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Submission to Senate Economics Legislation Committee

Inquiry into the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015 26 August 2015

1. About Independent Contractors Australia

Independent Contractors Australia is a not-for-profit, volunteer advocacy group dedicated to securing and enhancing the right of self-employed people across Australia effectively to be in business for themselves.

We were formed in 2000 and operate through our website at www.independentcontractors.net.au.

We have been campaigning since 2010 to have the consumer unfair contract laws extended to small business people.

2. Our position on the Bill. Our request to the Committee

We strongly support and advocate for the *concept* of extending the consumer unfair contracts protections to the 5.3 million individuals running Australia's small businesses as displayed in the Bill.

However:

- We strongly oppose the current Bill.

The limitation of the protections to contracts worth less than \$100,000 (\$250,000 for contracts longer than 12 months) will significantly neuter the application of the protections for the 5.3 million people who should have those protections.

We ask the Committee to recommend:

- The removal of the contract value limitation of the Bill.

Or

- Rejection of the Bill if the limitations are not removed.

3. The numbers of people who potentially should benefit from the unfair contract protections being extended to small business people

According to the Australian Bureau of Statistics, 1,999,900 individuals run their own business in Australia – that is, 17.7 per cent of the workforce. (2013)

Of these:

- 986,400 are independent contractors. That is, they are businesses of one. They do not employ others.
- 1,013,500 are business owner/operators who employ others. In 2013, that amounted to 3,300,000 employees.

(See <http://www.independentcontractors.net.au/Research/How-Many/independent-contractors-how-many>)

If the unfair contracts protections currently available to consumers are fully applied to the small business sector (where a small business is defined as having fewer than 20 employees), these 5.3 million individual Australians who own and run Australia's small businesses will face a fairer commercial environment in which to run their businesses and contribute to the Australian economy and society.

4. ICA's experience with unfair contracts

We have been receiving complaints from self-employed people and case studies of unfair contract treatment against them for the 15 years that we have been in existence. We have assisted many of them where we can. We have accumulated a significant repository of unfair contract examples and situations. We are arguably the only organisation in Australia with such a detailed knowledge and case studies on the issue including contract examples. Much of this is contained on our website at <http://www.independentcontractors.net.au/Current-Issues/fair-contracts/index.html>

We made a detailed submission to the Federal Treasury's Consultation Paper on Extending Unfair Contract Term Protections to Small Businesses. That submission provides a number of examples of unfair contracts situations taken from our case studies. The submission is included as an addendum to this Senate Committee submission.

5. This submission

- Gives an overview of ICA's background and position on the issue.
- Discusses the importance of unfair contract protections.
- Covers the success of the consumer laws.
- Identifies the specific provision to which we object.
- Identifies limitations under consumer law.
- Explains that \$100,000 is not \$100,000.
- Shows how unfair contracts are structured.
- Identifies who is excluded by the \$100,000 limit.
- Explains how big business can/will exploit the \$100,000 limit.
- Shows the legal complexity arising from the \$100,000 limit.
- Gives the reasons claimed for needing the \$100,000 limit and our replies.
- Discusses the *Independent Contractors Act*.
- States the consequences of not having the \$100,000 limit.

Addendum: ICA Submission to the Treasury Consultation Paper 2014

6. Overview of ICA's background and position on the Bill

Since 2010 we have campaigned for the consumer unfair contract laws to be extended to small business people.

In 2010, when the consumer protections were legislated, self-employed people and their employees were at the last minute excluded from the benefits of fair contract principles. Our constituency was duded!

We support the *concept* contained in the current Bill.

Unfortunately, however, the current Bill with its exclusion of contracts of an annual value of greater than \$100,000 (\$250,000 for contracts longer than 12 months) duds as an estimate perhaps more than half of our constituency again. For example, self employed accountants, lawyers, engineers, IT professionals and many other categories of workforce participants are engaged on standard form contracts for an annual value which exceeds \$100,000.

Furthermore, those on contracts of less than \$100,000 will be readily able to be manipulated out of the fair contract benefits of this Bill by large companies and government agencies. All that will be required is for these large organisations to offer a contract with an annual value of \$100,001 and insert clauses for 'at whim' cancellation (which can be given effect after, say, 3 months) and all the unfair contract protections are avoided. As a result, our constituency would once more gain no fair contract benefits from this Bill.

It seems that no logical reason for this destructive exclusion can be offered by the government. (See item 16 below.)

The government claims that the \$100,000 limitation will cover 80 per cent of contracts. That figure, in our view, has no substance in fact. There are no statistical data identifying the number or size of business contract transactions occurring in the community or data that indicate the number and size of contract transactions by size of business. The 80 per cent claim is a figure plucked from the imagination. Further, even if the 80 per cent claim were accurate, why exclude 20 per cent of small business people from the protections?

The exclusion is so destructive in our view that it renders the Bill worthless for the great bulk of the 5.3 millions Australians in the workforce it purports to serve.

7. The importance of unfair contract protections: A discussion

For many free-market economists, lawyers and commentators the idea of Parliament determining what is an 'unfair' contract is an unacceptable interference in commerce. But this is exactly the proposal before Federal Parliament at the moment with the *Small Business and Unfair Contract Terms Bill 2015*.

On the broad issue the free-marketeers are correct. Market-based economic activity happens through and because of freedom to enter commercial contracts. This should not be distorted. It's key to economic freedoms.

However, what is mostly missed in the debate is that commercial contracts have embedded in them a certain structure determined under common (and Roman) law that creates the contract freedom. This structure, for example, holds that a contract must be genuinely entered. Otherwise it's not a 'contract'. Further, that the terms of the contract cannot be changed without the agreement of all parties.

These features are found in common law but are only occasionally tested in disputes through the legal process.

Unfortunately, the theory of contract freedom breaks down in practice in certain circumstances – most often in the application of 'standard-form' contracts. When a big business or government agency has to engage in large numbers of contracts, they will often create a 'standard form'. They do this for managerial convenience because it's too difficult to negotiate every contract individually.

What happens with these standard-form, 'take it or leave it' contracts is that the terms are often written to give the large business unrestrained control over the contract. For example, the large party can change the contract terms or cancel the contract at whim. Other examples are as per (a) to (m) below. The small party is denied the same contract rights. In effect, such 'contracts' cease to have the necessary structural features at common law that make a contract a genuine contract.

Big businesses can do this because the small person at the other end of the contract doesn't understand it, is not allowed to negotiate the contract and hasn't the time, money or expertise to legally challenge the 'contract'..

In 2010, 'unfair' contract protections laws were introduced covering standard-form contracts for consumers. Effectively these laws embed in statute the common law structure of commercial contracts. For example, if one party has the right to change the terms of the contract, the other party must have the same right. It's about retaining the balance of power between the parties under the contract structure. It doesn't touch other practical matters such as price.

The common sense of this is evidenced in the specific contract features that are defined as 'unfair' in the consumer law. These features make it clear that a contract is 'unfair' if it gives one party but not the other the ability to:

- a) Avoid or limit the performance of the contract.
- b) Terminate the contract.
- c) Apply penalties against the other party for a breach or termination of the contract.
- d) Vary the terms of the contract.
- e) Renew or not renew the contract.
- f) Vary the price payable under the contract without the right of the other party to terminate the contract.
- g) Unilaterally vary the characteristics of the goods or services to be supplied under the contract.
- h) Unilaterally determine whether the contract has been breached or to interpret its meaning.
- i) Limit one party's vicarious liability for its agents.

- j) Permit one party to assign the contract to the other party's detriment without their consent.
- k) Limit one party's right to sue the other party.
- l) Limit the evidence one party can adduce in legal proceedings in respect to the contract.
- m) Impose the evidential burden on one party in legal proceedings in respect to the contract.

The practical reality is that the unfair contracts protections are needed because the theory of contract freedom often fails to hold good because of the expense and complexity of the legal system.

8. The success of the consumer Unfair Contract Protections

The consumer unfair contract protections have the following features:

- Protections are available where standard form contracts operate. Where a consumer genuinely negotiates a contract, the protections do not apply.
- The price of a contract is not a consideration of unfairness.
- Consumers' access to the protections is not specifically limited by the value of a contract except by virtue of the definition of a consumer (see item 10 below).

We believe that the consumer unfair contract protections have been a success principally because there has *not* been widespread litigation in relation to the laws. What has in fact happened is that firms with standard form contracts have voluntarily reviewed and corrected their contracts to conform to the laws. This review/improvement process has been undertaken because the law was clear that it could not be avoided. Further, the Australian Competition and Consumer Commission has been active in contacting businesses with standard form contracts and assisting them to review their contracts to ensure compliance with the law.

The real strength of the consumer unfair contract protections lies with the maximization of voluntary compliance. It is this strength that needs to be replicated with the small business implementation. We explain below why the limitation on contract value contained in the Bill will diminish voluntary compliance in the small business space.

9. The Bill provision to which we object

The *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015* introduces a concept and provision not contained in the consumer unfair contract law. The Bill changes the existing unfair contract laws so that Section 12BF is amended to add:

- (4) A contract is a small business contract if:
 - (a) at the time the contract is entered into, at least one party to the contract is a small business; and
 - (b) either of the following applies:
 - (i) the upfront price payable under the contract does not exceed \$100,000;
 - (ii) the contract has a duration of more than 12 months and the upfront price payable under the contract does not exceed \$250,000.

It is part (b) which creates a problem and *which we request the Committee to recommend be deleted*.

In introducing part (b), the jurisdictional application of the unfair contract protections available to consumers is significantly altered and instead applies a different standard to small business people.

10. Limitations under consumer law

The value of consumer contracts subject to the unfair contracts protections is not specifically limited, except by virtue of the definition of a consumer under Australian Consumer Law [ACL]. [<https://www.comlaw.gov.au/Details/C2015C00327>]

Volume 3, Schedule 2, Chapter 1, Section 3 in part states:

3 Meaning of *consumer*

Acquiring goods (and services) as a consumer

- (1) A person is taken to have acquired particular goods as a ***consumer*** if, and only if:
 - (a) the amount paid or payable for the goods, as worked out under subsections (4) to (9), did not exceed:
 - (i) \$40,000; or
 - (ii) if a greater amount is prescribed for the purposes of this paragraph—that greater amount; or
 - (b) the goods were of a kind ordinarily acquired for personal, domestic or household use or consumption; or
 - (c) the goods consisted of a vehicle or trailer acquired for use principally in the transport of goods on public roads.

Note that the \$40,000 limit can be higher where at (b) the value of the goods is ordinarily of a consumer nature, for example, or at (c) with motor vehicles.

Presumably, when drafting the unfair contracts Bill for small business it was considered necessary to create a contract limit to ensure consistency with the ACL for consumers. However, the small business Bill makes no accommodation for an amount over \$100,000 where the additional amount relates to activities normal and necessary for a business operation.

Further, the consumer contract limitation of \$40,000 does not have a time limitation placed upon it, but presumably only a per-contract limit. Therefore, the \$40,000 per contract limit for consumers is an exceedingly high threshold. For example it could be for a contract for one month!

In comparison, the \$100,000 limit for small business does have a time limit and, ICA argues, does not match the reality of small business contracts. It is in fact an exceedingly low threshold.

11. \$100,000 is not \$100,000

The notional values of \$100,000 and \$250,000 included in part (b) paint an inaccurate picture of the true net value of a contract to a small businessperson.

When setting contract prices, statutory obligations and other essential costs must be included. These costs must allow for GST (9 per cent), workers' compensation (1–5 per cent), payroll tax, where applicable (4 per cent), public liability and product/indemnity insurance (say 1–5 per cent) and more. All of these, where applicable, must be discounted from a contract price to arrive at a net value of the contract as it applies to the practical income of the small businessperson.

The part (b) notional values must therefore be significantly discounted by, say, around 20 per cent to reflect the practical net value of a contract to the small businessperson. Therefore, \$100,000 is more likely \$80,000 and \$250,000 more likely \$200,000. And, as explained below, where an asset is also provided – for example, in the case of owner-drivers (see 13(b) below) – the real value of the contract is even less.

This recalculation more accurately reflects reality and further limits and reduces the scope of the unfair contract protections.

12. How unfair contracts for self-employed consultants are structured

To understand the true impact of the 'upfront price' (\$100,000) exclusion it is necessary to understand the structure of the standard form, 'take-or-leave-it' contracts that are typically imposed on consultants and the value of their contracts.

Standard form contracts for consultants regularly follow a template. For example, the Commonwealth government has a template organized through Centrelink which is widely used for the engagement of consultants. The contracts will ordinarily stipulate a time-frame, say, 9 months or whatever, but have a clause/s that enables the engager to terminate the contract at whim, something that often occurs. The contract will most likely state an hourly, or daily, or sometimes a unit rate. Specialist consultants (IT, engineering, legal, etc) can often charge \$80 to \$300 an hour or more before the 'add-ons' described above.

Under this scenario, a contract for (say) nine months will very quickly exceed the notional (gross to the contractor) 'upfront price' of \$80,000 (\$100,000 under the Bill) as explained above. Yet the contract can be terminated at whim by the 'client' and consequently the 'upfront price' of over \$80,000 may never actually be paid.

13. Who would immediately be excluded

There are a number of categories of small business people that come to mind who would immediately be excluded due to the part (b) 'upfront price' limitation.

- a) As described above, part (b) will exclude huge numbers of independent contractor consultants. This is because the notional 'upfront price' will readily exceed the limit set for unfair contract protections. There would be several hundreds of thousands of consultants in Australia that would probably be excluded by part (b).
- b) Any small businessperson who supplied both their services and a large, valued asset, such as a vehicle, will be excluded. This will include, for example, owner-drivers.

Owner-drivers include the operating costs of their vehicles when they calculate the ‘upfront price’ of a contract. Vehicle values may range from (say) \$15,000 to \$200,000. When the value and cost of running a vehicle is included in a contract, the actual contribution of the contract to the owner-drivers’ personal income is considerably less than the ‘upfront price’ of the contract itself. If this is combined with the scenario described above – where part (b) limits the unfair contract protections to \$100,000 and we have demonstrated that the real ‘value’ of that is \$80,000 – then the true further discounted value to an owner-driver may reduce quite easily to (say) \$50,000. The numbers of owner-drivers in Australia stands in the tens of thousands and most, if not all, would be highly likely to be excluded from the unfair contract protections because of part (b).

‘Subbies’ in the construction sector may also find themselves excluded. When construction head contractors win a large job, the actual work cascades down the contract chain. The small business contractors who actually do the work must sign standard form contracts that are designed to transfer unreasonable levels of risk to the subcontractor. The unfair contract provisions for small business people should create an improved contract situation in construction. But because construction contracts will quite readily and easily exceed the part (b) limit for the reasons we have stated above and given the cascading nature of construction contracts, many tens of thousands of small business subbies will be denied the protections.

These categories of individuals who would/will be excluded are just the three most obvious. There are other scenarios that could be explored.

14. Scenario under which large businesses and governments can organize contracts to avoid unfair contract oversight

The part (b) exclusion creates a perfect scenario in which large firms or government entities will be able artificially to construct standard form contracts that avoid the oversight of the small business unfair protection laws.

Quite simply, large organizations will be able to manipulate contracts into ‘appropriate’ timeframes so that the ‘upfront price’ of a contract exceeds the \$100,000 (or \$250,000) limits set in the Bill. This will remove the contract from any consideration of unfairness. The large organization may have no intention to honour the notional time limit that has been set. All the contract then needs to have is an ‘at whim’ contract termination clause favouring the large organization. The contract can and will be as ‘unfair’ as the large organization wishes – but the organization will have legally avoided the reach of the unfair contract provisions for small business people.

Not only is this scenario likely, but we believe that it will occur (with variations on the foregoing theme) and occur on a wide and systemic basis.

15. Legal complexity and disputes

The part (b) exclusion will result in major legal disputes and complexity.

As discussed above, the real value of the consumer unfair protection laws has not been found in their enforcement but in the voluntary review of standard form consumer contracts that occurred across the economy with the introduction of the laws. The consumer laws are clear that they capture all standard form consumer contracts. Large firms, particularly telco and finance companies, knew they could not escape the laws and fixed their contracts to ensure compliance.

The part (b) exclusion for small business will, however, create a different scenario. Instead of reviewing contracts, we predict that large organizations will focus the attention of their lawyers on manipulating contracts to stay outside the reach of the laws. Contracts across the economy for small business people will not be improved. Instead, they will be made more complex and legalistic to avoid the unfair contract oversight.

Further, in the event of the regulator or an individual seeking to have an unfair contract term voided, there will first ensue complex legal arguments over the meaning of 'upfront price' and its application to the contract in question. The aim of lawyers for the alleged offending party would be to deny jurisdiction. This, of itself, escalates compliance costs and creates a diversion from the real issue of importance – namely, whether contract clauses are 'unfair'. This process, itself, defeats the real advantage of the unfair contract protections – that is, to trigger voluntary compliance.

It is this understanding of legal process that highlights why the unfair contract laws were needed for consumers and is needed (in the same form) for small business people.

We repeat our earlier argument supporting the laws. In liberal, free-market communities, the 'rule of commercial contract law' contains a principle that parties to a commercial contract, no matter what their status or wealth, are 'equals' at law under contract. This is a bedrock legal principle of commercial transactions in a well functioning, free-market economy. However, the cost of legal enforcement of this principle of contract 'equality' often undoes the principle itself. Essentially, the 'little people' (consumers and small business people) can't afford the money or the time to secure their contract rights through the courts. Larger parties know this and exploit their financial capacity to conduct legal action with the express strategic purpose of intimidating the smaller party into submission.

It is this use of legal process by large organizations that is the crucial marker of the 'imbalance of bargaining power' between large and small businesses. It is this that the unfair contract protections go some way to addressing in a practical and relatively simple way. But it is undone by introducing a limitation on the 'upfront price'.

16. Purported reasons for having the 'upfront price' exclusions

We have heard of two purported justifications for creating the 'upfront price' exclusion.

a) That it is part of defining a small business: We believe this is unnecessary. A small business is defined in the Bill as a business with fewer than 20 employees. That is the only definition needed and we believe it is an acceptable definition at this stage.

b) That over a certain value of contract the small businessperson should be responsible and should negotiate the contract. This is a value judgment that does not match the realities of the commercial world. It assumes that small business people are always in a position to negotiate a contract. But what typically happens is that work is offered on a 'take it or leave it' basis, replicating the same situation faced by consumers – only the contract values are much higher.

An essential understanding is that the \$100,000 limit will not force small business people to negotiate their contract. The problem is that with standard form contracts the larger party refuses to negotiate. Rather than forcing negotiation, the \$100,000 limit will play into the hands of the larger party who has created the unfairness in the first place. This amounts to a neutering of the protections.

Consider a comparison. Laws have been in place for some time that stipulate the structure and content of residential property sale contracts. This has been done to protect people from unscrupulous and unfair practices in the real estate sector. If these residential sale contracts excluded property sales above \$100,000 in value, there would not be a residential sale in Australia that had the protection of the law in this respect.

Over the last 30 years-or-so there has been a progressive realisation that if free markets are to operate on a truly competitive basis, the concept of equality of bargaining power between parties under commercial contracts must operate in a practical sense and not just in a theoretical sense. What has occurred is that laws have ensured that 'standard form' contracts in many areas must comply with a format that secures the 'equality of bargaining power'. Real estate contracts for domestic residential sales are one example. The same has been developed for residential tenancies, car sales and the list goes on. The unfair contract laws are part of that progression. Yet such laws would all be undone if contract value limitations were imposed.

If the limitation being created for unfair contracts protections for small business people were applied across all contract regulations (as described above), huge damage would be done to the competitive operation of the economy.

17. Independent Contractors Act

It could be argued that unfair contract issues for small business people could be handled through the *Independent Contractors Act*. However, this has proven not to be the case. The *Independent Contractors Act* in this respect has been ineffective.

Unlike the unfair contract laws, the definition of 'unfairness' in the *Independent Contractors Act* was not clear and specific. And it has been left to the courts to determine what unfairness means. This has involved considerable legal expense on the part of individuals as well as huge investments of time.

The first test cases were the 'Riteway' and 'ABB Warehousing' cases, both of 2008. The judgments spent considerable time discussing what unfairness meant, what the precise powers of the court were and what remedies could be applied. The judgments gave guidance to future possible cases, but it was clear that the outcomes would vary

depending on the specifics of each case. The Riteway case, for example, took three-and-a-half years for resolution to be achieved.

Since the Riteway and ABB Warehousing cases, we believe that there has only been a limited number of unfair contract cases utilizing the *Independent Contractors Act*. Essentially it is still an expensive, drawn-out, technical and highly legalistic process. Its essential failure is that it doesn't trigger changes in commercial behaviour but relies on expensive legal action. It only addresses unfairness *after* the event and *after* the damage has been done to the small business party.

ICA was a strong backer and promoter of the *Independent Contractors Act*. That support notwithstanding, we recognize its failure as an effective trigger for improving contract fairness. It hasn't created an environment of voluntary compliance. We don't suggest the repeal of the *Independent Contractors Act*. But we see it as weak when it comes to instigating commercial change in this realm.

18. The consequence of not having the \$100,000 limitation

In comparison, the unfair contract laws for consumers have proven to be effective in generating voluntary compliance. This is because the specification of what is unfair is clearly stated, with many practical examples given.

Based on experience and the evidence, applying the consumer unfair contract laws to small businesses should result in contracts being reviewed to remove unfair clauses and this, in turn, should lead to subsequent changes in commercial behaviour. This creates an environment in which unfairness is prevented, rather than one in which unfairness occurs, damage is done and litigation sought to seek redress for unfairness.

The consequence of removing the \$100,000 limit is to make the unfair contract protections available to all small business people for all of their commercial transactions. But most importantly it is only for transactions where standard-form contracts are being used. If a large business or government agency doesn't want the unfair contract protections applied, all they have to do is genuinely negotiate the contract.