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Peter Sise
Melbourne, Victoria

ENHANCEMENT TO UNFAIR CONTRACT TERM PROTECTIONS: CONSULTATION REGULATION IMPACT STATEMENT

I. INTRODUCTION

1. Thank you for the opportunity to make a submission on the *Enhancement to Unfair Contract Term Protections.* I am a lawyer who has practised commercial law since 2006.[1] One of my areas of focus is "unfair contact terms" (**UCTs**). The annexure to this submission addresses my work in this field.

2. This submission addresses some but not all of the questions in the consultation paper published by Treasury on 13 December 2019. The questions are grouped under headings below.

II. PENALTIES FOR UTCS

Question 6: Do you consider making UCTs illegal and introducing financial penalties for breaches would strengthen the deterrence for businesses not to use UCTs in standard form contracts?

3. Introducing financial penalties for using UCTs would strengthen deterrence, but deterrence of UCTs is not the only consideration relevant to whether penalties should be introduced. For the reasons in my answer to question 8 below, penalties should **not** be introduced.

Question 8: What do you consider are the additional costs and benefits for each of the proposed options?

4. Penalties should **not** be introduced for using UCTs. If penalties were introduced, several changes to the *Australian Consumer Law* (**ACL**) and *Australian Securities and Investments Commission Act 2001* (**ASIC Act**) should be considered by this review to address some of the consequences of introducing penalties.

Why penalties should not be introduced

5. Penalties should not be introduced for three reasons.

6. **First,** using a UCT is not sufficiently egregious to warrant a financial penalty. To qualify as unfair, a term does not need to be unconscionable, be misleading, be false or cause significant harm to anyone. It simply needs to meet a statutory test for unfairness which captures terms that may not be unfair based on a broader view of what is acceptable business conduct.

[1] The opinions in this submission are entirely my own and not those of any of my past or present employers.

7. A term may be unfair if it causes a significant imbalance in the parties' rights and obligations; is not reasonably necessary to protect a legitimate interest of the party that seeks to rely on it; and causes some form of detriment (even if it is insignificant detriment). There is nothing inherently wrong with a party striking a bargain that is significantly in its favour or goes beyond what is reasonably necessary to protect its interests. From time to time, a bargain may be so imbalanced that it could be unconscionable or it could be obtained through deception, but in those cases, the prohibitions on unconscionable conduct and false or misleading statements will penalise the offending party.

8. One justification for introducing penalties is to prevent serious harm to consumers and small businesses, but UCTs do not necessarily cause serious harm since the legislation only requires "detriment" and even insignificant detriment will suffice. Also, any detriment can be addressed through plaintiffs seeking compensation under the legislation.

9. **Second,** the test for whether a term is unfair is not sufficiently clear to justify imposing a penalty. It would be unjust to a business to impose a penalty where it was unclear to it whether it broke the law.

10. The test for whether a term is unfair has three elements:

    (a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract;

    (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and

    (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on: s 24(1) of the ACL and 12GB(1) of the ASIC Act.

11. The first element of the test turns on the phrase "significant imbalance". What constitutes a "significant imbalance" is difficult to determine. The case law says there is a "significant imbalance" if "a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in its favour": *ACCC v CLA Trading Pty Ltd* [2016] FCA 377 at [54(d)]. "Significant" means "significant in magnitude", "sufficiently large to be important" or "being a meaning not too distant from substantial": *ACCC v CLA Trading Pty Ltd* [2016] FCA 377 at [54(e)]. None of this provides much clarity. Section 25 of the ACL provides examples of terms that *may* be unfair, but whether a term is unfair will ultimately depend on the test in the legislation.

12. The second element of the test for unfair is not much clearer than the first. This is because fair minds may disagree on what is "*reasonably* necessary" and what is a "*legitimate* interest". It is important to note that the onus is on the defendant to prove that the impugned term is reasonably necessary to protect one of its legitimate interests: s 24(4) of the ACL and 12GB(4)

of the ASIC Act. This means a defendant must prove that it has passed a vague test in order to protect itself.

13. The third element of the test for unfair is likely to be easy for a regulator to establish. This is because the detriment does not need to be significant (note the word "significant" is used in the first element of the test but not the third) and any form of detriment will suffice whether it is "financial or otherwise". It is possible that mere disappoint or distress would be sufficient.

14. When determining whether a term is unfair, a court *must* take into account the extent to which the term is "transparent": s 24(2)(a) of the ACL and 12GB(2) of the ASIC Act. It is unclear how the concept of "transparency" is logically relevant to the three elements of the test for unfairness.[2] A term is defined to be transparent if it is "expressed in reasonably plain language", "legible", "presented clearly" and "readily available to any party affected by the term": s 24(4) of the ACL an s 12GB(4) of the ASIC Act. In relation to the first element of the test, whether a term causes a "significant imbalance" in the parties' rights and obligations will depend on what those rights and obligations are and not whether a term is "presented clearly" or "expressed in reasonably plain language".

15. For the second element of the test for unfair, what constitutes a legitimate interest of a business is not affected by how clearly a term is presented. Nor does the presentation of the term affect whether it is reasonably necessary to protect that interest.

16. For the third element of the test for unfair, whether a person suffers detriment is not affected by whether a term is presented clearly.

17. Even though it is unclear why "transparency" is relevant to the test for unfairness, a court is forced to consider it by the legislation. Forcing a decision-maker to consider something which is irrelevant does not add to certainty.

18. Some might say there are other prohibitions in the ACL, ASIC Act and *Competition and Consumer Act* (**CCA**) which carry penalties and are equally unclear as the UCT provisions. Three examples would be:

    (a) the prohibition on "unconscionable conduct" in the ACL and ASIC Act;

    (b) the prohibition on false or misleading statements in the ACL and ASIC Act; and

    (c) the competition law provisions in the CCA.

19. These three examples are all distinguishable from the UCT provisions.

[2] This issue is looked at in Peter Sise, "The unfair contract term provisions: What's transparency got to do with it?" (2017) 17(1) *QUT Law Review* 160.

20. Unconscionable conduct is serious. There is no clear line between what is unconscionable and what is not, but unconscionable conduct is more than merely unfair conduct. In many cases, unconscionable conduct involves trickery and the exploitation of the vulnerable. These are the kind of practices which can easily be avoided by any scrupulous business. Avoiding an unfair term is not so easy particularly when the test for unfair is vague.

21. The ACL imposes penalties on false or misleading *statements*. It is quite straightforward for a business to avoid making a statement which is false or misleading. The same cannot be said for using an unfair term. It is important to note that the ACL prohibits *conduct* that is *likely* to mislead or deceive, but does *not* impose penalties for this conduct. Conduct is likely to mislead or deceive "if it has a tendency to lead into error": *ACCC v TPG Internet Pty Ltd* [2013] HCA 54; (2013) 250 CLR 640 at [39]. "Conduct" may include many things other than statements; for example, silence may even be misleading in some circumstances. It may be difficult for a business to judge whether its conduct "has a tendency to lead into error", particularly if that conduct is silence. It is therefore fitting that no penalties apply for a breach of this prohibition, but penalties apply for a *statement* that is false or misleading. It is appropriate that UCTs not be subject to penalties for the same reason that misleading or deceptive conduct is not subject to penalties.

22. The competition law provisions contain concepts which may be difficult to apply; for example, whether an arrangement "substantially lessens competition" or whether a firm has a "substantial degree of power in a market". Fair minds may differ in the application of these concepts. This may make it difficult for a business to judge whether it will contravene the law and be exposed to a penalty. However, these prohibitions are only likely to apply to a small number of large businesses that have a "substantial degree of market power" or the capacity to "substantially lessen competition". Even then, not every one of their actions is likely to pose a risk of substantially lessening competition or amount to a misuse of market power. By contrast, businesses of all sizes use standard form contracts numerous times per day. This creates a widespread and ever-present risk of penalties. This would create a heavy regulatory burden.

23. The lack of certainty around the meaning of unfair is compounded by the fact that it is not always clear whether a contract is a "standard form" contract and whether the contract falls within the "upfront price" thresholds for small business contracts.

24. All in all, there is insufficient certainty around the meaning of unfair to make the imposition of penalties fair. The lack of certainty is even acknowledged on page 19 of the discussion document for this consultation, which states:

> *… determining whether a contractual term is unfair involves an exercise of considerable interpretation and judgement. It is possible that different independent authorities … could potentially make inconsistent decisions on the same or similar contract terms ...*

25. **Third,** if penalties are imposed for UCTs, businesses may do one or both of the following.

(a) First, they may continue using standard form contracts but increase their prices to account for the risk of a penalty being imposed. It is worth noting that businesses already face the financial risk of having to remediate customers (perhaps on a very large scale if a contract is widely used) if a term is found to be unfair. The introduction of penalties will create further financial risk on top of this.

(b) Second, businesses may reduce their use of standard form contracts to reduce the risk of penalties. This will increase costs for all involved because businesses may resort to negotiating terms which would otherwise be in standard form. A business may resort to "reinventing the wheel" each time it enters into a contract.

Options proposed in the discussion paper

26. Sections 4.2 to 4.6 of the discussion paper puts forward four options for strengthening deterrence of the use of UCTs.

27. Options 1 and 2, which are the status quo and strengthening compliance and enforcement activities, are both acceptable. Option 3 (introducing penalties) is inappropriate for the reasons stated above. Option 4a (introducing infringement notices) is dependent on the adoption of option 3 and is therefore inappropriate as well.

28. Option 4b proposes that regulators be given the power to determine whether a term is unfair. The proposal seems to be similar to the system which currently exists for notification of conduct that may amount to "exclusive dealing".[3] Notification gives businesses some protection against the risk of engaging in exclusive dealing. This is explained on page 5 of the ACCC's *Exclusive dealing notification guidelines* as follows:

> *The protection from legal action provided by a notification automatically commences on the day the notification is validly lodged with the ACCC. The protection will continue unless or until the notification is revoked or withdrawn.*
>
> *While the notification is in force, the business is able to engage in the exclusive dealing conduct as described in the notification without the risk of breaching the exclusive dealing provisions of the Act.*

29. The protection for exclusive dealing is justified because it is difficult for a business to determine whether it has engaged in exclusive dealing. This is because conduct will only amount to exclusive dealing if it is has the purpose of "substantially lessening competition" or is likely to have the effect of "substantially lessening competition". In many cases, it is difficult for a business to determine whether it is likely to "substantially lessen competition". The precise

[3] Notification is also available for "resale price maintenance" and collective bargaining.

same point can be made about determining whether a term is unfair. To be consistent across the CCA and ACL, a notification regime should be created for UCTs if penalties are introduced. The discussion paper says at page 19 that "this is not considered a viable option, given the costs and significant resources required". However, it could be viable provided the fees charged for notification are sufficient to cover the costs. This is addressed in paragraphs 43 to 49 below.

Changes to the legislation that may be necessary if penalties are introduced

30. If penalties are introduced for UCTs, three changes should be made to the UCT provisions.

31. **First,** the provisions that place an onus on the defendant should be altered when a regulator is seeking a penalty. Currently, the defendant must prove that:

(a) the impugned term was not reasonably necessary to protect its legitimate interests; and

(b) a contract is not a standard form contract: see ss 24(4) and 27(1) of the ACL and 12GB(4) and 12BK(1) of the ASIC Act.

32. It is **in**appropriate that a defendant should have to prove their own innocence when faced with a financial penalty. A regulator should prove **all** the elements of a contravention and not be allowed to rely on presumptions in its favour. For this reason, the two presumptions in the previous paragraph should be removed when a regulator is seeking a penalty, but should be retained in civil proceedings when a private litigant is seeking redress. It is appropriate to maintain them for private litigants since:

(a) consumers and small businesses do not have significant resources to devote to litigation and are hence likely to need the assistance of presumptions in their favour; and

(b) it may be very difficult for a consumer or small business (which does not have the resources of a regulator) to address whether a term is reasonably necessary to protect a legitimate interest of a defendant's business, particularly a large and sophisticated business. This is likely to require a detailed knowledge of the defendant's business and industry. The defendant is better placed to address this issue than the plaintiff. Similarly, it may be very difficult for a consumer or small business to prove that a contract was a standard form contract since that is likely to turn on the extent to which the defendant used that contract in other circumstances. The defendant is also better placed to address this is issue than the plaintiff.

33. The ACL does not place the onus on the defendant to prove their innocence for other penalty provisions. One might say that it does for ss 29(1)(e) and (f) of the ACL which deal with false testimonials, but that is not correct. Section 29(2) states that a representation concerning a testimonial is "taken to be misleading unless evidence is adduced to the contrary". This is quite

different to ss 24(4) and 27(1) of the ACL, which require a defendant *to prove* that the impugned term was not reasonably necessary and the contract was not a standard form contract. For s 29(2), the defendant simply needs to produce some evidence to the contrary. It is not required *to prove* that the representation concerning the testimonial was accurate.[4]

34. **Second,** the maximum penalties for using a UCT should be less than the highest maximum penalties that exist for contraventions of the ACL and the ASIC Act. The maximum penalty available under the ACL depends on the nature of the contravention and whether the defendant is a corporation or individual. The highest maximum penalty and lowest maximum penalty for contraventions of the ACL are shown in the table below.

	Corporation	**Individual**
Highest maximum penalty	The greater of: (i) $10 million; or (ii) three times the value of the benefit of the contravention. If (ii) cannot be determined, 10% of the turnover of the defendant for the 12 months leading up to the contravention.	$500,000
Lowest maximum penalty	$5,000	$1,000

35. Unconscionable conduct and false or misleading representations are among the contraventions that carry the highest maximum penalty under the ACL.

36. If penalties are introduced for UCTs, the maximum penalty should not be the highest maximum penalty currently available under the ACL. As noted in paragraph 6 above, using an unfair term is not egregious conduct. It does not warrant the same kind of penalty as unconscionable conduct or false representations. It is true that a court may not impose the maximum penalty, but the maximum does affect the penalty by serving as a yardstick.[5]

37. An appropriate maximum penalty under both the ACL and ASIC Act would be $100,000 for a corporation and $10,000 for an individual. This is appropriate for the following reasons.

    (a) The defendant has not necessarily misled anyone or acted unconscionable. If it has, it can be penalised under the laws dealing with false or misleading statements and unconscionable conduct.

    (b) The defendant may have done nothing more than prepare an agreement which gives it significantly more protection than is necessary and goes beyond what is reasonably

[4] The same point can be made concerning representations about future matters and the onus created by s 4(2) of the ACL and s 12BB of the ASIC Act.
[5] See *ACCC v Volkswagen Aktiengesellschaft* [2019] FCA 2166 at [197].

necessary to protect its interests. This kind of conduct is not egregious or deserving of severe penalties.

38. **Third**, consideration should be given to whether specific provisions should be made addressing how penalties will apply to UCTs. Consider the following situation. Term A is used in Standard Form Contract A and Standard Form Contract B by a particular business. The business uses Standard Form Contract A 1,000 times and Standard Form Contract B 2,000 times. Term A is found to be unfair in the context of each of Standard Form Contract A and Standard Form Contract B. How many contraventions of the ACL or ASIC Act has there been? You could say there has been only one since there was only one term that was unfair. Alternatively, you could say there were only two since Term A was only used in two forms of standard form contract. Alternatively again, you could say there were 3,000 since Term A was used on 3,000 separate occasions. The number of contraventions determines the amount of the maximum penalty. The maximum penalty could range from a small amount (if there is only one contravention) to a very large amount (if there are 3,000 contraventions).

39. This sort of conundrum is dealt with by courts quite frequently when imposing penalties. For example, a business may issue the exact same brochure 3,000 times. If that brochure contains a false statement, has there been one contravention or 3,000? The courts address the issue by asking whether the multiple contraventions should be treated as one "course of conduct" and hence only one contravention.[6] Neither the ACL nor the ASIC Act states how the "course of conduct" principle applies. The "course of conduct" principle is very likely to apply to UCTs since standard form contracts are often used numerous times.

40. Consideration should be given to whether the ACL and ASIC Act should address how the "course of conduct" principle applies to UCTs. It is submitted that this is **un**necessary since:

(a) the courts have applied the "course of conduct" principle in the past without legislative guidance and will be able to apply it in relation to UCTs; and

(b) it will be difficult (if not impossible) for the legislation to address every situation that may arise for consideration.

41. None the less, consideration should be given to whether it is necessary. If the consultation panel considers it necessary to address the "course of conduct" principle in legislation, it is submitted that each version of a standard form contract containing an unfair term should be treated as a distinct contravention even if the exact same term is used in each version of the standard form contract. So, returning to the example in paragraph 38, the number of contraventions would be two because there were two versions of a standard form contract using Term A. This approach is appropriate because the context in which a term appears is essential to whether it is unfair or not. Section 24(2)(b) of the ACL requires a court to consider the

[6] See *ACCC v Volkswagen Aktiengesellschaft* [2019] FCA 2166 at [206]-[214].

"contract as a whole" when determining whether a term is unfair. In one contract, the impugned term may be unfair, but it may be fair in another.

42. It is **in**appropriate to treat every use of the standard form contract as a separate contravention. This could lead to a maximum penalty which is stratospheric and utterly out of proportion to the harm done. Also, stratospheric penalties may discourage businesses from using standard form contracts which would lead to increased costs and inefficiencies.

43. **Fourth**, if the maximum penalty for using a UCT is significant, a notification regime should be considered. This submission proposes that any penalty should be kept relatively low (a maximum of $100,000 for corporations and $10,000 for individuals), but if this proposal is not accepted, a notification regime should be considered.

44. As noted in paragraphs 28 and 29 above, a notification regime exists for conduct that may amount to exclusive dealing. Exclusive dealing is subject to severe penalties but it may be difficult for a business to determine whether it has engaged in exclusive dealing. The notification regime allows businesses to address this risk. Put briefly, if a business notifies the ACCC of the proposed conduct, it may lawfully engage in that conduct without being at risk of engaging in exclusive dealing until the ACCC informs it that it considers the conduct amounts to exclusive dealing.[7] The fee for notification is $2,500, which may seem substantial but is small compared to the potential penalties for exclusive dealing.

45. If the maximum penalty for using a UCT exceeds those proposed above ($100,000 for corporations and $10,000 for individuals), a notification regime would be desirable. If the maximum penalties are the highest that are currently available under the ACL, a notification regime would be highly desirable.

46. A notification regime could be administered by the ACCC for contracts that fall under the ACL and ASIC for contracts that fall under the ASIC Act. Alternatively, the ACCC and ASIC could administer it jointly with a shared portal for businesses to submit proposed contracts.

47. The details of a notification regime would need to be considered carefully with input from the ACCC and ASIC. One possible format is as follows.

    (a) A business submits a proposed standard form contract to the ACCC, ASIC or a portal run jointly by them. The business pays a processing fee.

    (b) The submission from the business states which terms of the contract it requires the ACCC or ASIC to review to determine whether they are unfair. The submission contains an explanation of why the terms are not unfair. The submission is required

[7] For a detailed account of how notification works, refer to s 93 of the CCA and the ACCC's *Exclusive dealing notification guidelines* (November 2017).

to address each of the three elements of the test for unfairness as well as transparency.

(c) From the date the submission is received, the business is immune from any penalty or civil action for using any of the terms that it has asked the ACCC or ASIC to review in the particular contract it has submitted. It is not immune in relation to any other terms or the use of any term in a different contract.

(d) The immunity ends:

(i) 30 days after the ACCC or ASIC informs the business that it considers the terms to be unfair;

(ii) the ACCC or ASIC informs the business that the submission does not meet the requirements of a valid submission and the business fails to rectify this within 30 days; or

(iii) the ACCC or ASIC requests further information from the business to make a determination and the business fails to provide it within 30 days.

(e) There is no appeal from the decision of the ACCC or ASIC that the term is unfair or that the submission was not validly made.

48. It is true that a notification regime would occupy the time and resources of the ACCC and ASIC, but this could be mitigated by the following measures.

(a) The amount of the application fee could be set so as to offset the additional cost of the notification regime. This would mean that regulators would not need to divert funds from other areas.

(b) The fee could be on a sliding scale depending on the size of the contract and the size of the terms that need to be reviewed. For example, the fee could vary according to the length of the contract (measured in words, not pages) and the length of the terms that the business requires the ACCC or ASIC to review to determine whether they are unfair (measured in words).

(c) Not allowing a right of appeal from the decision of the ACCC and ASIC will also reduce costs.

49. It is likely that the ACCC and ASIC would receive a large number of submissions, but it may not be quite as large as expected. In 2019, the ACCC only received nine notifications for exclusive dealing. Arrangements that could amount to exclusive dealing are quite common, but admittedly are not as common as the use of standard form contracts. Still, the experience with exclusive

dealing suggests that businesses are willing to assess the risk of breaching the law themselves and only elevate the issue to the ACCC through notification on a few occasions.

50. **Fifth**, if the maximum penalty for using a UCT will be significant, consideration should be given to whether companies should be permitted to indemnify their officers against penalties for using UCTs. A penalty may be imposed on an individual who "has been in any way, directly or indirectly, knowingly concerned in, or party to" a contravention of the ACL: s 224(1)(e). If using a UCT is a contravention, an employee of a business who prepares a contract or presents a contract to another party may be exposed to a penalty.

51. Sections 229 and 230 of the ACL prevent a corporation from indemnifying an "officer" against (i) a pecuniary penalty and (ii) the legal costs incurred in defending proceedings in which the "officer" is found liable to pay a pecuniary penalty. A similar provision is found in s 12GBD of the ASIC Act. The term "officer" is defined by the Corporations Act. The definition does not cover all employees of a corporation but does include individuals who have significant influence over it.

52. It is understandable that a corporation should not indemnify an officer against liability for serious contraventions of the ACL. Doing so may encourage serious breaches of the law by the officer. Also, the shareholders of a corporation should not bear the costs of an officer's errant behaviour (assuming the shareholders are different to the officer).

53. If the maximum penalty for using a UCT is significant, ss 229 and 230 of the ACL and s 12GBD of the ASIC Act should perhaps be amended to permit a corporation to indemnify its officers in respect of liability for UCTs. This may be justified for the following reasons.

    (a) An officer may be the most appropriate person to prepare a contract for the business, but will be exposed to liability if they prepare the contract and are not indemnified by the business. To avoid this risk to the officer, the business may need to employ a person specifically to prepare the contract (since the business is permitted to indemnify an employee who is not an officer) or engage external lawyers to prepare the contract. These two options, however, will incur additional costs for the business. Also, it is not always clear whether a particular employee is an officer. This may result in the business indemnifying an employee, who it believes is not an officer, only to discover that they later qualify as an officer and cannot be indemnified.

    (b) Even if the contract is prepared by external lawyers, an officer of a business may be liable for presenting the contract to another party or being "directly or indirectly" concerned with the contract in another way. It is often unclear whether a term is unfair. This exposes officers to a risk which is difficult for them to avoid. In those circumstances, a business should be permitted to indemnify the officer if it considers it appropriate.

(c) Using a UCT is not a serious contravention of the law. So, there is no concern about the indemnification encouraging serious breaches of the law. Even if there were such a concern, a corporation may still obtain insurance from an insurer for the liability of an officer in relation to a UCT. Since the theoretical risk of encouraging a serious contravention exists in any case, it is appropriate to allow the corporation to decide whether to manage that risk through indemnification or insurance.

(d) It is fair that shareholders bear the cost of an officer being found liable in respect of a UCT since the contravention is unlikely to be the result of seriously egregious behaviour but more likely to be due to the company simply using a term which gives it greater protection and rights than are reasonably necessary. This is more likely to be an error of judgment where fair minds differ. It is fair for shareholder to bear this kind of risk.

54. However, there are arguments against allowing a corporation to indemnify an officer for liability for a UCT.

(a) First, ss 229 and 230 of the ACL currently prevent indemnification of officers for penalties concerning minor contraventions; for example, failing to provide a consumer with an invoice for the supply of goods or services (see s 100 of the ACL). Therefore, the minor nature of a contravention (which the use of a UCT is likely to be) does not appear to justify creating an exemption.

(b) Second, there do not appear to be any exemptions from the prohibition on indemnities under the ACL and ASIC Act, which means there would need to be a clear and compelling reason to have an exemption for UCTs.

Sanctions other than penalties

55. If using a UCT becomes a contravention of the ACL and ASIC Act, one will need to decide if it should be punished by the sanctions in ss 246, 247 and 248 of the ACL and the equivalent provisions in the ASIC Act.

56. A contravention of the ACL can lead to sanctions other than financial penalties. The ACL allows for the following sanctions, among others:

(a) a community service order: s 246(2)(a) and (aa);

(b) an order that a business establish a compliance or education program: s 246(2)(b);

(c) an order that a business make a corrective publication: ss 246(2)(c) and 247; and

(d) an order disqualify a person from managing a corporation: s 248.

57. If UCTs become a contravention of the ACL and the ASIC Act, they should be carved-out of s 248 so that a contravention cannot result in a person being disqualified from managing a corporation. It should also be carved out of s 12GLD of the ASIC Act, which is equivalent to s 248 of the ACL. This is because the use of a UCT is not so egregious as to warrant such a severe penalty. Disqualifying a person from managing a corporation can have a significant impact on their livelihood and family. It can also impact severely on their reputation and future job prospects. This might be warranted for severe breaches of the ACL and ASIC Act, such as unconscionable conduct, but not using a UCT.

III. REMEDIES

Question 10: If a court determines a term or terms in a standard form small business contract are unfair, should it also be able to determine the appropriate remedy (rather than the term being automatically void)?

58. A term should automatically be declared void if it is unfair. The alternatives to this are a court:

(a) allowing the contract to continue with an unfair term; or

(b) rewriting the term in a way that it considers fair.

59. The first option is unacceptable because it forces the parties to continue with an arrangement which the court has concluded is contrary to the law.

60. The second option is also unacceptable because it amounts to the court forcing the parties to adhere to an agreement that they never entered into. This is too great an interference with the principle of freedom of contract. Certain interferences are tolerable (for example, striking down an unfair term) but forcing parties to adhere to a contract that they never entered into is going too far.

61. Declaring an unfair term void may result in the entire contract being void if the term was an essential part of the contract. If so, that is the appropriate outcome because the parties are very unlikely to have entered into a contract that was missing an essential component. It is unlikely that an entire contract will be declared void if one or more terms are declared void due to unfairness. This is because:

(a) the UCT provisions do not apply to terms that define the "main subject matter of the contract" or set the "upfront price", so it is unlikely that an essential term will be declared void;[8] and

[8] Section 26 of the ACL and 12BI of the ASIC Act.

(b) if a term is declared void, the "contract continues to bind the parties if it is capable of operating without the unfair term."[9]

Question 11: Do you consider a regulator should be able to commence court proceedings on behalf of a class of small businesses on the basis that an unfair term has caused or is likely to cause the class of small businesses to suffer loss or damage?

62. Section 239 of the ACL and s 12GNB of the ASIC Act allow the ACCC and ASIC to seek redress on behalf of "non-party consumers". Those provisions do not appear to apply to non-parties who are small businesses, but the position is unclear.

63. The justification for extending UCT protections to small businesses was that they are vulnerable in the same way as consumers. That justification requires regulators to be given the same power to commence court proceedings on behalf of small businesses as consumers. For this reason, the ACL and ASIC Act should be amended to make it clear that the ACCC and ASIC can obtain remedies on behalf of small businesses.

IV. COVERAGE OF UCT LAWS

Question 15: Do you consider $10 million annual turnover to be an appropriate threshold?

64. The headcount threshold should be replaced with a threshold of $1 million annual revenue.[10] There should not be the option for a business to fulfil either the headcount threshold or a threshold based on revenue. The only thresholds should be the annual revenue threshold of $1 million plus the threshold for the upfront price of the small business contract.

65. There are three issues to address:

(a) why the headcount threshold should be replaced with a revenue threshold;

(b) why the revenue threshold should be $1 million; and

(c) how the revenue threshold should be calculated.

Why the headcount threshold should be replaced with a revenue threshold

66. The UCT laws are intended to protect businesses that are vulnerable in the same was as consumers. No metric is a perfect measure of vulnerability, but annual turnover is a better

[9] Section 23(2) of the ACL and 12BF(2) of the ASIC Act.

[10] The term "turnover" is used in the discussion paper. Revenue or income is a more appropriate term. On this point, s 328-10(1) of the *Income Tax Assessment Act 1997* gives the following definition of "annual turnover": *"An entity's annual turnover for an income year is the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business"*. Section 2 of the ACL gives a definition of "annual turnover" which is also consistent with revenue. That definition is *"the sum of the values of all the supplies that the body corporate, and any body corporate related to the body corporate, have made, or are likely to make, during the 12-month period, other than"* certain excluded items.

measure than employee numbers. A business may have a very small number of employees yet be sophisticated and powerful. Technological advancements and outsourcing make it easier for businesses to employ fewer people yet still have sophisticated operations and significant resources.[11] A better indication of the resources of a business is its revenue.

67. It is true that a business may make a small profit despite having high revenue. On this point, page 29 of the discussion paper says that a threshold based on revenue may:

> *exclude small businesses with a high annual turnover but low profit margin, for example, an independent petrol station. This would be inconsistent with the original justification for extending UCT protections to small business contracts.*

68. The justification for extending UCT protections to small businesses was not to protect businesses with small profits. The justification was that small businesses may be vulnerable like consumers. Further, revenue is a more appropriate threshold than profit for the following reasons.

(a) Profitability is a measure of a business's success. Legal protections should not be available to a business depending on whether it is successful or not.

(b) The "original justification for extending UCT protections to small business contracts" was that some small businesses may be vulnerable like consumers. Low profitability despite high revenue is not an indication of vulnerability. High revenue often indicates that a business has a devoted customer base and an appealing offering. It also indicates that its operators are accustomed to dealing with large value transactions or a high volume of low-value transactions. None of this suggests vulnerability. On this point, very large businesses with high revenue (including publicly-listed businesses) post losses in some years.

Why the revenue threshold should be $1 million

69. A revenue threshold of $10 million is inappropriate for two reasons.

70. First, it is inconsistent with the justification for extending UCT protections to small businesses. The justification was that small businesses are vulnerable like consumers. On this point:

(a) page 32 of the discussion paper states "Small businesses, like consumers, are vulnerable to UCTs …";

[11] The headcount threshold appears only to include employees of a business and not independent contractors. The legislation is not entirely clear on this point, but that appears to be correct. This is addressed in Peter Sise, "The extension of unfair contract term provisions to small business contracts: A lack of clarity?" (2016) 23 *Competition and Consumer Law Journal* 217.

(b) page 3 of the discussion papers states "The extension of the UCT protections to small business recognised that small businesses can often face the same challenges as consumers in a contractual relationship";

(c) page 25 of the discussion papers states "As per the justification for extending UCT protections to small business contracts, small businesses and consumers share similar characteristics, including limited financial resources and negotiation powers"; and

(d) the explanatory memorandum for the legislation which extended the UCT protections to small businesses said:[12]

> *Small businesses, like consumers, are vulnerable to unfair terms in standard form contracts ... 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.*

71. As at May 2019, the average annual salary for an Australian was approximately $64,392.[13] So, $64,392 is an accurate proxy for the revenue of a consumer. $10 million is vastly more than $64,392. Someone who deals with $10 million is likely to be far more sophisticated and savvy than someone who deals with a mere $64,392. Further, the operations of a business are far more sophisticated than those of a consumer going about their daily life. It is true that the costs of a small business will be higher than the costs of a consumer going about their daily life, but managing a higher volume of costs (for example, salaries and commercial rent) is another indication of how a business operator is more sophisticated than a consumer. For these reasons, the justification for extending UCT protections to small businesses only applies to very small businesses who are truly vulnerable like consumers.

72. Second, it seems implausible that all businesses with annual revenue of up to $10 million require UCT protections. Page 29 of the discussion paper states that 98.5% of businesses have annual revenue of less than $10 million. It is difficult to accept that 98.5% of Australian businesses are so vulnerable that they need laws to protect them against contractual terms that cause a significant imbalance between their rights and those of a contractual counterparty. If this were true, you would expect the number of small businesses in Australia to be less than it is. It is also difficult to accept that almost all businesses in Australia are as vulnerable as consumers going about their daily lives, but this is the outcome if we accept a revenue threshold of $10 million.

[12] Explanatory Memorandum, Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill (2015) at [1.2], [1.6], [2.2] and [2.6].
[13] See ABS release *6302.0 - Average Weekly Earnings, Australia, May 2019.*

73. What then is an appropriate threshold? Page 29 of the discussion paper states:

(a) 24.8% of businesses have annual revenue of up to $50,000;

(b) 59.1% have annual revenue of up to $200,000;

(c) 93.2% have annual revenue of up to $2 million;

(d) 97.2% have annual revenue of up to $5 million; and

(e) 98.5% have annual revenue of up to $10 million.

74. The discussion paper does not state what percentage of business have annual revenue of up to $1 million. Assuming an even distribution across the bracket of $200,000 to $2 million, approximately 74% of Australian businesses have annual revenue of up to $1 million.[14] It is plausible that 74% of Australian businesses are so vulnerable as to be treated as consumers.

75. Further, the threshold of $1 million is more than the revenue of a typical consumer (being $64,392) but not vastly more. The revenue of a consumer does need to be increased to an extent since a small business is a larger operation than a single consumer and has higher costs. $1 million seems an appropriate amount. That said, a slightly larger or smaller amount than $1 million may also be appropriate.

How the threshold is applied

76. Applying the revenue threshold could be complicated. This will need to be addressed in the legislation. One way of dealing with these complexities is as follows.

(a) If the contracting party is a corporation, the limit of $1 million applies to the *combined* annual revenue of all related body corporates. This will prevent a large business from availing itself of the UCT protections by structuring its affairs in a particular way.

(b) The relevant 12-month period will be 12 months ending on the month immediately before the contract was entered into. For example, if a contract is entered into on 12 August 2020, the relevant period is 1 August 2019 to 31 July 2020.

(c) If a corporate entity has not existed for the full 12 months prior to the contract being entered into, its revenue for the period that it has existed is multiplied out to 12 months. For example, if it existed for only 67 days, its turnover for that period will be multiplied by 365/67.

[14] 93.2% minus 59.1% is 34.1%. Divide 34.1 by 1,800,000 which is $2 million minus $200,000. This gives approximately 0.00001894. Multiple 0.00001894 by 800,000, which is the difference between $1 million and $200,000. This gives approximately 15. Add 15 to 59.1 to get approximately 74.

(d) If a corporate entity did not exist at all prior to the contract being entered into, its revenue is measured for the 12 months following entry into the contract. If court proceedings are commenced before 12 months have elapsed, the period up to the date of the court proceedings is counted and then multiplied out to 12 months.

(e) The onus will be on the plaintiff or regulator to prove that the $1 million threshold has been met.

Question 17: In terms of determining which businesses should be covered by the UCT protections for small business, how should employee numbers for subsidiaries be counted?

77. For the reasons stated above, the headcount threshold should be replaced with a threshold of $1 million in annual revenue.

78. If a headcount threshold is maintained, it should be clarified as follows.

(a) The legislation should state that it only counts employees (i.e. person engaged under a contract of employment) and not independent contractors.

(b) Employees of any related body corporate should be included in the headcount test.

79. The legislation is currently unclear on whether independent contractors are included in the headcount test, but it appears that they are not.[15]

80. If employees of subsidiaries are not counted, it is possible that large businesses may avail themselves of the UCT protections by using one subsidiary to engage employees and using another to enter into contracts.

Question 20: Are there likely to be any negative impacts if the current contract value threshold were to be increased to $5 million?

81. The contract value threshold should not be increased beyond the current limits of $300,000 for a contract that lasts up to 12 months and $1 million for a contract that lasts longer than 12 months. Increasing the thresholds would encourage businesses to conduct inadequate due diligence on important contracts.

82. The purported justification for extending the UCT protections to small businesses was that they are vulnerable in the same way as consumers. This justification does not sit well with the fact that the UCT protections are limited to standard form contracts. If a large business wished to exploit the vulnerability of a small business, it could do this using negotiated contracts. It is submitted that part of the justification was to excuse small businesses from not taking the time to review standard form contracts and challenge terms which were against their interests. This is a

[15] See Peter Sise, "The extension of unfair contract term provisions to small business contracts: A lack of clarity?" (2016) 23 *Competition and Consumer Law Journal* 217.

valid justification to an extent. A small business may be presented with a long and convoluted standard form contract which is for goods or services of low value. It may be an inefficient use of the small business's resources to conduct a detailed review of this contract. However, if the contract were of great importance to the small business, it would be worth reviewing it and it should be reviewed.

83. $300,000 and $1 million are both significant amounts of money. This is the case if the annual revenue of the business is $10 million and certainly the case if it is $1 million. Small businesses should be encouraged to review contracts, particularly contracts with a value beyond the thresholds of $300,000 and $1 million. Extending UCT protections to contracts creates a disincentive for businesses to review them. This is undesirable because:

(a) the cost of addressing an unfair term through litigation will be higher for all involved (including the public resources of the legal system) than addressing the term upfront through contract negotiations;

(b) it encourages careless practises for small businesses which may flow into areas other than contract review; and

(c) the law generally should not encourage careless practises.

Question 21: Are there likely to be any negative impacts if the contract value threshold were to be removed completely?

84. If the contract value thresholds were entirely removed, there is a risk that businesses will not carefully review important contracts because they believe they can resort to the UCT protections if they later discover a term which is contrary to their interests. For this reason, the current thresholds should be maintained.

V. STANDARD FORM CONTRACTS

Question 25: Do you have any suggestion as to how regulators could better promote and enhance guidance on what constitutes a 'standard form contract'?

85. The requirement that a UCT must be in a standard form contract should be removed. This is for three reasons.

86. First, there is no logical reason only to protect consumers and small businesses from UCTs in standard form contracts. If a term causes unjustifiable hardship, it should not matter whether it is in a negotiated contract or a standard form contract. Also, if a consumer or small business is vulnerable to a large business, the large business could exploit that vulnerability through a negotiated contract as well as a standard form contract.

87. Second, removing the requirement of a standard form contract avoids the complications of trying to clearly define a standard form contract in the ACL and the ASIC Act. It also avoids the costs of parties disputing whether a contract is a standard form contract or not.

88. Third, the requirement of a standard form contract may encourage businesses to use negotiated contracts, when using a standard form contract is more efficient, simply to circumvent the UCT protections. Introducing penalties may incentivise this behaviour, as noted on page 17 of the discussion paper. Removing the requirement of a standard form contract will remove any encouragement for such an inefficient practice.

89. Removing the requirement of a standard form contract is not without precedent. The unfair contract term provisions in the *Consumer Rights Act 2015* (UK) do not require an unfair term to be in a standard form contract nor did the provisions that existed in the now-repealed *Fair Trading Act 1999* (Vic) from 9 October 2003 to 1 July 2010. The now-repealed *Unfair Terms in Consumer Contracts Regulations 1999* (UK) did not require an unfair term to be in a standard form contract either. Instead, those Regulations only applied to terms that had not been negotiated.[16]

[16] *Unfair Terms in Consumer Contracts Regulations 1999* (UK), reg 5(1).

ANNEXURE: Work in the field of UCTs

Articles

- "Can a Big Business Avail Itself of the Unfair Contract Term Provisions in the Australian Consumer Law" (2018) 26 *Australian Journal of Competition and Consumer Law* 276
- "The unfair contract term provisions: What's transparency got to do with it?" (2017) 17(1) *QUT Law Review* 160
- "The extension of unfair contract term provisions to small business contracts: A lack of clarity?" (2016) 23 *Competition and Consumer Law Journal* 217
- "Expanding the net: the unfair contract term provisions will now extend to small business contracts" (2016) 90(11) *Law Institute Journal* 44
- "Is there a gap in the unfair contract term provisions between a 'consumer contract' and a 'small business contract'?" (2017) 25(1) *Australian Journal of Competition and Consumer Law* 14
- "Paciocco v ANZ and penalties v 'unfair contract terms': The differences between two laws that can both invalidate a contractual term" (2016) 32(9) *Competition and Consumer Law News* 271
- "Unfair contract term provisions: what's relevant to determining whether a contract is a 'standard form contract'?" (2016) 32(8) *Competition and Consumer Law News* 259
- "How does a choice-of-law clause affect the operation of the unfair contract term provisions?" (2016) 32(7) *Competition and Consumer Law News* 242
- "Counting down to 12 November: some tips on how to identify potentially unfair contract terms" (2016) 20(6) *Inhouse Counsel* 129
- "Terry Truck Rentals Pty Ltd v Haseeb: another decision about the unfair contract term provisions and vehicle-hire arrangements" (2016) 32(6) *Competition and Consumer Law News* 222
- "A holiday cruise, a cyclone and an unfair contract term: Ferme v Kimberley Discovery Cruises Pty Ltd" (2016) 32(2) *Competition and Consumer Law News* 167
- "ACCC v Chrisco Hampers: a decision on unfair contract terms delivered in time for Christmas" (2016) 32(1) *Competition and Consumer Law News* 133, 151
- "Paciocco v ANZ: unconscionable, unfair, extravagant and other ways a contractual term may be challenged" (2015) 31(8) *Competition and Consumer Law News* 106

Legal commentaries

- Editor of the chapter on unfair contract terms in the Australian Competition and Consumer Law Commentary, which is published by Wolters Kluwer CCH.

External Presentations

- Presentation to the Leo Cussen Centre for Law on 26 February 2019: "An update on the unfair contract term regime"
- Presentation to the Leo Cussen Centre for Law on 7 June 2017: "The new unfair contract regime"

- Presentation at the Law Council of Australia “Rising Stars” competition and consumer law conference on 11 November 2016 on unfair contract terms
- Presentation to the Leo Cussen Centre for Law on 9 November 2016: The “Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015”
- Presentation to members of the Association of Corporate Counsel Australia on 19 October 2016: “Be ready for 12 November!: The extension of the provisions on unfair contract terms”
- Presentation to the Leo Cussen Centre for Law on 27 September 2016: “Unfair Contracts - Recent developments and essential update on the pending changes to the *Australian Consumer Law*”
- Presentation to the Consumer Action Law Centre on 21 August 2016 regarding the unfair contract term provisions in the Australian Consumer Law

Media

- Interviewed on *The Business* on ABC television on 11 November 2016