Promoting fairer franchise agreements: A way forward?

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The question of whether or not the judiciary or the legislature should intervene to promote fairer franchise agreements is a longstanding and difficult one. At the heart of the question is the need to balance a franchisor's ability to maintain the integrity of the franchise system by being able to enforce franchisee conformity with that system, and ensuring that a franchisee's contractually captive status is not exploited by the franchisor through the inclusion of contractual terms in the franchise agreement that are not reasonably necessary for the protection of the franchisor's legitimate interests. Within this context the article will consider whether or not existing Australian laws allow sufficient scope to deal with allegations that a franchisor has included contractual terms in a franchise agreement that are not reasonably necessary to protect the legitimate interests of the franchisor. Where existing laws are found to be lacking, the article will explore possible new legislative frameworks that could be implemented to allow judicial consideration of allegedly unfair contractual terms.

Introduction

The question of whether the judiciary or the legislature should intervene to promote fairer franchise agreements is a longstanding and difficult one. At the heart of the question is the need to balance a franchisor's ability to maintain the integrity of the franchise system by being able to enforce franchisee conformity with that system, and ensuring that a franchisee's contractually captive status is not exploited by the franchisor through the inclusion of contractual terms in the franchise agreement that are not reasonably necessary for the protection of the franchisor's legitimate interests. In Australia the question of fairness within franchising arrangements has historically been restricted to judicial and statutory concepts of unconscionability. These existing notions of unconscionability have, in turn, focused on what has traditionally been referred to as procedural unconscionability. In particular, the focus has been on the franchisor's conduct towards the franchisee in the making of the contract or during the course of their relationship rather than solely on the fairness or otherwise of the actual terms of the franchise agreement. Not surprisingly, this judicial and statutory focus on procedural unconscionability has meant that little, if any, attention has been focused on what is described as substantive unconscionability.

Indeed, with substantive unconscionability concerned with the fairness or otherwise of the terms of the contract, the refusal by Australian courts to consider claims based solely on the alleged unfairness of the terms of a contract has meant that such claims have rarely been tested before the courts. While there may be instances where claims of substantive unconscionability may come before the courts, these will tend to occur where claims of

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procedural unconscionability are also being made by the weaker contractual party. In short, the procedural unconscionability bias of existing judicial or statutory concepts of unconscionability has meant that the question of whether or not the terms of a franchise agreement need to be fair and reasonable has historically received little judicial attention. In the absence of judicial scrutiny, there has been growing interest amongst law reform and other policy development bodies, both in Australia and the United Kingdom, as to whether or not there should be a new legislative framework that focuses solely on the fairness or otherwise of the terms of commercial contracts.

Such interest by law reform and other policy development bodies has centred on the question of whether or not a new legislative framework is needed to deal with contractual terms that are unfair on the basis that they are not reasonably necessary to protect the legitimate interests of the party seeking to rely on the term. This, in turn, raises three broad questions. Firstly, should the courts or the legislature be concerned with the fairness or otherwise of contractual terms within a commercial context and, in particular, the terms of a franchise agreement? This clearly focuses attention on whether franchisees are sufficiently able to look after their own interests or whether their contractually captive status makes them vulnerable to franchisors intent on imposing contractual terms that are not reasonably necessary for the protection of the franchisor's legitimate interests. In short, this first question involves balancing the respective interests of franchisors and franchisees in what is typically a longstanding and mutually dependent relationship.

In considering the respective interests of the franchisors and franchisees it is readily apparent that while franchisors need to be able to maintain and enforce the integrity of the franchise system, it would be of concern if franchisors used this position to include terms in the franchise agreement that went beyond what was reasonably necessary for the protection of the franchisor's legitimate interests. In view of these concerns, a second question arises as to whether or not existing laws adequately deal with terms of a franchise agreement that allegedly go beyond what was reasonably necessary for the protection of the franchisor's legitimate interests.

Finally, where existing laws arguably fail to adequately deal with a particular concern, the question arises as to whether or not a new legislative framework is required to deal with that particular concern.

Should the courts or the legislature be concerned with the fairness or otherwise of the terms of a franchise agreement?

While the courts and the legislature have allowed allegations of unconscionable conduct on the part of the stronger contractual party to be reviewed, this willingness has hitherto not been extended to allowing the fairness or otherwise of the terms of the contract to be reviewed. Historically, this has been because of the adherence to the longstanding notion of freedom of contract. Under this notion, the parties were presumed to have freely negotiated the terms of the contract and to have freely entered the contract. Having done so, courts took the view that the contracting parties were to be bound by the contract and that the courts would not intervene on the grounds

of unconscionable conduct unless the conduct of the stronger party during the making of the contract fell within well established parameters. These parameters were very narrowly defined by the courts and came to be known as the equitable doctrine of unconscionability.

In the late 1970s and 1980s there was a growing acceptance on the part of Australian legislatures that the equitable doctrine of unconscionable conduct was unduly narrow and did not allow for consideration of a broader range of circumstances under which the weaker contractual party could be on the receiving end of exploitative, harsh or oppressive conduct by the stronger party. As a result, Australian legislatures enacted broader statutory notions of unconscionable conduct. These broader statutory notions of unconscionable conduct have been in operation in Australian for over 25 years in relation to consumers and almost 10 years in relation to small business. Importantly, these broader statutory notions have focused attention on how the stronger party behaves towards the weaker party not only in the making of the contract but also during the course of their dealings. Clearly, the legislature recognised that the growing disparity in the bargaining power of the parties in some contractual relationships could lead to conduct that was unconscionable under a broader meaning of the term than had been previously used by the courts. Indeed, consumers and small businesses were viewed as being potentially vulnerable to exploitative, harsh or oppressive conduct by large businesses during the course of their dealings. While initially it was only consumers that were seen as being vulnerable because of their lack of bargaining power in the negotiation process or their contractually captive position in longer term contracts, in more recent times such concerns have emerged in relation to small businesses dealings with larger businesses within a number of ongoing relationships such as supply agreements, retail tenancies and franchising.

Although succeeding in widening the meaning of the expression ‘unconscionable conduct’, the statutory notions of unconscionability have been given a clear procedural unconscionability bias by the courts. In doing so, the courts have focused almost exclusively on whether or not there has been exploitative, harsh or oppressive conduct by the stronger parties rather than allowing a broader review of the stronger party’s inclusion of contractual terms that are not reasonably necessary to protect the legitimate interests of the party. Once again, the courts adherence to the notion of freedom of contract meant that they were refraining from using the statutory notions of unconscionability to deal with allegations based solely on the alleged unfairness of contractual terms. During the 1990s, however, legislatures started to again question whether or not the notion of freedom of contract properly reflected modern circumstances, especially given that in a consumer context contracts were increasingly likely to be ‘standard form’ leaving little, if any, room for the consumer to renegotiate the ‘standard terms’. In short, the obvious disparity of bargaining power between consumers and large businesses meant that contracts were (i) increasingly standard across whole industries, (ii) were offered on a ‘take it or leave it’ basis, and (iii) included terms that went beyond what was reasonably necessary to protect the legitimate interests of the business.

The growing use of standard form contracts and the inability of consumers to renegotiate the terms of such contracts were seen as particular concerns

within consumer transactions. This concern led to the United Kingdom[1] and more recently the Australian State of Victoria[2] to enact legislation dealing directly with allegedly unfair terms in consumer contracts. With the sole focus of this legislation being to make void or unenforceable unfair terms in consumer contracts, it is clear that the legislation is aimed at providing a mechanism for dealing with contractual terms that go beyond what is reasonably necessary to protect the legitimate interests of the stronger party. By dealing with allegedly unfair contractual terms, this legislation is concerned to ensure that the inequality of bargaining power increasingly faced by consumers in their dealings with large businesses is not taken advantage of by the business to include terms not reasonably necessary for the legitimate protection of its interests.

This growing recognition among legislatures that a significant imbalance of bargaining power between consumers and large business may be exploited by the business in the drafting of contracts has prompted debate as to whether a growing imbalance of bargaining power between small businesses and larger businesses may also lead to the larger businesses drafting contracts to include terms not reasonably necessary to protect its legitimate interests. This debate has emerged from discussion papers prepared by law reform bodies in Australia and the United Kingdom. In January 2004 the Australian Standing Committee of Officials of Consumer Affairs (SCOCA) released a national discussion paper on the issue of unfair contract terms in which it called for comment on the possible inclusion of business to business contracts in any legislation dealing with unfair contract terms.[3] Similarly, in 2002 the English Law Commission issued a consultation paper on unfair terms in contracts in which it considered extending the protection against unfair terms to businesses.[4]

Both papers include a number of arguments both for and against including business to business contracts within a legislative framework for dealing with unfair contract terms. In doing so, it is readily apparent that both papers have identified allegedly unfair terms in business to business contracts involving small business as an issue needing to be addressed. Indeed, while both papers acknowledged the commercial character of business to business contracts and the possibly greater sophistication of small businesses as compared to consumers,[5] both papers expressed concern that small businesses in many cases faced comparable imbalances in bargaining power when dealing with

1 The UK legislation was implemented first and is now found in the Unfair Terms in Consumer Contracts Regulations 1999. These Regulations came into force on 1 October 1999.

2 The Victorian legislation is found in Pt 2B of the Fair Trading Act 1999 and came into force on 9 October 2003.

3 <http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/web+pages/CD456F7C38F523684A256E240014EF7C?OpenDocument&L1=Publications>.

4 <http://www.lawcom.gov.uk/docs/cp166.pdf>.

5 See The Law Commission, *Unfair terms in contracts: A joint consultation paper*, Consultation Paper No 166, London, England, 2002, p 131. See also The Standing Committee of Officials of Consumer Affairs (SCOCA), *Unfair contract terms: A discussion paper*, 2004, p 54.

larger businesses as the imbalances faced by consumers when dealing with large businesses.[6]

Similarly, both papers also formed the view that the use of standard form contracts offered on a take it or leave it basis within a business to business context could, as in the case of consumer contracts, possibly lead to the inclusion of potentially unfair terms in contracts between small businesses and larger businesses.[7] Within this context, both papers identified examples of what could potentially be seen as unfair terms in a business to business context. For example, the English Law Commission identified the following contractual terms as potentially going beyond what was reasonably necessary to protect the legitimate interests of the stronger party:

- deposits and forfeiture of money paid clauses;
- high default rates of interest (unless these can be shown to be penalties);
- clauses allowing unilateral variation in price;
- termination clauses allowing one party to terminate in a wider set of circumstances than allowed for the other party;
- unequal notice periods; and
- arbitration and jurisdictional clauses which seek to severely restrict the rights of a party to choose the forum for dispute resolution.[8]

In short, while both papers recognised that the potential problems with allegedly unfair terms could, when compared to consumer contracts, be less severe in business to business contracts involving small business, such problems could arise and therefore needed to be considered.[9]

In doing so, it must be remembered that consideration of allegedly unfair terms in business to business contracts such as franchise agreements is only concerned with the question of whether or not the franchisor has included terms that are not reasonable necessary for the protection of the franchisor's legitimate interests. Clearly, a franchisor is perfectly entitled to rely on contractual terms that are reasonably necessary to protect its legitimate interests. Indeed, both contracting parties should be entitled to include contractual terms that are reasonably necessary to protect their respective legitimate interests. In this sense, freely negotiated contracts may be seen as involving a sharing or an apportioning of the contractual risks and rewards between the parties. In particular, in any genuine negotiation process the parties will seek to strike a balance in their respective rights and obligations arising from the contract. Where, however, the franchise agreement includes terms that are not reasonably necessary to protect the franchisor's legitimate interests, there is a real danger that the franchise agreement has been drafted in a way that: seeks to shift those contractual risks disproportionately onto the franchisee; creates an significant imbalance in the respective rights and obligations of the parties in favour of the franchisor; or simply seeks to impose an additional detriment on the franchisee or minimises the potential benefit to the franchisee under the contract without any offsetting reward.

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6 The Law Commission, above n 5, p 131. See also SCOCA, above n 5, p 50.
7 See The Law Commission, above n 5, p 130. See also SCOCA, above n 5, p 50.
8 See The Law Commission, above n 5, p 126. See also SCOCA, above n 5, p 51.
9 See The Law Commission, above n 5, p 131. See SCOCA, above n 5, p 50.

Thus, the issue of fairness when dealing with unfair terms in business to business contracts such as franchise agreements involves an objective assessment of particular contractual terms. Fairness within this context is to be tested by an objective standard of whether or not a contractual term that places a franchisee at a disadvantage is reasonably necessary for the protection of the legitimate interests of the franchisor. Implicit in such a standard is the recognition that a franchise agreement involves trade offs whereby a franchisee may be disadvantaged in one way, but is rewarded in another way so as to offset the disadvantage. Where the offsetting reward is reasonably proportionate to the disadvantage, the franchisor would be entitled to contractually protect the trade off. As the reward is reasonably proportionate to the disadvantage and the franchisor may itself be at a financial disadvantage if the trade off is not contractually protected, the franchisor would be entitled to claim the relevant contractual terms protecting the trade off as reasonably necessary for the protection of the legitimate interests of the franchisor. In this way seeking to deal with unfair terms in franchise agreements would in no way detract from, or undermine the franchisor's ability to include contractual terms that are reasonably necessary to protect its legitimate interests.

Do existing laws allow the courts to deal directly with terms of a franchise agreement that allegedly go beyond what was reasonably necessary for the protection of the franchisor's legitimate interests?

While there may be instances where a franchisor may choose to include terms in a franchise agreement that are arguably not reasonably necessary for the protection of the franchisor's legitimate interests, Australian courts have, as discussed above, traditionally refused to consider such claims in their own right. In particular, judicial and statutory concepts of unconscionability have historically had a procedural unconscionability bias with the courts having a clear preference for focusing almost exclusively on the stronger party's conduct in the making of the contract or during the course of the relationship. In the absence of such conduct being considered 'unconscionable', the courts have generally refrained from considering the fairness or otherwise of contractual terms. Not only have the courts historically taken a narrow view of what they would consider 'unconscionable' at equity, but they have also been reluctant to use more recently enacted statutory notions of unconscionability to consider the fairness or otherwise of the terms of contract.

This judicial reluctance to rely on statutory notions of unconscionability to deal with issues of substantive unconscionability can be seen from a review of the Australian cases dealing with equitable and statutory concepts of unconscionable conduct. Interestingly, these statutory concepts of unconscionability were intended to have a broader operation than the equitable doctrine of unconscionability, a doctrine that could only be invoked where the weaker party was under a particular type of 'special disadvantage' recognised by the courts. While the categories of special disadvantage were not closed, the courts did focus on particular types of categories of 'special disadvantage'. This can be seen from the following comments by Mason J in

Commercial Bank of Australia Ltd v Amadio, the landmark Australian case on the equitable doctrine of unconscionability:

> It goes almost without saying that it is impossible to describe definitively all the situations in which relief will be granted on the ground of unconscionable conduct. As Fullagar J said in *Blomley v Ryan* (1956) 99 CLR 362, at 405: 'The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-à-vis the other.'
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> Likewise Kitto J (at 415) spoke of it as 'a well-known head of equity' which '. . . applies whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands'.
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> It is not to be thought that relief will be granted only in the particular situations mentioned by their Honours. It is made plain enough, especially by Fullagar J, that the situations mentioned are no more than particular exemplifications of an underlying general principle which may be invoked whenever one party by reason of some condition or circumstance is placed at a special disadvantage vis-à-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created. I qualify the word 'disadvantage' by the adjective 'special' in order to disavow any suggestion that the principle applies whenever there is some difference in the bargaining power of the parties and in order to emphasise that the disabling condition or circumstance is one which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that condition or circumstance and of its effect on the innocent party.[10]

In outlining what his Honour considered to be the underlying principle in relation to the equitable doctrine of unconscionability, Mason J had emphasised the need to show a special disadvantage along with an unconscientious taking advantage of that 'disabling condition' as being essential ingredients in the equitable doctrine. This principle remains the same today and reinforces the need to demonstrate the existence of procedural unconscionability before the court will even consider the terms of the contract itself.

This continued emphasis on procedural unconscionability means that little, if anything, of substance has changed with the equitable doctrine of unconscionability since the *Amadio* case. Not only have the courts consistently restricted themselves to consideration of the long established categories of special disadvantage as the basis for granting relief under the equitable doctrine, but the High Court has emphatically refused to consider inequality of bargaining power, even a major disparity of bargaining power, as sufficiently 'special' to constitute a disabling condition permitting the equitable doctrine's intervention. This has been especially true in cases involving commercial transactions. Indeed, in its recent decision in *ACCC v*

10 (1983) 151 CLR 447; 46 ALR 402 at 412–13.

C G Berbatis Holdings Pty Ltd,[11] a commercial tenancy case, the High Court has made it clear that an inequality of bargaining power on its own will not give rise to a special disadvantage. Provided a person is capable of understanding the nature of the transaction, an inequality of bargaining or even a taking advantage of that inequality of bargaining power by the stronger party will not be sufficient to invoke the equitable doctrine. This position clearly emerges from the following comments by Gleeson CJ in that case:

> One thing is clear . . . A person is not in a position of relevant disadvantage . . . simply because of inequality of bargaining power.
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> . . .
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> Unconscientious exploitation of another's inability, or diminished ability, to conserve his or her own interests is not to be confused with taking advantage of a superior bargaining position. There may be cases where both elements are involved, but, in such cases, it is the first, not the second, element that is of legal consequence.[12]

Similar comments were made by Gummow and Hayne JJ:

> . . . It will be apparent that the special disadvantage of which Mason J spoke in [the *Amadio* case] was one seriously affecting the ability of the innocent party to make a judgment as to that party's own best interests.
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> In the present case, the respondents emphasise that point and stress that a person in a greatly inferior bargaining position nevertheless may not lack capacity to make a judgment about that person's own best interests. The respondents submit that the facts in the present case show that Mr and Mrs Roberts [as tenants] were under no disabling condition which affected their ability to make a judgment as to their own best interests in agreeing to the stipulation imposed by the owners for the renewal of the lease, so as to facilitate the sale by Mr and Mrs Roberts of their business. Those submissions should be accepted.[13]

As the retail tenants understood the nature of the transaction that was before them, the High Court considered that they were able to make a decision about what was in their best interest notwithstanding the great disparity of bargaining power between the parties and that the stipulation offered by the landlord for the renewal of the lease was effectively done so on a take it or leave it basis. Clearly, under the equitable doctrine the focus of the inquiry is on whether or not one of the parties is affected by a disabling condition recognisable by the courts. Accordingly, the equitable doctrine has no role to play where, absent a recognisable disabling condition, a party to a contract understands or is capable (for example, through independent legal advice) of understanding the nature of the transaction. A gross inequality of bargaining power and having no real choice but to accept allegedly unfair contractual terms are not in themselves 'special' enough for the equitable doctrine. In summary, the High Court's emphasis on procedural unconscionability or the requirement that there be a disabling condition recognisable by the courts means that in the absence of such a disabling condition the equitable doctrine has no role to play in dealing with unfair contractual terms.

Ironically, the limitations of the equitable doctrine of unconscionability

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11 (2003) 214 CLR 51; 197 ALR 153.
12 Ibid, at [11]–[14].
13 Ibid, at [55]–[56].

were being expressed in the late seventies and early eighties[14] and were being responded to by Australian legislatures at that time; firstly, by the NSW Parliament[15] and then followed closely by the Federal Parliament.[16] Indeed, there can be little doubt that these legislative responses were intended to expand the notion of unconscionability to one more responsive to what were perceived as the 'modern' needs of the time. Even in the early eighties the equitable doctrine was viewed as a very narrow one based on notions of procedural unconscionability restricted essentially to whether or not a party to the contract was under a recognisable disabling condition in the lead up to the making of the contract. Faced with a narrow equitable notion of unconscionability and a judicial unwillingness to broaden the scope of that doctrine, it was generally considered that only statutory intervention would bring about a doctrine of unconscionability more responsive to the then 'modern' concerns arising from a growing inequality of bargaining power; standard form contracts and substantive unconscionability.

In seeking to deal with these concerns the Federal Parliament enacted such provisions as s 51AB and s 51AC of the Trade Practices Act 1974 (Cth) (TPA). Of these provisions, s 51AB came first and was aimed at consumer transactions:

> (1) A corporation shall not, in trade or commerce, in connection with the supply or possible supply of goods or services to a person, engage in conduct that is, in all the circumstances, unconscionable.
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> (2) Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person (in this subsection referred to as the *consumer*), the Court may have regard to:
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> (a) the relative strengths of the bargaining positions of the corporation and the consumer;
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> (b) whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation;
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> (c) whether the consumer was able to understand any documents relating to the supply or possible supply of the goods or services;
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> (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the consumer or a person acting on behalf of the consumer by the corporation or a person acting on behalf of the corporation in relation to the supply or possible supply of the goods or services; and
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> (e) the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services from a person other than the corporation.
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> (3) A corporation shall not be taken for the purposes of this section to engage in unconscionable conduct in connection with the supply or possible supply of

14 See, generally, J Peden, *Harsh and Unconscionable Contracts*, Report to Minister for Consumer Affairs and Co-operative Societies and the Attorney-General for New South Wales, 1976.

15 See Contracts Review Act 1980 (NSW).

16 See s 51AB of the TPA.

goods or services to a person by reason only that the corporation institutes legal proceedings in relation to that supply or possible supply or refers a dispute or claim in relation to that supply or possible supply to arbitration.

(4) For the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person:

(a) the Court shall not have regard to any circumstances that were not reasonably forseeable at the time of the alleged contravention; and

(b) the Court may have regard to conduct engaged in, or circumstances existing, before the commencement of this section.

(5) A reference in this section to goods or services is a reference to goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption.

(6) A reference in this section to the supply or possible supply of goods does not include a reference to the supply or possible supply of goods for the purpose of re-supply or for the purpose of using them up or transforming them in trade or commerce. . . .

More recently, s 51AC of the TPA was enacted in relation to business to business contracts involving small business:

(1) A corporation must not, in trade or commerce, in connection with:

(a) the supply or possible supply of goods or services to a person (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);

(c) engage in conduct that is, in all the circumstances, unconscionable.

(2) A person must not, in trade or commerce, in connection with:

(a) the supply or possible supply of goods or services to a corporation (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a corporation (other than a listed public company);

engage in conduct that is, in all the circumstances, unconscionable.

(3) Without in any way limiting the matters to which the Court may have regard for the purpose of determining whether a corporation or a person (the supplier)[17] has contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the business consumer), the Court may have regard to:

(a) the relative strengths of the bargaining positions of the supplier and the business consumer; and

(b) whether, as a result of conduct engaged in by the supplier, the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

whether the business consumer was able to understand any documents relating to the supply or possible supply of the goods or services; and

(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer or a person acting on

17 While s 51AC(3) deals with the conduct of suppliers, it should be noted that s 51AC(4) deals with the conduct of acquirers. For present purposes, s 51AC(4) and other subsections of s 51AC related to s 51AC(4) have been omitted.

behalf of the business consumer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and

(e) the amount for which, and the circumstances under which, the business consumer could have acquired identical or equivalent goods or services from a person other than the supplier; and

(f) the extent to which the supplier's conduct towards the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers; and

(g) the requirements of any applicable industry code; and

(h) the requirements of any other industry code, if the business consumer acted on the reasonable belief that the supplier would comply with that code; and

(i) the extent to which the supplier unreasonably failed to disclose to the business consumer:

(I) any intended conduct of the supplier that might affect the interests of the business consumer; and

(II) any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); and

(j) the extent to which the supplier was willing to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; and

(k) the extent to which the supplier and the business consumer acted in good faith.

. . .

(5) A person is not to be taken for the purposes of this section to engage in unconscionable conduct in connection with:

(a) the supply or possible supply of goods or services to another person; or

(b) the acquisition or possible acquisition of goods or services from another person;

by reason only that the first-mentioned person institutes legal proceedings in relation to that supply, possible supply, acquisition or possible acquisition or refers to arbitration a dispute or claim in relation to that supply, possible supply, acquisition or possible acquisition.

(6) For the purpose of determining whether a corporation has contravened subsection (1) or whether a person has contravened subsection (2):

(a) the Court must not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and

(b) the Court may have regard to circumstances existing before the commencement of this section but not to conduct engaged in before that commencement.

(7) A reference in this section to the supply or possible supply of goods or services is a reference to the supply or possible supply of goods or services to a person whose acquisition or possible acquisition of the goods or services is or would be for the purpose of trade or commerce.

. . .

(9) A reference in this section to the supply or possible supply of goods or services does not include a reference to the supply or possible supply of goods or services at a price in excess of $3,000,000, or such higher amount as is prescribed.

A number of points can immediately be made regarding s 51AB and s 51AC. Firstly, they refer to conduct that is in all the circumstances 'unconscionable' and list a number of non-exhaustive matters that the courts may take into account when considering whether or not the conduct is 'unconscionable' under the provision. Secondly, the matters listed in both sections raise both procedural and substantive unconscionability issues. Thirdly, and more importantly, as the matters in both sections are neither exhaustive nor restricted to procedural unconscionability there was some hope that the courts could seek to develop a broader notion of unconscionability that could also deal with allegations based solely on the substantive unfairness of the terms of the contract. In practice, however, there has been a natural inclination by the courts to emphasise procedural unconscionability in cases under s 51AB and s 51AC.

Indeed, the courts have noted that the terms of a contract cannot, on their own, form the basis of an action under s 51AB and s 51AC. In the words of the Full Federal Court in *Hurley v McDonald's Australia Ltd* something more is required than merely pointing to the terms of the contract:

> No allegation of unconscionable conduct is made in . . . relation to the making of the alleged contracts between McDonalds, on the one hand, and the Applicant and the group members, on the other. The allegation is simply that it would be unconscionable for McDonalds to rely on the terms of such contracts.
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> . . .
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> There is no allegation of any circumstance that renders reliance upon the terms of the contracts unconscionable. For example, it might be that, having regard to particular circumstances it would be unconscionable for one party to insist upon the strict enforcement of the terms of a contract. One such circumstance might be that an obligation under a contract arises as a result of a mistake by one party. The mistake is an additional circumstance that might render strict reliance upon the terms of the contract unconscionable. Mere reliance on the terms of a contract cannot, without something more, constitute unconscionable conduct.
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> . . .
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> Before sections 51AA, 51AB or 51AC will be applicable, there must be some circumstance other than the mere terms of the contract itself that would render reliance on the terms of the contract '*unfair*' or '*unreasonable*' or '*immoral*' or '*wrong*'.[18]

These comments have more recently been echeoed by Nicholson J in *ACCC v Lux Pty Ltd*:

> To ground a finding of contravention of s 51AB, there must be some circumstance other than the mere terms of the contract itself which renders reliance on the terms of the contract unconscionable . . .[19]

In short, s 51AB and s 51AC cannot be used by a party to prevent the enforcement of a contractual term unless there is some additional circumstance arising from the particular case that would render the enforcement of that term unconscionable. Thus, for the purposes of s 51AB and s 51AC a party to a contract is, in the absence of procedural unconscionability on their part, able to rely on the terms of a contract. Clearly,

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18 (2000) ATPR 41-741 at [24]–[31].

19 [2004] FCA 926 (unreported, 16 July 2004, BC200404429) at [94].

substantive unconscionability or the alleged unfairness of a contractual term will not, on its own, be enough to bring an action under s 51AB and s 51AC. Once again, the courts have focused on the conduct of the parties in the making of the contract or during the course of the contractual relationship rather than dealing solely with allegations that the stronger party has included terms that are not reasonably necessary to protect its legitimate interests.

This judicial focus on the conduct of the parties in the making of the contract or during the course of the contractual relationship is also found in the approach taken under s 106 of the Industrial Relations Act 1996 (NSW), a NSW statute that gives the Industrial Commission of New South Wales in Court Session (the Commission) the power to deal with an 'unfair contract' in very specific circumstances:

> (1) The Commission may make an order declaring wholly or partly void, or varying, any contract whereby a person performs work in any industry if the Commission finds that the contract is an unfair contract.
> (2) The Commission may find that it was an unfair contract at the time it was entered into or that it subsequently became an unfair contract because of any conduct of the parties, any variation of the contract or any other reason.
> (2A) A contract that is a related condition or collateral arrangement may be declared void or varied even though it does not relate to the performance by a person of work in an industry, so long as:
> (a) the contract to which it is related or collateral is a contract whereby the person performs work in an industry, and
> (b) the performance of work is a significant purpose of the contractual arrangements made by the person.
> (3) A contract may be declared wholly or partly void, or varied, either from the commencement of the contract or from some other time.
> (4) In considering whether a contract is unfair because it is against the public interest, the matters to which the Commission is to have regard must include the effect that the contract, or a series of such contracts, has had, or may have, on any system of apprenticeship and other methods of providing a sufficient and trained labour force.
> (5) In making an order under this section, the Commission may make such order as to the payment of money in connection with any contract declared wholly or partly void, or varied, as the Commission considers just in the circumstances of the case.
> (6) In making an order under this section, the Commission must take into account whether or not the applicant (or person on behalf of whom the application is made) took any action to mitigate loss.

In applying this section the Commission has emphasised that a claim of unfairness under the section would need to be considered by reference to the conduct of the parties and their individual circumstances. For example, in *Port Macquarie Golf Club Ltd v Stead*, the Full Bench of the Commission stated that:

> The nature and degree of the unfairness . . . as a matter of law, relates to ordinary standards of fairness by directing attention to the particular circumstances of the individual contract or arrangement concerned. Whether or not a contract or arrangement is unfair is a matter to be decided upon examination of the facts of each particular case: *Incitec Ltd v Barry* (1992) 45 IR 148 at 154; and *Baker v National Distribution Services Ltd* (1993) 50 IR 254 at 270.
>
> . . .

> The test of unfairness involves the commonsense approach characteristic of the ordinary juryman by applying standards providing a proper balance or division of advantage or disadvantage between the parties who have made the contract or arrangement, bearing in mind the conduct of the parties, their capability to appreciate the bargain they have made and their comparative bargaining positions when entering into the contract or arrangement; *Davies v General Transport Development Pty Ltd* (1967) 67 AR (NSW) 371 at 374; *A & M Thompson Pty Ltd v Total Australia Ltd* [1980] 2 NSWLR 1 at 13 and *Baker* at 271.[20]

While the Commission has taken a broader approach to the question of unfairness under s 106 than have the courts under the other statutory concepts of unconscionability discussed above, a Commission finding of unfairness does still very much depend on reviewing the conduct of the parties having regard to the facts of the individual case.

Overall, therefore, the courts have not only adhered to their procedural unconscionability bias when applying the existing statutory concepts of unconscionable conduct, but have refused to use these statutory concepts to deal with claims based solely on allegations that a contractual term goes beyond what is reasonably necessary to protect the legitimate interests of the stronger party. In short, unless there is an element of procedural unconscionability, the existing statutory prohibitions against unconscionable conduct will continue to be of little or no value in dealing directly with allegedly unfair contractual terms.

New directions in dealing with unfair terms in franchise agreements

Once it is recognised that the courts have refrained from using existing judicial and statutory notions of unconscionable conduct to consider allegations based solely on the unfairness of contractual terms, the question arises as to whether or not a suitable statutory framework could be developed to deal directly and effectively with such allegations. In dealing with this question, the recent adoption of a new statutory framework by the United Kingdom and the Australian State of Victoria to deal with unfair terms in consumer contracts provides very useful guidance as to how such a new framework could be developed within a commercial context like franchising.

Significantly, both the UK and Victorian frameworks begin with a definition of what constitutes an unfair term. The inclusion of a clear definition would be critical in any framework involving business to business contracts like franchise agreements. In both legislations unfair terms are defined primarily by reference to the concept of good faith and a significant imbalance in the contractual rights and obligations of the parties to the detriment of the consumer. While the two pieces of legislation have these common elements to the definition of an unfair term, there are some differences in the definitions. For example, the UK framework targets unfair terms in standard form contracts, while the Victorian framework targets unfair terms in consumer contracts generally. In particular, under reg 5 of the UK framework the focus is on terms not individually negotiated by the parties:

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20 (1996) 64 IR 53 at [5]–[7].

(1) A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.
(2) A term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.
(3) Notwithstanding that a specific term or certain aspects of it in a contract has been individually negotiated, these Regulations shall apply to the rest of a contract if an overall assessment of it indicates that it is a pre-formulated standard contract.
(4) It shall be for any seller or supplier who claims that a term was individually negotiated to show that it was.

This regulation also includes a number of safeguards to ensure that only genuinely negotiated terms will be considered to be individually negotiated, with the onus falling on the seller or supplier. In comparison, s 32W of the Victorian framework refers to a consumer contract which can include both standard and individually negotiated terms:

> A term in a consumer contract is to be regarded as unfair if, contrary to the requirements of good faith and in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer.

Although the framework does not directly exclude individually negotiated terms from its coverage, the issue of whether the term is individually negotiated remains, along with other matters, a factor to be taken into account by the court or tribunal under the Victorian framework. This list of factors is found in s 32X and is particularly noteworthy as it provides a valuable guide to the types of terms that may be considered unfair under the Victorian framework:

> **32X Assessment of unfair terms**
> Without limiting section 32W, in determining whether a term of a consumer contract is unfair, a court or the Tribunal may take into account, among other matters, whether the term was individually negotiated, whether the term is a prescribed unfair term and whether the term has the object or effect of —
> (a) permitting the supplier but not the consumer to avoid or limit performance of the contract;
> (b) permitting the supplier but not the consumer to terminate the contract;
> (c) penalising the consumer but not the supplier for a breach or termination of the contract;
> (d) permitting the supplier but not the consumer to vary the terms of the contract;
> (e) permitting the supplier but not the consumer to renew or not renew the contract;
> (f) permitting the supplier to determine the price without the right of the consumer to terminate the contract;
> (g) permitting the supplier unilaterally to vary the characteristics of the goods or services to be supplied under the contract;
> (h) permitting the supplier unilaterally to determine whether the contract had been breached or to interpret its meaning;
> (i) limiting the supplier's vicarious liability for its agents;

(j) permitting the supplier to assign the contract to the consumer's detriment without the consumer's consent;
(k) limiting the consumer's right to sue the supplier;
(l) limiting the evidence the consumer can lead in proceedings on the contract;
(m) imposing the evidential burden on the consumer in proceedings on the contract.

A similar list is provided in Sch 2 of the UK Regulations. The following terms are listed in the UK framework as being an indicative and non-exhaustive list of the terms which may be regarded as unfair:

1 Terms which have the object or effect of —

(a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
(b) inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
(c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone;
(d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
(e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
(f) authorising the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
(g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
(h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early;
(i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
(k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;
(l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
(m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;

(n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;
(o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
(p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;
(q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

2 Scope of paragraphs 1(g), (j) and (l)

(a) Paragraph 1(g) is without hindrance to terms by which a supplier of financial services reserves the right to terminate unilaterally a contract of indeterminate duration without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof immediately.
(b) Paragraph 1(j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.
Paragraph 1(j) is also without hindrance to terms under which a seller or supplier reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that he is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract.
(c) Paragraphs 1(g), (j) and (l) do not apply to:
  – transactions in transferable securities, financial instruments and other products or services where the price is linked to fluctuations in a stock exchange quotation or index or a financial market rate that the seller or supplier does not control;
  – contracts for the purchase or sale of foreign currency, traveller's cheques or international money orders denominated in foreign currency;
(d) Paragraph 1(l) is without hindrance to price indexation clauses, where lawful, provided that the method by which prices vary is explicitly described.

Where a term is found to be unfair, reg 8 of the UK framework provides that: (i) the term will be unenforceable against the supplier, and (ii) the remainder of the contract is binding provided it can continue without the unfair term. Under s 32Y of the Victorian framework an unfair term in a consumer contract is void, with the contract also continuing to bind the parties where it is capable of existing without the unfair term.

While both the UK and the Victorian framework directly target unfair terms and provide important guidance as to what may be regarded as an unfair term, the Victorian framework goes a step further by providing that not only can a term be prescribed as unfair, but that such a prescribed unfair term will be void under s 32Y when used in a standard form contract. Within this context, s 32U

of the Victorian framework defines a 'prescribed unfair term' as 'a term that is prescribed by the regulations to be an unfair term or a term to the like effect', and a 'standard form contract' is defined as 'a consumer contract that has been drawn up for general use in a particular industry, whether or not the contract differs from other contracts used in that industry'. Under s 32Z it also becomes an offence for a supplier to either use or enforce against a consumer a prescribed unfair term in a standard form contract. Thus, not only does the Victorian framework take a firm position against prescribed unfair terms, but by allowing for the prescription of unfair terms it has established a valuable mechanism for dealing swiftly and effectively with unfair terms.

In summary, the UK and Victorian frameworks aim to provide a targeted mechanism for dealing directly with unfair terms in contracts. Indeed, dealing with unfair terms in a consumer context is the sole focus of both frameworks and this allows the enforcement agency in the particular jurisdiction to go after such terms in a direct manner. In doing so, the enforcement agency has the ability to directly approach sellers and suppliers and seek their cooperation in modifying a term perceived to be unfair under the terms of the particular framework. Although a cooperative approach has been used in the overwhelming majority of cases, the enforcement agency in each jurisdiction is given sufficient powers to take enforcement action against the continued use of the allegedly unfair term. There can be no doubt that this ability under the UK and Victorian framework to pro-actively deal with unfair contractual terms in a timely manner is of considerable benefit to consumers. Not only do these regulatory frameworks seek to clearly define the nature of an unfair term covered by the framework and provide examples of the type of terms likely to be unfair, but each framework empowers the enforcement agency to take appropriate action to prevent the continued use of the allegedly unfair term.

While clearly the UK and Victorian frameworks are aimed at unfair terms in consumer contracts, a review of these frameworks reveals a number of elements that could form part of a new legislative framework for dealing with allegedly unfair terms in business to business contracts involving small businesses. These elements include:

- a clear definition of what constitutes an unfair term;
- be solely focused on substantive unfairness;
- provide a comprehensive listing of potentially unfair terms;
- contain an ability to prescribe terms accepted as being unfair;
- impose a penalty for using a prescribed unfair term;
- have a well resourced government agency enforcing the legislative framework;
- provide guidance and education to the parties covered by the legislative framework;
- allow for enforceable undertakings to be provided to the government agency;
- allow for advisory opinions by a quasi-judicial body as to whether a term is unfair under the legislative framework;
- enable private enforcement by the small business;
- require plain English drafting of contracts; and
- allow for advisory opinions by the government agency.

Such elements would allow the legislative framework to deal with allegedly

unfair contract terms in a direct and targeted manner. In doing so, they enable the framework to provide a readily accessible and transparent mechanism for identifying and dealing with unfair terms in business to business contracts involving small businesses. Importantly, the elements allow the new regulatory framework to respond to unfair terms in a way that has not been possible under the equitable doctrine of unconscionability and the existing statutory prohibitions against unconscionable conduct. In short, it is the combination of the identified elements that would allow the new legislative framework to respond to unfair terms in a direct and measured manner.

Concluding remarks

With the growing disparity of bargaining power between small businesses and the larger businesses with which they deal, it is tempting for larger business to draft terms that are not only favourable to that larger business but go further in tilting the balance of contractual rights and obligations significantly in favour of the larger business. That terms may be favourable to the larger business is to be expected. Of course, the larger business is entitled to include terms that are reasonably necessary to protect its legitimate interests. To go beyond that, however, runs the risk that contracts are being used in an oppressive or exploitative manner. As small business dealing with such larger businesses are ordinarily contractually captive and have little or no ability to prevent the larger party from changing the terms of the contract during the course of the contract, it is clear that, in the absence of any legislative or judicial restriction against the use of unfair terms, the larger business is effectively left to its own devices in deciding whether or not to go beyond what is reasonably necessary to protect its interests. While clearly some larger businesses will show self-restraint, there are those corporations which will always seek to increasingly push the boundaries in their favour. With the equitable doctrine of unconscionability and the existing statutory provisions against unconscionable conduct having a procedural unconscionability bias, it is readily apparent that these existing judicial and legislative mechanisms are of extremely limited use where the small business concern relates solely to the substantive unfairness of a contractual term. Indeed, with existing mechanisms typically only relevant where there is procedural unconscionability or, at least a mixture of procedural and substantive unconscionability, a new legislative framework may be needed to deal directly with unfair terms in business to business contracts involving small businesses. If such a new legislative framework is to be implemented it must be targeted in its operation and provide clear guidance as to what constitutes an unfair contractual term.