THOMSON GEER
LAWYERS

ADVICE | TRANSACTIONS | DISPUTES
Domestic & Cross Border

COMPETITION AND CONSUMER LAW ALERT

PROPOSED EXTENSION OF "UNFAIR CONTRACT" LAWS TO BUSINESS TO BUSINESS TRANSACTIONS

28 MAY 2014

On 23 May 2014, the Commonwealth Department of Treasury released a consultation paper outlining proposals to extend unfair contract term protections to small businesses.

The proposal to extend unfair contract protection to small business is not unexpected. It implements a key part of the Liberal Party's election policy, which was described in its "Our Plan: Real Solutions for Real Australians" policy document as follows:

> *We will extend unfair contract protection currently available to consumers, to small business. We will ensure that big and small business get a 'fair-go' and do the right thing by each other in their respective marketplaces, delivering real and lasting benefits to consumers.*[1]

However, if implemented at their widest, the changes proposed will be much more extensive than many had expected, and could considerably alter the competitive landscape in Australia.

All businesses that use "standard form" terms and conditions should be aware of what is proposed and consider how it may impact on their business.

There is an opportunity to make submissions to the government on the proposed new laws before 1 August 2014.

THE CURRENT UNFAIR CONTRACTS LAWS

There is already an unfair contracts law in Australia, but currently it only applies to standard form "consumer contracts".[2] Consumer contracts are contracts for the supply of goods or services to an individual whose acquisition is wholly or predominantly for personal, domestic or household use or consumption.

What is proposed in the consultation paper, is to extend that regime to cover business to business dealings where one of the businesses is a "small business", so it is important to understand how the current regime works.

Under the current unfair contracts regime, a term in a consumer contract will be void where:

[1] *http://bit.ly/webcontentbusiness (Accessed 23 May 2014)*

[2] *Part 2-3 of the Australian Consumer Law (contained in Schedule 2 of the Competition and Consumer Act 2010 (Cth)*

- the contract is a *standard form contract*; and
- the term is *unfair*.

What is a standard form contract?

All contracts will be standard form contracts unless otherwise established. The burden of displacing this rebuttable presumption rests with the party seeking to rely on the term.

Factors taken into account by the Court include the bargaining power of the parties, whether the contract was prepared by one party before any discussion between the parties occurred relating to the transaction, whether the contract was presented as a 'take it or leave it' proposition, whether another party was given an effective opportunity to negotiate the terms of the contract and whether the terms of the contract take into account the specific characteristics of another party or the particular transaction.

Essentially, any contract which is typically not negotiated, or negotiated only in relation to incidental terms (potentially including price, scope of services, quantities of goods, etc) rather than the substantive legal provisions of the contract.

When is a term unfair?

A term will only be regarded as 'unfair' if it meets three tests:

- the term must cause a significant imbalance in the parties' rights and obligations under the contract;
- the term must not be reasonably necessary to protect the legitimate interests of the party advantaged by the term; and
- the term must cause financial or other detriment to a consumer if it were relied on.

In determining whether the term is unfair, the court will take into account the extent to which the term is transparent (that is, expressed in reasonably plain language, legible, presented clearly and readily available to the party affected by the term) and will also taken into account the contract as a whole.

The Australian Consumer Law provides a non-exhaustive list of examples of terms that may be deemed 'unfair' by the Court under section 23 of the Australian Consumer Law.

What happens when a term is found to be unfair?

If a term is found to be unfair by the Court within the meaning of section 23 of the Australian Consumer Law, then that clause is deemed to be void. The remainder of the contract will continue to bind the parties, provided it is capable of operation without the unfair term.

The effect of this can be to render critical provisions of a contract such as warranties, releases from liability and termination rights void, even in circumstances where a similar warranty, release or termination right would have been valid and enforceable if more carefully drafted.

EXTENSION TO "SMALL BUSINESS", OR "ALL BUSINESS"?

While the headline might suggest that the changes will only affect "small business", the changes have the potential to impact on most if not all businesses operating in Australia.

One of the key considerations for the review, is how it should define "small business". The options canvassed in the consultation paper are:

- all businesses that are not publicly listed companies
- all businesses where the transaction value of the contract is below a certain threshold
- all businesses that have an annual turnover below a certain threshold
- all businesses that employ less than a certain number of employees

A second consideration is whether the unfair contract law protection should apply only to contracts for the *acquisition* of goods and services by small businesses, or to all contracts engaged in by small businesses (i.e. including contracts where the small business is *supplying* goods or services).

Depending on how these questions are resolved, the breadth of any new laws may go well beyond what most would understand to mean "small business". For instance, there would be few (if any) businesses in Australia that do not supply and/or acquire goods and services from other businesses using standard form contracts.

The proposal could also see protection given to very large businesses when they acquire goods or services from very small businesses. For instance, there are many unlisted companies in Australia that have annual revenues of hundreds of millions of dollars that would be protected by unfair contract laws in their dealings with other businesses if the threshold of "publicly listed companies" was used.

Because of the difficulty of defining "small business" and, ultimately, of determining whether the business that you are transacting with is a "small business", it is likely that all businesses will need to include provisions in their standard form contracts that only apply where the other party is not a "small business". This will inevitably lead to longer contracts and increased compliance costs for all business using standard form contracts.

HOW WIDESPREAD IS THE USE OF "STANDARD FORM CONTRACTS"?

Unfair contract laws only apply to "standard form contracts", but it is not well understood just how many contractual situations that might capture.

Most businesses that deal with multiple customers will not negotiate new contractual terms on each occasion. Typically, such businesses will utilise "standard supply terms" which cover all of their dealings with commercial customers. If the unfair contracts law regime is extended to business to business contracts, it is likely that most if not all of these businesses will need to amend those terms to comply with the new laws.

The consultation paper seeks to gain a better understanding of this landscape, asking questions including:

- How widespread is the use of standard form contracts for agreements with small business and in what circumstances are they used?
- What types of transactions are they commonly used for, that is for

which goods and services, in which industries and over what range of transaction values?

- How many businesses offer goods and services to small businesses via standard form contracts?

In considering any extension of the unfair contract terms laws, these issues will need to be carefully considered. There could otherwise be many small businesses forced into the expensive exercise of re-drafting their standard supply terms or, worse still, at risk of having their supply contracts rendered void for failure to comply with the new laws.

UNDERMINING THE DOCTRINE OF FREEDOM OF CONTRACT?

One of the central objections that will no doubt be raised in response to the proposal, is that the changes undermine the ability of businesses to choose the basis on which they contract with their customers.

The consultation paper addresses this by suggesting that:

- disparities in bargaining positions may mean that a business is not always free to negotiate terms

- businesses signing a contract may not have the resources or skills to completely understand the implications of contractual terms they are presented

Some have questioned whether this is sufficient justification for undermining such a fundamental legal principal as "freedom of contract".

If businesses truly do not have any choice about entering into a contract, then existing laws regulating unconscionable conduct and misuse of market power already provide protection against businesses using their bargaining power to unfair advantage. The "consumer guarantees" under the Australian Consumer Law also provide existing protection for businesses acquiring goods or services with a value of less than $40,000 (or goods acquired for more than $40,000 in the case of a vehicle or trailer used mainly to transport goods, or for goods or services that are normally used for personal, domestic or household purposes).

The consultation paper suggests that these existing laws may be inadequate, because:

- "unfair conduct" does not necessarily equate to "unconscionable conduct";

- a contract can be "unfair" without having an anti-competitive purpose (as is necessary for a finding of misuse of market power); and

- consumer guarantees primarily apply to terms about the nature and quality of products or services supplied, rather than terms relating to issues such as dispute resolution or termination rights.

The questions that many will be asking are:

- how many layers of protection are necessary to protect businesses in a free market economy? ; and

- is there a risk that "over protection" might undermine the aims of competition policy in Australia (which are "to enhance the welfare of Australians through the promotion of competition and fair trading and

provision for consumer protection"), by restricting competition and ultimately raising prices for consumers?

The key concern of the enquiry appears to be that the use of "excessive" or "unfair" terms in standard form contracts may result in the inefficient passing of all or most of the risk in a transaction to a small business that may not be well placed to manage this risk.

Of course, one of the benefits of the use of standard form contracts is that a business (big or small) can easily and readily enter into contracts to supply their goods or services, without needing to be concerned about the exposure to liability they might face. Increased exposure to risk through a perceived inability to adequately protect itself contractually may actually serve to reduce business confidence, which could lead to unexpected and harmful impacts on the overall economy, such as reduced competition and increased prices for consumers in order to protect businesses from such risk.

These questions are also relevant to the government's "Root and Branch Review" of competition laws (also known as the "Harper Review"), which is being conducted in parallel with the unfair contract laws consultation. The protections afforded to small business under the *Competition and Consumer Act 2010* are a key consideration for the Harper Review.

OPPORTUNITY TO MAKE SUBMISSIONS

If your business uses standard form contracts in its supply of goods or services, it is likely that these laws will affect you. If you have concerns about how they may affect your business, you have an opportunity to raise these issues now, by making a submission.

Submissions to the Treasury on its consultation paper are open until 1 August 2014.

WRITTEN BY:

Josh Simons | Partner | +61 8 8236 1122 | jsimons@tglaw.com.au

For further information, please click here to contact our national Intellectual Property Technology & Regulatory team or contact our office directly:

SYDNEY
Level 25
1 O'Connell Street
Sydney NSW 2000
+61 2 8248 5800

MELBOURNE
Level 39
Rialto South Tower
525 Collins Street
Melbourne VIC 3000
+61 3 8080 3500

MELBOURNE
Level 20
385 Bourke Street
Melbourne VIC 3000
+61 3 9670 6123

BRISBANE
Level 16
Waterfront Place,
1 Eagle Street
Brisbane QLD 4000
+61 7 3338 7500

ADELAIDE
Level 7
19 Gouger Street
Adelaide SA 5000
+61 8 8236 1300

www.tglaw.com.au