



Australian Government
The Treasury

TSY/AU

Review of Unfair Contract Term Protections for Small Business

Discussion Paper
November 2018

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Manager
Media and Speeches Unit
The Treasury
Langton Crescent
Parkes ACT 2600
Email: medialiaison@treasury.gov.au

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Consultation Process

Request for feedback and comments

This consultation paper invites interested parties to provide feedback on the effectiveness of the extension of unfair contract term protections to small business. The consultation process will run for a period of four weeks. If you would like to make a written submission, please provide it before the closing date.

Throughout this paper there are questions for you to consider in your submission. There is no obligation to answer any or all of the questions. There is no limit to the length of submissions. Submissions should be uploaded using the consultation page of the Treasury website. For accessibility reasons, please upload submissions in a Word, RTF or PDF format.

Closing date for submissions: 21 December 2018

Mail Manager
 Unfair Contract Terms Review
 Consumer and Corporations Policy Division
 The Treasury
 Langton Crescent
 PARKES ACT 2600

Enquiries consumerlaw@treasury.gov.au

Phone 02 6263 2111

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless it is indicated that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submissions to remain confidential should provide this information marked as such in a separate document.

A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

1. Introduction

1.1 Unfair contract term protections

On 1 July 2010, protections for consumers against unfair contract terms (UCTs) in standard form contracts were introduced into the *Trade Practices Act 1974* (now the Australian Consumer Law (ACL)) and the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). This formed part of the response to the Productivity Commission's 2008 *Review of Australia's Consumer Policy Framework*¹, which recommended incorporating a provision in the consumer law to address UCT related issues.

The extension of the UCT protections to small businesses delivered one of the Government's key commitments to extend UCT protections to small businesses that often faced the same vulnerabilities and difficulties as consumers in a contractual relationship.

The ACL provisions address UCTs for goods, services and land, and the ASIC Act provisions address UCTs for financial products and services.

UCTs are defined in the relevant legislation as those contract terms that:

- would cause significant imbalance in the parties' rights and obligations arising under the contract;
- are not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- would cause detriment (financial or otherwise) to a party if they were to be relied upon.

1.2 Extension of UCT protections to small business

Like individual consumers, many small businesses lack the time, resources, legal or technical expertise and bargaining power to negotiate changes to terms specified in standard form contracts.

In November 2016, the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (the Act) took effect to:

- extend the consumer UCT protections in the ACL and the ASIC Act to small business contracts that meet the prescribed criteria; and
- make provision for exempting certain small business contracts from the operation of the legislation, where those contracts are subject to prescribed laws that are deemed equivalent to the UCT protections in the ASIC Act or the ACL, and which are enforceable.

The Explanatory Memorandum accompanying the Act noted:

"The objective of this reform is to promote fairness in contractual dealings with small businesses with regard to standard form contracts. This will reduce small business detriment and have positive impacts on the broader economy by increasing small business certainty and confidence, and providing for a more efficient allocation of risk. Small businesses, in dealing with other businesses through standard form contracts, should have confidence that the contract they are offered is fair and reasonable and that the risks are allocated efficiently".

The protections apply to small business contracts that meet prescribed criteria. These are:

- the contract is a standard form contract;

1 Available at: <https://www.pc.gov.au/inquiries/completed/consumer-policy>

- at the time the contract is entered into, at least one party to the contract is a business that employs fewer than 20 persons; and
- the upfront price payable under the contract does not exceed \$300,000, or \$1 million if the contract runs for more than 12 months.

2. Purpose

During the passage of the Act through Parliament in late 2015, the Government agreed to undertake a review of the extension to small business within two years after its commencement. The legislation commenced on 12 November 2016.

This discussion paper is seeking feedback from stakeholders on the impact of the extension of UCT protections to small business and whether the objective set for the original reform has been met. It is also seeking views about whether any changes are required to improve the current framework.

If, following consideration of the review findings, the Government considers that legislative amendments are required, it will seek agreement from states and territories to make those amendments before introducing relevant bills to the Australian Parliament.

3. How do UCT protections operate?

The UCT protections allow a court to declare a term of a standard form contract to be unfair and, therefore, void. Contracts between businesses are covered where one or more of the businesses employs fewer than 20 people and the upfront price payable under the contract is under \$300,000 in a single year or \$1 million if the contract runs for more than 12 months.

The law applies to standard form small business contracts entered into or renewed on or after 12 November 2016. If a contract was varied on or after 12 November 2016, the law applies to the varied terms.

Enforcement of the unfair contract terms protections is shared between the Australian Competition and Consumer Commission (ACCC), Australian Securities and Investments Commission (ASIC) and the state and territory consumer protection agencies. However, regulators do not have power to impose penalties for the imposition of UCTs that are ultimately voided, because the current regime does not prohibit the inclusion of UCTs in a standard form contract. Individual consumers may also be entitled to take their complaint to the small claims court or tribunal in their state or territory, or to take private legal action.

In October 2018, ASIC and the ACCC were given investigative powers to compulsorily obtain information, documents and evidence to determine if a term in a contract may be unfair.² This will help the regulators to investigate UCT allegations. Previously, the compulsory information gathering powers of the regulators were not applicable to UCTs as these powers were triggered by 'contraventions' or 'possible contraventions' of the law. As the use of UCTs is not prohibited by the law it is not possible to breach or contravene these provisions in the law.

These new powers apply only in relation to contracts entered into on or after the day the relevant provisions commenced.

3.1 What are standard form contracts?

Standard form contracts are commonly used throughout the economy and are a cost effective option when conducting business, as they allow parties to avoid the transaction costs associated with negotiated contracts.

Some parties can lack the resources or skills to fully understand the implications of contract terms, and businesses that offer standard form contracts often do so on a 'take it or leave it' basis.

Generally, a contract is considered to be in standard form if one of the parties has not had the opportunity to negotiate or change the terms of the contract when agreeing to it.

2 *Treasury Laws Amendment (Australian Consumer Law Review) Act 2018*, available at: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6097

3.2 Other related proposals

Extending UCT provisions to insurance contracts

The UCT protections currently do not apply to insurance contracts. In 2017, the Legislative and Governance Forum on Consumer Affairs³ agreed to apply the UCT protections to contracts regulated by the *Insurance Contracts Act 1984*.

The Government subsequently released a consultation paper *Extending Unfair Contract Terms Protections to Insurance Contracts*⁴ in June 2018. Submissions on the paper closed in August 2018. Following the consultation process further work is being undertaken to refine the model proposed in the paper.

Inquiry into the operation and effectiveness of the Franchising Code of Conduct

The Parliamentary Joint Committee on Corporations and Financial Services is currently inquiring into the operation and effectiveness of the Franchising Code of Conduct⁵, including the workability of UCT protections for franchising agreements. The focus of the inquiry is on addressing structural issues relating to franchising agreements in Australia and challenges with the operation and enforcement of the Code and related legislation (including UCT protections). The Committee is expected to release a final report on the effectiveness of the Code by 6 December 2018. Treasury will incorporate relevant information and findings from the Committee's report when finalising this review.

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

As part of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Commissioner Hayne is inquiring into the implementation of the UCT protections to small business with a focus of the compliance and enforcement activities of the regulators. The Commission released its Interim Report⁶ on 28 September 2018 and is scheduled to submit its Final Report to the Governor-General by 1 February 2019.

3 The Legislative and Governance Forum on Consumer Affairs consists of all Commonwealth, State, Territory and New Zealand Ministers responsible for fair trading and consumer protection laws. The role of the forum is to consider consumer affairs and fair trading matters of national significance and, where possible, develop a consistent approach to those issues.

4 Available at: <https://treasury.gov.au/consultation/c2018-t284394/>

5 Further information on the inquiry is available at: https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Franchising

6 Available at: <https://financialservices.royalcommission.gov.au/Pages/interim-report.aspx>

4. Issues for discussion

4.1 Thresholds

It is important that legislation be unambiguous to assist compliance and enforcement. The current UCT protections apply to businesses that have fewer than 20 employees at the time of entering a contract where the value of the contract did not exceed \$300,000 (or \$1 million for contracts longer than 12 months). This effectively sets two thresholds for the application of UCT protections - the number of employees of the business and the monetary value of the contract.

Number of employees

The number of employees of a business is often used as a method of defining a small business. The employee number for defining small business under UCT protections is consistent with the small business definition adopted by the Australian Bureau of Statistics, the *Corporations Act 2001* and Section 12BC of the ASIC Act⁷. The Senate Standing Committees on Economics also endorsed the use of an employee headcount of 20 in defining small business for UCT protections in its examination of the bill.⁸ As at June 2017, there were approximately 2.2 million actively trading businesses having employees fewer than 20 in Australia.⁹ Alternatively, the Australian Financial Complaints Authority defines a small business as an organisation with less than 100 employees, and the *Australian Small Business and Family Enterprise Ombudsman Act 2015* adopts 100 employees as one of the thresholds to define a small business.

The Government is aware of the concerns raised by a number of industry stakeholders when the legislation was introduced relating to the headcount approach used to define small business under UCT protections.

The Explanatory Memorandum accompanying the Act discussed an alternative definition of small business by using annual business turnover. For instance, the Australian Tax Office defines a small business as a business with an annual turnover (excluding GST) less than \$2 million. However, a business turnover definition was not preferred by the Government at the time on the basis that it may provide a less clear indicator of human resources capacity and could exclude small businesses in low margin and high turnover sectors (for example, petrol retailers).

Discussion questions

1. Does the headcount approach work in practice? If so, is an employee number of 20, appropriate to define a small business for the purpose of UCT protections? If not, what are alternative approaches and what would be the benefit of adopting them?

⁷ Section 12BC of the ASIC Act and section 761G of the Corporations Act also prescribe that if a business is a manufacturing business and employs less than 100 employees, the business is a small business.

⁸ Senate Standing Committees on Economics, Inquiry into Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015, 14 September 2015.

⁹ ABS, 8165.0 – Counts of Australian Businesses, including Entries and Exits, 20 February 2018.

Monetary value of a contract

Consistent with the proposal contained in the Decision Regulation Impact Statement¹⁰ that preceded the development of the Act, the Government initially proposed that the UCT protections would only be applicable to contracts which have an upfront price that does not exceed either \$100,000, or \$250,000 if their duration is more than 12 months. However, as the Senate Standing Committees on Economics recommended, the Government increased the value threshold substantially to the current monetary value.

During the operation of the Act, industry and regulators have indicated that businesses have mixed views on the thresholds: the views include preferences to retain the current values, to increase or reduce the values and to remove them entirely.

As the Senate Standing Committees on Economics pointed out, a value threshold places the onus on small businesses to undertake due diligence for high-value transactions.¹¹ This is to avoid a moral hazard situation occurring where a small business relied solely on the UCT protections without undertaking the necessary due diligence before signing a contract. While the legislation appears to strike an appropriate balance, feedback will inform Government consideration as to whether any improvements or adjustments are required for the value threshold.

During development of the legislation, some stakeholders noted the possible avoidance of the UCT protections by businesses purposely increasing the value of contracts. For example, large businesses could increase the value of contracts above the threshold by a notional amount or bundle small value contracts into a single high value contract. The Government has not seen any evidence that this is currently happening in the market.

Discussion questions

2. Does the value threshold appropriately cover contracts that warrant UCT protections? If not, how should the thresholds be altered and why?
3. Do you have experience or are you aware of any contracting practices designed or undertaken to avoid the UCT protections?

4.2 Coverage

The UCT protections are currently only applicable to standard form contracts. In these instances, one of the parties typically has limited bargaining power relating to the transaction or does not have an effective opportunity to negotiate the terms of the transaction.

Standard form contracts are normally pre-prepared by one party and are typically offered on a 'take it or leave it' basis to the counterparty. Standard form contracts are widely used in Australia when businesses and consumers purchase goods and services as they are cost effective; avoiding unnecessary transaction costs.

¹⁰ Consumer Affairs Australia and New Zealand, *Decision Regulation Impact Statement for Extending Unfair Contract Term Protections to Small Businesses*, 11 June 2015.

¹¹ Senate Standing Committees on Economics, *Inquiry into Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015*, 14 September 2015.

While the ACL and the ASIC Act do not contain a legal definition for what is a standard form contract, they set out a number of matters for a court to consider in determining if a contract is a standard form contract. These are:

- whether one of the parties has all or most of the bargaining power relating to the transaction;
- whether the contract was prepared by one party before any discussion relation to the transaction;
- where another party was, in effect, required either to accept or reject the terms of the contract in the form presented;
- whether another party was given an effective opportunity to negotiate the terms of the contract;
- whether the terms of the contract take into account the specific characteristics of another party or the particular transactions; and
- any other matter prescribed by the regulation.

Provisions of the law require that, if a party to a proceeding alleges that a contract is a standard form contract, it is presumed to be a standard form contract unless another party to the proceeding proves otherwise.

However, it is ultimately a matter for a court to determine whether a contract is a standard form contract. Some small businesses, when entering into a contract, may benefit from greater certainty as to whether the contract they intend to sign is likely to fall within the protections of the UCT regime where a claim that a contract is a standard form contract may be challenged.

Discussion questions

4. In your experience, what factors and circumstances make it difficult to determine whether a contract is a standard form contract? What clarifications would assist with making this determination? Can you provide examples?

4.3 Exemptions

The UCT protections do not apply to terms that:

- define the main subject matter of the contract;
- set the upfront price payable under the contract; and
- are required, or expressly permitted, by a law of the Commonwealth, a state or territory.

There is also an exemption mechanism that allows certain contracts to be excluded from the protections, where those contracts are subject to equivalent and enforceable protections under a law that is prescribed by regulation. This mechanism applies to both of the ACL and the ASIC Act¹². The purpose of this mechanism is to avoid regulatory duplication. Industry self-regulation is not exempted as it is not enforceable. To date, no contracts have been made exempt from the UCT protections under the mechanism.

In addition, the UCT provisions do not apply to contracts of marine salvage or towage, ship charter parties, contracts for the carriage of goods by ship, or provisions in the constitution of a company, managed investment schemes or other similar bodies.

12 Subsection 28(4) of the ACL and subsection 12BL(2) and paragraph 12BL(3)(a) of Division 2 of Part 2 of the ASIC Act.

The Government is aware of suggestions made by industry stakeholders when the protections were introduced, that certain business contracts or terms should be exempted from the UCT protections. Situations mentioned by industry stakeholders included: where contracts are in a standard form, but are not used in a ‘take it or leave it’ fashion and are subject to individual negotiation; where terms included in a standard form contract are drafted in line with an industry code; and where ‘minimum standards’ prescribed by state and territory laws may conflict with the UCT protections or cause uncertainty for businesses.

Discussion questions

5. Are the exemptions appropriate? Can you provide examples of where the exemptions to the UCT protections have been ineffective? Is there evidence that would justify an expansion of the exemptions, for example, as a result of regulatory overlap?
6. Should industry ‘minimum standards’ prescribed by state and territory laws be exempt from the UCT protections? Is there data and evidence to support your opinion?

4.4 Overall effect

Since the UCT protections were extended to small business two years ago, there has been a range of enforcement and compliance activities by regulators.

Australian Competition and Consumer Commission

The ACCC has successfully taken litigation against two businesses under the UCT regime. In October 2017, the Federal Court declared that eight terms in the standard form contract used by JJ Richards & Sons Pty Ltd (a provider of waste management) to engage small businesses were unfair and therefore void.¹³ In July 2018, the Federal Court ruled that two Servcorp Ltd (a provider of serviced office space) subsidiaries agreements with small business customers contained 12 unfair terms.¹⁴ In addition, in June 2018, the ACCC commenced court proceedings against a business for allegedly entering into standard form contracts with potato farmers which include UCTs.

The ACCC has also resolved a number of UCT concerns through public administrative resolutions, including court enforceable undertakings.

In May 2017 following engagement with the ACCC, Sensis Pty Ltd agreed to amend particular terms in its Product Contract Terms that the ACCC was concerned were likely to constitute UCTs once the legislation commenced.¹⁵

In March 2018, the ACCC accepted a court enforceable undertaking from Cardtronics Australasia Pty Ltd that it would amend terms likely to be UCTs in contracts governing non-bank ATMs deployed on the premises of small businesses.¹⁶ Also in March 2018, the ACCC announced that grain marketing organisation AWB Harvest Finance Pools Pty Ltd had made changes to its standard form grain pool contracts to address terms the ACCC considered were likely to be UCTs.¹⁷ In July 2018, the ACCC announced that Warrnambool Cheese and Butter Factory Company Holdings Limited had altered

13 ACCC v JJ Richards & Sons Pty Ltd [2017] FCA 1224.

14 ACCC v Servcorp Limited [2018] FCA 1044.

15 <https://www.accc.gov.au/media-release/sensis-provides-undertaking-and-amends-contract-terms>

16 <https://www.accc.gov.au/media-release/cardtronics-to-amend-unfair-atm-contracts>

17 <https://www.accc.gov.au/media-release/awb-amends-contract-terms-following-accc-concern>

terms in its milk supply agreements and milk supply handbook to address terms the ACCC considered were likely to be UCTs.¹⁸

Australian Securities and Investments Commission

On 9 March 2017, ASIC and the Australian Small Business and Family Enterprise Ombudsman announced that a joint review of small business standard form contracts had revealed that there had been a failure by eight lenders to take sufficient steps to comply with their obligations under the unfair contract terms provisions. After negotiations with ASIC, in August 2017, the four major banks agreed to specific changes to the standard terms in their small business loan contracts to address terms that raised concerns under the unfair contract terms law.¹⁹

On 15 March 2018, ASIC released a report setting out the details of the changes made by the big four banks to remove unfair terms from small business loan contracts of up to \$1 million.²⁰ The report also provides general guidance for other lenders to small business borrowers by outlining the types of terms that raise concerns under the unfair contract terms law and the ways these terms can be addressed.

In September 2018, following an ASIC review, Prospa Advance Pty Limited amended terms in its standard form small business loan contract which were considered unfair to borrowers and guarantors. Prospa has agreed that all customers who entered into or renewed contracts from 12 November 2016 will be subject to those amendments.²¹

ASIC's surveillance of lenders' small business loan contracts to examine whether their loan contracts contain unfair terms is ongoing.

Examples of unfair terms

The compliance and enforcement activities undertaken by the regulators over the last two years have broadened business understanding of UCTs, in particular through litigated cases. Section 25 of the ACL and Section 12BH of the ASIC Act set out some examples of unfair terms. In light of the decisions made by the courts, it may be appropriate to consider if additional examples need to be added to enhance clarity.

Discussion questions

7. Do you think the current UCT regime offers appropriate level of protections to small businesses?
8. Do you think additional examples are needed to clarify unfair terms?
9. Are there any other issues relevant to the Government's review of UCT protections for small business that impact on the effectiveness of the regime?

18 <https://www.accc.gov.au/media-release/warrnambool-cheese-and-butter-amends-contract-terms>

19 <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2017-releases/17-278mr-big-four-banks-change-loan-contracts-to-eliminate-unfair-terms/>

20 ASIC, Report 565: *Unfair contract terms and small business loans*, 15 March 2018.

21 <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-262mr-prospa-removes-unfair-loan-terms-for-small-business-borrowers-and-guarantors/>