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28 August 2015

By E-mail

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Senate Economics References Committee
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Your Ref
Our Ref MDL ZM
File No. 011105082

Contact
Matthew Lees

Zaven Mardirossian

Dear Dr Dermody

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

Thank you for your invitation by email on 14 August 2015 to make a submission to the Inquiry into the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015.

The Bill is substantively the same as the Exposure Draft of the Bill. We previously made submissions to Treasury dated 1 August 2014 and 12 May 2015 in relation to, respectively:

- Treasury's Consultation Paper, *"Extending Unfair Contract Term Protections to Small Businesses"* dated May 2014; and
- the Exposure Draft of the Bill.

We **enclose** copies of those submissions.

The Bill does not address the issues we raised in our previous submissions. We maintain the concerns we have previously stated.

In our view, the proposed extension of the unfair contract terms regime to small businesses would significantly undermine freedom of contract and commercial certainty. It would also lead to a proliferation of commercial disputes.

The Bill would prohibit so-called "unfair terms" only when such terms occur in standard form contracts. This means the same terms can be employed without objection as long as there is a process of negotiation of the terms of the contract. As a result, businesses large and small would be required to engage in costly, time-consuming and fruitless negotiations on a transaction-by-transaction basis, without any guarantee of achieving the stated objectives of fairness, reasonableness and efficient risk allocation.

Even if the Committee was minded to extend the unfair contract terms regime to small businesses, we consider there are a number of practical difficulties with the Bill:

- the business size threshold is based on a matter (employee headcount) that is not known to the counterparty, is arbitrary and open to manipulation;
- rather than merely extending the unfair contract terms regime to protect small businesses, the Bill would apply that regime to all types of goods and services, whereas it is currently limited to consumer products;
- the unfair contract terms regime would, under the Bill, apply to contracts between two small businesses; and
- the broad and open-ended nature of the regime makes it inappropriate to apply to the standard terms of a small business.

These matters are addressed in further detail in our previous submissions.

If (contrary to our submissions) the current unfair contract terms regime is to be extended to apply to small businesses, we urge the Committee to give further consideration to the alternative proposal put forward in our previous submissions. Our alternative proposal was to limit the regime to consumer products — in other words, to a supply of goods or services, or a sale of an interest in land, "*to a person* [which can be an individual or company] *where the goods or services are of a kind ordinarily acquired for personal, domestic or household use or consumption*".

As a second element of our alternative proposal, we also argued that the unfair contract terms regime should not apply to goods or services that are acquired for the purpose of re-supplying them in trade, consuming them in the course of a process of production or manufacture or, in the case of goods, repairing or treating, in trade, other goods or fixtures on land. Such exclusions would be consistent with the exclusions under the New Zealand unfair contract terms regime that commenced in March 2015. There are also similar exclusions in the definition of "consumer" in s 3(2) of the *Australian Consumer Law*.

Our alternative proposal would have a number of advantages compared to the provisions of the Bill:

- It would mean that businesses (big or small) would have the same rights as individuals when they buy the same goods or services.
- It would avoid the compliance costs of extending the unfair contract terms regime to goods and services that are not already affected by that regime.
- It would avoid the difficulty of trying to define what is a "small business", and thus be clearer and provide greater business certainty.
- It would be consistent with the law in New Zealand.

Our proposal is referred to on page 76 of the Explanatory Memorandum, as part of the Regulation Impact Statement. It is noted that our proposal would be

consistent with the unfair contract term provisions for small businesses introduced in New Zealand this year. A similar proposal was apparently also made by the New Zealand Law Society as part of its submission to Treasury.

There is nothing in the Explanatory Memorandum to indicate that our alternative proposal was given proper consideration. It is referred to under the heading of "*Defining small business*" (page 75) when, in fact, our alternative proposal avoids entirely the difficulty of defining small business. Further, our alternative proposal is not considered as part of, or an alternative to, the Commonwealth's preferred option (Option 3) of legislating to extend the existing unfair contract terms regime to small businesses (page 79).

Please do not hesitate to contact us if you have any queries.

Yours sincerely

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12 May 2015

By Internet Upload

Consumer Policy Framework Unit
Small Business Competition and Consumer Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

Your Ref
Our Ref MDL ZM
File No. 011105082

Contact
Matthew Lees

Zaven Mardirosslan

Dear Sir / Madam

Submission on Exposure Draft to Extend Unfair Contract Term Protections to Small Businesses

Thank you for your email on 28 April 2015, identifying us as a key stakeholder in the consultation process and inviting us to make a formal submission.

We welcome the opportunity to make the following submission on the Exposure Draft of the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015 (**Exposure Draft**).

Introduction

This submission follows our submission dated 1 August 2014 in response to your Consultation Paper, *"Extending Unfair Contract Term Protections to Small Businesses"* dated May 2014 (**Consultation Paper Submission**, copy enclosed), which was referenced in your *Decision Regulation Impact Statement: Extending Unfair Contract Term Protections to Small Businesses* (2015).

In our Consultation Paper Submission, we acknowledged that the Government made an election commitment in 2013 to extend the current consumer unfair contract terms regime to protect small businesses. However, for the legal and practical reasons set out in this submission, we consider that the Exposure Draft does not meet its stated objectives, and unnecessarily reduces contractual freedom and certainty.

In summary, we are concerned that, under the Exposure Draft:

- the proposed business size threshold is based on a matter (employee headcount) that is not known to the counterparty, is arbitrary and open to manipulation;
- rather than being a mere extension of the unfair contract terms regime to protect small businesses, the regime would apply to all types of goods and services, whereas the regime is currently limited to consumer products;
- the unfair contract terms regime would apply to contracts between two small businesses;

- the broad and open-ended nature of the regime makes it inappropriate to apply to the standard terms of a small business; and

- the regime requires the parties to engage in costly negotiations on a transaction-by-transaction basis, without guaranteeing that it will meet the stated objectives of fairness, reasonableness and efficient risk allocation.

Accordingly, we again propose that, if the unfair contract terms regime is to be extended to protect small businesses, the protection should be limited to consumer products. This would be consistent with the law in New Zealand.

The Exposure Draft

The Exposure Draft would amend the *Australian Consumer Law* (**ACL**), and the corresponding provisions of the *Australian Securities and Investments Commission Act 2001* (Cth), to extend the current consumer unfair contract terms regime to prohibit unfair terms in standard form contracts that are "small business contracts".

A contract would be a "small business contract" if:

- at least one party is a "small business" — that is, it employs fewer than 20 persons (not including casual employees, unless employed on a regular and systematic basis); and

- the upfront price payable under the contract (excluding any interest) does not exceed:
  - $100,000; or
  - if the duration of the contract is more than 12 months, $250,000.

As explained in the *Decision Regulation Impact Statement*, the stated objective of the Exposure Draft is to promote fairness, reasonableness and efficient risk allocation in contractual dealings with small businesses.[1]

Further, the Commonwealth considers its proposed business size threshold[2]

> "achieves an appropriate balance between protecting those businesses most likely to lack sufficient resources and bargaining power with regard to unfair terms, while preserving contractual freedom and certainty and encouraging businesses to take reasonable steps to protect their interests."

However, for the reasons stated below, we are concerned about the ability of the Exposure Draft to meet these objectives.

[1] *Decision Regulation Impact Statement*, p11.
[2] *Decision Regulation Impact Statement*, p25.

Consultation Paper Submission

In our Consultation Paper Submission, we submitted that the proposed extension of the unfair contracts regime is unwarranted and not in the interests of small businesses, or businesses generally. In summary, this is because:

- The proposed extension would undermine the certainty of contract that businesses big and small require in order to conduct their commercial operations effectively and plan for the future.
- Standard form contracts are efficient, and avoid significant costs associated with negotiating subsidiary terms on a transaction-by-transaction basis.
- Small businesses are already protected by a range of laws, including the laws against misleading or deceptive conduct, the laws against unconscionable conduct, and the "consumer guarantees" under the ACL.
- It will be less attractive to deal with businesses that are covered by the unfair contract terms regime, and this may ultimately harm the businesses the regime is intended to protect.

We maintain those concerns.

We turn now to the Exposure Draft.

Concerns regarding the Exposure Draft

The proposed business size threshold

First, a fundamental difficulty of the proposed extension to protect small businesses is defining what is a "small business".

In terms of preserving business certainty, the proposed business size threshold is undesirable because the number of employees within a business is not a matter which a counterparty can reasonably be expected to know — let alone the status of any casual employees.

If the parties have an ongoing business relationship, they may have some idea of the size of each other's workforce. However, for one-off transactions — such as purchases over the internet — where standard form contracts offer considerable efficiencies, a business would have no idea how many employees its counterparty has.

The proposed threshold is also arbitrary. It cannot be seriously contended that a business with 19 employees requires protection, but a business with 20 employees does not. There are also businesses in Australia that have fewer than 20 employees, but are nevertheless highly-sophisticated, well-resourced and do not suffer from a lack of bargaining power.

The Explanatory Memorandum states that a threshold of less than 20 employees was chosen *"as it is a commonly used head count measure and has been found by the Australian Bureau of Statistics to provide a good proxy of small businesses"*. However, that does not mean that the headcount measure is

a good proxy for whether a business lacks "sufficient resources and bargaining power with regard to unfair terms", such as to warrant protection under the unfair contract terms regime.

Further, as the threshold is something that is within the control of business, it may encourage behaviour to try to take advantage of the laws inappropriately. For example, a large company could set up a small subsidiary, employing fewer than 20 persons, to carry out its procurement activities.

In this regard, we note that the Exposure Draft refers to a "small business" (which is defined as a type of "business") being party to a "small business contract". This drafting is not appropriate because it is persons (whether natural or legal such as bodies corporate) that are parties to contracts, not "businesses". It is therefore unclear whether employees of related bodies corporate are included in the headcount threshold.

Under our alternative proposal explained below, the proposed business size threshold would be unnecessary. This is because the application of the unfair contract terms regime would depend on the nature of the goods or services being acquired under the relevant contract, regardless of whether the acquirer is an individual or a company/business and regardless of the size of the company/business.

Extension to non-consumer products

Second, the current unfair contract terms regime is limited to "consumer contracts" under which an individual acquires goods, services or an interest in land *"wholly or predominantly for personal, domestic or household use or consumption"* (ACL s 23(3)). There is no similar limitation on the type of goods or services in the proposed definition of a "small business contract" under the Exposure Draft. As a result, the unfair contract terms regime would apply to all manner of goods or services, subject only to the business size threshold and the maximum limit of the upfront price payable.

This would be a fundamental change to the unfair contract terms regime, which would apply to many areas of business where it has never previously applied.

For example, as stated in our Consultation Paper Submission, we consider that the unfair contract terms regime should not be extended to contracts for financial products and services provided to small businesses. Given the nature of financial products and services, and the risks involved, it is fundamental that such contracts be certain and enforceable. Further, the increased uncertainty associated with the application of the unfair contract terms regime will make it less attractive for lenders to lend money to small businesses.

Moreover, the Exposure Draft would mean that the protections afforded to small businesses under the unfair contract terms regime go beyond the protections provided to consumers, who are only protected in respect of their acquisition of consumer products.

In our view, this goes well beyond what is required to achieve the Commonwealth's objective and stated policy of extending the current unfair contracts regime to protect small businesses.

We address this issue further in our alternative proposal below.

Contracts between two small businesses

Third, despite the stated objectives of the Exposure Draft, the proposed extension of the unfair contract terms regime is not limited to situations where there is a lack of "bargaining power" or "sufficient resources" by one party.

In particular, the extended regime would apply to contracts between two small businesses. This limits the ability of small businesses to use standard form contracts and would necessarily force them to negotiate the subsidiary terms of their contracts repeatedly on a transaction-by-transaction basis. This would place a considerable strain on the already-limited time and resources of small businesses. It would not be a desirable or efficient use of those resources.

Broad and open-ended laws

Fourth, the unfair contract laws are drafted in broad and open-ended terms. As a result, there is scope for significant dispute and litigation about whether a term is "unfair" and even whether a contract is a "standard form contract".

This breadth and uncertainty may be acceptable where the regulator or a consumer is able to challenge the standard form contract terms of a business. However, if a small business' standard terms are being challenged in litigation by another "small business" (which may, in fact, be well-resourced), the small business whose standard terms are being challenged may be considerably disadvantaged due to its limited resources. In that situation, the small business would also face the rebuttable presumptions:

- under ACL s 24(4), that any term that advantages it is not reasonably necessary to protect its legitimate interests, which indicates that the term is unfair; and
- under ACL s 27(1), that a contract is a standard form contract.

The proposed extension would therefore plainly increase the risk that a small business will not be able to enforce its standard contract terms against a well-resourced "small business".

Failure to address the fundamental issues

Fifth, despite the stated objectives of the Exposure Draft, the proposed extension does not alter any underlying lack of resources or bargaining power, nor does it guarantee fairness, reasonableness or efficient risk allocation. The proposed extension operates by restricting the ability of businesses to use standard form contracts for subsidiary terms. Ultimately, the proposed extension may result in the parties agreeing the same subsidiary contract terms, but after they have spent time and cost negotiating — a cost the stronger party may be expected to seek to recoup from the weaker party through the "upfront price payable".

We note that the "upfront price payable" and terms that define "the main subject matter of the contract" are excluded from the scope of the unfair contracts regime (ACL s 26).

Not directed towards efficient risk allocation

Sixth, although efficient risk allocation is stated to be one of the objectives of the proposed extension of the unfair contract terms regime, that concept is not present in either the current regime or the Exposure Draft. Rather, whether a term is "unfair" is to be determined by the court based on open-ended and contestable concepts such as (ACL s 24):

- significant imbalance in the parties' rights and obligations;
- reasonable necessity to protect the "legitimate interests" of a party;
- "detriment (whether financial or otherwise) to a party"; and
- "transparency" — which means whether the term is expressed in "reasonably plain language", legible, presented clearly and readily available.

These concepts are not the same as efficient risk allocation and, if efficient risk allocation is an objective of the Exposure Draft, it would desirable for that objective to be expressly recognised in the legislation.

Our Alternative Proposal

In our Consultation Paper Submission, we proposed that if, contrary to our submissions, the current unfair contract terms regime is to be extended to apply to small businesses, it should be limited to consumer products — in other words, to a supply of goods or services, or a sale of an interest in land, "*to a person* [which can be an individual or company] *where the goods or services are of a kind ordinarily acquired for personal, domestic or household use or consumption*".

The *Decision Regulation Impact Statement* acknowledged our alternative proposal, and the similar position in New Zealand raised by the New Zealand Law Society in its submission.[3] No reason is given for why our proposal or the New Zealand position was not supported. The *Decision Regulation Impact Statement* simply states that the Commonwealth's proposed business size threshold is "consistent"[4] with the preferred option (Option 3) to legislate to extend the consumer unfair contract term protections to small businesses.

Our proposed alternative approach is also consistent with the Commonwealth's stated policy of extending the unfair contract terms regime to protect small businesses. Further, as we submitted in our Consultation Paper Submission, our proposed alternative approach would also:

- mean that businesses (big or small) would have the same rights as individuals when they buy the same goods or services;

[3] *Decision Regulation Impact Statement*, p38.
[4] *Decision Regulation Impact Statement*, p41.

- avoid the compliance costs of extending the unfair contract terms regime to goods and services that are not already affected by that regime;
- avoid the difficulty of trying to define what is a "small business"; and
- be more consistent with the law in New Zealand, following the commencement of its unfair contract terms regime in March 2015.

The New Zealand unfair contract terms regime does not apply to goods or services that are acquired for the purpose of re-supplying them in trade, consuming them in the course of a process of production or manufacture or, in the case of goods, repairing or treating, in trade, other goods or fixtures on land. Similar exclusions are included in the definition of "consumer" in s 3(2) of the ACL.

In our view, it is appropriate to have such exclusions in the Australian unfair contract terms regime in the interests of preserving contractual freedom and certainty. However, if the Commonwealth considers that those exclusions go too far and are not consistent with its objectives, the exclusions could be omitted so that the unfair contract terms regime would apply to consumer products that are acquired for purposes such as re-supply or manufacture.

For the reasons stated in this submission and our Consultation Paper Submission, we submit that further consideration should be given to our alternative proposal, rather than that contained in the Exposure Draft.

Yours faithfully

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1 August 2014

By Internet Upload

Unfair Contract Terms Consultation Paper
Small Business, Competition and Consumer
Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

Your Ref
Our Ref MDL ZM
File No. 011105082

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Dear Sir / Madam

Submission on Extending Unfair Contract Term Protections to Small Businesses

1 We refer to the Treasury's Consultation Paper, "*Extending Unfair Contract Term Protections to Small Businesses*" dated May 2014.

2 We welcome the opportunity to make the following submission in response to the Consultation Paper.

The Proposed Extension is Unwarranted and Not in the Interests of Small Businesses

3 At the outset, we acknowledge that the Commonwealth Government has committed to extending the current consumer unfair contract regime to small businesses. This was set out in the Coalition's *Real Solutions for All Australians* policy document in January 2013, before the Federal election. However, in our view and experience acting for small and large businesses, the proposed extension is unwarranted and not in the interests of businesses generally, or in the interests of small businesses.

4 The proposed extension would undermine freedom of contract and, perhaps even more importantly, certainty of contract. Certainty is critical for all businesses. In order to make plans and invest for the future, businesses need confidence that when they make a contract the deal is the deal. Making the enforceability of contracts uncertain is particularly harmful to small businesses, who cannot realistically afford the significant time, expense and additional uncertainty of litigation through the courts.

5 The current unfair contract regime in Part 2-3 of the *Australian Consumer Law* is inherently uncertain. It does not merely prohibit specific clauses that, in effect, would deny one party the entire benefit of the contract. Rather, the regime prohibits all "*unfair terms*" in "*standard form contracts*". Both of those concepts are defined not by precise criteria but rather by lists of various matters that a court may or must take into account in forming an essentially subjective view as to whether

a contract term is "*unfair*" or whether a contract is a "*standard form contract*". Such broad definitions may be appropriate to protect consumers but, in our view, they should not be introduced into commercial dealings between businesses.

6 The Consultation Paper argues that small businesses, "*like consumers, can lack the time and legal or technical expertise to critically analyse contracts, and the power to negotiate.*" In our submission, the analogy is inappropriate. Unlike consumers, businesses are about creating value and this inevitably involves operating efficiently and taking risks. All businesses can face time pressures and this may or may not be a real barrier to reading a standard form contract. Depending on the length of a standard form contract, reading it might typically take anywhere from 5 minutes to an hour. Further, there is no shortage of external legal or technical expertise available to businesses. The question for all businesses is how they should best allocate their time and financial resources. Similarly, a lack of bargaining power or other ability to negotiate amendments to contract terms does not mean a business has no interest in knowing or understanding what it would be agreeing to if it enters into the contract.

7 In our experience, if a business does not analyse a standard form contract before agreeing it, that is because the business considers it is not *worthwhile* to spend the time or other resources to do so. In other words, it is more efficient to assess and accept the level of risk associated with the standard terms than to spend resources critically analysing those terms.

8 In this context, it is important to understand the scope of the current unfair contracts regime. Under s 26 of the *Australian Consumer Law*, the regime does not affect the most important contract terms — those that define the main subject matter of the contract or set the price. The regime only applies to lesser, subsidiary terms. Those are precisely the types of terms that are appropriate and efficient to be specified in standard form contracts that are proffered and accepted, rather than being subject to detailed critical analysis and negotiation on every transaction. For businesses, and even for consumers, legal analysis and negotiation are not ends in themselves. Whilst it might seem fairer for supermarket shoppers to have the opportunity to negotiate the price of each grocery product, rather than accept or reject the supermarket's take-it-or-leave-it offer, that would dramatically increase waiting times at the checkout.

9 Further, small businesses are already protected by a range of laws, including:

(a) misleading or deceptive conduct under Part 2-1 of the *Australian Consumer Law*;

(b) unconscionable conduct in Equity and under Part 2-2 of the *Australian Consumer Law*; and

(c) the "consumer guarantees" under Division 1 of Part 3-2 of the *Australian Consumer Law.*

10 In particular, under s 3 of the *Australian Consumer Law*, the "consumer guarantees" protect individuals and businesses that purchase goods or services where:

(a) the price does not exceed $40,000; or

(b) the goods or services are of a kind ordinarily acquired for personal, domestic or household use or consumption; or

(c) the goods are a vehicle or trailer for use principally in the transport of goods on public roads;

provided that, in the case of goods, the goods were not acquired for the purpose of resupply or to be used up or transformed in a production, manufacturing, repair or treatment process.

11 Importantly, the protections of the laws referred to in paragraph 9 above cannot be excluded by contract, whether standard form or otherwise.

12 The proposed extension would also increase red-tape and the regulatory burden on businesses, including small businesses.

Definition of "Small Business"

13 The Consultation Paper highlights a further difficulty with the proposed extension of the current consumer unfair contract regime to small businesses. The difficulty is how to define what is, and what is not, a "small business". This inherent difficulty means that attempting to apply the unfair contracts regime based on the size of the relevant business will likely result in the arbitrary application of the provisions and increased uncertainty (and cost) for businesses. Many businesses may seek to portray themselves as small businesses in order to gain an advantage by being subject to the regime. Further, counterparties will not know whether they are contracting with a business that is a "small business" or not.

14 If, contrary to our submission above, the current unfair contract term regime is extended to apply to small businesses, the application of the regime should depend on the nature of the goods or services being acquired under the relevant contract, regardless of whether the acquirer is an individual or a business. Under s 23(3), the current regime applies to a supply of goods or services "*to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption*". This could be amended so that the regime applies to a supply of goods or services "*to a person* [which can be an individual or company] *where the goods or services are of a kind ordinarily acquired for personal, domestic or household use or consumption*".

15 This approach would mean that the extension of the unfair contracts regime is limited to suppliers and to goods and services that are already, by and large, affected by the unfair contracts regime because those suppliers supply those goods or services to individuals. In other words, the extension of the unfair contracts regime in this way would give small businesses the same rights as individuals when they buy the same goods or services, but it would not impose the costs of compliance on suppliers who previously have not been subjected to the unfair contracts regime.

16 The proposed approach would also be clearer and more certain than applying the unfair contracts regime based on matters such as the number of employees or the turnover of a business. Those are matters that a counterparty cannot be expected to know.

17 The proposed approach is also largely consistent with that taken in New Zealand to the application of unfair contract term provisions. The application of the unfair contract term provisions under the New Zealand *Fair Trading Act 1986*, which are due to come into force in 2015, will be based on whether the goods or services are of a kind ordinarily acquired for personal, domestic or household use or consumption (other than for purposes such as resupply).

Financial Products and Services

18 In our view, the unfair contract regime should not be extended to contracts for financial products and services provided to small businesses. The nature of financial products and services, and the risks involved, means that it is particularly important that contracts for such products and services are certain and enforceable. Extending the unfair contract regime to financial products and services provided to small businesses would increase uncertainty about the enforceability of financial contracts. We expect that this would increase the cost of finance to small businesses because of lenders' concerns about the risks of lending to small businesses subject to the operation of the unfair contract regime. Such a result would be a disaster for both small businesses and the economy more generally.

Yours sincerely

Zaven Mardirossian
Partner

Matthew Lees
Partner