Incorporated Victoria No A0050004U
ABN: 54 403 453 626
www.independentcontractors.net.au
PO Box 143 Watsonia 3087

Unfair Contract Protections for Small Business People

This submission responds to the proposal by the Federal Government to implement its policy to extend unfair contract protections to small business people. The policy is in fact a 2013 Coalition election commitment which was again committed to in the 2014 Federal Budget.

The Federal Treasury released a Consultation Paper, 'Extending Unfair Contract Term Protections to Small Businesses' in May 2014, inviting responses to the policy and various implementation options.

Independent Contractors Australia (ICA) is a strong supporter of the policy. Specifically, ICA strongly endorses the policy to extend to small business people the unfair contract protections currently available to consumers under Australian Consumer Law (ACL).

This submission is in three parts:

Part One: Overview of ICA's views. The principles of unfair contract protections.
Part Two: Responses to specific questions in the Treasury Consultation Paper.
Part Three: Examples of unfair contracts and situations.

PART ONE
Overview of ICA's views
The principles of unfair contract protections

1.1. The specific idea of 'unfair' being proposed

There is considerable misunderstanding, even fear, about the meaning of 'unfair' under the proposed laws. That fear is based on the notion that the proposed laws would interfere with, and prevent parties from freely entering and engaging in, commercial contracts. This is not what is proposed. ICA would object to any such proposal.

The idea of 'unfair' in the proposal, and which ICA supports, is quite specific and should be clearly understood. The proposed definition is taken from ACL and, as such, 'unfair':

- only applies to those items identified under the ACL for consumers (see below);

- does not and should not extend to issues of price; and
- only applies to standard form contracts.

1.2 Codifying common law

In a simplified, layperson's understanding of the ACL unfair contract laws, the laws largely codify what is contained in the understanding of a commercial contract under common law. The same understandings operate under Roman law. (See Note A at the end of this submission.)

Basically, the law holds that, for a contract to exist, five key elements must be displayed by the parties:

- An intention to create a legal relationship.
- Clear terms understood by all parties.
- Offer and acceptance.
- Consideration. (This is the wide legal idea of payment.)
- Genuine consent by all parties.

A commercial contract (as opposed, say, to an employment contract) is one in which the 'structure' of the contract under common law does not impose 'control' or 'dependency' of one party over the other. In other words, the parties have equal rights under the contract. [That this 'equality of control' is part and parcel of the commercial contract is most clearly demonstrated by the ILO's determination, in 2006, about the nature of the commercial contract as it applied to self-employed people. More information on this can be found in Note A at the end of this submission.]

The current ACL provides a raft of protections in commercial contracts between businesses and consumers. The proposal is to apply the same protections to contracts between businesses where one or both businesses are small.

To summarise, for a contract to have the legal structure of a commercial contract it must be one in which both parties have equal rights to control the terms of the contract. This idea of equality to control the contract leads to a series of practical tests to which courts (across the globe) will generally look, to see if the contract is a *bona fide* commercial contract. These subtests are, in fact, the sort of items which identify unfairness under Australian Consumer Law.

The following list is taken (and edited for meaning) from the ACL.

A term of a contract is unfair if it:

- Would cause a significant imbalance in the parties' rights and obligations arising under the contract.
- Is not necessary in order to protect the legitimate interests of the party who would be advantaged by the term.
- Would cause financial or other detriment to one party if it were applied or relied on.

More particularly, a contract term is unfair if it gives one party, but not the other, the ability to:

- Avoid or limit the performance of the contract.
- Terminate the contract.
- Apply penalties against the other party for a breach or termination of the contract.
- Vary the terms of the contract.
- Renew or not renew the contract.
- Vary the price payable under the contract without the right of the other party to terminate the contract.
- Unilaterally vary the characteristics of the goods or service to be supplied under the contract.
- Unilaterally determine whether the contract has been breached or to interpret its meaning.
- Limit one party's vicarious liability for its agents.
- Permit one party to assign the contract to the other party's detriment without their consent.
- Limit one party's right to sue the other party.
- Limit the evidence one party can adduce in legal proceedings in respect to the contract.
- Impose the evidential burden on one party in legal proceedings in respect to the contract.

The foregoing items make it clear that the idea of 'fairness' depends on each party having equal rights over the contract itself. It is the idea of the 'structure' of the contract that is being examined for fair/unfair items. That is, fairness exists if both parties have the same rights. Unfairness exists if one party has a right that cannot be exercised by the other party.

ICA believes that when a person without legal training looks at the list above, this assessment of fair/unfair strikes a chord of common sense and reasonableness. This is really the basis upon which 'common law' has been created over the centuries. It is a test of what is 'common' sense for the 'common' person.

1.3 Commercial contract: The legal base-rock of a market economy

This idea of equality under the *structure* of the commercial contract is in fact the legal bedrock of a market economy. It is the primary institutional process by which 'trust' in commercial transactions is secured in an economy.

Without 'trust', transactions in an economy descend into chaos where bullies, thugs and thieves command and control transactions for the purposes of maximizing their personal accumulation of wealth and power to the detriment of others. Such economies are not 'market' economies but rather 'wild west'.

A society with a culture that displays and values high levels of trust in commercial transactions will generate high levels of economic activity. The economy that evolves is one in which both wealth creation and wealth distribution are maximised for the largest number of people.

Trust operates through two mechanisms:

- *Behavioural*: Where a person's word is his or her 'bond'. That is, what people say they will do, they do! This is the most important mechanism for the promotion of trust.
- *Legal*: Where an independent legal system operates to ensure that people do what they said they would do. The legal mechanism is the back-up to the behavioural. In commercial transactions it is the law of contract that the courts apply. Where the legal system operates effectively to apply contract principles, people are more inclined to operate with trust in their commercial dealings.

The essence of the legal process is that when any two parties enter a commercial contract, the courts will look to see if the *structure* of the contract embodied the crucial feature: did both parties have equal rights to control the contract? Typically, courts will look to the types of issues identified in ACL as listed above.

For example, if the structure of a contract gives equal rights to both parties when deciding the price under the contract, and if the price cannot be changed unless both parties agree, then the contract is 'fair'.' If, however, the 'contract' allows one party to change the price under the contract without the other party agreeing, then the contract is one of inequality, and is 'unfair'.

1.4 Equality/fairness of process/structure versus equality/fairness of outcome

This equality/fairness of contract structure and process should not be confused with equality/fairness of outcome.

A further element of a market economy that makes it successful is that people have the right to take risks and to benefit or lose as a result of risk-taking. Therefore, commercial transactions and the processes of commercial contract law are not concerned with (nor should they be concerned with) whether one party has achieved better outcomes from a transaction than the other party.

That is, if an individual enters a commercial contract at a price which might be thought detrimental to that individual, that alleged detrimental price is not of concern or interest to the processes of the law. What the law must protect is the integrity/fairness of the contract structure, as discussed above.

Societies that operate market economies operate a balancing act. All individuals have a right to take risks and benefit or lose from risk-taking. However, when taking commercial risks, the contracts they enter and the law and institutions that support/apply the law must ensure that those persons are treated with equity and fairness under the structure of the contract.

The proposal to extend unfair contract protections currently available to consumers under ACL to small business people is one that will improve the quality of the legal processes in Australia in relation to commercial contract law. This will further strengthen the operation of trust in business-to-business commercial transactions in the Australian economy. The benefits to the community and the economy are

considerable, although difficult to quantify.

What should eventuate, over time, is that people who are or seek to be in business for themselves will have a higher level of 'trust' that they can engage in business and be treated with fairness. They will be more inclined to be in business or to start a business. That is, the proposal will help improve both the quality and the quantity of small business activity in the Australian economy. With small business constituting some 96 per cent of all businesses and employing some 60–70 per cent of the workforce, the likely positive impact on the Australian economy and society should be significant.

1.5 Why the protection is required for small business people

In Part Three of this submission Independent Contractors Australia provides a large number of case studies involving examples of unfair contract terms and circumstances. Over some fifteen years of operation, ICA has accumulated these case studies and many more (not included in the submission). We can say with certainty that, in the Australian economy, unfair contracts (as defined by ACL) are a normal feature of commercial transactions where small business people are doing business with large organizations—both private sector and government entities.

What happens as a matter of routine is as follows:

- Large or medium businesses that engage numbers of small business people (mostly independent contractors) put in place standard form contracts drafted by legal advisers that are designed to protect the interests of the engaging party.
- The standard form contracts form the basis of the larger firms' management processes and in fact dictate the form of the management systems and the authority levels of the managers in the firms.
- The standard form contracts give the engaging party significant power over and above that necessary to operate the business and to disadvantage the small business person in critical areas.
- The larger firms and their legal advisers justify this power on the basis that the contracts are 'offer and acceptance' and therefore legitimate contracts. Further, larger firms sees themselves as 'reasonable' and 'fair' and are convinced that they will always do the right thing.
- When aggrieved as a result of treatment under a contract, small business people are in a 'no-win' situation. They do not have the money to mount a legal challenge. Moreover, they fear that if they challenge the larger firm, they will be harassed by the managers of the firm, and risk losing their contract and their income. They therefore stay quiet. The larger firms rely on this acquiescence as an integral part of their business model.
- In ICA's experience, the government sector, including the Commonwealth government, operates under these sorts of 'unfair contract' arrangements as much if not more than the private sector does. There is some evidence, however, of improvement in the Commonwealth government's approaches in recent times.

The implementation of the ACL unfair contract protections will, ICA believes,

provide a sea change in the working/contractual relationships between small and larger organizations in the Australian economy.

A comment on unconscionable conduct
Where small business people have suffered unfair treatment and it has been widespread, attempts have been made to use the unconscionable conduct provisions of the *Trade Practices Act* to address the issue. However, the common experience is that the unconscionable conduct provisions are next-to-useless in providing practical protections for small business people. Proving unconscionable conduct is a highly complicated and technical legal process that usually extends over many years and requires extremely large sums of money to be spent on lawyers. Small business people cannot afford either the time or the money and instead have to 'move on'. This failure of the unconscionable conduct provisions to be of any practical assistance to small business people further demonstrates the need for the ACL unfair contract provisions to be made available to small business people.

1.6 Government entities must be subject to unfair contract laws

The government sector often talks about being a 'model' of good business practice and acting as 'model' litigants. Based on evidence, however, the reality is that, in their commercial dealings, government entities behave no differently from businesses in the private sector. Some government entities are excellent to deal with, but others can be plain horrid. Government entities will and do create contract terms that are designed to avoid and transfer liability from the government entity to the contracted party. This often occurs in a way that is unreasonable given the commercial realities and requirements of any particular job being contracted. It happens most often where government entities make use of standard form contracts.

It is imperative, therefore, that when the ACL unfair contract protections are extended to small business persons that the law applies equally to all government sectors and entities in the same way it applies to private-sector businesses. There should be no dispensation or special treatment for government. When governments engage in commercial transactions with the private sector, the rules that apply to the private sector should apply equally to government. This should apply to all levels of government—Commonwealth, state and local.

ICA does not know if Commonwealth unfair contract legislation would or could have constitutional reach to state and local governments. If Commonwealth law does not have such reach, ICA recommends that the Commonwealth government engage in discussions with the state governments with a view to ensuring that the unfair contract laws would apply to state and local governments.

1.7 Identifying 'small business'

For the purposes of the ACL proposal and the identification of a 'small business', ICA recommends the approach taken by the Small Business Commissioner (SBC) models operating in Victoria, New South Wales, South Australia and Western Australia.

The SBC's most important role is to provide cheap, easy dispute-resolution processes for disputes involving small business people. In each state, the Commissioners have the legislative authority to apply their discretion as to who they identify as a small business on a case-by-case basis.

ICA recommends that whatever law enforcement instrumentality has the power to review alleged unfair contracts also has the discretionary power to determine who is a small business for the purposes of the law on a case-by-case basis.

The alternative is to apply numerical 'cut-off' points—for example, the number of employees or dollar turnover. Such definitions are unnecessarily restrictive, run the risk of excluding 'small business' people on arbitrary grounds, create the potential for larger businesses to require small business people to structure in ways to avoid the law and can't cover the full variety and diversity of business situations in the economy.

1.8 No application to instances where the contract has been fully negotiated

It is important to note that the existing ACL for consumers and the law as proposed for small business people only applies to standard form contracts. That is, contracts that are on offer to consumers/small business people but in which the consumer/small business person has little or no capacity to negotiate the terms of the contract. This is an important aspect of the proposal.

Standard form contracts are a 'take it or leave it' type of contract. The unfair contract protections for consumers primarily came into being because of experience and concern with standard form contracts in the consumer area, principally with financial services and telecommunication (phone etc.) contracts. The evidence was that consumers were being 'screwed' by terms in the contracts that they could not negotiate.

The same situation applies to small business people who are in a very consumer-like situation, most commonly being individuals running a business.

On the other hand, where a contract has been fully negotiated, legal advice by the small business person has been sought and the contract has been designed specifically for the circumstances of a particular situation, it must be assumed that the process of 'offer and acceptance' has been fully applied in practice and not just theory. That is, that both parties have fully and freely entered the contract, aware of and agreeing to all the terms. In these situations, ICA would not support the application of the ACL unfair contract protections and this is not part of the proposal.

1.9 Retail tenancy leases

Subject, perhaps, to further discussion, Independent Contractors Australia does not believe that the ACL unfair contract protections for small business people need to be applied to the area of retail tenancy leases.

Retail tenancy leases—particularly those used by the large retail shopping centre conglomerates—are in every sense standard form contracts. There is a long history over several decades of these leases being ethically questionable and 'unfair' as defined in this submission. Considerable controversy has raged over the leases, with many examples of unfair contracts in place and unfair behaviour by landlords.

However, in response to unfair leases, state governments have responded with what are now advanced and well-developed retail tenancy laws with strong enforcement procedures. The laws are designed to ensure 'fair' retail tenancy leases and have effective dispute-resolution processes. In several states, these laws are administered and enforced by the state Small Business Commissioners.

ICA is cautious about overlaying a new Commonwealth law over the state retail tenancy laws given that the state laws appear to be effective. Such an overlay and duplication could constitute an intrusion of Commonwealth law into an area already being effectively governed by state law.

ICA would, however, support a 'desk audit' of state retail tenancy laws to see if any of the state laws allowed aspects of ACL-style 'unfairness' to slip through. ICA suspects that a desk audit would not discover any such issues. However, if issues were identified, the preferred process would be to work with the states on a harmonization process to rectify them.

1.10 Franchise Agreements

Franchise laws in Australia lie mostly within the Commonwealth's jurisdiction. However, perceived failures of the laws over a decade or more have led a number of the states to become involved. Independent Contractors Australia has not been impressed with the federal franchise laws to date, believing that many legal 'holes' exist which make many franchise agreements 'unfair'. Further, the dispute-resolution processes have verged on being a 'sham', effectively giving the franchisor in any dispute total superiority.

Nonetheless, the Commonwealth laws have recently been under review and new laws are pending. ICA has not yet had the opportunity to consider those proposed new franchise laws and so reserves judgment and commentary. However, the proposed new franchise laws should have the 'ruler' of the ACL unfair contract protections run over them to ensure that 'fairness' is assured.

Note A

Between 1996 and 2006 the International Labour Organisation (ILO) engaged in one of its most contested debates ever, over whether labour law extended to covering self-employed people. Critical to the debate were arguments that the definitions of employee versus self-employed were vague, unknown and confusing. However, in 2005, the ILO presented the research findings of the most comprehensive investigation of the issue, identifying definitions used across some 70-plus national jurisdictions. Their finding was that, rather than confusion, the law in all jurisdictions

is clear and the same.

In the first instance the ILO 2005 Report stated
http://www.ilo.org/public/english/standards/relm/ilc/ilc95/pdf/rep-v-1.pdf

> "*What is surprising is the amount of convergence between the legal systems* of different countries in the way they deal with this [distinguishing employment] and other aspects of the employment relationship, even between countries with different legal traditions or those in different parts of the world.... Irrespective of the definition used, the concept of a worker in an employment relationship has to be seen in contrast to that of a self-employed or non-dependent worker..."
> (Paragraphs 86-87)

Further, the same report explained that,

- An *employee* is an individual working under a contract of control or dependency—in other words, an *employment contract*.
- An *independent contractor (self-employed person*) is an individual working under a *commercial or civil contract*. Such contracts are not denoted by control or dependency.

(Note: This was consistent with a 2003 ILO 'Conclusion' on the issue.)

That is, that for the purposes of this discussion on 'unfair' contracts, the commercial or civil contract is a contract in which *the structure of the contract is not denoted by control or dependency but rather one in which both parties are 'equal'*.