BAKER & MCKENZIE

Submission for Exposure Draft Consultation

Extending Unfair Contract Term Protections to Small Business

Thank you for the opportunity to present a submission in response to the Commonwealth Government's Exposure Draft legislation to extend the unfair contract term protections to small business.

Baker & McKenzie has advised numerous local and international clients on the application of:

- the unfair contract terms protections for consumers;
- the Australian Consumer Law (**ACL**) protections for consumers and business; and
- related industry-specific regulation.

Drawing on our experience and feedback from Australian and multi-national clients, we comment on some issues relevant to the Exposure Draft legislation.

Executive summary

Baker & McKenzie believes that there are three key areas in which the Exposure Draft requires further consideration. These are:

- That the "equivalent laws" test for exempting contracts from the unfair contract terms protections is too narrow. The proposed test would prevent the Minister from applying an exemption to small business contracts covered by existing industry-specific legislation designed to meet similar objectives, and having similar (but not necessarily equivalent) protections.
- The "upfront price" test remains unclear. This is not assisted by the varying statements made in the Regulatory Impact Statement and the Fact Sheet (on the one hand) and the Exposure Draft and Explanatory Materials (on the other). These differ in how they define the upfront price test.
- There should be a simple process that can be relied on by a party to identify whether it would be contracting with a small business under a contract regulated by the unfair terms laws. Some further refinement of the "small business" test is needed for this to be achieved.

Detailed comments

1. Limited application of exemptions

The Exposure Draft allows a small business contract to be exempt from the new unfair terms laws if the small business contract is covered by a law prescribed in the regulations.[1] The Exposure Draft provides that, before a law can be listed in the regulations, the Minister must be satisfied that the law provides enforceable protections for small businesses "equivalent" to the scope of the unfair terms laws, including terms dealing with enforcement and remedies. "Equivalent" sets a very high standard.[2]

[1] Proposed amendment to *Competition and Consumer Act 2010* (Cth) section 139G(2).
[2] The first limb of the Macquarie Dictionary online version of "equivalent" is "equal in value, measure, force, effect, significance": https://www.macquariedictionary.com.au/features/word/search/?word=equivalent&search_word_type=Dictionary

This, together with the fact that it refers to enforcement and remedies ***as well as*** to contractual terms, will make it extremely unlikely that the Minister will be in a position to allow any such exemption. A broader test would be more appropriate. Suggested alternatives are set out below.

Several existing federal and state laws were designed to redress unfairness arising from an imbalance between parties to contracts in specific industries. In these cases, legislators have examined where unfairness may arise, and introduced a tailored response for the industry in question. Examples of these include:

- A motor dealer agreement regulated by the *Motor Dealers and Repairers Act 2013* (NSW) (**MDR Act**) that would otherwise qualify as a small business contract might be eligible for an exemption based on the equivalent law test. The MDR Act defines an unfair term in an almost identical way to the ACL test.[3] However, the MDR Act and the ACL take a different approach on enforcement and remedies for unfair terms. Under the MDR Act, an unfair term may be declared void, but, unlike in the ACL, is not automatically void.[4] The MDR Act provides a more consultative approach than the ACL in dealing with a term alleged to be unfair. The different approach to remedies means it would not be "equivalent" on the test contained in the Exposure Draft.

- The Franchising Code has been subject to numerous federal government reviews examining the appropriateness of regulatory steps to redress power imbalances between franchisor and franchisee. The most recent of these resulted in a new Code which commenced on 1 January 2015, the adequacy of which has yet to be tested. The result of the numerous Code reviews has been that the Code identifies contractual terms which might be perceived to be unfair, or requires or includes certain terms to redress any imbalance. Examples of these are terms as relating to the ability to terminate, the notice to terminate, the ability to cure defaults, the obligation to act in good faith, the venue for disputes and the ability to exclude representations or require releases, enforce a non-compete provision, refuse transfers and require capital expenditure. These Code provisions have effectively the same result as if the contractual terms dealing with such areas were unfair under the ACL, as in each case they will be unenforceable. The difference is that the Code legislators decided on a tailored, list approach. Combined with other protections in the Code dealing with franchisor behaviour and disclosure obligations, this was considered to be a balanced and appropriate response to a highly-regulated industry sector. Applying the general ACL unfair contract term provisions in addition to the Code would ignore the carefully considered approach to the franchising sector to date, and would create complexity and regulatory uncertainty.

To provide the Minister with the flexibility to exempt contracts covered by laws which either expressly or, in effect, deal with the unfair contract term issue, we suggest that the test be widened to:

> "…must be satisfied that the law provides enforceable protections for small businesses that are **substantially** equivalent to those provided **by Part 2-3**",

removing reference to Parts 5-1 and 5-2 of Schedule 2, which is adequately covered by the term "enforceable protections". This would allow more discretion around appropriateness of alternative remedies.

[3] Compare MDR Act section 143 with ACL section 24.
[4] See section 147 of the MDR Act.

To enable the Minister to give due regard to industry-specific approaches, we suggest that section 139G(2A)(b) be broadened to require the Minister to take into consideration "the impact of a law regulating unfair terms of a small business contract in a particular industry".

2. The "upfront price" test

The intended meaning of the "upfront price" test in the Exposure Draft is confusing and needs to be clarified before the process is progressed. The current consultation process uses at least three separate definitions and applications of "upfront price" being:

- **the Exposure Draft**[5] creates thresholds where the "upfront price payable under the contract" must not exceed $100,000 or $250,000 (as applicable) applying the meaning in existing section 26(2) of the ACL (which defines the "upfront price" as the consideration (a) provided or to be provided under the contract; or (b) disclosed at or before contract entry. In the case of (a) and (b), the upfront price excludes consideration contingent on the occurrence or non-occurrence of an event);
- **the Fact Sheet for the Exposure Draft** states that the provisions will apply "where the value of the contract does not exceed" the relevant thresholds; and
- **the Regulatory Impact Statement** identifies the test as the "transaction value" applying the relevant threshold.

Each is a different test.

A further concern with the "upfront price" test under the current Exposure Draft is how it is intended to apply to an "on-demand" type of contract which is a common contract form used in business. Often under these types of contracts, no upfront price is payable, there is no minimum purchase and the contract is of indefinite duration. The total consideration to be provided over the course of the contract will not be known upfront. The uncertainty of not knowing if such a form of contract is intended to fall within the scope of the new laws has been raised with Baker & McKenzie by a number of clients.

3. The "small business" test - employee numbers

The threshold upfront price amounts are still quite high for small business contracts, meaning that a large number of contracts will be captured under the new legislation. As a result, in practice, the most important threshold test may be the "small business" test.

We do not have a view on whether fewer than 20 employees is an appropriate number for setting a small business threshold. However, we await with interest industry comments on this test. We also expect some concerns to be raised about uncertainty in assessing when a casual employee would be counted as "employed by the business on a regular and systematic basis".

Our major concern regarding the small business test is the level of due diligence that contracting parties will be required to undertake to determine whether the unfair contract terms apply. For example, it would be useful to have clarity on whether a party can rely on the unfair terms protections if the party failed prior to contract to disclose its employee number details to the other party, or if it misrepresented the number.

[5] This position is also reflected in the Explanatory Materials.

Baker & McKenzie feels that more consideration needs to be given to how contracting parties are to identify small businesses. A party should be able to enter a contract with an understanding of whether the unfair terms protections apply. The party should not be disadvantaged because of uncertainty about employee numbers.

Baker & McKenzie

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