

## Chapter 7

### Prohibited contract terms and contract terms exempt from the bill's provisions

7.1 This chapter looks at two aspects of the bill: the provision for the Minister to prohibit certain contract terms and the provision to exempt certain terms of a given contract from the bill's provisions.

#### Prohibited contract terms

7.2 The bill states that a prohibited term of a consumer contract is a term of a kind prescribed by the regulations (subsection 6(4)). Subsections 6(2) and 6(3) state that:

- a person must not include, or purport to include, a prohibited term in a consumer contract that is a standard form contract; and
- a person must not apply or rely on, or purport to apply or rely on, a prohibited term of a consumer contract that is a standard form contract.

It adds that in both cases, a pecuniary penalty may be imposed for a contravention (see chapter 8).

7.3 The EM states that no regulations are proposed to be made at the present time and so there are no prohibited terms. Prohibited terms in the ACL may be prescribed by the Minister in accordance with the requirements for the amendment of the ACL (Part XI of the TPA and the Intergovernmental Agreement). Any future prohibition of terms in regulations made by the Minister is subject to a voting process for amending the ACL as set out in the IGA as well as the Australian Government's best practice regulation requirements.<sup>1</sup>

7.4 Prohibited terms under the ASIC Act may be prescribed by the Minister in accordance with the requirements for the amendment of the ASIC Act set out in the *Corporations Agreement 2002*.<sup>2</sup>

#### Views

7.5 The Law Council of Australia has expressed concern at the potential for the legislation to 'ban terms outright'. It argued that 'whether a term is fair or unfair is wholly dependent on the relevant circumstances of each case'.<sup>3</sup> Mr Dave Poddar, Chair of the Council's Trade Practices Committee, told the committee that:

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1 *Explanatory Memorandum*, p. 27.

2 *Explanatory Memorandum*, p. 28.

3 Law Council of Australia, *Submission 47*, p. 2.

Whether or not a particular term is unfair should always be dependent upon the assessment of that term in its context and take into account all relevant circumstances. Other regulators have taken the view that a term may be fair in one context but unfair in another. An approach which requires assessment of all the relevant circumstances in every case would maintain the flexibility required for efficient and effective regulation of consumer contracts. Such an approach would be consistent with comparable regimes and does not risk the unintended consequences that may occur, particularly given no economic cost-benefit analysis appears to have been done.<sup>4</sup>

7.6 In this context, the Law Council defended the use of a unilateral variation clause noting that while it may 'on its face' seem unfair, suppliers clearly require some flexibility to vary the terms of their arrangement 'from time to time'.<sup>5</sup> It noted that suppliers cannot reasonably be expected to separately negotiate and agree to variations with millions of customers. Nor would customers expect this to be the case.

7.7 The Law Council cited the Victorian experience to support its argument that an ability to ban terms outright is not needed under the national unfair contract terms law. While there is provision in the Victorian *Fair Trading Act* to proscribe and prohibit certain terms, no term has been proscribed in the 6 years that the Act has operated.<sup>6</sup>

7.8 ABACUS has also argued that whether or not a term is unfair should be judged on all the relevant circumstances of each case. In this context, it feared that despite their efforts in trying to ensure that their standard-form contracts are fair, it will not know until the contract has been signed as subsequent proceedings taken against the term.<sup>7</sup>

7.9 Various submitters also expressed concern at what they saw as the bill's inadequate basis for consulting with stakeholders in prohibiting a term. The Law Council, notably, argued that the process by which the government proposes to ban terms outright is:

...devoid of any independent or stakeholder consultation and although the Minister has stated that the process will be subject to the Government's "best practice regulation" processes and an intergovernmental voting process, these alone do not amount to adequate safeguards for what is a very important power, and one that has the potential to have widespread detrimental effects if exercised incorrectly.<sup>8</sup>

7.10 Mr Poddar elaborated on these concerns to the committee:

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4 Mr Dave Poddar, *Proof Committee Hansard*, 21 August 2009, p. 31.

5 Law Council of Australia, *Submission 47*, p. 2.

6 Law Council of Australia, *Submission 47*, p. 3.

7 Mr Mark Degotardi, *Proof Committee Hansard*, 21 August 2009, p. 27.

8 Law Council of Australia, *Submission 47*, p. 3.

...there will be government processes and, as part of COAG, the government and the states will consider very carefully as to what provisions are prohibited, but we have seen no other guidance. We have expressed concerns that there is no economic analysis. There have been no underpinnings to show that a government body's decreeing that provisions are inappropriate has been subject to any cost-weighting or benefit economic analysis. We also believe that that is inappropriate because that does not go through parliament to actually ban those types of provisions.<sup>9</sup>

7.11 Similarly, FOXTEL has observed the process of subjecting a term to a general test of unfairness (subsection 3(1)) before prescribing a term as prohibited 'is not clearly drafted in the ACL'. It noted that Victoria's *Fair Trading Act 1999* provides for the Governor in Council to make regulations for or with respect to prescribing unfair terms which are unfair terms for the purposes of Part 2B of the Act. FOXTEL recommended that the regulation making power should 'mirror the approach' taken in Victoria.<sup>10</sup>

7.12 Colonial First State Property Management has argued that the (draft) bill give a court 'extraordinarily wide discretion' to determine what an unfair contract is or when a contract is not a standard form contract.<sup>11</sup>

7.13 Mr Ian Tonking SC noted in his submission that there is nothing in the exposure draft of the bill which provides any criteria for the proscription of a prohibited term. He drew the committee's attention to the clause in subsection 6(3) of the bill that 'a person must not apply or rely on, or purport to apply or rely on, a prohibited term', and the EM's definition of the expression 'rely on' as including 'asserting the existence of a right conferred, or purportedly conferred' by a term.<sup>12</sup> He argued that:

It is clear from this definition that the prohibition in s.6 would prevent a person from disputing in a court of law or elsewhere whether a particular term was a prohibited term and whether the contract in which it was included was a standard form contract...

One of the consequences of s.6(3) therefore is that, once another party to a [sic] contract has made an assertion that a particular term of the contract has the characteristic of being a prohibited term of a standard form contract, regardless of whether that assertion is made genuinely or has any proper foundation, the other party will be prohibited, under pain of exposure to a pecuniary penalty (and presumably an injunction if applied for), from asserting the contrary, whether in negotiations or in a court of law. A further consequence will be that any legal representative of the party against whom such an assertion is made will be exposed to the possibility of a

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9 Mr Dave Poddar, *Proof Committee Hansard*, 21 August 2009, p. 38.

10 FOXTEL Management Pty Ltd, *Submission 7*, p. 1.

11 Colonial First State Property Management, *Submission 11*, p. 4.

12 Mr Ian Tonking SC, *Submission 4*, p. 7. See also *Explanatory Memorandum*, p. 28.

pecuniary penalty if that person is knowingly involved in asserting the existence of a right conferred, or purportedly conferred, under the contested term, even if appearing in court!

It surely was not the intention to alter the rights of parties to a contract to this extent, namely that, by mere assertion, one party can achieve the result that a particular term of a contract is automatically rendered void because the other party risks exposure to a civil penalty if that party seeks to contest the assertion.<sup>13</sup>

7.14 The BCA focused its criticism on the compliance costs: every time a new term is deemed 'unfair', businesses will need to review all their standard-form contractual agreements and prepare new documents.<sup>14</sup>

### **Contract terms that are exempt from the bill's provisions**

7.15 Section 5 of the bill exempts terms from the unfair contract term provisions in section 2 if they define the subject matter of the contract, establish the upfront price payable under the consumer contract or are required or expressly permitted by a law of the Commonwealth, State or Territory.<sup>15</sup>

7.16 Terms that define the main subject matter or upfront price are often referred to as the 'core terms' of the contract.<sup>16</sup> The Consumer Action Law Centre has noted that the exclusion for core terms is based on the rationale that consumers are much more likely to be 'aware of, consider and negotiate' over these terms than other contract terms.

7.17 However, the Law Council has argued that the bill's exclusion of the upfront price may lead to unintended consequences. As Ms Bodger from the Council's Trade Practices Committee explained:

'Up-front price' does not include the payment of any charge or fee which is contingent on an event. For example, it would not pick up an early termination charge. The issue is that a lot of those sorts of charges go into the whole cost modelling for businesses. If they are carved out, it will lead to uncertainty as to whether that charge would be able to be relied upon and therefore whether or not businesses need to redo their pricing models for certain goods and services and bring all the prices up front. It is also thought that if these prices are made very clear, up front, fully disclosed, clearly disclosed, transparent, the ability for a consumer to argue that it was unfair when they had knowledge of it may not be the right balance between supplier and consumer.<sup>17</sup>

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13 *Submission 4*, pp. 7–8.

14 Business Council of Australia, *Submission 20*, p. 3.

15 Schedule 2, Part 2, Division 1, Section 5.

16 Consumer Action Law Centre, *Submission 19*, p. 7.

17 Ms Bodger, Proof Committee Hansard, 21 August 2009, p. 32.

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*'Excluded assessment' and 'excluded term' constructions—subsection 5(1)*

7.18 The Consumer Action Law Centre has expressed concern that while section 5 is intended to be based on the similar provision in the 1999 UK regulations, it is drafted differently. Whereas the UK regulations provide that the assessment of fairness of a term 'shall not relate to' the subject matter or price, the bill states that:

Section 2 does not apply to a term of a contract to the extent that, but only to the extent that, the term: ... (b) sets the upfront price payable under the contract.

7.19 The Centre explains in its submission that the UK provisions only exclude core terms from assessment for unfairness to the extent that the unfairness is alleged to relate to the main subject matter or upfront price. They are otherwise assessable for unfairness. This is called the 'excluded assessment' construction of the provisions. Conversely, the bill's approach entirely excludes core terms from any assessment for unfairness, regardless of whether the unfairness is alleged to arise from a different aspect of the terms. This approach is known as the 'excluded term' construction.<sup>18</sup>

7.20 The Centre recognises that the bill's phrase 'only to the extent that' may mean that the bill follows an 'excluded assessment' approach. However:

...because it is drafted differently to the UK provision this is less clear, and will probably only be determined following a superior court decision on the issue.<sup>19</sup>

7.21 The Centre argued that it needs to be made clear that section 5 only excludes terms from the unfairness test to the extent that any unfairness relates to the main subject matter or the upfront price. These terms are void for other types of unfairness.

### ***Views on other aspects of Section 5***

7.22 The Consumer Action Law Centre is strongly supportive of subsection 5(2) of the bill. This subsection states that the 'upfront price' payable under a consumer contract is disclosed at or before the time the contract is entered into 'but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event'. It noted in its submission that it had concerns that exempting the core term of 'upfront price' would risk creating a loophole for suppliers to avoid scrutiny by imposing additional fees and charges. The Centre is satisfied that this loophole has been closed.

7.23 GE has argued that the exemption on terms which establish the upfront price payable is not sufficiently drafted. It claims that 'clear upfront disclosure, and transparency to the consumer, of the price of products or services under an agreement, should be sufficient to indicate that a price is not unfair'. In other words, in these

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18 Consumer Action Law Centre, *Submission 19*, p. 8.

19 Consumer Action Law Centre, *Submission 19*, p. 8.

circumstances, the consumer would enter (or not enter) into an agreement with a clear understanding of the effect of the relevant term. GE argues it is unjustifiable for these prices to be reviewed at a later stage as 'unfair'.<sup>20</sup>

7.24 GE has also criticised the bill's exemption of 'terms required or expressly permitted by law' for being too narrow. It argued that the exemption should be broadened to exempt terms 'where it is clear that such terms are consistent with, and contemplated by, a law or laws'.<sup>21</sup>

7.25 While strongly supporting the exclusions in section 5 of the bill, ABACUS has argued that the exclusion of price terms in subsection 5(1b) should be broadened to exclude all price terms. It noted that financial institutions need to set and re-set fees on a regular basis and feared that 'without a carve out for price terms a major fee challenging industry will develop'.<sup>22</sup>

7.26 The Investment and Financial Services Association (IFSA) is concerned that the bill applies to standard form contracts for financial products and financial services. It argued that the concepts in the bill will create overlap with other Acts to which the sector is bound and will thereby result in greater uncertainty within the sector. Accordingly, IFSA recommended that:

- (1) clause 5 of the exposure draft which excludes certain terms in a standard form contract should be expanded beyond the use of certain terms to exclude specified types of documents. They would include, but should not be limited to, a standard form document:
  - i) that is required by law to be provided to a consumer/investor in relation to the provision of a financial product or service; and
  - ii) the content of which is prescribed by law; and
  - iii) that is subject to regulatory supervision under the relevant law; and
  - iv) in respect of which the consumer/investor has statutory right of redress.

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20 GE, *Submission 26*, p. 2.

21 GE, *Submission 26*, p. 3.

22 ABACUS, *Submission 33*, p. 6.