



**Small Business
Development Corporation**

Our ref: D20/1483

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CONSULTATION REGULATION IMPACT STATEMENT – ENHANCEMENTS TO UNFAIR CONTRACT TERM PROTECTIONS

The Small Business Development Corporation (SBDC) welcomes the opportunity to provide its views on the Consultation Regulation Impact Statement (CRIS) relating to the enhancement of unfair contract term (UCT) protections for small businesses.

The SBDC is an independent statutory authority of the Government of Western Australia (WA), established to support and facilitate the growth and development of small businesses in the state¹. One of the SBDC's key strategic objectives is to advocate for a fair, conducive and productive environment for WA small businesses, and to influence the policy and regulatory environment affecting the small business sector. In this regard, the SBDC regularly contributes to policy and legislative reviews, inquiries and regulatory reform proposals undertaken across all tiers of government.

The SBDC welcomes the release of the CRIS and supports the Federal Government's intent to increase the UCT protections for small businesses and extend these to insurance contracts and franchising agreements.

Ongoing unfair contract term instances

Since UCT protections were extended to 'small business contracts' the SBDC has continued to see unfair terms being used. Anecdotally the SBDC's advisory team believe that, while there has been a decrease in the number small businesses presenting to SBDC for advice and assistance on UCT related matters, unfair contract terms and poor contracting behaviour remains an ongoing issue facing small businesses in WA.

¹ The views presented here are those of the SBDC and not necessarily those of the WA Government.

The SBDC has partnered with the John Curtin Law Clinic (JCLC) to provide some recent case studies on the usage of UCTs in small business contracts in WA. Established by Curtin University of Technology, the JCLC is a dedicated law clinic within the Curtin Law School that offers clinical legal education to law students and affordable legal services to the WA community. Amongst other things, the JCLC assists small businesses with legal issues involving lease agreements, franchise agreements, contracts, and consumer law matters.²

The JCLC has shared the following case studies which highlight the types of UCTs found in small business contracts.

Case Study 1 - Onerous Obligations and Unilateral Rights

A small business owner entered into contracts for the supply of concreting materials and for commercial credit with the supplier. The small business owner was also required to provide the supplier with a personal guarantee and indemnity, even though the small business was not an incorporated entity.

A number of clauses in both contracts granted unilateral rights to the other party ("the Company") and imposed onerous obligations on the small business owner ("the Customer").

Extracts from the standard form material supply contract:

(a) In the event of any dispute arising between [the Company] and the Customer as to whether an amount is payable, the Customer shall, within the relevant period under Clause 17, pay to [the Company] the amount claimed by [the Company] to be payable (including any amount charged by [the Company] under Clause 18), to be held by [the Company] until settlement of the dispute.

(b) A statement signed by [the Company] certifying any amount payable by the Customer to [the Company], including any Costs, interests or other claims whether under these Terms or otherwise, shall, in the absence of manifest error, be prima facie evidence of the amount payable.

Extracts from the commercial credit contract:

(a) Withdrawal or Variation of Credit: [the Company] may at any time, without the need to provide a reason, vary or withdraw any credit granted to the Customer.

(b) Charge over Customer's Property: As security for payment to [the Company] of all moneys payable by the Customer, the Customer charges in favour of [the Company] all of the Customer's interests in freehold and leasehold property both current and later acquired. The Customer irrevocably appoints each Officer [of the Company] as its attorney to do all things necessary to create and register each such charge.

² Additional information on the John Curtin Law Clinic is available at < <https://businesslaw.curtin.edu.au/law/john-curtin-law-clinic/> >

(c) Suspension or Ceasing of Supply: (a) [the Company] may in its complete discretion and without incurring any liability to the Customer, cease or suspend supply of Products to the Customer or amend these Terms. (b) Without limiting clause 4(a), if an Event of Default occurs, [the Company] may, without prejudice to its other rights, call up moneys owed to it by the Customer, retain all moneys paid on account, or cease further deliveries and recover from the Customer all loss of profits arising therefrom, and/or take immediate possession of any Products not paid for.

Case Study 2 – Leasing Context³

A small retail business owner became the sub-tenant of a property owned by the State of Western Australia. The commercial sub-lease agreement was with a landlord company for the initial term of 10 years. There were numerous UCTs throughout the lease agreement that went beyond protecting the interests of the landlord, creating onerous obligations on the tenant and conferring unilateral rights to the landlord's benefit.

Some examples of where additional costs [to rent charges] may be imposed through a number of clauses include:

(a) in respect of outgoings, where the landlord is entitled to 'any other expenditure reasonably and properly incurred... in respect of the building'.

(b) in relation to insurance, where the landlord may request higher sums from the tenant in respect of any claim arising for any reason and require the tenant to insure against any other risks the landlord 'may from time to time determine' (and, arguably, therefore unilaterally vary the Lease).

(c) in respect of insurance from outgoings, where the landlord may at any time, exclude insurance premiums from outgoings.

(d) in relation to rates and taxes, where the landlord may at any time exclude rates and taxes from outgoings.

Case Study 3 – Franchising Context

A small business owner signed a franchise agreement with a company incorporated in England to exclusively sell a physical development program for children.

At the expiry of the franchise term, the small business owner attempted to sell the franchise business. However, the franchisor repeatedly refused consent to the sale without explanation and then sought to terminate the franchise agreement, telling the franchisee that any dispute had to be filed in the UK. It also sought to claim its legal fees from the franchisee on the basis of an indemnity clause in the agreement.

With the assistance of the JCLC, the franchisee attended mediation and was able to reach an agreement with the franchisor to exit the franchise without financial penalty.

Examples of UCTs in the franchise agreement are extracted below:

³ For additional details on this case study please see Kooy, Ruth 'Unfair Terms In Standard Form Commercial Leases: A Case Study' [2019] WASTuLawRw 9, available at < <http://classic.austlii.edu.au/au/journals/WASTuLawRw/2019/9.html> >

(a) During the continuance of this Agreement, the [franchisee] agrees not:

- To do or omit to do any act or thing which may in the [franchisor's] sole opinion bring the System or the Proprietary Marks into disrepute or which may in the [franchisor's] sole opinion damage or conflict with the interests of the Business or the [franchisee];

- To the extent permitted by law, the [franchisor] may terminate this Agreement forthwith by immediate or, at its discretion, greater notice in writing to the [franchisee] in any of the following events:

(b) if the [franchisee] neglects or fails to perform or observe any of the provisions of this Agreement or commits any breach of its obligations hereunder, which breach if remediable is not remedied to the satisfaction of the [franchisor] immediately or if not reasonably possible, within thirty days of a notice in writing to the [franchisee] requesting its remedy, provided that the [franchisor] shall not be obliged to give such notice in the case of a persistent breach which shall be one which has occurred more than twice in any twelve month period;

(c) The [franchisee] keep indemnified the [franchisor] as well after as before the expiry or termination hereof for and against all damages, losses, claims, demands, expenses (including legal and professional expenses), costs and liabilities which the [franchisor] may at any time incur as a result of any and all breaches by the [franchisee] of the obligations specified in Clauses 22 and 23 above or any other provisions of this Agreement.

Case Study 4 – ATM leasing

A small business sole trader entered into an agreement with a company for the hire and use of an ATM at her business premises. The contract provided that the small business would pay a \$16.50 monthly fee, with additional security and maintenance upgrade fees charged per transaction.

The small business owner experienced ongoing issues with the machine that began three days after the machine was installed at her premises. Despite multiple visits by a technician, the machine errors continued creating a burden on the small business. The small business owner made multiple attempts to contact the company in an effort to inform them of, and resolve, the issues, without success. Eventually she attempted to terminate the contract, stating she did not want to pay and have the machine at her business premises if it was not going to work. The company rejected the termination, and informed the small business owner that her request to terminate the contract and have the ATM removed amounted to a breach of their contract.

It is understood that the company sent the small business a letter of demand requesting liquidated damages under the contract of \$16,500. The ATM agreement included a term to the effect that, if the company decided that the small business owner had breached the agreement, the company would be entitled to liquidated damages of \$15,000, and a \$1,500 fee for the removal of the ATM. The terms of the contract were written in complex

legal language and in very small sized font, making them difficult for a lay-person to understand. The small business owner's first language was not English, and she had difficulty communicating with the company.

The company had previously entered into an enforceable undertaking with the ACCC not to enforce its unfair contract terms for existing merchants. Even so, it has, through a third party debt collector, continued to attempt to collect the alleged monies owing from the small business owner. The matter is ongoing.

Examples of UCTs in the agreement are extracted below:

1. Consequences of termination

a. If Merchant breaches this Agreement, in addition to such other non-monetary rights and remedies to which the ATM Company may (pursuant to this Agreement by, law in equity or otherwise) be entitled, the ATM Company shall be entitled to collect from the Merchant, as an immediately due and payable obligation of Merchant, stipulated as liquidated damages and not as a penalty, an amount equal to the sum of:

The greater of:

- (i) If the ATM's location at the Premises have completed at least 6 calendar months of operation, the average month revenue received by ATM Company from the ATMs located at the Premises in the prior 12 calendar months (or such shorter period if between 6 and 12 months) including (without limitation) Surcharge Fee, interchange, processing, service plan, security upgrade plan and other revenue multiplied by the months remaining under the then existing Term or Renewal Period; and*
- (ii) If the ATM's located at the Premises did not complete 6 calendar months of operations or never commenced operation; \$15,000, plus*
 - > Any portion of prepaid bonus or incentive previously paid to the Merchant; plus*
 - > Removal cost of \$1,500 per Contracted ATM.*

2. The Parties hereto agree and recognise that they cannot accurately determine the ATM Company monetary loss or damages as a result of a breach of the terms hereof by Merchant and that therefore payment pursuant to this provision represents a fair estimate of the appropriate damages to be paid to the ATM Company.

A common theme throughout the four case studies is the power imbalance that is present between the contracting party and the small business operator. The SBDC has long argued that small businesses can be just as vulnerable as individual consumers in terms of their knowledge of the law and access to resources (financial and otherwise) required to protect their legal rights, or pursue their legal entitlements. With this in mind, small businesses continue to be disadvantaged and changes need to be made to the current UCT protection regime to ensure small businesses are better protected.

Consultation Regulation Impact Statement

The SBDC believes that small businesses should be afforded the same level of protection as individual consumers under the Australian Consumer Law. To this end, the SBDC supports the enhancement of the current UCT protections and wishes to

make some additional comments on a number of the specific proposals, discussed in the CRIS, as follows.

Definition of a 'small business contract'

The SBDC has long argued that the overarching principle of the UCT provisions should be to provide protection to as many small businesses as possible and therefore the applicability criteria should reflect this. To this end, the SBDC agrees with the observation made in the CRIS that the current definition of a 'small business contract' does not adequately capture all small businesses vulnerable to UCTs.

The SBDC welcomes the consideration of the expansion of the definition of a 'small business contract' and supports Option 3 – headcount threshold or turnover threshold. The SBDC believes that this option will capture the greatest number of small businesses of those presented in the CRIS.

While Option 3 would provide greater coverage of the UCT protections, the SBDC believes that using the "factor approach" to define small business is counterproductive and may continue to create unintended consequences in the policy setting. As the SBDC has outlined in its previous submissions in 2014 and 2018 on the topic, limiting a definition to factors can create circumstances in which a small business falls in and out of the definition as their factors change (for example, employee numbers may fluctuate).

The SBDC recommends that the definition of a 'small business contract' should be evaluated regularly to ensure that it continues to meet its policy objectives.

Value Threshold

The SBDC agrees with the observations made in the CRIS that the current value thresholds are too low to adequately protect a broader range of small businesses. The current UCT protections apply to contracts that have an upfront price payable not exceeding \$300,000, or if the contract extends beyond 12 months, \$1 million.

The attachment of a value threshold to the application of UCT protections not only excludes certain small businesses who operate in specific industries, namely farming, from being covered, but it can also cause uncertainty around whether a contract is covered by the UCT protections or not, particularly when a contract value may fluctuate based on market conditions.

To this end, the SBDC supports Option 3 – remove the value threshold. The SBDC believes that there is no disadvantage to small businesses in removing this threshold. Importantly it will ensure that regardless of value, small business contracts will be covered by the UCT protections, including insurance contracts and franchising agreements should coverage be extended to them.

Legality and Penalties

The SBDC has strongly advocated for the introduction of pecuniary penalties and for UCTs to be made illegal since the UCT protections were extended to standard form small business contracts.

As outlined in the CRIS, the current consequences for including an unfair term in a standard form small business contract do not act as a strong deterrent or disincentive for businesses to ensure their contracts are free from UCTs. Further, as the onus is on the small business to pursue a remedy through the courts if they believe an unfair term is included in their standard form contract, larger companies are able to capitalise on a small business's typically weaker bargaining position and often continue to include UCTs in their contracts.

It is well documented that small businesses generally experience a lack of access to justice based on a combination of factors including, the cost of engaging legal representation, unfamiliarity with legal process and the stress associated with pursuing court action. Should a small business successfully pursue their rights and succeed in proving that the term is unfair, the remedy is for the court to void that particular clause. For the party that included the unfair term in the contract, there is no other consequence beside the clause being ruled invalid. The SBDC believes that often larger businesses take the risk of including an unfair term to reap the benefits, knowing that it is unlikely that a contracted small business will pursue its removal through legal action.

In the SBDC's opinion, the protection would be far more effective if there was an actual penalty for including unfair terms in small business contracts. As such, the SBDC supports Option 3 – making UCTs illegal and attaching penalties. We believe that if there was an appropriate civil penalty attached to this behaviour then larger businesses would be more motivated to ensure that they remove such terms from their standard form contracts.

The SBDC also supports the empowerment of the regulator through the use of the existing tools they have at their disposal, particularly in the initial stages of the proposed changes. We note the downsides to Option 4a and 4b and should they be implemented, the SBDC hopes that the regulator will be adequately supported to meet the objectives of the changes.

Flexible Remedies

In addition to supporting the introduction of pecuniary penalties and for UCTs to be made illegal for standard form small business contracts, the SBDC also supports Option 3 – align remedies for non-party small businesses. As the CRIS acknowledges, like consumers, small businesses share similar characteristics in terms of limited financial resources and negotiating power.

Through the alignment of remedies available for 'non-party consumers' to also apply to 'non-party small businesses', the regulator would be able to commence court proceedings on behalf of a class of small businesses on the basis that a declared unfair term has caused or is likely to cause the class of small businesses to suffer loss or damage. Currently each affected small business with unfair terms within their standard form contract would need to individually apply to the court to have the term voided, which would be expensive and highly unlikely.

By aligning remedies and empowering the regulator to bring a case on behalf of a class of affected small businesses, contract issuing parties are more likely to review their standard form contracts and remove terms that may be considered unfair.

Clarity on standard form contracts

The SBDC is aware that small businesses experience uncertainty around what are standard form contracts, particularly in relation to whether a contract is considered to be 'standard form' and whether terms can or cannot be negotiated. To this end, the SBDC supports Option 2 – repeat usage and Option 3 – clarifying 'effective opportunity to negotiate'.

Given the legal uncertainty that has manifested in recent years regarding standard form contracts and the meaning of the 'effective opportunity to negotiate', the SBDC is hopeful that the proposed changes will provide small businesses with some much needed clarity of this issue.

Extension to insurance contracts

The SBDC supports the application of UCT protections to insurance contracts. In August 2019 the SBDC provided a submission to that effect to the Federal Government's draft Regulation Impact Statement relating to extending the protection from UCTs to insurance contracts.⁴

Currently, the UCT laws apply to most financial products and services regulated by the *Australian Securities and Investments Commission Act 2001* but not to insurance contracts regulated under the *Insurance Contracts Act 1984*, which the SBDC believes to be unsound.

As the SBDC outlined in that submission, ensuring that small businesses and consumers have the equivalent level of protections when entering into an insurance contract as they do under other financial products and services by removing terms that are unfair is the right thing to do. Further it will likely lead to small businesses more adequately insuring themselves, as the extension of the UCT provisions to insurance contracts would increase confidence in the industry.

The SBDC's recommendations regarding legality and penalties as discussed above should then equally apply to UCTs if they present in insurance contracts once legislation is passed.

Application to franchising agreements

Similarly to insurance contracts, the SBDC believes UCT protections should be extended to franchising agreements and has previously advocated for this change in our submissions to the Franchising Taskforce. The SBDC also believes that the changes to legality and penalties discussed above should equally apply to UCTs if they are present in franchising agreements.

Concluding comments

The SBDC welcomes this latest review of UCTs and firmly believes that the law needs to be strengthened in order to better protect more small businesses. Importantly, making UCTs illegal and attaching pecuniary penalties will disincentive

⁴ SBDC's complete submission is available at < https://treasury.gov.au/sites/default/files/2019-10/small_business_development_corporation.pdf >

the use of terms in standard form contracts that are unfair and not necessary to protecting the legitimate interests of contracting parties in the course of doing business in Australia.

If you would like to discuss this submission in more detail, please contact Nikki Forrest, Policy and Advocacy Officer at nikki.forrest@smallbusiness.wa.gov.au or on (08) 6552 3373.

Yours sincerely



David Eaton
SMALL BUSINESS COMMISSIONER

16 March 2020