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Dear Sir or Madam

ENHANCEMENTS TO UNFAIR CONTRACT TERM PROTECTIONS

We appreciate the chance to comment on issues raised in the Enhancements to Unfair Contract Term Protections Consultation Regulation Impact Statement, published December 2019 (RIS).

About us

The NSW Small Business Commission (NSWSBC) focuses on improving the operating environment and supporting approximately 786,000 small businesses throughout NSW.

We advocate on behalf of firms, speak up in government for small business, provide mediation and dispute resolution services and make it easier to operate successfully through policy reform initiatives.

In addition to our advocacy, mediation and dispute resolution services, we also administer the *Retail Leases Act 1994* on behalf of the NSW Minister for Finance and Small Business.

Background

In 2010, the unfair contract terms (UCT) regime for standard form consumer contracts was introduced. The Australian Consumer Law (ACL) provides that a term is unfair if it:

- causes a significant imbalance in the parties' rights and obligations,
- is not reasonably necessary to protect the legitimate interests of the party relying on it, and
- would cause detriment if relied upon.

The ACL only provides that an unfair term, once determined as such by a Court, is void. It is not illegal to include an unfair term in a standard form contract and doing so does not attract penalties.

In 2016, the regime was extended to small business contracts that meet certain criteria:

- a standard form contract (as defined),
- where one party is a business with fewer than 20 employees, and

- the price payable is below a certain threshold.

In 2018, the Commonwealth Government conducted a review of the UCT regime for small business. That review relied on submissions from interested parties which indicated UCTs remained prevalent in small business contracts.

In response to that and other feedback the Commonwealth announced its intention to strengthen the UCT protections for small businesses, including through a range of legislative amendments where appropriate.

General impressions

Given that a contract term is legal until declared void by a Court, the only risk currently faced from including a UCT in a contract is a low probability that one day that term, in isolation, could be rendered void.

Regulator intervention is considered ineffective as a deterrent because even if a regulator threatens or commences proceedings – a business could simply amend the UCT, and continue to use the same term in other contracts.

The effectiveness of the regime also seems to be constrained by a lack of awareness. Awareness aside, small businesses sometimes can't or don't negotiate terms in contracts drafted by counterparties. Contract drafters meanwhile, seeking to protect their own interests, may tend to include UCTs – whether or not they're familiar with the regime.

Legality and penalties

Commonwealth Treasury discusses in the RIS several options to address the challenge of deterrence:

Option 1 – status quo – the current laws would continue to operate

Option 2 – strengthened compliance and enforcement activities – regulators would allocate additional resources to strengthen their compliance and enforcement activities

Option 3 – making UCTs illegal and attaching penalties – a court would continue to decide whether a term in a standard form small business contract was unfair, and could apply a civil pecuniary penalty for the contravention

Option 4 – strengthened powers for regulators

Option 4a – infringement notices – regulators could also be given the power to issue infringement notices

Option 4b – regulator determinations – regulators could be given the power to determine whether a contractual term is unfair and request the contract-issuing party to vary the term

We consider that options 2, 3, 4a and 4b are necessary to meaningfully enhance deterrence of including UCTs in standard form small business contracts and for businesses to be more likely to take proactive steps to remove UCTs from their contracts.

Although we have some pause in supporting option 3, our impression is that adequate deterrence is difficult to achieve without it, and that it is also a necessary precursor for option 4a, which would likely be a more efficient mechanism than court action.

An advantage of option 3 is that a small business could, as it can presently, bring legal action to enforce its rights. Cost-to-benefit considerations would continue to result in parties progressing only a small proportion of matters through courts. However, because the consequences of a court ruling a term to be a UCT would go beyond rendering the term void, triggering a finding of illegality and potential pecuniary penalty, respondents would be more likely to negotiate UCTs with counterparties, or to proactively remove UCTs from contracts.

An advantage of the strengthened powers for regulators under options 4a (infringement notices) and 4b (regulator determinations), is the fact that these treatments would generally be low cost and low risk to small businesses.[1] We're conscious that if these powers were developed, regulators might receive a substantial number of reports, might be reluctant to make determinations on certain matters, and would require appropriate resourcing to administer.

Compliance costs

When the UCT protections were extended to small business in 2016, a compliance cost of $50 million for the first year (with no ongoing compliance costs) was estimated by Consumer Affairs Australia and New Zealand (CAANZ). This figure assumed that large and medium businesses would review their contracts and some would amend their contracts.

While we noticed around that time some law firms promoting services to adjust contracts for UCTs, our intuition is that even proactive business operators realised no practical consequences would likely flow from declining to adjust their contracts, and so they didn't.

If options 3 and 4 are adopted, we think it is reasonable to expect that compliance costs of the quantum described above will be subsequently incurred, perhaps for the first time[2], and that additional ongoing compliance costs appear likely.

Definition of a small business contract

We note that under the current law, one of the requirements for a contract to be considered a small business contract is that at least one party to the contract employs fewer than 20 persons at the time the contract is entered. While this definition covers around 97 per cent of Australian businesses, some businesses are unintentionally excluded from the coverage.

We attempted prior to the UCT regime's introduction in 2016 to draw attention to this unintentional exclusion risk, and did not endorse the 20 employee threshold because some firms that could reasonably argue they were a small business might narrowly be disqualified from protection for something as simple as employing one too many casuals.

[1] the possibility of reprisals notwithstanding
[2] if they were in fact substantially averted in 2016-17

For small business entity concessions, the Australian Tax Office (ATO) defines a small business entity as a sole trader, partnership, company or trust that operates a business for all or part of the income year and has an aggregated turnover less than $10 million.

While numerous definitions are used to categorise a firm as a small business in Australia for different purposes, we consider that the ATO turnover threshold would serve as a reasonable benchmark and make it easier for parties to identify whether a contract would be considered a small business contract for the purposes of UCT protections.

Of the relevant options discussed in the RIS, we favour option 3 – a contract being considered a small business contract if at least one party to the contract is a business that employs less than 100 employees or has an annual turnover of less than $10 million.

Value threshold

The UCT protections currently apply to contracts that have an upfront price payable not exceeding $300,000, or if the contract runs for longer than 12 months, $1 million.

The RIS indicates this threshold is considered too low for certain industry sectors. For example, farming businesses tend to be capital intensive and have high revenue with low profit margins. The value of contracts for heavy farming equipment or supply of produce can be higher than the current value threshold, inadvertently excluding firms in this industry. Another example of where the threshold may be too low is where small retail businesses enter contracts that run for several years and the contract value pushes over $1 million.

The RIS explores whether, to strengthen the effectiveness of the UCT provisions, this value threshold should be changed.

Of the three alternatives presented in the RIS, we favour option 3 – remove the value threshold – because it provides certainty a contract won't be excluded from UCT protections based on value, which is helpful for larger contracts and where the upfront contract price isn't clear at time of signing. We consider that small businesses require UCT protections irrespective of contract value. Removing the value threshold would also eliminate any need for indexation.

When considered in tandem with the turnover threshold used to define a small business contract, removing the value threshold, while the boldest option, appears unlikely to render a significant additional number of contracts as small business contracts. As noted in the RIS, businesses who already offer small business contracts normally use the same standard form contract template, regardless of whether the contractual value is below or above the current thresholds.

Application to franchising agreements

The RIS queries how the various options for defining a small business would apply to franchisors and franchisees.

Current research suggests that establishment numbers in this sector are projected to rise modestly over the next five years, from 101,180 in 2020 to 110,250 in 2025.[3] Employment in the sector is expected to rise from 598,000 in 2020 to 632,240 in 2025.[4] These figures tend to suggest that the average franchisee employs around 5-6 staff.

We consider the aggregated turnover less than $10 million threshold would capture virtually all firms that could reasonably be considered small businesses operating in the franchising sector.

Recent research indicates that less than one-fifth of franchisees and small business owners believed they had a clear understanding of the term 'due diligence' prior to purchase or start up; and approximately one-third of franchisees and small business owners consulted an accountant, lawyer or financial adviser prior to purchase or start up.[5]

Use, prevalence and impacts of UCTs

If a small business has a contract dispute, whatever the cause, its operators can approach us for support. As at the time of writing we have directly received a low number of complaints relating specifically to UCTs.

To inform this submission in February 2020 we conducted a survey of small businesses, receiving 68 responses. Around half the respondents identified themselves as operating in the retail industry, with the balance made up of professional services, transport, hospitality, construction, agricultural, and other industry participants. Key results included:

In answer to the question: *'what sort of contracts do you have for your business?'* the following answers were supplied:

- lease for business premises: 51%
- contract for supply of goods: 37%
- franchise agreement: 21%
- licensing agreement: 16%
- other: 37%[6]

In answer to the question: *'are you concerned about being treated unfairly due to business contracts you have signed?':*

- 69% of respondents answered, 'yes I am'
- 18% of respondents answered, 'no I am not'

In answer to the question *'where do you currently go for advice on contracts?':*

- 35% of respondents said they consult a lawyer
- 26% of respondents replied that they don't seek advice
- 11% identified their accountant

[3] Burgio-Ficca, C. *Franchising in Australia*: IBIS World Industry Report X0002, September 2019, p.11
[4] Ibid.
[5] Frazer, Prof. L; Buchan, Assoc. Prof. J; Weaven, Prof. S; Tran-Nam, Prof. B; Grace, Mr A. *The effectiveness of undertaking due diligence prior to starting up or purchasing a small business or franchise*: January 2016.
[6] Respondents could identify more than one type of contract, therefore the total exceeds 100 per cent.

In answer to the question 'what's unfair about the contract/s in question?', responses included:

- *Terms regularly changed, margins eroded or mixed to cover actual profit loss.*
- *Offered a set rate for waste removal but inserted clauses deep into fine print of the contract that allowed them to increase the price as they see fit and the customer has no recourse and can't cancel the contract.*
- *To get an account the supplier wants us to sign that they can take over our personal property if there is any dispute in an account. Most suppliers now won't let us deal with them unless this PPSA part of the form is signed.*
- *The terms and conditions were not negotiable after 25 years told take it or leave it, after having built up 25 years of good will.*

In answer to the question, *'did you know the law includes protections designed to help small businesses with standard form contracts they feel are unfair?*:

- 68% of respondents replied either 'No' or 'No but I would like more information'.

Based on these survey results, it appears that some NSW small businesses continue to face issues related to their contracts and would benefit from additional support and protections. Please find summary data enclosed at Attachment A.

Should any questions arise from this submission please contact Murray Johnston, Principal Advisor Advocacy and Strategic Projects, on (02) 6885 9388 or at murray.johnston@smallbusiness.nsw.gov.au.

Yours sincerely

Stephen Brady
Acting NSW Small Business Commissioner

25 March 2020