

21 December 2018

Miss Ruth Moore
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Consumerlaw@treasury.gov.au

Dear Miss Moore

REVIEW OF UNFAIR CONTRACT TERM PROTECTIONS FOR SMALL BUSINESS

We welcome the opportunity to provide feedback on the effectiveness of the extension of unfair contract term protections to small business. As our previous inquiries have found consumers are protected by law, large businesses by their power to negotiate, small businesses are left without a means to access justice.

The following advocates strengthening the unfair contract terms (UCT) legislation to ensure the intent of providing justice for small businesses is achieved. In our assistance function, which deals with small business disputes, the vast majority of contracts still contain clauses that the ACCC have already identified as unfair.

We recommend an increase to the cap, support enhancement of the enforcement capability of regulators and advocate for the expansion of sectors covered by UCT. We also engaged K.M. Corke & Associates to address key questions raised in the review, this report can be found in Appendix A.

Cap lifted to \$5m

Current caps in UCT are limiting the effectiveness of protecting small businesses against an asymmetry of power with large businesses when entering into unfair standard form contracts.

The current UCT legislation defines small business as fewer than 20 employees and applies contract limits of \$300,000 for up front contracts or \$1 million for contracts longer than 12 months. A single, higher, threshold is recommended to create simplicity and reflect the capital requirements of small businesses.

We have previously raised in our 2016 Inquiry into Small Business Lending and our submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Interim Report the need for a cap of \$5 million. The current caps are not fit for purpose as they exclude the majority of loans taken by a small business to grow and capital intensive small businesses such primary producers.

The most common standard form contract for a small business is with their financial services provider. Our findings that a cap of \$5 million is needed to capture small businesses is supported by recently launched Australian Financial Complaints Authority (AFCA) which has a raised cap for complaints it can consider, being for facilities of \$5 million or less.

In addition to a raised cap, the limit must be indexed or not fixed in primary legislation. Over time, the remedial benefits of UCT legislation will be lost if the dollar figures used in the laws are fixed in primary legislation. This is an issue that Parliament has considered in over 60 pieces of legislation.

To keep currency, a 'device commonly used to address this is a provision varying the benchmark monetary amount contained in primary legislation according to changes in the consumer price index prepared by the Australian Bureau of Statistics' (refer appendix A).

Increase enforcement capabilities of regulators

Small businesses are reluctant to damage commercial relationships. They lack resources to pursue legal remedies, collectively bargain with larger business and often don't know how to identify or challenge an unfair contract term. Consequently small businesses are unlikely to take action when faced with an unfair term in their standard form contract.

As discovered in Phase 1 of our Access to Justice Inquiry nearly half of businesses who resolved a serious dispute would continue a business relationship in spite of the dispute as they believe they have no alternative¹. Therefore, the incentive to take a business to court if a term is unfair is not an option considered, that is even before taking into account the financial burden that induces. Also, of the businesses surveyed in the Inquiry, 59% of regional businesses and 48% of urban businesses were unable to vary contract terms². This is further exacerbated as the Australian Competition and Consumer Commission (ACCC) and Australian Securities and Investments Commission (ASIC) need instances of unfair terms to be systemic to consider investigating.

It is also our experience that where litigation is commenced, the larger party with greater resources stretches out the time over which proceedings are conducted in an endeavour to exhaust either/or the time or financial resources of the smaller party.

Regulator Role

The regulators ACCC and ASIC are in a unique position through their enforcement mandate. The ACCC has taken the lead taking many high profile companies to court. While ASIC have released a document following discussions with the four major banks, to date ASIC have not tested any terms in the new standard form contracts issued, or contracts of other financial service providers, through the court system.

While the ACCC have won several enforceable undertakings they only apply to the contracts issued by the company taken to court not the use of the unfair term itself.

The capacity to allow the regulators to make a legislative instrument declaring that terms of a particular kind could be a term that may be unfair (rather than via regulation) would increase the ability of the UCT provisions to keep pace with marketplace developments (further discussed in Appendix A).

Make unfair terms illegal

As court rulings only apply to the company not the unfair term itself the UCT legislation is effectively operating as a compliance measure. The ACCC and ASIC do not have the resources to individually take every company to court. Making unfair terms illegal will enable the regulators to have a bigger stick to enforce the legislation.

¹ Australian Small Business and Family Enterprise Ombudsman, 'Access to Justice: Where do small businesses go?' p. 13.

² *ibid*, p. 16.

If businesses are aware of specific terms being illegal, there will be a greater incentive for large businesses to not include them in standard form contracts offered to small businesses. Broad publication of terms found to be unfair will increase awareness among, and confidence for, small businesses challenge illegal terms if found.

There is also an issue of a lack of distinction between terms that are clearly unfair and terms that are considered unfair depending on how they are used. For example, terms deemed not unfair in prescribed circumstances. In the Banking Code of Practice there is the ability to take action with no notice. While this term appears unfair, it is reasonable to take action with no notice where a borrower has been found to be involved in illegal activities.

The legislation prescribes that there needs to be consideration of the contract as a whole. This immediately puts onus on the small businesses to decipher legalistic permutations without access to legal expertise. Transparency on when terms can be used and prohibiting words such as 'reasonable' will help level the playing field for small businesses in identifying if a term is unfair.

Void rather than voidable

Our inquiries, particularly regarding financial contracts and services, found low motivation for compliance with UCT legislation by large banks. UCT legislation as drafted has the unintended consequence of failing to motivate compliance as voidable terms are legal until found otherwise through the courts. The ACCC has also acknowledged the limitation of unfair contract terms not being illegal. Currently, the Australian Consumer Law (ACL), allows a potentially unfair contract term to be challenged in a court so it can be declared void but it does not prohibit such a term being included in a contract³.

Also for many small businesses in Australia the supply chain has limited suppliers or customers so there is high risk of business failure through raising disputes. Making UCT void, removes the relationship risk from the small business.

Penalties

In October 2018 legislation was amended to give the ACCC and ASIC investigative powers in relation to potential UCTs but no ability to issue penalty or infringement notices. The regulators cannot seek civil pecuniary penalties for contract terms that are void or issue infringement notices for contract terms that are unlikely to be unfair. This leaves the current situation allowing large businesses to simply amend the terms when it is raised by the ACCC. This is not an effective deterrence and reinforces a non-level playing field.

Significant penalties must be applicable when unfair, preferably illegal, contract terms are found in standard form contracts. For example, a breach of Australian Consumer Law attracts a civil penalty of up to 10% of turnover⁴. The risk of financial penalties will further incentivise large businesses to remove unfair contract terms from their standard form contracts.

Compensation for damages

The UCT legislation needs to be expanded to require compensation for damages incurred by a small business as a result of an unfair term. Where penalties and compensation are awarded and the large business does not have the financial capacity to meet both, priority must be given to paying the compensation.

³ <https://www.accc.gov.au/speech/major-changes-needed-to-get-rid-of-unfair-contract-terms>

⁴ <https://static.treasury.gov.au/uploads/sites/1/2018/04/ASIC-Enforcement-Review-Report.pdf>

Expand to the insurance sector

As stated in our submission of 21 August 2018 we support the proposed extension of unfair contract term provisions (UCT) to the insurance sector. For example, that allowing a small business consumer to select from different policy options does not make a contract negotiable, but a standard form contract and subject to the UCT provisions.

To operate, small businesses will have many contracts, with the ACCC estimating that small businesses enter into about 8 standard form contracts per year⁵. Having to know which piece of legislation applies to which contract, particularly if they have different rules, simply adds complexity. Any, and all, changes to legislation or regulation that effect small business must aim to reduce red tape and level the playing field between small businesses and larger players.

Expand to Australian government contracts

Government should demonstrate leadership and only issue fair standard form contracts. Recent announcements show leadership in some areas, the recent commitment to 20 day payment terms for government contracts⁶, but fair must apply across all contracts with small businesses.

In particular, to remove terms that allow unilateral variation of a contract; restrict the supplier's ability to terminate the contract; restrict or omit options for dispute resolution.

Thank you for the opportunity to comment. If you would like to discuss this matter further, please contact Jill Lawrence on 02 6121 5312 or at jill.lawrence@asbfeo.gov.au.

Yours sincerely



Kate Carnell AO

Australian Small Business and Family Enterprise Ombudsman

⁵ <https://www.accc.gov.au/media-release/accc-warns-businesses-time-is-running-out-to-review-their-standard-form-contracts-for-unfair-contract-terms>

⁶ <https://www.pm.gov.au/media/australian-chamber-commerce-and-industry-annual-dinner>

K.M. Corke and Associates

Q.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?

Q2 Does the value threshold appropriately cover contracts that warrant UCT protections? If not, how should the thresholds be altered and why?

Headcount

In a speech given in August 2018 to the Council of Small Business of Australia (**the COSBOA speech**) the ACCC Commissioner has made a number of observations about the reach of the small business provisions:

When the unfair contract terms regime was extended to cover small businesses, we expected that these thresholds would cover most small business transactions, but we are finding that is not the case.

In the ACCC's experience this threshold sometimes excludes businesses that we think should be protected from unfair contract terms. For example, we think it is likely that the majority of authorised motor dealers fall outside the current thresholds because of the high value of the products sold and perhaps also the number of employees.

In our Dairy Inquiry we came across a number of potentially unfair contract terms in milk supply contracts that allow retrospective changes in farmgate milk prices. For some of those contracts where there is a fixed volume and price for the duration of the contract, the upfront price exceeds the threshold and so the unfair contract term protections do not apply.

We are also aware of a number of potentially unfair payment terms in the trucking industry, however, many of the businesses that we spoke to employed more than 20 people and so were over the threshold.

There is no logical reason why the small businesses in these examples should be excluded from the of the unfair contract term legislation.⁷

As the Australian Securities and Investment Commission has said on its website:

'Small business' is defined differently by regulators in Australia depending on the laws they administer.

For example, ASIC regulates many businesses that are 'small proprietary companies', which means a company with two out of these three characteristics:

- an annual revenue of less than \$25 million
- fewer than 50 employees at the end of the financial year, and
- consolidated gross assets of less than \$12.5 million at the end of the financial year.

⁷ *Major changes needed to get rid of unfair contract terms* speech to COSBOA National Small Business Summit 31 August 2018 <https://www.accc.gov.au/speech/major-changes-needed-to-get-rid-of-unfair-contract-terms>

The Australian Taxation Office defines a small business as one that has annual revenue turnover (excluding GST) of less than \$2 million. Fair Work Australia defines a small business as one that has less than 15 employees.

Despite these differences, many regulators have informally adopted the definition of 'small business' used by the Australian Bureau of Statistics (ABS), which is a business that employs fewer than 20 people.⁸

Finally, a background paper prepared for the Royal Commission Into Misconduct in the Banking, Superannuation and Financial Services Industry has helpfully listed a number of different statutory definitions of a 'small business'.⁹

The statutory test in the extract from the ASIC website set out above is contained in subsection 45A(2) of the *Corporations Act 2001*.

Rather than identify businesses by way of sector, the objective tests set out in subsection 45A(2), suitably modified so as to capture all forms of small business irrespective of their legal structure (i.e. to include sole traders, partnerships, trusts etc) should provide sufficient headroom to allow small businesses in most sectors to receive the remedial benefits contained in UCT laws, as intended by the Parliament.

Value threshold

Concerns have been raised about the fact that over time, the remedial benefits of UCT legislation will be lost if the dollar figures used in the laws are fixed in primary legislation.

This is an issue that Parliament has considered in over 60 pieces of legislation.

The most common device used to obviate this problem is a provision varying the benchmark monetary amount contained in primary legislation according to changes in the consumer price index prepared by the Australian Bureau of Statistics.

A typical example of the CPI index provision can be found in section 321A of the *Commonwealth Electoral Act 1918*. It is set out in the **Attachment**.

There is no identifiable policy reason not to incorporate this reasonably common device to protect (in this case) small businesses having the remedial benefits of the UCT legislation eroded by inflation.

Q3 Do you have experience or are you aware of any contracting practices designed or undertaken to avoid the UCT protections?

Q4 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?

Whilst undoubtedly some larger businesses have designed contracts to avoid the UCT provisions, the greater concern revolves around identifying and dealing with contractual clauses clearly unfair on their face.

⁸ <https://asic.gov.au/for-business/your-business/small-business/small-business-overview/small-business-what-is-small-business/>

⁹ *Background paper 12 – Financial Services and Small and Medium Sized Enterprises (SMEs)* Figure 1: Statutory definitions of small business in Commonwealth legislation
<https://financialservices.royalcommission.gov.au/publications/Documents/financial-services-and-small-and-medium-sized-enterprises-paper-12.pdf>

As a general proposition, the matters to be taken into account when considering whether a contract is a standard form contract broadly appear to be workable.

It would be hoped that the capacity to prescribe other matters by regulation contained in paragraph 27(2)(f) of the Australian Consumer Law (and similar provisions in the ASIC Act) would be used as and when relevant market behaviour is identified.

A better device could be to permit the ACCC to declare, by legislative instrument, matters that are to be taken into consideration when identifying what constitutes a standard form contract, an idea discussed in greater depth later.

Q8 Do you think additional examples are needed to clarify unfair terms?

Deeming contract terms falling within examples contained in section 25 of the ACL to be deemed (taken to be) unfair contract terms

The ACCC and ASIC has been active in pursuing cases in which various standard form contracts have been found to be unfair. Many of the cases are discussed on pages 10 and 11 of the discussion paper.¹⁰

In *ACCC v CLA Trading*¹¹ Gilmour J summarised the authorities on unfair contract terms (in the context of unfair consumer contracts) as follows:

(a) The underlying policy of unfair contract terms legislation respects true freedom of contract and seeks to prevent the abuse of standard form consumer contracts which, by definition, will not have been individually negotiated:

(b) The requirement of a “significant imbalance” directs attention to the substantive unfairness of the contract:

(c) It is useful to assess the impact of an impugned term on the parties’ rights and obligations by comparing the effect of the contract with the term and the effect it would have without it: .

(d) The “significant imbalance” requirement is met if a term is so weighted in favour of the supplier as to tilt the parties’ rights and obligations under the contract significantly in its favour. This may be by the granting to the supplier of a beneficial option or discretion or power, or by the imposing on the consumer of a disadvantageous burden or risk or duty:

(e) Significant in this context means “significant in magnitude”, or “sufficiently large to be important”, “being a meaning not too distant from ‘substantial’”:

(f) The legislation proceeds on the assumption that some terms in consumer contracts, especially in standard form consumer contracts, may be inherently unfair, regardless of how comprehensively they might be drawn to the consumer’s attention:

(g) In considering “the contract as a whole”, not each and every term of the contract is equally relevant, or necessarily relevant at all. The main requirement is to consider terms that might reasonably be seen as tending to counterbalance the term in question:¹².

¹⁰ The ACCC has also been involved in actions involving Bytecard Pty Ltd, Chrisco Hampers Australia Limited and CLA Trading.

¹¹ [2016] FCA 377

¹² Paragraphs 54 (a)(g), cited by Moshinsky J *Australian Competition and Consumer Commission v. JJ Richards and Sons* [2017] FCA 1224 at para 19

In *ACCC v JJ Richards and Sons*, Moshinsky J observed:

21 As Edelman J stated in *Chrisco* at [39], in relation to consumer contracts, s 24 of the Australian Consumer Law creates broad evaluative criteria to be developed incrementally in the decided cases. Edelman J referred to *Plevin v Paragon Personal Finance Ltd*[2014] 1 WLR 4222; [2014] UKSC 61, where the United Kingdom Supreme Court considered a legislative provision that permitted reopening of credit transactions where the relationship between the creditor and the debtor was “unfair”. Lord Sumption, who delivered the leading judgment, said at [10] that it was not possible to state a precise or universal test for the application of such a provision.

22 Edelman J (at [40] of *Chrisco*) also referred to the statement by Leeming JA, writing extra-judicially, that open-ended statutes that turn on broadly expressed concepts “naturally and indeed necessarily attract a more purposive and less minutely textual mode of construction” (Leeming M, “Equity: Ageless in the ‘Age of Statutes’” (2015) 9 *Journal of Equity* 108 at 116). Edelman J characterised the legislative concept of “unfairness” in s 24 as a “guided form of open-ended legislation”.

It is this absence of precision referred to above that makes it very difficult for small businesses to be able to identify precisely what constitutes an unfair contract.

Both:

- the head provision contained in subsection 24(1) of the Australian Consumer Law must be necessarily broad; and
- the nature of the analysis spelt out in *CLA Trading* needs to be followed

so as to capture terms that are unfair having regards to the facts of the particular case.

However, ASBFEO has identified there is a need for greater certainty as to what constitutes an unfair contract.

Section 25 of the Act lists examples of provisions that ‘may’ be unfair.

There is some scope to amend section 25 of the ACL (and similar provisions in the ASIC Act) to provide that the head provision reads that without limiting section 24, the examples contained in section 25 will be deemed (taken to be) unfair.

In that way, those who design and use standard form contracts will be aware of terms that are illegal *per se* and so reducing transaction costs and increasing clarity, whilst retaining the structure of section 24 so as to ensure contracts with terms, when taken as a whole, that are ‘unfair’ to small business, can be dealt with under UCT laws.

Role of the ACCC

The ACCC has a special role in identifying and taking action against companies using UCTs in standard form contracts.

Some have argued that the ACCC should have the capacity to render void contracts with UCTs.

The separation of powers doctrine suggests that it may be difficult for the ACCC to be vested with this power, if the capacity to render void a contract is characterised as being an act authoritatively deciding a dispute between parties about the existence of their rights and liabilities.¹³

¹³ *Huddert, Parker and Co Ltd. V. Moorehead* (1909) 8 CLR 300;

However, the role the ACCC plays in the enforcement of the UCT laws means that it is best placed to identify common examples of unfair terms, as they are developed and applied over time by larger companies.

The *Legislation Act 2003* creates the concept of a legislative instrument. It is subordinate legislation capable of parliamentary disallowance.¹⁴ It is used in many pieces of legislation.¹⁵

Even if the proposed amendment to UCT laws discussed above is not immediately adopted, the capacity to allow the ACCC to make a legislative instrument declaring that terms of a particular kind could be a term that may be unfair (rather than via regulation) would increase the ability of the UCT provisions to keep pace with marketplace developments, as particular terms with unfair outcomes are developed and become popular with those using standard form contracts.

Q9 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?

Enforcement

In his COSBOA speech the ACCC Commissioner said:

The business-to-business unfair contract term law is an extremely valuable law that works to protect small businesses against terms that just should not be in contracts. We have, however, seen the law's limitations and believe the law should be strengthened considerably.

Fortunately, the Government has committed to commence a review of the unfair contract term law before the end of this year.

As part of the review, the Government will draw upon data collected from regulators and other key stakeholders. We will be bringing together the issues we've identified and making the case for significant strengthening of the law. So what are the limitations?

There are two fundamental problems.

The biggest limitation that the ACCC has identified is this: unfair contract terms are *not* illegal.

They should be!

Currently, the Australian Consumer Law, or ACL, allows a potentially unfair contract term to be challenged in a court so it can be declared void but it does not prohibit such a term being included in a contract.

The second biggest limitation to the current regime is that the ACCC cannot seek civil pecuniary penalties when a term in a contract is declared unfair and void by the court. Nor can we issue infringement notices for contract terms that are likely to be unfair. By making unfair contract terms illegal, the ACCC would be able to seek pecuniary penalties and issue infringement notices.

Prohibition and penalties

These limitations force the ACCC into the position of being a compliance agency for companies, which we should never be. Under the current arrangements, companies can simply amend their unfair contract terms when the ACCC raises an issue with them, and there is nothing that we can do to hold them to account for prior conduct.

¹⁴ Section 10 and Part 2 of the *Legislation Act 2003*

¹⁵ The device is used in the *Competition and Consumer Act 2010* in section 60B

Penalties and infringement notices should apply if unfair contract terms are included in standard form contracts. Otherwise, no real incentive exists for businesses to ensure their standard contract do not contain such terms.

Given unfair contract terms are not illegal or attract penalties, current unfair contract term laws are not in line with other provisions of the CCA.

There is some scope for arguing that there should be specific and general deterrence measures be introduced to encourage larger companies not to 'game' the system and force smaller businesses to accept a standard form contract containing UCTs, safe in the knowledge that there is limited financial and reputational risk in employing such provisions.

It follows that the ACL should make a UCT illegal, with appropriate pecuniary penalties and the capacity to impose infringement notices inserted into the law.

Enforcement of rights by small businesses

Unfortunately the ACCC cannot take up every unfair contract case.

On occasion, small businesses must take legal action to protect their interests.

Restraining 'unfair contracts' during dispute resolution

ASBFEO believes that there are circumstances where a larger companies attempt to enforce UCTs during a period of dispute between the vendor and the small business.

Given the usual imbalance of negotiating and financial power between the parties, there is an argument to say that the status quo should be maintained whilst a dispute is being resolved.

Paragraph A.7.1 of the Complaint Resolution Scheme Rules published by the Australian Financial Complaints Authority¹⁶ reads:

A.7.1 While AFCA is considering a complaint, the Financial Firm is subject to the following restrictions.

- a) The Financial Firm must not begin legal proceedings against the Complainant, anyone else joined as a party to the complaint or Other Affected Party about any aspect of the subject matter of the complaint.
- b) The Financial Firm must not seek judgment or take other action to pursue debt recovery legal proceedings that the Financial Firm began before the Complainant submitted the complaint to AFCA, other than to the minimum extent necessary to preserve the Financial Firm's legal rights.
- c) The Financial Firm must not take any action to:
 - (i) recover a debt the subject of the complaint, including enforcement of a default judgment obtained in court,
 - (ii) protect any assets securing that debt,
 - (iii) assign any right to recover that debt, or
 - (iv) list a default on a Complainant's credit file.

There is some scope to insert into the law similar provisions into UCT laws in a circumstance where a small business has commenced proceedings with respect to an UCT.

¹⁶ https://www.oaic.gov.au/resources/privacy-law/privacy-registers/recognised-edr-schemes/afca/afca_complaint-resolution-scheme-rules_v4.3_FINAL.PDF

Speed in dealing in litigation

It is also the experience of ASBFEO that where litigation is commenced, the larger party with greater resources stretches out the time over which proceedings are conducted in an endeavour to exhaust either/or the time or financial resources of the smaller party.

The Equity Division of the Supreme Court of NSW has developed a concept called a 'stopwatch hearing', with the relevant Practice Note providing as follows:

Stopwatch Hearings

50. An option for matters that are heard by the Court and/or referred to Referees is the stopwatch method of trial or reference hearing. In advance of the trial or reference, the Court will make orders in respect of the estimated length of the trial or reference and the amount of time each party is permitted to utilise. The orders will allocate blocks of time to the aspects of the respective cases for examination in chief, cross-examination, re-examination and submissions. If it is in the interests of justice, the allocation of time will be adjusted by the Court or the Referee to accommodate developments in the trial or reference.

51. This method of hearing is aimed at achieving a more cost effective resolution of the real issues between the parties. It will require more intensive planning by counsel and solicitors prior to trial including conferring with opposing solicitors and counsel to ascertain estimates of time for cross-examination of witnesses and submissions to be built in to the estimate for hearing.

52. Any party wishing to have a stopwatch hearing must notify the other party/parties in writing prior to the matter being set down for hearing or reference out. At the time the matter is set down for hearing or referred out to a Referee it is expected that solicitors or counsel briefed on hearing will be able to advise the Court:

52.1 whether there is consent to a stopwatch hearing and

52.2 if there is no consent, the reasons why there should not be a stopwatch hearing.

53. If there is consent to a stopwatch hearing counsel and/or solicitors must be in a position to advise the Court of:

53.1 the joint estimate of the time for the hearing of the matter and

53.2 the way in which the time is to be allocated to each party and for what aspect of the case.¹⁷

The courts within the Federal Court system and those state tribunals having jurisdiction to consider unfair contracts claims through the application of the ACL as a law of the State should be encouraged to adopt rules that make a 'stopwatch hearing' approach the process by which UCT matters are heard.

Remedies

Finally, the only outcome that flows from the discovery of a UCT in a standard form contract is that the term is void.

¹⁷ Practice Note SC Eq3 Supreme Court Equity Division – Commercial List and Technology and Construction List

http://www.practicenotes.justice.nsw.gov.au/practice_notes/nswsc_pc.nsf/a15f50afb1aa22a9ca2570ed000a2b08/5a7a17ffe5925011ca25751c001f353c?OpenDocument

Having regard to the harm that the smaller business may have suffered whilst an unfair contract is on foot, it is appropriate the business has a full range of remedies should a contract be found to have terms that are unfair.

Subsection 1325C(2) of the *Corporations Act 2001* provides that with regards to certain payments made in the context of a takeover bid for a company that was unfair or unconscionable, a court may:

- declare the agreement, or any part of it, to be void or to have always been void; or
- direct a person to whom a benefit is given, or another specified person, to make a payment or transfer property to the body corporate or do any other act for the benefit of the body corporate; or
- make any other order it considers appropriate

It is appropriate that similar remedies are available to those small businesses who must take action to correct the effects of an unfair contract.

Universal concept of unfair applicable to all areas of federal legislation

Over time, it may be desirable to have what is regarded as an 'unfair' 'small business contract' identified for use in remedial legislation in other policy areas, such as insurance.

Developing a universal definition for these concepts will assist courts in developing an 'unfairness' jurisprudence as well as providing certainty for small businesses and their advisers as to whether a particular business can avail of small business protections inserted into law.

This could be done by inserting into section 2B of the *Acts Interpretation Act 1901* (a provision that acts as a 'dictionary' for Commonwealth legislation) definitions that say the terms:

- 'Small business contract' and
- 'unfair', in relation to a small business contract

has the same meaning as in the *Australian Consumer Law*, in much the same way as section 2B provides that the phrase 'Australian Privacy Principle' has the same meaning as in the *Privacy Act 1988* when used anywhere in Commonwealth law.

Good faith

As Edelman J said in *ACCC v. Chrisco Hampers Australia Limited*¹⁸

41. The Explanatory Memorandum to the *Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010* (Cth) [5.2]-[5.4] explained that the regime which contained s 24 was introduced following an agreement between the Council of Australian Governments to establish a national law. The national law had been recommended by the Productivity Commission and proposed by the Ministerial Council on Consumer Affairs. The Productivity Commission had noted that common unfair contract provisions had been adopted in the United Kingdom and Victoria: Productivity Commission Inquiry Report, *Review of Australia's Consumer Policy Framework Volume 2 – Chapters and Appendices* (No 45, 30 April 2008) p 159.

¹⁸ [2015] FCA 1204

Despite the origin of much of the unfair contract term definition in the UK regulations, Parliament departed from the precise terms of the UK provision. In particular, reference in UK to the requirement of “good faith” was removed from the Australian provision. The Regulation Impact Statement in Chapter 11 of the Explanatory Memorandum (pages 133 and 135) described the unsettled status of good faith in Australia and proposed that the definition should not make reference to “good faith” given that uncertainty.

The law on good faith was comprehensively reviewed in 2015 by the Full Federal Court in *Australia and New Zealand Banking Group Limited v. Paciocco*¹⁹.

It said:

287. Paragraph (l) in sub-ss (1) and (2) refers to good faith. That is a conception that has been recognised (though not by all courts in Australia) as an implication or feature of Australian contract law attending the performance of the bargain and its construction and implied content: [Renard Constructions \(ME\) Pty Ltd v Minister for Public Works](#) (1992) 26 NSWLR 234; [Hughes Aircraft Systems International v Airservices Australia \(No 3\)](#) [1997] FCA 558; 76 FCR 151; Seddon N, Bigwood R, Ellinghaus M, *Cheshire and Fifoot’s Law of Contract* (10th Ed, Aust Ed, 2012) 10.41- 10.47; cf [Commonwealth Bank of Australia v Barker](#) [2014] HCA 32 at [42] and [107]; 88 ALJR 814 at 827 and 837. Yet, good faith in the performance of contracts is well-known to the common law and to civilian systems. It is a good example of the presence of values in the common law. I repeat what I said in [United Group Rail Services Ltd v Rail Corporation New South Wales](#) [2009] NSWCA 177; 74 NSWLR 618 at 634 [58] (in a commercial context of a clause expressly incorporating good faith):

... [G]ood faith is not a concept foreign to the common law, the law merchant or businessmen and women. It has been an underlying concept in the law merchant for centuries: L Trakman, *The Law Merchant: The Evolution of Commercial Law* (Rothman 1983) at p 1; W Mitchell, *An Essay on the Early History of the Law Merchant* (CUP 1904) at pp 102 ff. It is recognised as part of the law of performance of contracts in numerous sophisticated commercial jurisdictions: for example *Uniform Commercial Code* §1-201 and § 1-203 (1977); *Wigand v Bachmann-Bechtel Brewing Co* 118 NE 618 at 619 (1918); E A Farnsworth, *Farnsworth on Contracts* (Aspen 3rd Ed 2004) Vol 1 at pp 391-417 § 3.26b; International Institute for the Unification of Private Law, *UNIDROIT Principles of International Commercial Contracts* 2004, Rome, Art 1.7 (www.unidroit.org [Ed. 3 May 2010]); R Zimmerman and S Whittaker (Eds) *Good Faith in European Contract Law* (CUP 2000). It has been recognised by this Court to be part of the law of performance of contracts: [Renard Constructions \(ME\) Pty Ltd v Minister for Public Works](#) (1992) 26 NSWLR 234 at 263-270; [Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney](#) (1993) 31 NSWLR 91; [Burger King Corporation v Hungry Jack’s Pty Ltd](#) at 565-574 [141]-[187]; and [Alcatel Australia Ltd v Scarcella](#) at 363-369. ...

288. The usual content of the obligation of good faith that can be extracted from cases such as [Renard Constructions](#), [Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney](#) (1993) 31 NSWLR 91, [Burger King Corporation v Hungry Jack’s Pty Ltd](#) [2001] NSWCA 187; 69 NSWLR 558, [Alcatel Australia Ltd v Scarcella](#) [1998] NSWSC 483; 44 NSWLR 349, and *United Group Rail Services Limited* is an obligation to act honestly and with a fidelity to the bargain; an obligation not to act dishonestly and not to act to undermine the bargain entered or the substance of the contractual benefit bargained for; and an obligation to act reasonably and with fair dealing having regard to the interests of the parties (which will, inevitably, at times conflict) and to the provisions, aims and purposes of the contract, objectively ascertained.

289. None of these obligations requires the interests of a contracting party to be subordinated to those of the other. It is good faith or fair dealing between the parties by reference to the bargain and its terms that is called for, be they both commercial parties or business dealing with consumers. As Posner J said in [Market Street Associates Limited Partnership v Frey](#) 941 F.2d 588 (1991) the contractual notion

¹⁹ [2015] FCAFC 78

of good faith varies in what is required for its satisfaction by reference to the nature of the contract. But the notion is rooted in the bargain and requires behaviour to support it, not undermine it, and not to take advantage of oversight, slips and the like in it. To do so is akin to theft, and if permitted by the law led to over-elaborate contracts, and defensive and mistrustful attitudes among contracting parties. At 595 Posner J said:

The contractual duty of good faith is thus not some newfangled bit of welfare-state paternalism or (*pace* Duncan Kennedy, “Form and Substance in Private Law Adjudication”, 89 Harv Law Rev 1685, 1721 (1976)) the sediment of an altruistic strain in contract law, and we are therefore not surprised to find the essentials of the modern doctrine well established in nineteenth century cases.

290. The standard of fair dealing or reasonableness that is to be expected in any given case must recognise the nature of the contract or relationship, the different interests of the parties and the lack of necessity for parties to subordinate their own interests to those of the counterparty. That a normative standard is introduced by good faith is clear. It will, however, not call for the same acts from all contracting parties in all cases. The legal norm should not be confused with the factual question of its satisfaction. The contractual and factual context (including the nature of the contract or contextual relationship) is vital to understand what, in any case, is required to be done or not done to satisfy the normative standard.

291. It is unnecessary to deal with the jurisprudence on the subject of good faith in other jurisdictions, beyond saying that the above expression of the matter is consistent with the content ascribed to the phrase “good faith” in persuasive cases in influential jurisdictions in the United States: for example, refraining from acting with subterfuge and evasion: [Daitch Crystal Dairies Inc v Neisloss](#) 190 NYS 2d 737 (Appeal Div 1959); [Harbor Insurance Co v Continental Bank Corp](#) 922 F.2d 357 (7th Cir 1990); refraining from opportunistic conduct such as by taking advantage of a disadvantageous position of the other party who has performed first: [Industrial Representatives Inc v CP Clare Corp](#) 74 F.3d 128 (7th Cir 1996); refraining from hindering or preventing the occurrence of conditions of the party’s own duty or the performance of the other party’s duty: see the discussion in Farnsworth E A, *Farnsworth on Contracts* (3rd Ed, Aspen, 2004) Vol 2 at § 7.17 p 362 and § 8.6 and 8.15; co-operating to achieve the contractual goals: *Larson v Larson* 636 NE 2d 1365 (Mass App Ct 1994); [AMPAT/Midwest Inc v Illinois Tool Works Inc](#) 896 F.2d 1035 (7th Cir 1990). See generally, *Farnsworth on Contracts* at § 7.17-7.17b and [Director General of Fair Trading v First National Bank plc](#) [2001] UKHL 52 at [17], [36], and [54]; [\[2002\] 1 AC 481](#) at [494,500](#) and [505](#). The above are but a few examples.

292. Good faith does not import an equitable notion of the fiduciary that is rooted in loyalty to another in the service of her or his interests: Smith L, “Fiduciary Relationships: Ensuring the Loyal Exercise of Judgement on Behalf of Another” (2014) 130 *LQR* 608. Rather, it is rooted in honest and reasonable fair dealing: [Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service](#) [2010] NSWCA 268 at [\[12\]-\[13\]](#).

293. Trickery and sharp practice impede commerce by decreasing trust and increasing risk. Good faith and fair dealing promote commerce by supporting the central conception and basal foundation of commerce: a requisite degree of trust. Business people understand these things.

This discussion suggests that the concept of good faith is now established within Australian jurisprudence.

Subsection 5(1) of *The Unfair Terms in Consumer Contracts Regulations 1999* (UK)²⁰ reads as follows:

5.—(1) A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.

²⁰ 1999 No.2083

Disclaimer

This paper was prepared to permit ASBFEO to prepare a response to the Treasury Discussion Paper *Review of Unfair Contract Term Protections for Small Business* and for no other purpose.

It does not purport to be legal advice and should not be used as such.

A handwritten signature in black ink, appearing to read 'K.M. Corke', written in a cursive style.

K.M. Corke

Principal

K.M. Corke and Associates

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