

Business
Council of
Australia



submission

Submission to the Department of
Treasury on the Exposure Draft
Legislation for Extending Unfair
Contract Term Protections to Small
Businesses

MAY 2015

*Working to achieve
economic, social
and environmental
goals that will benefit
Australians now and
into the future*

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The Business Council of Australia (BCA) is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council's submission to the Department of Treasury exposure draft of the *Small Business and Unfair Contract Terms Bill 2015* (draft Bill).

The proposed legislation aims to extend consumer unfair standard contract term protections to small businesses.

The Business Council continues to regard new regulation as unwarranted, for the reasons outlined in our earlier submission to Treasury.¹ We remain concerned about the additional regulatory burden on business from new compliance costs, regulatory uncertainty, the increased risk of litigation, and disincentives to use standard form contracts. Conversely, while there may be benefits to some small businesses from the changes, these are unquantified and the decision Regulation Impact Statement (RIS) does not demonstrate that these benefits offset the costs of the new legislation.

The Business Council's submission on the draft legislation:

- proposes changes to the draft Bill to reduce what Business Council member companies consider to be the risk of unintended impacts from the exposure draft.
- sets out our concerns with the adequacy of the assessment in the decision RIS, released with the draft legislation.

Key recommendations

The Business Council recommends the exposure draft be changed to:

1. Only apply unfair contract term protections to contracts for the supply of goods or services to small business, not the acquisition of goods and services from small business.
2. Enable the minister to exempt from the proposed legislation, existing laws, self-regulatory and co-regulatory schemes that already include reasonably comparable small business protections against unfair contract terms.
3. Allow flexibility in the contract threshold definition (currently an upfront price payable of up to \$100,000 or \$250,000 for contracts of more than 12-months' duration) to avoid capturing high-value contracts that include regular payments based on the number and type of services used within the contract period.
4. Allow a party to justify a contract term or condition on the basis that it was reasonably necessary to protect their legitimate interests.
5. Include definitions for a 'standard form contract' and specify the type of standard contract terms considered to be 'unfair'.

1. BCA (Business Council of Australia), *Submission to the Department of Treasury Consultation Paper on Extending Unfair Contract Terms to Small Business*, BCA, Melbourne, August 2014.

6. Limit the definition of a 'small business' to businesses that are in a position which is comparable to that of consumers, up to a maximum of 20 employees, and exclude public companies from the unfair contract term protections.
7. Require a post-implementation review to be conducted within three years.

Explanation for the BCA's recommendations

Supply of goods by a small business

Unfair contract term protections will apply to contracts for the supply of goods and services (or sale or grant of an interest in land) where one of the parties is a small business. In effect this means the protections would apply where:

- the *purchase* of goods and services is by a small business, and
- the *supply* of goods and services is by a small business.

The Business Council argues the consumer unfair contract term protections should not be extended where small business is the supplier. It would go beyond the government's 2013 election commitment to 'extend unfair contract protection currently available to consumers, to small businesses'.²

Unfair contract protections in the Australian Consumer Law (ACL) apply to the purchase of goods and services by consumers. The rationale for these protections is the potential imbalance in resources, understanding or bargaining power between parties that may result in 'unfair' contract terms advantaging the supplier of the goods or service.

The ACL does not contain unfair contract term protections for suppliers that can be extended to small businesses.

The case for extending unfair contract term protections where small business is the supplier has not been explained. The decision RIS provides no quantitative evidence of a substantive problem with existing protections for suppliers. The costs and risks of extending unfair contract term protections to contracts for the *supply* of goods and services by a small business, have not been fully assessed. Case law in this area has not been established.

The arguments for unfair contract term protection in the RIS, that small businesses 'lack sufficient resources and bargaining power' or it may be reasonable not to expect a business 'to undertake appropriate due diligence before signing', do not necessarily apply when a small business is a supplier.

Protections already exist, as the decision RIS notes. The Commonwealth's *Independent Contractors Act 2006* already provides protections for independent contractors (who sell services) against contract terms that may be 'harsh' or 'unfair'.

2. *Backing Small Business*, 2013 Election Policies, Liberal Party of Australia, accessed 8 May 2015, <https://www.liberal.org.au/our-plan/small-business>

The introduction of an unfair contract terms provision where small business is the *supplier* will introduce a legislative risk for the purchaser under a standard form contract. It could lead to reduced use of standard form contracts and higher transaction costs for both parties and may result in reduced incentives to acquire goods and services from small businesses.

Businesses may have an incentive to deal with larger suppliers due to the complexities of dealing with multiple small suppliers under these provisions. For example, where major retailers look to source products from smaller, local suppliers and support local small businesses for services (such as maintenance), this may be at risk if regulatory arrangements become too cumbersome.

The introduction of this additional regulation has not been subject to proper evaluation and consultation and it should be removed from the draft legislation.

Recommendation 1

Only apply unfair contract term protections to contracts for the supply of goods or services to small business, not the acquisition of goods and services from small business.

Exemptions

To remove duplication, the proposed legislation allows the minister to exempt from the legislation an industry-specific law of the Commonwealth, states or territories. The exemption would apply only if the existing industry-specific law already includes protections against unfair contract terms. However, industry self-regulation schemes cannot be exempted.

An example of an existing law that includes protections against unfair contract terms is the Commonwealth's *Independent Contractors Act 2006*.

The Business Council supports exemptions for self-regulatory and co-regulatory schemes, particularly for schemes that are mandatory and enforceable and enable customers to obtain remedies from their supplier, such as the *Telecommunications Consumer Protection Code 2012*.

Self-regulatory and co-regulatory schemes are usually developed through extensive consultation with a range of stakeholders. This allows industries to develop schemes that account for the individual needs of their particular industry and are workable for all stakeholders. Such schemes should be exempted from this law where they provide reasonably comparable protection, even if not equivalent in all respects.

Further, not allowing an exemption for self-regulation and co-regulatory approaches to dispute resolution discourages the use of alternative dispute resolution mechanisms. This risks increasing overall regulatory costs without providing additional benefits to small business.

Recommendation 2

Enable the minister to exempt from the proposed legislation, existing laws, self-regulatory and co-regulatory schemes that already include reasonably comparable small business protections against unfair contract terms.

Contract threshold definition

The intended public policy aim of the draft Bill is to protect small businesses that are insufficiently resourced to understand standard form contracts and to negotiate contract terms. The draft Bill targets low-value contracts on the grounds that financial incentives exist for small businesses to more carefully consider or obtain legal advice when entering into high-value contracts.

The Business Council agrees that there should be a low-value contract threshold.

However, the proposed contract threshold of an upfront price payable of up to \$100,000 risks inadvertently capturing high-value contracts. This could occur where the upfront price of a contract or unit price of a good or service is low but regular payments are made for that good or service over the contract period, thus making it a high-value contract.

In these circumstances, the upfront or unit price per good or service will not reflect the overall value of the contract. For example, mortgage brokerage arrangements often include fees and commissions paid contingent upon certain events occurring, despite these amounts being known and expected to be paid at the time of entering into the contract.

Another example is standard form contracts in the telecommunications industry providing a package of business telecommunications needs (e.g. phone, internet and related equipment). While each individual good or service may have a low unit price or monthly fee, the total price payable over a 12-month period may be well in excess of \$100,000. Similar pricing structures are used in other industries.

Recommendation 3

Allow flexibility in the contract threshold definition (currently an upfront price payable of up to \$100,000 or \$250,000 for contracts of more than 12-months' duration) to avoid capturing high-value contracts that include regular payments based on the number and type of services used within the contract period.

Protecting legitimate interests

It is unclear whether the proposed legislation would enable a party to defend a complaint that a standard contract term was unfair, if it could be demonstrated that its inclusion was necessary to protect its legitimate commercial interests. The new law should allow for such a defence.

Recommendation 4

Allow a party to justify a contract term or condition on the basis that it was reasonably necessary to protect their legitimate interests.

Definitions of ‘standard form contract’, ‘unfair term’ and ‘small business’

The exposure draft does not include clear definitions of a ‘standard form contract’, nor what would be considered to be an ‘unfair term’. The interpretation is to be left to the courts.³

This lack of certainty will cause businesses to incur higher costs when identifying and amending contracts subject to the additional protections. The uncertainty also creates the risk that business might inadvertently contravene the law or be subject to an increased risk of litigation. This may harm innovation and dull incentives to improve price and product offerings to consumers. It may create an incentive for businesses not to use standard form contracts, to the detriment of both supplier and consumer in many cases.

To reduce this uncertainty, definitions of a ‘standard form contract’ and ‘unfair terms’ should be included in the legislation.

It is also important that the definition of a ‘small business’ is consistent with the government’s policy commitment so as to prevent the policy from overreaching. In considering a business size threshold, the decision RIS appropriately seeks to ‘limit protections to those businesses considered most vulnerable to unfair contract terms’. The decision RIS recommends using the ABS definition of a small business as 20 employees. However, there would be many businesses of 20 employees or less that should not be considered ‘vulnerable’.

Given the ambiguity in the decision RIS about the extent of the problem, the definition of a ‘small business’ should be limited to businesses considered ‘vulnerable’. Businesses should be considered vulnerable if they are in a position comparable to that of consumers, and have a maximum of 20 employees. For this reason, public companies should be excluded from the unfair contract term protections.

Recommendation 5

Include definitions for a ‘standard form contract’ and specify the type of standard contract terms considered to be ‘unfair’.

Recommendation 6

Limit the definition of a ‘small business’ to businesses that are in a position which is comparable to that of consumers, up to a maximum of 20 employees, and exclude public companies from the unfair contract term protections.

Post-implementation review

Given this policy’s potential costs and risks, which we are concerned have not been fully explored in the decision RIS, the Business Council recommends that a post-implementation review be conducted sooner than the five years envisaged in the decision RIS (p. 44). The review should test whether the regulation is achieving the stated benefits while minimising the regulatory costs on business. It should assess any unintended costs

3. See page 2, footnote 7 in the decision RIS.

arising from legislative change, including from uncertainty around key terms in the legislation, and where there may be a need to amend the legislation.

The review should assess whether the unfair contract terms legislation continues to be required, or can be considered for the government's red tape reduction program.

Recommendation 7

Require a post-implementation review to be conducted within three years.

Comments on the decision Regulation Impact Statement (RIS)

The release of the decision RIS, along with the exposure draft, enables informed public comment on the proposal consistent with the Council of Australian Government's (COAG) 2007 guide to best practice regulation.⁴

The decision RIS states that it has been certified as compliant by the Office of Best Practice Regulation (OBPR).

Notwithstanding this, the Business Council has concerns with the analysis that has been undertaken.

In considering the decision RIS against the best practice principles set out in the COAG guide, we think that more adequate assessment of the need for new legislation is warranted in these areas:

- The decision RIS does not quantify the net benefits of the proposed legislation. Rather, the decision RIS makes a qualitative assessment stating that 'it is expected that the benefits of a legislative extension of the consumer unfair contract term protections to small business will significantly outweigh any costs'.⁵
- The benefits of each of the four options have not been quantified, including for the preferred option to introduce legislation.
- Costs are only estimated for implementing the preferred option, so the decision RIS includes no comparison with the costs of any other option.
- Only the one-off transition costs to business (\$50 million in the first year) are estimated for the preferred option. As a result, the cost estimate does not include:
 - additional ongoing compliance and administrative costs on contracting businesses. Businesses will need to consider whether each new contract is subject to the new law and what terms are considered 'unfair'.
 - ongoing costs for business from legislative uncertainty and the greater risk of commercial disputes and litigation.

4. COAG, *Best Practice Regulation: A Guide for Ministerial Councils and National Standard Setting Bodies*, October 2007.

5. The Australian Government (The Treasury), *Extending Unfair Contract Term Protections to Small Business, Decision Regulatory Impact Statement*, 2015, p. 34.

- potential for reduced use of standard form contracts when dealing with small businesses.

We also consider that the discussion in the decision RIS in support of the introduction of legislation would have benefited from considering the following:

- First, the decision RIS asserts that there are incentives for businesses to include unfair terms in standard form contracts, as this allows businesses to compete more vigorously on price and quality. However, it should equally be acknowledged that businesses also have an incentive not to include unfair contract terms if they want to win customers in competitive markets, especially where consumers can readily source products from alternative suppliers. This is important context for considering whether regulation is really necessary or whether non-regulatory options should be preferred.
- Secondly, the decision RIS quotes the Productivity Commission (PC) as the original source of the advice to government to introduce unfair contract terms legislation for consumers. The PC 2008 report on *The Consumer Policy Framework* identified that those changes would in many cases also benefit small businesses as *consumers*. However, it did not argue that the protection should be extended to small businesses in the law, and the reasons for this should have been explored in the RIS. In particular:

In the Commission's view, there are no clear principles that can be brought to bear in deciding the extent to which small business should be covered by generic consumer protections. They share some common characteristics with household consumers, but in other respects they differ. And the provision of protection is likely to come at a cost to business (and, ultimately, consumers).

Productivity Commission, *The Consumer Policy Framework*, p. 320.

On the whole, our view is the decision RIS does not sufficiently assess the potential for additional costs on business that will flow through to consumers from the draft legislation, nor the risks that the changes may discourage the use of standard form contracts when dealing with small business.

Finally, we would like to clarify a misrepresentation in the decision RIS of the Business Council's position in our response to the 2014 consultation paper.⁶ The decision RIS states our position as supporting Option 1, the 'status quo'. As noted elsewhere in the decision RIS, the Business Council submission to the consultation paper supported Option 2 – 'light touch or non-regulatory options'.

Regulatory offsets

To comply with the Commonwealth Government's commitment to best practice regulation and its red tape reduction program, any new legislation should be offset by a reduction in other regulatory costs.

The Commonwealth has allocated the \$50 million of identified costs of this new legislation:

- across a ten-year period – thus allocating the costs to future governments.

6. See page 13, footnote 30 of the decision RIS.

- across all Australian jurisdictions – thus dramatically reducing the Australian Government’s share of the costs for the purpose of requiring offsets under the red tape reduction program and making it highly unlikely that business will ever see a commensurate regulatory offset from the federation.

While we understand this approach has been assessed as compliant by the OBPR, the Business Council questions whether it is consistent with the government’s laudable commitment to offsetting the additional costs of new red tape through equivalent reductions in existing red tape elsewhere in the system.

No specific offsetting reductions for the Commonwealth Government’s share of the increased regulatory costs are identified in the decision RIS. No offsetting state or territory regulatory cost reductions are identified to offset their respective shares of the estimated increase in their regulatory costs.

BUSINESS COUNCIL OF AUSTRALIA

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