this approach would reduce the risk of excluding vulnerable businesses from the protections, it would mean that a number of well-resourced medium-sized companies would be covered by the protections.

3.127 It is therefore recommended that the definition of small business adopted by the ABS (less than 20 employees) be used, given that it is a commonly used headcount measure and has been found by the ABS to provide a good proxy of small businesses.

3.128 When using an employee headcount, consideration must be given to the point at which it is measured, the time period it is calculated and how to account for factors such as seasonal variation, part-time and casual employment.⁵⁰ For example, to account for seasonal variations an annual measure may need to be used (that is, calendar or financial year).

3.129 Another approach which may account for some of these factors, used in the *Fair Work Act 2009* (Cth), is to measure the number of employees who are employed on a 'regular and systematic basis'. This would mean that only casual employees that are employed on a regular and systematic basis, as opposed to a seasonal roster, would be counted.

A transaction value threshold

3.130 A **transaction value threshold** could also be used to limit the scope of the protections to maintain the onus on businesses to take reasonable steps to protect their interests. To achieve this, a threshold would be set at a value above which it would be considered reasonable for a business to undertake due diligence by, for example, seeking legal advice.

- Some stakeholders suggested that small businesses often have more bargaining power than they realise (see Law Council of Australia SME Committee Submission) and small businesses should be seeking legal advice for these more substantial transactions.

⁵⁰ Employee numbers can fluctuate (e.g. seasonal businesses, start-ups) and can change depending on calculation methods (e.g. based on last financial year/calendar year, at the point of contracting or at the point of enforcing rights).

- On the other hand, some stakeholders had concerns with using a transaction threshold, suggesting that small businesses should be protected for high-value transactions where the consequences of an unfair term can be significant and small businesses have limited bargaining power. Further, it was suggested that regardless of transaction size, some small businesses may lack the resources to acquire the necessary level of legal advice.

3.131 Small businesses have a number of similarities to consumers in that they often lack the resources and bargaining power to adequately review and negotiate contracts for low-value day-to-day transactions. However, unlike consumers, small businesses are also engaging in high-value commercial transactions that are fundamental to their business, where it may be reasonable to expect that they undertake appropriate due diligence.

3.132 Providing a protection against unfair terms for small businesses engaging in such high-value contracts may reduce the possibilities available to small businesses. Specifically, small businesses are often offered contracts that contain terms which allow for a lower-priced contract, and if these terms are removed then the cost for small businesses under these types of contracts may increase. Some small businesses may prefer to take on more risk in exchange for a lower-priced contract.

- The Productivity Commission's 2008 Inquiry Report, *Review of Australia's Consumer Policy Framework*, notes that: 'barring specific terms alters the complex balance of the contractual bargain, thus affecting profits and placing upward pressure on prices. For instance, a reduced capacity for businesses to impose some contingent charges on consumers, such as certain termination fees, would lead to recovery through higher upfront charge'.⁵¹
- In their submission, the Australian Corporate Lawyers Association notes:
 - '... a business may elect to accept a standard form contract that purportedly has onerous terms, not because it does not have the capability or resources to protect itself, but because there is a commercial advantage to doing so – this could be first mover advantage, the low risk not warranting

51 See page 155.

delaying the transaction or the risk being compensated for through better commercial terms such as pricing.

- The more prescriptive the reforms, the greater the risk that the inclusion of a term that is commercially reasonable for the particular circumstances, may be inadvertently prevented.⁵²

3.133 Such an approach would support time-poor small businesses entering into contracts for day-to-day transactions, while ensuring they do their due diligence when entering into big contracts that underpin their business model.

3.134 Based on findings from the consultation process, a transaction threshold of \$100,000 for contracts of 12 months or less in duration and \$250,000 for contracts of more than 12 months in duration is recommended (see Box 1).

- A two-tiered transaction value threshold is recommended to account for multi-year contracts. This is expected to capture a large proportion of day-to-day small business contracts (only 12 per cent of small business survey respondents reported they were offered contracts of more than \$250,000).

52 See page 6.

Box 1: Setting a transaction value

Two factors are relevant to determining the level of a transaction value threshold:

- the point at which it would be reasonable to expect that a business seek legal advice before entering into a contract (appropriate due diligence); and
- where small businesses are clearly more likely than medium and large businesses to enter into standard form contracts under this threshold.

Some stakeholders indicated support for using a transaction value threshold to encourage appropriate due diligence.⁵³

- For example, the Law Council of Australia's Competition and Consumer Committee recommended a threshold 'slightly more than the existing \$40,000 [for consumer guarantees], and...closer to a \$100,000 threshold'. The Committee suggested that this threshold was appropriate given 'the majority of standard form contracts are generally for transactions which occur frequently, don't require parties to give extensive thought to negotiating every term of the contract and are for a lower dollar value.'⁵⁴
- For low value contracts, the cost of legal advice can represent a disproportionately large share of the total value, with legal costs for reviewing contracts up to \$100,000 typically ranging from \$1,000 to \$4,000 (depending on the jurisdiction and transaction value).⁵⁵

Feedback from the consultation suggested a threshold of \$100,000 would capture most small business transactions.⁵⁶

- Only 22 per cent of small business survey respondents indicated that they were offered contracts valued more than \$100,000. Of the small businesses who reported that they had experienced an unfair term in the past 12 months, around 80 per cent indicated that that the value of the contract in question was less than \$100,000.
- Such a threshold is anticipated to cover most small business purchases of consumption goods and services⁵⁷, small to medium acquisitions and supplies of goods and services, most independent contracting, some business loans and some retail tenancy and franchise agreements.

53 Most stakeholders did not raise the issue of a transaction value in their submissions, though the issue was raised during stakeholder meetings.

54 The Committee also suggested 'a higher threshold will require companies to consider the operation of the [unfair contract terms] regime for transactions where companies should really be receiving independent legal advice rather than relying on the operation of the [unfair contract terms] regime to protect them and their rights.' See the submission by the Law Council of Australia Competition and Consumer Committee.

55 Based on information provided by the Law Council of Australia.

56 Note: Most submissions that provided examples of unfair contract terms involving small businesses did not include a transaction value. Where they were included a significant proportion of these were less than \$250,000.

57 Such as telecommunications, office supplies, utilities, cleaning, waste management, advertising, IT services, general banking services, insurance, motor vehicle purchase and equipment higher.

Box 1: Setting a transaction value (continued)

However, the consultation also indicated that some small business transactions involve multi-year contracts that can significantly exceed \$100,000 (for example, retail tenancy agreements and loan agreements). To capture these without setting a much higher transaction threshold for all contracts, a threshold of \$250,000 for contracts longer than 12 months would be appropriate.

- Only 12 per cent of small business survey respondents reported that they were offered standard form contracts valued more than \$250,000. By contrast, 58 per cent of medium and large businesses reported they were offered standard form contracts worth more than \$250,000.

Preferred approach

3.135 In line with the policy objective and the Commonwealth Government's commitment to extend unfair contract term protections to small businesses, the Commonwealth recommends that a legislative extension cover small businesses engaging in low-value contracts, by including a small business definition based on a business size threshold and applying a transaction value threshold.

3.136 The business size threshold would be used to limit protections to smaller businesses and the transaction threshold would be used to limit the scope of the protections to lower-valued contracts.

3.137 The Commonwealth considers that this approach achieves an appropriate balance between protecting those businesses most likely to lack sufficient resources and bargaining power with regard to unfair terms, while preserving contractual freedom and certainty and encouraging businesses to take reasonable steps to protect their interests.

Industry coverage

3.138 A key design question is whether the unfair contract term protections should apply to small businesses across the entire economy, including in industries that have implemented self-regulation.

3.139 In the consultation, a number of stakeholders suggested that certain sectors be exempt from the unfair contract term protections, arguing that they are already protected by existing industry mechanisms,⁵⁸ and an exemption would help to minimise compliance costs.

58 These sectors include: franchising, retail tenancies, domestic/residential building contracts, direct selling, and supply agreements with insurers.

3.140 To ensure that the protections enhance rather than impede or duplicate existing mechanisms, it is recommended that the legislative extension includes a regulation-making power to allow the Commonwealth Minister to exempt the application of the unfair contract term protections for small businesses, where an industry-specific legislation or regulation is deemed enforceable and equivalent.

- Under this test, most existing industry mechanisms, with the possible exception of the *Independent Contractors Act 2006* (Cth) and the *Motor Vehicle Dealers and Repairers Act 2013* (NSW), do not provide an adequate level of protection so would not be deemed equivalent (see Attachment C: *Existing laws and regulations*).
- Non-enforceable mechanisms, such as voluntary industry codes that are not legislated, are not intended to be captured by this power.

Financial goods and services

3.141 The consumer unfair contract term protections also apply to financial products and services as legislated in Subdivision BA of Division 2 of the ASIC Act. Whether the proposed extension to small businesses should also cover financial products and services was raised in the discussion paper. During the consultation process, some stakeholders, including the Australian Bankers' Association, expressed the view that existing measures are already in place to provide small businesses with protections against unfair contract terms, citing the Code of Banking Practice 2013 which covers small business contracts for the provision of financial products and services as an example.

3.142 However, the overriding view of stakeholders was that the existing mechanisms do not provide substantive protections (see Attachment C: *Existing laws and regulations*). Examples of practices where protections against unfair contract terms for small businesses can be inadequate were raised in a confidential submission (see *Consultation: Examples of unfair contract terms*).

3.143 The Australian Government's preferred approach is to include financial products and services in the protections through an amendment to the ASIC Act.

3.144 In its final report released in December 2014, the *Financial System Inquiry* endorsed the Government's process to extend unfair contract term protections to small businesses. The Inquiry considered that the protections could improve broader contracting practices and the fair exercise of rights pursuant to non-monetary default covenants.⁵⁹

Other design issues

3.145 A range of other design issues were raised in the consultation.

3.146 A key issue of scope is whether the protections should cover both small business *acquisition* and *supply* of goods and services, and small business-to-small business contracts. Given the evidence from the submissions that unfair contract terms occur in all of these circumstances it is recommended that the protections apply to all of these contracts.

3.147 Given that the proposed legislative intervention is to extend the current framework for consumer unfair contract term protections to small businesses, a number of stakeholders raised concerns with the clarity of current concepts such as 'unfair', 'standard form contract' and 'transparency'. These stakeholders submitted that these concepts are difficult to interpret in their current form and may cause uncertainty in commercial dealings.⁶⁰

- These concepts were carefully considered during the design of the consumer protections, where it was recognised that they are subjective and hence appropriate for a court to determine.
- The upcoming ACL Implementation Review will provide an opportunity to review these concepts.⁶¹

Impact analysis

3.148 The proposed legislative extension seeks to address the identified problem by voiding unfair contract terms in low-value standard form contracts agreed to by small businesses. This will reduce the incentive for businesses offering standard form contracts to include unfair

59 See Recommendation 34 of *The Financial System Inquiry Final Report*, November 2014, <<http://www.fsi.gov.au/publications/final-report/>>.

60 For example in relation to the criteria for 'unfair', some stakeholders queried what constituted a legitimate business interest. Others were concerned that it was not clear whether a contract could be classified as standard form if only some and not all of the terms were negotiated.

61 This review is expected to commence in 2016.

terms, which is expected to reduce their overall use within the broader Australian economy.

Decreased use of unfair contract terms

3.149 As was the case with introducing consumer unfair contract term protections, some businesses may review their contracts for unfair terms and make any changes necessary to ensure they comply with the new protections. This is expected to have positive flow-on effects to contracting practices throughout the economy.⁶²

3.150 A range of industry bodies (including those from the legal profession), small business commissioners and industry ombudsman are expected to support businesses and legal professionals to comply with the new protections. Further, the ACCC will initially undertake an education and compliance program before moving to a more enforcement-focused approach to dealing with unfair contract terms (see Implementation and evaluation section).

- This was the approach taken following implementation of the consumer unfair contract term protections and ‘achieved significant improvements to standard form consumer contracts in a number of industries’.⁶³

3.151 The introduction of unfair contract term protections for small business is expected to provide small businesses with the confidence to resolve issues directly with the party offering the standard form contract, as well as having complaints resolved through formal channels (for example, through the ACCC, ASIC, state and territory fair trading bodies, small business commissioners and various dispute resolution schemes).

3.152 For example, under the consumer unfair contract term protections, the ACCC has resolved the vast majority of complaints through informal and administrative means, with businesses amending or removing clauses considered problematic.⁶⁴

62 For example changes to industry standard contracts are expected to flow through to a significant number of contracts in the economy as they are heavily used in a number of industries, such as construction.

63 ACCC 2013, *Unfair Contract Terms, Industry review outcomes*, page 5. Particularly significant changes were achieved in relation to standard form contracts of major airlines, with 79 per cent of problematic terms identified by the ACCC amended or deleted as a result of the review.

64 As at 30 June 2014 ASIC had received over 300 reports of misconduct in relation to unfair contract terms since the commencement of these protections on 1 July 2010 from the public.

- To date, a total of five matters proceeded to an in-depth investigation, either due to the egregious nature of the breach or due to reluctance on the part of the business to reach an administrative resolution. As a result, the ACCC has issued one warning letter and obtained one court order by consent.⁶⁵
- The ACCC has also recently taken action regarding misleading contract terms and unfair conduct, against a car hire firm.⁶⁶

3.153 A number of private actions have also been pursued via the protections of the ACL and, prior to the ACL, the consumer unfair contract terms protection of the fair trading law in Victoria. For example, in 2011 the New South Wales Civil and Administrative Tribunal found a term of an airline ticket to be unfair and ordered a full refund.⁶⁷

3.154 As outlined in The Problem section, reducing the incidence of unfair contract terms is expected to provide a significant benefit to the Australian economy, with around two million small businesses⁶⁸ in Australia (97 per cent of all businesses) engaging in, on average, several standard form contracts a year.⁶⁹ This is also expected to reduce business detriment as a reduction in the use of unfair contract terms may also lead to:

- a more efficient allocation of risk in contracting, as unfair contract terms can shift the risks onto the party least able to manage them;
- increased small business confidence when transacting in standard form contracts, which in turn should encourage their engagement in economic activity; and
- it will encourage a stronger adherence to the ethical principle of fairness in contractual dealings.

65 On 30 July 2013 the Federal Court declared by consent that four terms in Bytecard's standard form consumer contract were unfair. This was the ACCC's first action based exclusively on the unfair contract terms provisions of the ACL.

66 See <<http://www.accc.gov.au/media-release/accc-takes-action-against-europcar-for-alleged-unfair-contract-terms-and-misleading-conduct>>.

67 *Kucharski v Air Pacific Ltd (General)* 2011 NSWCTTT 555.

68 Small business is defined as a business with fewer than 20 employees. See ABS Cat no. 8165.0.

69 Respondents to the survey reported a median of five standard form contracts being offered in the previous 12 months.

Unintended consequences

3.155 During the consultation some stakeholders criticised any intervention to protect against unfair contract terms as interfering with the freedom of contract. For example, some stakeholders suggested that it could limit their flexibility to offer particular terms and conditions.

3.156 There was also the suggestion that a legislative extension of the consumer protections to small businesses, particularly where it is not straightforward to determine whether a business is covered, could introduce significant uncertainty and compliance costs in business dealings.

3.157 Two possible consequences of introducing a legislative extension are an increase in the price and a reduction in the supply, of related goods and services. For example, this was raised with respect to financial services and products, where some stakeholders suggested that the protections might increase the cost and reduce access to finance.

3.158 This argument suggests that the inability to include unfair terms in standard form contracts might limit the degree to which a business can assign certain risks to the other party in return for a lower contract price, and that any compliance cost associated with the intervention could be passed onto small businesses through a higher contract price. Another possibility is that suppliers may respond by limiting their supply (or acquisition) of particular goods or services to small businesses, or moving to negotiated contracts for some transactions.

3.159 The consumer unfair contract term protections were carefully designed to reduce such unintended consequences and minimise interference with freedom of contract. For example, terms which are considered reasonably necessary to protect legitimate business interests cannot be considered unfair. In line with this, the experience with introducing unfair contract term protections for consumers was that such consequences have not been significant, including in financial product and service contracts. Standard form contracts continue to be widely used and there is no evidence to suggest that there was a significant impact on the price and supply of related goods and services.

3.160 While some financial lenders have raised the additional complexity involved in business lending compared to consumer lending, stakeholders were unable to quantify the cost of this or the impact on availability of credit to small businesses.

3.161 Further, the recommended design of a legislative extension of unfair contract term protections to small business seeks to reduce interference in the sanctity of the contract by using a transaction value

threshold to encourage small businesses to conduct due diligence for more significant contracts. The intention of this threshold is to provide protections for small businesses engaging in day-to-day transactions and not contracts crucial to their business model.

3.162 Another concern raised by some stakeholders was the potential for the protections to result in significant litigation. Evidence from the introduction of unfair contract term provisions for consumers in Australia and the UK suggests that such laws do not result in significant increases in litigation or difficulty in enforcing contracts.⁷⁰ As raised earlier, the ACCC have resolved the majority of consumer complaints regarding unfair contract terms through informal and administrative means and not through litigation.

3.163 Alternative dispute resolution processes provide an avenue for consumers and small businesses to resolve disputes around unfair contract terms themselves.

Compliance costs

3.164 There are three types of transitional costs that businesses could incur under this option.

3.165 It is anticipated that all Australian businesses (2.14 million) would incur **familiarisation costs** from the legislative change, but these costs would be relatively small given that this option would extend existing unfair contract term protections and not create a new prohibition or framework.

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

3.166 Businesses offering standard form contracts may incur **costs to ensure compliance** with the legislation, as they may need to review and if necessary amend contract terms. This compliance cost is expected to be primarily accrued during the first 12 months following the introduction of the protections (the transitional stage).

- Businesses are expected to apply one of several approaches: review (and amend) themselves; seek legal advice to review

⁷⁰ Productivity Commission, 2008, *Review of Australia's Consumer Policy Framework*, vol. 1, page 34.

(and amend); or take no action based on a risk assessment that it is not cost effective to review.⁷¹

- It is anticipated that those businesses who offer more complex standard form contracts are more likely to review their contracts, and that the majority of compliance costs would be incurred by medium and large businesses who generally offer more complex and/or different types of contracts. During the consultation it was suggested that larger businesses are the most likely to seek legal advice to ensure compliance.⁷²
- It is anticipated that small businesses will not incur significant compliance costs. Most do not offer standard form contracts and those that do generally offer only one or two contracts with simple terms and conditions.⁷³ Those who offer more complex contracts may investigate whether they can review terms through an industry body that provides businesses with an industry template, or choose to adopt terms used by a competitor.⁷⁴
- It is also assumed that businesses will not incur ongoing costs, as the cost of compliance for new contracts will be a ‘business as usual’ cost incurred through their routine update of standard form contracts.
- The ACCC will undertake an education and compliance program to support businesses with the transition.⁷⁵

71 As a legislative option would make unfair contract terms void and not prohibit the existence of unfair contract terms outright some businesses may decide not to review terms, or alter existing contracts, given the legislation would not penalise a business for mere inclusion of the term. Further, some businesses would have already reviewed and amended terms in contracts being offered to small businesses following the implementation of the consumer unfair contract terms protections.

72 In the consultation survey, the majority of respondents who experienced unfair terms in contracts suggested that the other party was a large business.

73 For example only a quarter of small business respondents to the survey offered standard form contracts.

74 Some smaller businesses can base their terms and conditions on industry competitors and as a result any changes to their competitor’s terms will flow through.

75 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 unfair contract terms provisions in which it worked with

- The availability of an exemption for equivalent enforceable legislation and regulation will ensure that compliance costs are not incurred in those industries that provide equivalent protections.

3.167 The legislative extension may also introduce **costs associated with a change in business** processes (the amount of which is likely to vary significantly from business-to-business). For example, it may require modification of: processes and systems; rules and operating practices; and staff education and training.

- It is expected that these costs will be small for most businesses as the information incorporated into business systems is often related to the key upfront characteristics of the product being sold and not the terms and conditions embedded in the fine print of the contract. Costs may be more substantial where businesses have complex systems and significant changes to processes and systems are required in order to comply.

Administrative costs for government

3.168 The ACCC was provided \$1.4 million in the 2014-15 Budget to support implementation of a legislative extension.

- It is expected that this would utilise existing implementation and enforcement architecture regarding the unfair contract term protections for consumers, and that ACCC guidance for small businesses could draw from previous guidance provided to consumers.

3.169 The enforcement of unfair contract term protections would require regulatory resources, including use of the court system. In line with the experience with the consumer protections it is expected that the majority of complaints will be resolved administratively and not through litigation.

Calculation of compliance burden

3.170 A detailed estimation of the compliance burden has been undertaken using the Business Cost Calculator from the Office of Best Practice Regulation. Consistent with regulatory impact analysis requirements, quantification has only been undertaken for those changes

businesses to remove or change unfair terms in standard form contracts and address identified issues, rather than moving immediately to an enforcement approach.

expected to result in more than a nominal or minor increase or decrease in compliance costs. Also, quantification has only been made for the one-off costs associated with seeking legal advice to ensure terms are compliant and system changes for very large businesses. The framework for calculating these costs is outlined in Box 2.

3.171 As raised in Box 2 below, aggregate compliance costs depend on how many firms choose to review and amend their contracts. This calculation assumes the following:

- a small business definition of fewer than 20 employees and a transaction value threshold of \$100,000 (or \$250,000 for contracts with a duration of more than 12 months);
- larger businesses who offer complex and/or many different types of standard form contracts may seek legal advice to review and some will amend their contracts, while smaller businesses are unlikely to review their contracts and those that do will utilise low-cost mechanisms;
- some large corporates, who offer many standard form contracts, may incur additional costs if they amend contract terms and need to modify associated business systems; and
- businesses who decide to review (and amend) their standard form contracts will likely do so within the first 12 months of implementation.

3.172 Based on the costs that can be quantified, it is expected that there will be a net annual compliance burden of around \$50 million in the first year, with no ongoing compliance costs. This equates to an average annual compliance cost (over 10 years) of around \$5 million.

3.173 As the decision will be made jointly by the Commonwealth, states and territories, one-ninth of the total regulatory costs will be allocated to the Commonwealth. As a result the Commonwealth will be allocated an average annual compliance cost (over 10 years) of around \$0.56 million (Table 2).

Table 3.2: Compliance costs

<i>Average annual regulatory costs (from business as usual)</i>				
Change in costs (\$ million)	Business	Community Organisations	Individuals	Total change in cost
Total, by sector	\$0.56	–	–	\$0.56
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Agency	–\$0.56	–	–	–\$0.56
Are all new costs offset?				
<input checked="" type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = \$0				

Note: A regulatory offset has been identified from within the Treasury portfolio, relating to the alignment of the legal frameworks for personal and corporate insolvency practitioners.

Box 2: Calculating compliance costs associated with seeking legal advice to amend and review contracts for unfair terms

Compliance costs have been calculated using the following parameters:

The number of standard form contracts that are reviewed and amended:

= a) number of businesses offering standard form contracts to small businesses x
b) number of different types of standard form contracts each business offers x c)
proportion of businesses that choose to review and amend their contracts.

a) Number of businesses offering standard form contracts to small businesses.

This is derived using the number of businesses in the Australian economy (2.14 million, sourced from the ABS⁷⁶) and an assumption of the proportion of businesses who offer standard form contracts based on findings from the consultation survey:

60 per cent of large business respondents (200+ employees), 40 per cent of medium business respondents (20-199 employees) and 20 per cent of small business respondents

(<20 employees) indicated they issue standard form contracts.

b) Number of different types of standard form contracts each business offers.

The consultation suggests most small businesses are likely to offer one type of contract, medium and large businesses are likely to offer a couple of different types of contracts, and very large businesses are likely to offer several different types of contracts.⁷⁷

c) Proportion of businesses that choose to review and amend their contracts.

This will depend on a number of factors, including how the legislative extension is designed. Large businesses are likely to seek legal advice while small and medium businesses are unlikely to do so, preferring instead to rely on industry standard templates in an attempt to minimise their compliance cost.⁷⁸ Of those firms that undertake a review of their contracts, it is likely that only some of these firms will need to make amendments to the contracts they offer.

The cost of reviewing and amending a standard form contract will depend on the length and complexity of the contract and whether a business has access to in-house legal expertise. Estimates have been sourced from the Law Council of Australia Competition and Consumer Committee.

76 See ABS Cat no. 8165.0 at 30 June 2013.

77 Consultations were held with the Law Council of Australia Competition and Consumer and SME Committees, as well as some large corporates, such as in the banking industry. Sectors such as banking, are an example of a sector where many different types of products are offered and there are many different types of standard form contracts.

78 Consultations with some large corporates, who offer a significant volume of standard form contracts indicate that they are likely to review a large proportion of their contracts and may require changes to systems if terms are amended.

Box 2: Calculating compliance costs associated with seeking legal advice to amend and review contracts for unfair terms (continued)

- In general, more simple contracts with a value of up to \$100,000 (around one to six pages) could cost between \$3,000-10,000 to review and amend, while more complex contracts valued over \$100,000 (around six to 20 pages) could cost slightly more.⁷⁹
- The consultation revealed that the cost of using in-house legal expertise is likely to be much lower and is in some cases considered a ‘business as usual’ cost.

Conclusion

3.174 For the reasons outlined above, it is expected that the benefits of a legislative extension of the consumer unfair contract term protections to small businesses will significantly outweigh any costs. By allowing the voiding of unfair terms in small business standard form contracts, the incentive to include and enforce them will be significantly reduced. This will reduce small business detriment arising from unfair terms and provide for a more efficient allocation of contract risk. Ultimately, it is expected that this option will have a significant positive impact on the wellbeing and confidence of the more than two million small businesses in Australia, most of which transact through standard form contracts. It will also support the ethical concept of fairness in contractual dealings.

3.175 Although businesses may incur compliance costs as a result of the reform, these are expected to be modest and mainly incurred by large businesses who offer many and/or complex standard form contracts.

Option 4 — Legislation to require standard form contracts with small businesses to be negotiated on request

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

3.177 Most stakeholders in the consultation did not comment on this option, with those stakeholders who did comment suggesting it would impose significant compliance costs on all contracting parties.

⁷⁹ The Treasury undertook targeted consultations with the Law Council of Australia Competition and Consumer Committee to obtain rough estimates of legal costs. These estimates include the cost of reviewing contracts and, if required, the cost of assessing whether a term constitutes a ‘legitimate business interest’ and the cost of amending terms. Note that legal costs can vary across jurisdictions and type of contract.

Impact analysis

3.178 Under this option, a small business could request that a standard form contract be negotiated if they identify what they consider to be an unfair term. As a consequence, the contract may no longer be considered a 'standard form contract' as it has been negotiated and not offered on a 'take it or leave it' basis.

3.179 This option is unlikely to address the identified problem, as it requires a small business to be able to identify an unfair contract term and be willing to incur the cost of renegotiating the contract. This cost may be significant and/or disproportionate for low-value contracts. In addition, the requirement to negotiate –with no protections against unfair terms– may be of little practical value as the small business may lack bargaining power to successfully negotiate meaningful changes to the contract.

3.180 The costs associated with requiring contracts to be negotiated on request could also preclude the significant efficiency benefits that standard form contracts offer — it may be costly and impractical for businesses to negotiate contracts in some circumstances, particularly for low-value transactions and those repeated with a large number of parties.

3.181 Given that this option does not address the information failure and bargaining power issues surrounding unfair terms of standard form contracts, and imposes substantial additional transaction costs, it is not considered further.

Consultation

3.182 The Commonwealth Treasury on behalf of Consumer Affairs Australia and New Zealand, conducted an extensive public consultation process from 23 May 2014 to 1 August 2014 which included releasing a consultation paper,⁸⁰ *Extending Unfair Contract Term Protections to Small Businesses*.⁸¹ The objective of the consultation was to gather additional evidence on the extent of the problem and the available policy options.

80 <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/~/_/media/E53165D4D8B24B4799395680E68FE0B0.ashx>.

81 Consultation took place in line with a strategy based on consultation principles recommended by the Office of Best Practice Regulation to ensure maximum input was received from the small and large business communities, and other interested stakeholders (as outlined in the consultation paper at pages 41-43).

3.183 An online business survey was also released as part of this process (see Attachment A: *Survey results*) to better understand business' experiences with contracts and unfair terms. Stakeholders were also invited to lodge formal submissions and provide brief comments on the Commonwealth Treasury website.

3.184 There were 85 submissions received during the consultation (including 20 confidential submissions)⁸² and 287 responses to the online business survey, with respondents from a range of business sizes.

3.185 The Commonwealth Treasury also met with a number of stakeholders following this consultation process to discuss issues raised in their submissions and explore additional questions that had arisen. Discussions were also held with some stakeholders that did not make a formal submission to the consultation process.

3.186 Information received during these consultations has been used to improve the understanding of the policy problem, fine-tune the scope of policy options and develop a targeted and effective implementation plan. Reflecting this, there are references to specific findings from the consultation throughout this document.

Key findings

3.187 Feedback from the survey, submissions and stakeholder meetings indicate that concerns with unfair terms in small business contracts span a wide range of industries including those which some stakeholders argue already have adequate protections.⁸³

- A number of examples of unfair terms were presented in stakeholder submissions and the online business survey (see Attachment A: *Survey results*). The online survey also shed light on why smaller businesses are more likely to be vulnerable to unfair contract terms.

3.188 In general, stakeholders were not supportive of maintaining the status quo (Option 1) with the majority of submissions supportive of

82 All non-confidential submissions were published on the Treasury website, together with the consultation RIS. These can be found at <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Small-Business-and-Unfair-Contract-Terms/Submissions>.

83 Industries where unfair terms were reported in stakeholder submissions included: telecommunications, financial products and services, franchising, retail tenancy, waste management, architecture, independent contractors and advertising.

extending the consumer unfair contract term protections to small businesses (Option 3).

- A few stakeholders preferred a non-regulatory response (Option 2), arguing that a legislative extension would impose compliance costs and increase uncertainty in contracting with small businesses.⁸⁴
- Most stakeholders did not provide views on Option 4, to introduce legislation to require standard form contracts with small businesses to be negotiated on request, though those that did were not supportive of implementing this option. One stakeholder suggested it would be ‘unworkable’ and another suggested it would involve ‘substantial costs’.⁸⁵

3.189 There were a number of stakeholders who suggested certain sectors should be exempt from a legislative extension, including franchising, retail tenancies, financial products and services, domestic/residential building contracts, direct selling, and supply agreements with insurers. A number of stakeholders raised concerns with providing sectoral exemptions, with some arguing that this could increase regulatory uncertainty and complexity.⁸⁶

Examples of unfair contract terms

3.190 Stakeholder submissions raised specific concerns about unfair terms in small business contracts across a wide range of industries, for example:

- **Franchisees** raised concerns about the inclusion of clauses permitting: unilateral termination; compulsory acquisition of franchises at less than market rate; liquidated damages that do not reflect actual losses in franchise agreements; and a franchisor to unilaterally vary the operation and procedures manual and change a franchisee’s obligations.⁸⁷
- For **retail tenancy** agreements, concerns were raised with onerous and non-transparent terms and conditions contained in shopping centre ‘fit out’ manuals.

84 For example, see submissions from Macpherson and Kelley Lawyers and Ai Group.

85 For example, see submissions by the Shopping Centre Council of Australia (page 14) and Dr J Buchan (page 6), respectively.

86 For example, see submissions by the Australian Newsagents’ Federation and Baker and McKenzie.

87 These examples were raised in a number of confidential submissions.

- For example, Lease1 suggested that lessors may impose unreasonable ancillary terms such as refurbishment requirements as part of these fit out guides.
- Two forms of unfair practices were raised in **financial services and credit contracts** targeting small businesses in urgent need of finance:⁸⁸
 - ‘fee farming’, where a small business that is seeking a loan is liable to pay a brokerage fee even if the broker’s conduct contributed to the small business failing to obtain the loan; and
 - ‘equity stripping’, where a small business that is already in default has its debt refinanced and is then liable to pay excessive interest and default fees.
- In the **telecommunications industry**, concerns were raised with terms permitting suppliers to unilaterally vary the price or included value (for example, the available data or calls), automatic renewal terms and terms that permit the supplier to avoid or limit their obligations.⁸⁹
- A number of contract terms in the **waste management sector** were raised by the Victorian Small Business Commissioner. These included terms which could limit a party’s right to sue, automatic renewal terms, terms permitting unilateral variation or disparity in the rights to terminate a contract, and terms that allow one party to limit or avoid their obligations.
- The Australian Institute of Architects raised concerns with **architecture** contracts requiring insurance to cover unlimited liability, clauses providing for excessive liquidated damages and the use of ‘contingency sums’ to cover design errors and discrepancies.
- Some stakeholders noted that contracts for **online advertising services** often provide for automatic renewal

88 These examples were raised in a confidential submission.

89 See the submission by the Telecommunications Industry Ombudsman. The Telecommunications Industry Ombudsman suggested that these terms will not always be unfair. Unilateral variation clauses can permit suppliers to flexibly reflect changes in their cost structures over time rather than having to anticipate these in advance, and automatic renewal can provide continuity of service to customers.

with onerous and/or excessive notice requirements, which can lock customers in, particularly as there are often significant fees for early termination.⁹⁰

Feedback on the design of a legislative extension

3.191 As was raised in the consultation paper⁹¹ there are a number of different parameters that need to be considered when designing a legislative extension. Stakeholder feedback on these parameters is outlined below.

Defining small business

3.192 There was a range of views on how to define small business transactions, reflecting different views from stakeholders on the extent to which businesses should be protected from unfair contract terms. Some of the options raised by stakeholders were:

- **Limiting protections to contracts under a certain value threshold.** Some argued this would maintain the onus on businesses to review contracts and seek legal or financial advice where it is reasonable to do so. The Law Council of Australia Competition and Consumer Committee suggested a transaction value threshold of \$100,000.
- **Limiting protections using a business size threshold.** Some suggested proxies of business size could be used to limit protections to small business, for example, using an employee headcount or annual turnover. There was no clear view on which measure was preferred. Alternatively, there were a number of stakeholders who favoured an ‘exclusion’ based approach, such as excluding publicly listed companies from relying on the protections.

– Some also thought a small business definition could introduce uncertainty and favoured a definition that was observable to the counterparty, such as excluding publicly listed companies or companies generally.⁹²

90 For example, see submission by Small Business Development Corporation of Western Australia.

91 <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/~media/E53165D4D8B24B4799395680E68FE0B0.ashx>>.

92 For example, see submissions by the Australian Newsagents Federation and the New South Wales Small Business Commissioner.

- Some stakeholders rejected a business size approach, arguing that it would impose unnecessary compliance costs and have unintended consequences,⁹³ whilst others proposed an approach based on relative size.⁹⁴
- **Limiting protections to small business consumption goods and services.**⁹⁵ A few suggested that small businesses should only receive protection for transactions where they act like consumers.⁹⁶ This would be consistent with the unfair contract term provisions for small businesses being introduced in New Zealand in 2015.

Other design issues

3.193 There were a number of other design issues considered in the consultation, including:

- **Whether to protect contracts for acquisition from small businesses.** Most submissions that considered this issue favoured an extension that covers contracts where goods and services are supplied to, or acquired from, small businesses.⁹⁷
- **Whether to protect contracts between small businesses.** Some suggested they should be covered as unfair terms can also occur in these contracts, while those against this design suggested it would impose unnecessary compliance costs on small businesses.
- **Whether to protect contracts for financial products and services (by amending the ASIC Act).** There were differing views on this issue, with some suggesting that existing industry measures already provide adequate protection⁹⁸ while others suggested there are still problems with unfair

93 For example, see submission by Macpherson and Kelley Lawyers.

94 For example, see submission by the Australian Automotive Dealer Association.

95 This would involve changing the definition of a consumer contract from one for supply of goods and services for personal or domestic household use to also include goods and services that are of a kind ordinarily acquired for personal, domestic or household use or consumption other than for resupply or transformation within a business.

96 For example, see submissions by New Zealand Law Society and Arnold Bloch Leibler.

97 For example, see submissions by the National Farmers' Federation and Independent Contractors Australia.

98 For example, see the submission by the Australian Banker's Association.

terms in small business contracts.⁹⁹ Some noted the complexity of these contracts and the need to design any protection carefully, including the exclusion of sophisticated parties.¹⁰⁰

Feedback on concepts used in consumer unfair contract terms protections

3.194 A number of concepts are described in the ACL's consumer protections, including 'unfair', 'standard form contracts' and 'transparency'. Attachment B outlines the current criteria used to determine these concepts.

3.195 While some stakeholders suggested these criteria should also apply to any small business protections to ensure consistency, others suggested they could be difficult to interpret and therefore introduce uncertainty into contractual dealings.

- **'Standard form contract'**: Some argued the current criteria is flexible and should be applied to the small business protections, while others suggested it was not always clear whether a contract could be classified as 'standard form' if only some terms were negotiated.¹⁰¹
- **'Unfair' terms**: Some argued it is not clear what constitutes a 'legitimate business interest'. Another concern was whether passing unfair terms up or down a supply chain would be considered 'reasonably necessary' to protect a legitimate business interest.¹⁰²
- **'Transparent' terms**: Some argued there should be greater clarity as to what constitutes transparency in the context of business-to-business contracts, particularly when external legal advice is sought. There were also some stakeholders that suggested that the threshold as to whether a contract is transparent should be higher for small businesses than for consumers, as small businesses should be more aware of their

99 For example, see the Law Council of Australia SME Committee and the Australian Chamber of Commerce and Industry. A confidential submission was also provided with a number of examples.

100 Given the complexity of issues relating financial product and services, the Treasury conducted a number of additional targeted consultations with key industry participants.

101 For example, see the Law Council of Australia Competition and Consumer Committee and Australian Corporate Lawyers Association.

102 For example, see the submission by Master Builders Australia.

legal rights and the consequences of entering into contracts, compared with consumers.¹⁰³

Feedback on the implementation of a legislative extension

3.196 Stakeholders had a number of recommendations to ensure that the implementation of a legislative extension was effective.

- It was widely suggested that implementation should be supported by a comprehensive **education** campaign.
- **Transitional arrangements** were raised, with some arguing that a 12 month transition period following implementation of any intervention would be appropriate to allow for an update of contracts.¹⁰⁴
- **Ensuring ‘access to justice’ for small businesses** was raised with a number of suggestions put forward:
 - The ACCC and ASIC could provide guidance material that includes advice on: the extent of negotiation at which a contract is no longer considered ‘standard form’; the types of terms that may be considered reasonably necessary to protect a ‘legitimate business interest’; examples of unfair contract terms (similar to those developed for the consumer protections); and guidance on ‘transparent’ terms.
 - Commonwealth, state and territory small business commissioners and dispute resolution services could help to reinforce the protections and support access to justice.
 - A role for state and territory tribunals in providing lower cost access to justice.

3.197 Stakeholders also generally expressed positive feedback regarding the ACCC’s education and compliance efforts following introduction of the consumer unfair contract term protections and supported a similar approach for small business protections.

103 See the submission by the Australian Corporate Lawyers Association.

104 See the submission by the Australian Corporate Lawyers Association.

Option selection

3.198 An analysis of the options for addressing the identified problem indicates that a legislative extension of the consumer unfair contract term protections to small businesses (Option 3) would bring the greatest net benefit:

- Option 1 — *the status quo* is not expected to address the problem as current laws do not provide adequate protections against unfair contract terms and market forces provide strong incentives to use them.
- Option 2 — *light touch or non-regulatory responses* could reduce the incidence of unfair contract terms and/or improve the availability of information, however their effectiveness in adequately and systematically dealing with unfair terms is limited and some have the potential to impose substantial compliance costs.
- Option 3 (preferred) — *legislative amendment* to extend the existing consumer unfair contract term protections to small businesses is expected to most substantially address the identified problem. By enabling unfair contract terms to be declared void the incentive to include and rely on them will be significantly reduced, resulting in a more efficient allocation of contract risk and increased small business confidence.
- Option 4 — *legislation to require small business standard form contracts to be negotiated on request* is not expected to address the identified problem as small businesses would still lack the resources and bargaining power to protect against unfair terms, and it is expected to impose substantial compliance costs.

3.199 Consistent with this, the Commonwealth recommends designing a legislative extension that targets those businesses considered most vulnerable, whilst maintaining the onus on businesses to undertake due diligence and minimising compliance costs. The Commonwealth recommends the legislative extension:

- apply a small business size threshold of fewer than 20 employees, combined with a transaction value threshold of \$100,000 (and \$250,000 for contracts with a duration of more than 12 months) to target low-value small business transactions; and
- allow for the exemption of enforceable and equivalent law.

Implementation and evaluation

3.200 A legislative extension (Option 3) requires an amendment of the ACL (Schedule 2 of the *Competition and Consumer Act 2010* (Cth)) to extend the protection to the supply and acquisition of goods and services, and to extend the protections to financial products and services, the ASIC Act. An Exposure Draft of the proposed amendments has been prepared and circulated for public consultation. Following this, it will be introduced into Parliament and presented to the Federal Executive Council.

Regulations

3.201 To enable the exemption of enforceable and equivalent law from application of the small business' unfair contract term protections, it is proposed that the regulation-making power be legislated to specify the circumstances under which an exemption would be granted.

3.202 To ensure a national approach, the Commonwealth Minister would be responsible for formally exempting an enforceable and equivalent law. This would be consistent with the approach employed in relation to permanent product safety bans and information standards under the ACL.¹⁰⁵

3.203 Any exemption from the small business' unfair contract term protections under the ACL that is likely to be considered more than a minor or inconsequential amendment would require a vote of the parties to the *Intergovernmental Agreement for the Australian Consumer Law*.

3.204 Prior to the Commonwealth Minister seeking to exempt a law, it is recommended that a number of steps would need to be satisfied. This may include for example:

- providing that the Minister can only grant an exemption in relation to a regulation and legislation once he/she is satisfied that it provides enforceable and equivalent protections; and

105 Consistent with clause 8 of the IGA, states and territories could submit proposals to the Commonwealth for industry exemptions.

- the Minister will need to be satisfied that the proposal meets a prescribed list of criteria before granting an exemption, such as that it is in the public interest.¹⁰⁶

Explanatory memorandum

3.205 The Explanatory Memorandum that accompanies the bill will provide additional information regarding its objectives and operation that will assist in the interpretation of the legislation.¹⁰⁷

Transitional arrangements

3.206 This law will not apply retrospectively but will apply to contracts formed or renegotiated, and terms that are varied, after the date on which the law comes into force. The law will come into effect following a six month transition period, beginning the day after the law receives Royal Assent. This will occur following the passage of the law through the Commonwealth Parliament.

3.207 To help businesses comply with the new laws the ACCC, which was provided \$1.4 million in the 2014-15 Budget, will initially take an education and compliance program, similar to that employed following the introduction of the consumer protections in 2010. Following this, the ACCC will move to a more enforcement-focused approach to dealing with unfair contract terms.

Support to business

3.208 The effectiveness of the legislative extension in protecting small businesses against unfair terms in standard form contracts will in part depend on business' awareness of the protections and their willingness and ability to comply.¹⁰⁸

106 For example see section 25(2) of the ACL, which requires the Minister to consider the impact on consumers and businesses, and the broader public interest, before prescribing any additional terms as unfair under the existing consumer unfair contract terms law.

107 The Legislation Handbook outlines that Explanatory Memorandums and Second Reading Speeches can be used 'to assist members of Parliament, officials and the public to understand the objectives and detailed operation of the clauses of the bill'. It also highlights that under section 15AB of the *Acts Interpretation Act 1901* (Cth), extrinsic material such as Explanatory Memorandums, may be used in interpreting a law. See <http://www.dPMC.gov.au/guidelines/docs/legislation_handbook.pdf> at page 38.

108 There are a number of key implementation risks: small businesses remain unaware of the protections and do not exercise their rights; businesses are unaware of the new protections

3.209 The ACCC and ASIC will work alongside state and territory consumer affairs agencies, small business commissioners, industry ombudsman, industry organisations and the business community, to help businesses transition to the new arrangements. For example, based on experiences following the introduction of the consumer protections, the following support may be provided:

- calling on key small business groups and industry associations to identify examples of problematic contracts terms;
- producing guidance material on how the new laws operate, including examples of the types of terms that could be considered ‘unfair’, and urging businesses to review their standard form contracts; and
- identifying particularly problematic unfair terms during the transition phase. This could involve undertaking targeted engagement with industries, to raise any issues and encourage compliance.¹⁰⁹

3.210 Also, the new Commonwealth Family and Enterprise Ombudsman and state and territory small business commissioners and agencies could provide an important education and information role and help to direct unfair contract term issues to the relevant bodies.

3.211 In consultations with industry, a number of bodies indicated that they would be prepared to assist with the education of both businesses and legal practitioners in the lead up to and following implementation.

3.212 For this legislative extension it is recommended that a review be undertaken within five years of it coming into force.

and the need to comply and even if businesses are aware of the protections they lack the resources to comply.

¹⁰⁹ The ACCC secured significant impact in addressing unfair contract terms in consumer contracts by identifying those market sectors in which such terms were prevalent. The ACCC drew upon its complaints data and extensive consultation with Australian consumer organisations to help identify these sectors.

Attachment A – Survey results

Survey: Business contracting practices and unfair contract terms

3.213 The Commonwealth Treasury, on behalf of CAANZ, undertook a survey from 23 May 2014 to 1 August 2014 on business contracting practices and unfair contract terms.

Key points

- Standard form contracts are used widely across a variety of industries and business sizes.
 - Many businesses reported experiencing unfair terms in standard form contracts and harm as a result of these terms.
- The results of the survey support the proposition that small businesses may be more vulnerable to unfair contract terms than medium and large businesses. This is supported by the findings that:
 - small business respondents are less likely to have in-house legal expertise, seek legal advice on contracts or be able to afford legal or financial advice;
 - small business respondents have less of an understanding of the common terms and conditions found in standard form contracts;
 - small business respondents spend less time reviewing contracts on average, though this could in part reflect a difference in the number and complexity of contracts that they are offered compared to larger businesses;
 - small business respondents are more likely to feel that their business does not have the resources to negotiate a better deal, that standard form contracts are offered on a ‘take it or leave it basis’ and terms can’t be negotiated; and
 - small business respondents are more likely to do nothing when they encounter an unfair term as their business does not feel it is in a position to negotiate.
- It should be noted, however, that a large proportion of medium and large businesses also reported lacking legal expertise and sufficient resources to negotiate contracts.

- Businesses of all sizes indicated that when purchasing a good or service using a standard form contract, the main focus of their business is on the price and quality of the good they were purchasing/supplying, and not contract terms.

Research method

- The survey was developed with the assistance of ORIMA Research and contained 48 questions. It was accessed via the Commonwealth Treasury website and was publicised through a variety of channels, including the websites of www.business.gov.au, industry associations, Small Business Commissioners and State and Territory Consumer Affairs agencies, as well being emailed directly to a broad range of stakeholders.
- Most questions in the survey were not mandatory. This led to low numbers of responses to some questions. Mandatory questions relating to business size and whether standard form contracts had been offered were used to filter access to follow up questions.
- There were 287 business representatives who commenced the survey, of whom 23 were excluded when they indicated they had no responsibility for contracts for their business.

Characteristics of participants

- The 264 participants came from a range of industries with the greatest numbers from retail (21 per cent), accommodation and hospitality (11 per cent), professional, scientific and technical services (11 per cent) and building and construction (10 per cent).
- The majority of participants were from businesses that could be classified as ‘small’, with 173 (66 per cent) having an annual turnover of less than \$2 million (Diagram 2) and 208 (79 per cent) reporting having fewer than 20 employees.
- Businesses with 20 to 199 employees were represented by 49 (19 per cent) participants and there were seven participants from large businesses (200+ employees), representing three per cent of total participants.
- For the purpose of this report, the definition of a small business is taken from the ABS, that is, a business that employs fewer than 20 people.

Diagram 3.1: Respondents by annual turnover

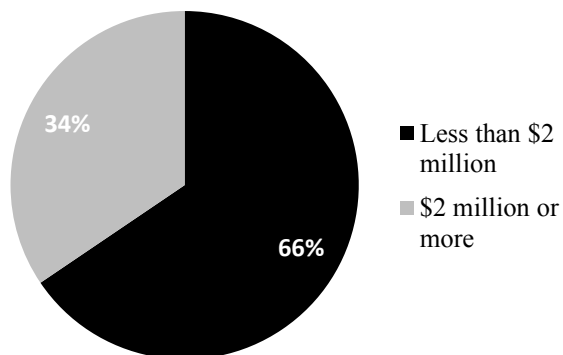
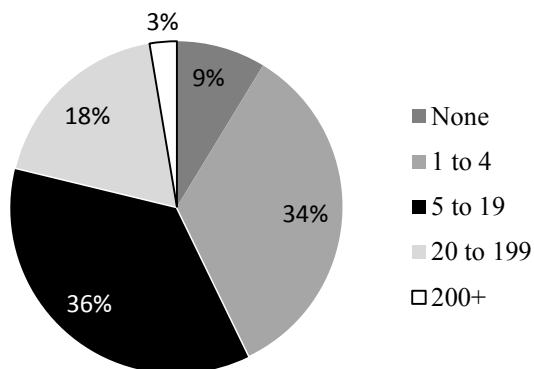


Diagram 3.2: Respondents by number of employees



- Only eight per cent of respondents from small business indicated that they had in-house legal expertise, compared to 16 per cent for medium businesses and 57 per cent for large businesses.

Experience with standard form contracts

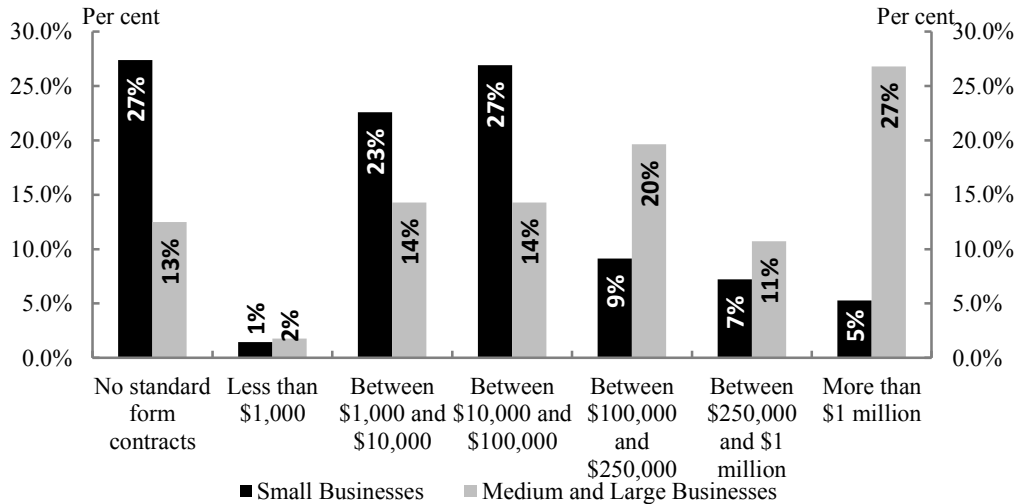
- The majority (80 per cent) of respondents reported being offered a standard form contract in the past 12 months. Most commonly, participants reported receiving one to five (39 per cent) or six to 20 (35 per cent) standard form contracts.
 - The median number of standard form contracts for small businesses was five and the average was 7.6.
- The table below shows the proportion of contracts offered to business that are standard form. Small business respondents were more likely to report that all or nearly all of the contracts they receive are standard form.

Table 3.3: Proportion of contracts standard form (%)

<i>Proportion</i>	<i>Small Business</i>	<i>Medium and large</i>
A minority were standard form contracts	13.1	19.2
Roughly half were standard form contracts	15.0	19.2
A majority were standard form contracts	33.1	38.5
All or nearly all were standard form contracts	38.8	23.1

- Standard form contracts are mainly used where the transaction value is below \$100,000 and least likely to be used for transactions above \$250,000.
 - The following diagram shows the maximum standard form contract value identified by respondents in the survey.
 - Only 22 per cent of small businesses are offered standard form contracts worth more than \$100,000, compared with 57 per cent of medium and large firms.

Diagram 3.3: Maximum value of standard form contracts for small businesses and medium to large businesses¹¹⁰ (Proportion of respondents)

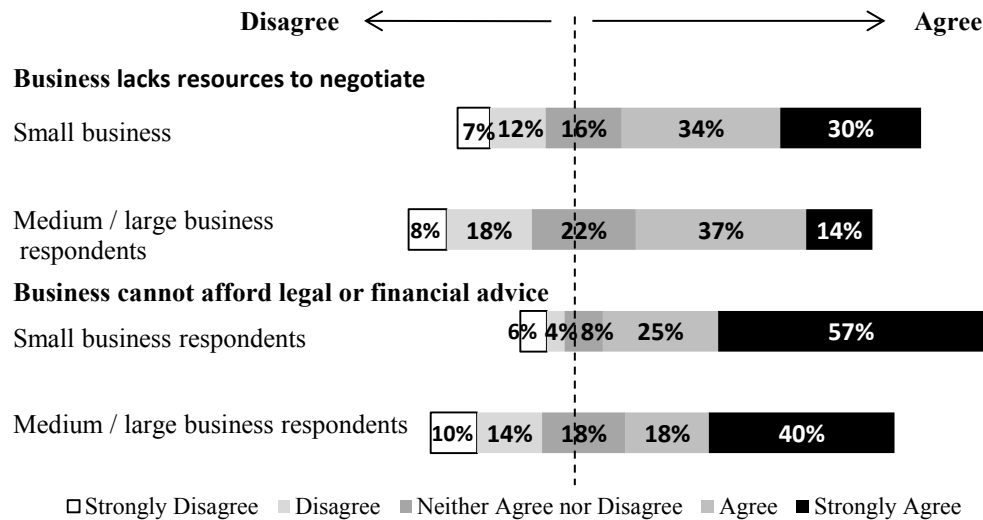


- Standard form contracts are used across a wide range of goods and services, with the most commonly reported being telecommunications (59 per cent of respondents), insurance (56 per cent), banking and financial products (48 per cent), utilities (43 per cent), and supply agreements (36 per cent).
 - It is likely that some small businesses would have standard form contracts for several different agreements. Of the respondents answering this question, 35 had been offered standard form contracts for all of telecommunications, insurance, financial products and services and utilities.
- Small businesses tend to spend less time reviewing standard form contracts, with 30 per cent selecting either less than five minutes or five to nine minutes. In contrast, only 12 per cent of medium to large business respondents reported spending less than 10 minutes, and 69 per cent reported spending 20 minutes or more reviewing standard form contracts.

¹¹⁰ For this diagram, the maximum standard form contract value indicated by participants can be used as a proxy for the maximum value of standard form contracts that the participant's business is offered. That is, if a participant gave responses only at levels between \$1,000 and \$100,000 it might be assumed that their business does not receive standard form contracts with values above \$100,000.

- Participants were asked to indicate the conditions in which their business was less likely to thoroughly review a standard form contract. There were small differences between business sizes for some of the more common responses, such as the contract being of low value, or being a renewal or of short duration.
 - Small business respondents, however, were more likely to not thoroughly review the contract if it is too complicated and they lack legal expertise.
 - In contrast, larger business respondents were much more likely to not thoroughly review standard form contracts when the contract is of low risk or where they trust the other party.
- Participants were asked about the extent of their agreement with several statements regarding their ability to review and negotiate standard form contracts. The figure below compares the responses to two of these statements, showing that many small businesses have neither sufficient resources to negotiate contracts or access to advice to assist in reviewing contracts.
 - In addition, small business respondents were more likely to agree that they assume contracts are standard and contain no unfair terms and that contracts are offered on a ‘take it or leave it basis.

Diagram 3.4: Agreement with statements relating to ability to negotiate for small businesses and medium to large businesses



- The survey also sought to understand what additional actions businesses take in addition to reviewing a contract. Approximately 59 per cent of respondents indicated that they often or always considered the penalty clauses contained in a contract. However, the majority of respondents also indicated that they never or rarely sought legal advice, contacted referees or seeks reviews.
- Another survey item considered understanding of common contract terms and conditions. It found that small business respondents were more likely than medium and large business respondents to have little or no understanding of all of these terms and conditions. This difference in understanding was particularly marked for mediation approaches, penalties and limits to liability.

Experience with unfair contract terms

- Of the 212 participants who reported being offered standard form contracts, 60 per cent of small businesses and 69 per cent of medium and large businesses claimed to have experienced unfairness in terms and conditions.
 - This difference might reflect a different understanding of contract terms, as the survey found that comprehension of

common terms was shown to be greater for larger business respondents.¹¹¹

- Large businesses were identified as offering contracts with unfair terms in the majority of cases. The goods and services most commonly cited by respondents as containing unfair contract terms included standard form contracts for supply of ATM services, waste removal, telecommunication services, and franchising agreements.
- Participants were also asked about the value of the contracts which included unfair terms. The majority unfair terms encountered by small businesses were in contracts with values of less than \$100,000. For larger businesses, 40 per cent of the contracts reported to have unfair terms were for values above \$250,000. In contrast, only 12 per cent of small businesses finding unfair terms stated that these contracts had a value above \$250,000. See Diagram 5 below.¹¹²

Diagram 3.5: Value of contracts with unfair terms reported by small businesses and medium to large businesses

- Those participants who reported experiencing unfair contract terms were asked about the action they took.
 - For small business respondents, the most common actions were to ask the provider to explain the terms, ask the provider to delete the terms or do nothing as the business is not in a position to negotiate.
 - Larger businesses also tended to ask for deletion or explanation, although they were much less likely than small businesses to ask for an explanation. Larger businesses were also far less likely to do nothing than small businesses and were more likely to look for another provider.
- Of the participants reporting unfair contract terms, 42 per cent (44 per cent of small business respondents)

111 Respondents were informed that the ACL contains provisions to protect consumers against unfair terms in standard form contracts and were given examples of terms that may be considered unfair.

112 Any respondents who gave a value of \$0 were excluded, leaving 71 respondents overall with 51 from small businesses and 20 from medium and large firms.

reported experiencing some harm as a result of the unfair terms. Examples of the loss or harm incurred by respondents included: ‘loss of clients due to failure to back products’, ‘an immense amount of executive management time and legal advice’, as well as ‘paying an absurd termination fee’.

– Of the 58 respondents who reported incurring losses, 76 per cent stated that they undertook informal negotiations with the other party to address the unfair term.

– Formal channels were used by 28 per cent of respondents to seek redress, including complaints to a regulator (such as the ACCC or ASIC), use of a dispute resolution service (including through a state Small Business Commissioner), or legal action. The use of formal resolution methods incurred additional costs, with 12 of the 16 respondents reporting costs to their business.

Issuing standard form contracts

- The final sections of the survey considered whether participants’ businesses issued standard form contracts to other firms and, if so, how these contracts were developed and reviewed.
 - The results showed that 24 per cent of small businesses and 41 per cent of medium/large businesses issued standard form contracts to other businesses.
 - The most commonly cited method of developing contracts was to use industry standard templates, followed by using a lawyer to design the contract, and drawing on in-house legal expertise.

Survey by Consult Australia

3.214 In their submission to the consultation process, Consult Australia reported that they had conducted a survey of their smaller member firms to ascertain the prevalence of, and how they treat standard form contracts.

3.215 Consult Australia noted that results of the survey suggest that ‘standard contracts in our industry are very common, and bespoke contracts are used more for larger projects.’

3.216 Consult Australia reported that:

- Approximately half of the respondents indicated that more than half of the contracts they are presented with are standard form, with only 25 per cent of respondents indicating that 20 per cent or less of their work is done using standard form contracts.
- Almost 85 per cent of respondents indicated that the standard contracts are for fees of less than \$100,000.
- When presented with standard contracts, more than 90 per cent of respondents indicated they review the terms all the time, with the remaining responses answering that they reviewed the terms most of the time.
- Just under half of respondents answered that they did not seek professional legal advice, while those respondents who indicated they did obtain professional legal advice overwhelmingly only used this advice sparingly, with more than half of respondents answering that they only obtained that advice for less than 20 per cent of contracts.
- Only one single respondent indicated that they get legal advice for 80 to 100 per cent of the contracts offered to them.

Small Business Development Corporation of Western Australia

3.217 The SBDC also conducted a survey, the results of which were included in its submission to the consultation process.

3.218 In summary, the SBDC found that all of the respondents to its survey had been offered standard form contracts with unfair terms in the past.

- Like the survey conducted by the Commonwealth Treasury, many small business respondents to the SBDC survey only sometimes read the contracts there were offered, or skimmed through them.
- Small business respondents were likely to believe that the other party would not negotiate contract terms and 69 per cent reported being offered contracts on a 'take it or leave it' basis. In addition, 40 per cent of respondents reported not having the power to negotiate.
- Considering the harm arising from unfair terms, the SBDC reported that financial loss was the most commonly mentioned detriment (30 per cent of respondents), followed

by loss of business opportunity (16 per cent); the creation of compliance obligations that required unreasonable time and effort to address (16 per cent) and reputational damage (13 per cent).

Attachment B - Consumer unfair contract terms protections in the Australian Consumer Law

3.219 The Productivity Commission's recommendation for introducing a legislative protection against unfair terms for consumer contracts was implemented in some jurisdictions from 1 July 2010 and for all jurisdictions from 1 January 2011. It is found in Part 2-3 of the ACL.

3.220 While the 2009 exposure draft legislation was expressed as capable of applying to business-to-business contracts, the final form of the legislation was expressed to apply to all businesses which use standard form contracts in their dealings with *consumers*.

3.221 A 'consumer contract' is defined 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'.¹¹³

3.222 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.¹¹⁴

3.223 A term is deemed to be 'unfair' if it:

- would cause a significant imbalance in the parties' rights and obligations;
- is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and

113 Section 23 of the ACL.

114 Section 27 of the ACL.

- would cause detriment (financial or otherwise) to a party if relied upon.¹¹⁵

3.224 In determining whether a term is ‘unfair’, the court is required to take into account:

- 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
- the contract as a whole.¹¹⁶

3.225 There are a number of exceptions to the application of the unfair contract terms provisions. For example, the provisions do not apply to terms that:

- define the main subject matter of the contract; or
- set the upfront price payable under the contract.¹¹⁷

3.226 Similar protections apply to most financial products and services purchased by consumers through Subdivision BA of the ASIC Act, where there are ‘unfair’ terms in a ‘consumer contract’ and the contract is a ‘standard form contract’. The definitions of these terms in the ASIC Act largely mirror those in the ACL.

3.227 Insurance contracts are excluded from the operation of the unfair contract term provisions in the ASIC Act by the *Insurance Contracts Act 1984* (Cth) (IC Act).¹¹⁸ 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.

Enforcement

3.228 Enforcement of the consumer unfair contract terms protections is shared between the ACCC, ASIC and the state and territory fair trading bodies. Individual consumers may also be entitled to take their complaint to the small claims court or tribunal in their state or territory, or to take private legal action.

115 Section 24 of the ACL.

116 Ibid.

117 Section 26 of the ACL.

118 Section 15 of the *Insurance Contracts Act 1984* (Cth).

3.229 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 unfair contract terms protections. It is not the role of a regulator to endorse contract terms or to state categorically that they are unfair.

3.230 If a court finds a contract term to be unfair, it can make orders such as: declaring all or part of the contract to be void; varying a contract or arrangement as the court sees fit; or 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.

3.231 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.¹¹⁹

Attachment C – Existing laws and regulations

3.232 This Attachment provides background to a number of laws and regulations that may be relevant to the issue of unfair contract terms in small business contracts.

The Competition and Consumer Act 2010

3.233 The ACL's **unfair contract term protections for consumers** could under some circumstances benefit small businesses. To the extent that a good or service is for both domestic and business use (for example, computer spyware software) and the business offering the standard form contract does not use different contracts for consumers and a small businesses, small businesses may also benefit where they are offered a contract free of unfair terms. However, small businesses have no legislative protections where the terms are present and enforced.

3.234 Under the prohibition against **misleading or deceptive** conduct, it is unlawful for a business to make statements in trade or commerce that are misleading or deceptive, or would be likely to mislead or deceive. This provides consumers and businesses with recourse where a contract they agree may not represent their informed consent due to the fraudulent or misleading behaviour by a party to the contract. However, a contract term can be unfair without behaviour being misleading or deceptive.

119 Section 23 of the ACL.

3.235 The ACL prohibits **unconscionable conduct** in trade or commerce in connection with the supply of goods or services to a person (other than a publicly listed company), which includes small businesses.¹²⁰ In 2010, the prohibitions were amended to provide that a court may have regard to a number of matters in determining whether there has been unconscionable conduct. These include relative bargaining power, whether any undue influence or pressure was exerted by the supplier, and the extent to which the supplier was willing to negotiate the terms and conditions of any contract for supply.

- It is unlikely that the unconscionable conduct provisions can directly address unfair contract terms as, to date, the courts have applied the provisions to matters of ‘procedural’ unfairness (that is, conduct), not ‘substantive’ unfairness (that is, the terms themselves).¹²¹ Therefore, an extension of unfair contract term protections for small businesses would complement unconscionable conduct provisions.

3.236 Under the ACL, suppliers of goods and services must adhere to the specified consumer guarantees which cannot be excluded, modified or limited by contract. They provide a minimum acceptable standard for terms in consumer contracts.¹²² The provisions apply to ‘consumer transactions’ and adopt the meaning of ‘consumer’ in section 3 of the ACL.¹²³ Therefore, small businesses can be protected for transactions of goods and services under \$40,000 that are ordinarily used for personal,

120 See section 21 of the ACL. See also section 12CB of the ASIC Act, which includes equivalent protections for the provision of financial products and services.

121 See, for example, Frank Zumbo’s submission to the Productivity Commission Inquiry in 2008 that led to the introduction of the consumer protections, which noted that ‘procedural unconscionability bias remains a critical limitation on using the equitable doctrine or the existing statutory prohibitions against unconscionable conduct to deal with unfair terms’ at page 15. Additionally, consultations in 2013 on the efficacy of the Franchising Code identified concerns with terms of franchise agreements, suggesting reforms to unconscionability provisions had not addressed concerns with contract terms between big and small businesses.

122 In relation to goods, the guarantees include that the goods supplied are of acceptable quality, goods supplied by description correspond with the description and that goods are reasonably fit for the purpose represented by the supplier or disclosed by the consumer (whether expressly or by implication). In relation to services, the guarantees include that the services will be rendered with due care and skill, within a reasonable time.

123 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.

domestic or household use, and not for the purpose of resupply or use in trade or commerce.¹²⁴

- Consumer guarantees primarily apply to core terms regarding the nature and quality of the good or service, rather than terms relating to matters such as dispute resolution or in the length of the contract. Consequently, consumer guarantees do not directly address unfair contract terms.

3.237 The CCA prohibits **anti-competitive conduct** in all sectors of the economy. In particular, it is unlawful to enter into contracts, arrangements or understandings which have the purpose, effect or likely effect of substantially lessening competition, or which contain exclusionary provisions. Section 46 prohibits the **misuse of market power**, with firms prohibited from taking advantage of a substantial degree of power for the purpose of eliminating or substantially damaging a competitor, preventing entry into a market or deterring competitive conduct.

- A number of submissions raised competition-related concerns with unfair contract terms in small business contracts. For example, the Pharmacy Guild of Australia and the Australian Newsagents' Federation suggested that pharmacies and newsagents (often small businesses) are vulnerable in negotiating leases, particularly with large shopping centres who can seek agreement to unfair contract terms on the basis that if they do not accept those terms, another business will.

State and territory measures

3.238 States and territories may also provide measures that can protect small business contracts. For example, Chapter 7 of Victoria's *Australian Consumer Law and Fair Trading Act 2012*, which sets out the Victorian Civil and Administrative Tribunal's powers, provides at section 185, that it may make any order it considers fair, including declaring unjust terms void, where the amount in dispute does not exceed \$10,000. This power is not limited to standard form contracts.

124 However, the guarantees do not apply to all transactions under \$40,000, given that the consumer guarantee provisions do not apply to: contracts of insurance; 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.

Industry-specific measures

3.239 In response to concerns in some industry sectors regarding the prevalence of unfair contract terms and contracting practices more broadly, several industry-specific measures have been introduced that protect against unfair contract terms.

3.240 Under the *Independent Contractors Act 2006* (Cth), independent contractors can seek judicial review of a services contract deemed 'unfair' or 'harsh'.¹²⁵ If deemed 'unfair' or 'harsh' the court may order that the contract be set aside (in whole or in part) or varied. When determining whether a contract is 'unfair' or 'harsh', a court may consider:

- the terms of the contract; and
- other matters permitted under the Act such as the relative bargaining power of the parties, whether any undue influence or tactics were used, and the appropriateness of the remuneration provided under the contract.

3.241 While there have only been a few cases there is evidence it provides a substantial level of protection. For example, in *Keldote Pty Ltd & Ors v Riteway Transport Pty Ltd* the applicant successfully argued that their contracts were unfair because they allowed the respondent to unilaterally require them to provide a truck that was considerably different from the one they had already provided under the contract.

- However, the consultations revealed differing views regarding whether the Act provides small businesses with sufficient protection from unfair contract terms.¹²⁶

3.242 New South Wales' *Motor Vehicle Dealers and Repairers Act 2013* provides protections against unfair contract terms in contracts for the supply of motor vehicles between motor dealers (often small businesses) and manufacturers. The test for unfairness, outlined in section 142, is the same as the test in the ACL's consumer unfair contract terms protections.

125 See section 12 of the *Independent Contractors Act 2006* (Cth). 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.

126 For example, Independent Contractors Australia argued the protections are ineffective while the Ai Group argued they are effective. Also, the Direct Selling Association of Australia argued that its members' distributor agreements are covered by the Act so should be exempt from any extension of unfair contract terms protections.

- However, it appears that the remedies available under this Act are substantially different to the ACL protections. For example, a business cannot institute proceedings until they have complained to the NSW Small Business Commissioner and obtained a certificate under section 19 of the *Small Business Commissioner Act 2013* (NSW) and they must also provide notice to the department that administers the Act. Where the available remedies are considered less favourable than the new protections it may not be exempted on the basis that it is not an equivalent enforceable mechanism.

3.243 A number of requirements are currently provided in the **telecommunications sector** which can apply to small businesses. These aim to provide customers of telecommunications businesses, including small business customers, with the information they need to make an informed decision, rather than providing protection against unfair contract terms. In this sense these requirements complement the proposed unfair contract term protections.

- For example, section 479 of the *Telecommunications Act 1997* (Cth) provides that the terms of a telecommunications contract with a person (including a person who operates a small business) are as agreed with them or as set out in a standard form contract which has been entered into by the parties. Where a standard form contract is used, there are disclosure obligations on telecommunications businesses to ensure customers can make an informed decision (for example, a requirement to provide a summary document setting out key contract terms such as those regarding termination or renewal).
- The *Telecommunications Consumer Protection Code 2012*, an industry code registered with the Australian Communications and Media Authority, sets out protections for consumers (including consumers who are small businesses). It provides that contracts must be made available and be in plain, clear language, and that a supplier must not ‘include terms which would be unfair in its standard form customer contracts under the law’ (for example, unilateral variation or contract extension).¹²⁷ A ‘customer’ can be a

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

business or not-for-profit organisation where the contract is worth less than \$20,000 per annum.¹²⁸

Industry Codes under the *Competition and Consumer Act 2010*

3.244 Part IVB of the *Competition and Consumer Act 2010* provides for the prescription of industry codes (mandatory or voluntary) to regulate the conduct of industry participants in their dealings with each other or towards consumers. It is a co-regulatory tool that is used where self-regulation has not been effective and a legislative solution is not considered appropriate, and allows for a clear set of rules that define best practice for conduct in a given industry.

3.245 To date, six industry codes of conduct have been prescribed under the Act, all of which are mandatory, except for the recently introduced voluntary Food and Grocery Code:

- *Franchising Code*: regulates the conduct of franchisors and franchisees in their dealings towards each other;
- *Horticulture Code*: regulates dealings to improve clarity and transparency of transactions between growers and wholesalers of fresh fruit and vegetables;
- *Oilcode*: regulates the conduct of suppliers, distributors and retailers in the petroleum retail industry in Australia;
- *Unit Pricing Code*: requires certain grocery retailers to adopt unit pricing when selling particular grocery items; and
- *Port Terminal Access (Bulk Wheat) Code*: regulates the conduct of bulk wheat port terminal operators.
- *Food and Grocery Code*: regulates the conduct of supermarket retailers or grocery wholesalers (that agree to be bound) in their dealings with suppliers. This code commenced on 2 March 2015 and is the first prescribed voluntary code under the Act.

3.246 The explanatory memorandum accompanying the regulatory amendments to introduce the industry codes framework in 1997 discussed the need to address unfair contract terms, recommending the introduction of industry codes of conduct to deal with unfair contract terms in

128 Clause 2.1.

franchising and retail tenancy. However, there is no prohibition of unfair contract terms in any of these above codes which largely focus on ensuring procedural fairness and would complement unfair contract term protections.

- For example, the Franchising Code sets out a number of protections and disclosure requirements, including cooling off rights, and was recently strengthened by the introduction of a general duty on all parties to act in good faith. It also limits the enforceability of certain terms, such as a restraint of trade clause, if certain conditions are met on conclusion of agreement. It does not, however, provide for a general review of unfair contract terms in standard form contracts, which was an issue raised in the consultation process.

3.247 There were mixed views on whether sectors which are subject to an industry code of conduct under the *Competition and Consumer Act 2010* should be exempt from a legislative extension of unfair contract terms protections. For example, some called for the franchising sector to be exempt because the sector ‘is already highly regulated’,¹²⁹ while others argued further protections should be provided, including unfair contract terms protections for small business contracts.¹³⁰

- Those calling for protections argued that despite disclosure requirements and other protections, unfair contract terms are still included in agreements and an imbalance of bargaining power can prevent prospective franchisees from negotiating their removal.
- Some also raised concerns with the use of documents prescribing rights and responsibilities that fall outside of the franchise agreement (for example, operating and procedures manuals).¹³¹

129 See, for example, submissions by Franchise Council of Australia, Real Estate Institute of Australia and the Victorian Small Business Commissioner.

130 See, for example, submissions by the Franchisees Association of Australia and Australian Automotive Dealer Association.

131 Such a document is prepared and maintained by the franchisor. Failure to comply with this document, including provisions that could be unfair, could result in the termination of the franchise agreement.

Retail Tenancy

3.248 Retail tenancy is regulated by state and territory laws which generally provide: minimum conditions; detailed rules on key issues such as information disclosure requirements and termination rights; and dispute resolution mechanisms. Retail tenancy legislation varies between jurisdictions and does not explicitly prevent the inclusion of unfair contract terms.

3.249 Retail tenancy legislation would complement a national unfair contract terms protections for small business. It provides additional measures to assist businesses to make contracting decisions or resolve disputes, while the proposed unfair contract terms protections provides specific rights with respect to reviewing unfair terms in standard form agreements.

3.250 Regarding the applicability of retail tenancy laws, those who support retail tenancy agreements being exempt from the proposed protections claim they are already appropriately regulated.¹³² Those who call for the protections to include retail tenancy agreements argue that the effectiveness of disclosure requirements is questionable, that a number of unfair terms are used (for example, permitting unilateral contract variation), and that documents referred to in retail leases can be provided after agreement has been reached and be unilaterally varied by the landlord (for example, fit-out requirements).¹³³

Financial Products and Services

3.251 A number of stakeholders suggest financial products and services should be exempt arguing current protections provide appropriate coverage of small business contracts.¹³⁴ For example:

- the ASIC Act regulates the provision of credit to small businesses, including lending, broking and advice activities, primarily through the prohibitions on unconscionable and misleading or deceptive conduct.
- Chapter 7 of the *Corporations Act 2001* (Cth) provides protections to small businesses where they are defined as

132 See, for example, the submission by the Shopping Centre Council of Australia.

133 See, for example submissions by the Pharmacy Guild of Australia and the Australian Retailers Association.

134 See, for example, Australian Bankers' Association's submission.

‘retail clients’ and obtain financial products or services, other than credit.

- the banking industry’s *Code of Banking Practice 2013* sets standards of good banking practice (including for credit facilities and requires signatories to be members of an ASIC-approved independent external dispute resolution service) for small business customers. However, the Code focuses on practices rather than terms and conditions and deals narrowly with some issues, raising the question of whether its provisions are sufficiently broad to protect against unfair contract terms.
- those providing financial advice and offering financial products require an Australian Financial Services Licence (AFSL). Under section 912A of the *Corporations Act 2001* (Cth), an AFSL-registered person must do all things necessary to ensure their services are provided ‘efficiently, honestly and fairly’.

3.252 However, a number of submissions argued that existing protections are not adequate in dealing with the underlying issue of fairness in contractual dealings and therefore the protections should cover financial products and services.¹³⁵ Examples of unfair terms include:

- the use of ‘fee farming’ and ‘equity stripping’ for small businesses in urgent need of finance.¹³⁶ It was also suggested that some non-monetary covenants in credit contracts may seem unfair.
- It was suggested that the introduction of consumer unfair contract term protections saw a change in terms that had imposed unfair liabilities on consumers, creating broad and effective outcomes, and that similar outcomes could be achieved for small businesses.¹³⁷

3.253 In its final report released in December 2014, the *Financial System Inquiry* endorsed the Government’s process to extend unfair

135 See, for example, the submission by the Tasmanian Small Business Council. Several confidential submissions also argued this point.

136 Fee farming’ occurs when a broker’s contract requires a small business to pay a fee irrespective of whether the loan proceeds or not. ‘Equity stripping’ occurs where finance is provided to a small business in a situation where default by the borrower is likely and requires the payment of excessive default fees.

137 This point was made in a confidential submission.

contract term protections to small businesses.¹³⁸ The report notes that these protections may improve broader contracting practices and help deal with issues relating to the fairness of non-monetary default covenants.

Insurance

3.254 Insurance contracts are governed exclusively by the *Insurance Contracts Act 1984* (Cth). Section 15 excludes the operation of any other law with respect to, among other things, whether an insurance contract is harsh, oppressive, unconscionable, unjust, unfair, inequitable or the result of a misrepresentation.

3.255 The Act provides an alternative set of requirements for insurance contracts. In particular, it requires insurance companies to observe the duty of utmost good faith in relation to other parties. While some argued the protections it provides for customers of insurance products are sufficient,¹³⁹ others argue the protections against unfair contract terms should be extended to insurance as it could result in different claim outcomes in certain circumstances.¹⁴⁰

Building and construction

3.256 Domestic building contracts are regulated by the states and territories and protections can vary between jurisdictions and do not explicitly prevent the inclusion of unfair contract terms.

3.257 The Master Builders Association has called for an exemption from any unfair contract term protections for domestic building contracts, arguing that such an extension would allow the re-opening of contracts that have already been negotiated transparently, create uncertainty and lead to increased litigation in the sector.

3.258 The House Industry Association also opposes the introduction of unfair contract term laws to the residential building industry. They argue that existing legal protections are adequate, including competition and consumer laws, the *Independent Contractors Act 2006* (Cth), and security of payment legislation, in addition to state and territory building and construction legislation.

138 See Recommendation 34 of *The Financial System Inquiry Final Report*, November 2014, <<http://www.fsi.gov.au/publications/final-report/>>.

139 See, for example, submissions by the Insurance Council of Australia and Insurance Australia Group.

140 See, for example, the submission by the Financial Rights Legal Centre.

3.259 A confidential submission argued that the extension of protections should capture small business suppliers of professional services in the construction industry. According to this submission, there has been an increase in contractual terms which trigger 'assumed liability', 'waiver of rights' exclusions and contracting out of proportionate liability, as well as terms such as unilateral rights of termination and variation of work without compensation.

Chapter 4

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015

4.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

4.2 This Bill extends the consumer unfair contract term protections contained in the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and Schedule 2 of the *Competition and Consumer Act 2010* (CC Act) to cover businesses with less than 20 employees agreeing to standard form contracts valued less than a prescribed threshold; and allows for the exemption of small business contracts that are subject to prescribed laws deemed enforceable and equivalent to the unfair contract term protection in the ASIC Act and/or the CC Act.

Human rights implications

4.3 This Bill does not engage any of the applicable rights or freedoms.

Conclusion

4.4 This Bill is compatible with human rights as it does not raise any human rights issues.

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