UNFAIR CONTRACT TERMS – SIGNIFICANT BROADENING OF SCOPE AND PENALTIES FOR BREACHES: IS YOUR BUSINESS PREPARED?

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IN BRIEF

The Australian Government has released the Exposure Draft legislation and Explanatory Materials for an anticipated suite of reforms to unfair contract terms (UCT) laws found in the Australian Consumer Law (ACL) and *Australian Securities and Investments Commission Act 2001* (ASIC Act). Treasury is now considering feedback on the exposure draft with a view to the Government introducing a bill to effect wide-ranging changes to the UCT regime.

There are six key proposed changes:

- significant financial penalties for contraventions;
- significantly expanding the number of business-to-business contracts subject to UCT laws;
- greater flexibility of remedies for breaches;
- introduction of a rebuttable presumption that certain terms which are "the same or substantially similar in effect" to UCT will also be unfair;
- clarity on the definition of a "standard form contract"; and
- exclusion of clauses that refer to "minimum standards" provisions contained in legislation.

These changes materially increase the risk profile for larger businesses that engage Business to Business (B2B) and Business to Consumer (B2C) via standard form contracts.

While many businesses reviewed relevant contracts in 2016 in the lead-up to the extension of ICT to B2B contracts, **the significant increase in scope of the UCT laws, the introduction of penalties, together with developments in the law means that it is vital for business to re-examine the terms of affected contracts to ensure compliance.**

WHAT IS THE CURRENT UCT REGIME?

Australia's UCT regime is designed to stop powerful businesses from using their stronger bargaining position to essentially "force" the inclusion of UCT into agreements with consumers or small businesses.

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The UCT regime currently captures standard form contracts that are either '**consumer contracts**' or '**small business contracts**'.

- A '**consumer contract**' exists where:
  - at least one party is an individual who acquires goods or services wholly or predominantly for personal, domestic or household use.
- At present, a '**small business contract**' exists where:
  - 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 AU$300,000, or AU$1 million if the contract runs for more than 12 months.

Under both the ACL and the ASIC Act, a term is **unfair** if it:

- would cause a **significant imbalance** in the parties' rights and obligations arising under the contract;
- is **not reasonably necessary** to protect the legitimate interests of the party who would be advantaged by the term (the term is presumed to *not* be reasonably necessary); and
- would **cause detriment** (whether financial or otherwise) to a party if it were to be applied or relied on.

The UCT regime only applies to 'standard form contracts'. Generally speaking, these are contracts where there are no opportunities to negotiate meaningful changes to the terms. However, exactly what 'standard form contract' means has never been clearly defined under the current regime, and is one of the proposed areas of reform.

The UCT regime does not currently provide any penalties for businesses that use UCT. Rather, if a term is found to be unfair, a court will declare the term void, and may also make a range of additional orders. Void terms are not binding on the parties, but the rest of the contract will continue to operate to the extent possible without those void terms.

THE PROPOSED CHANGES

Topic of Change	Current Law	New Law	Implication
1. Pecuniary penalties for contraventions	No equivalent	Prohibits the inclusion of, or reliance on, unfair terms in standard form consumer or small business contracts and enables a court to impose substantial pecuniary penalties for **each contravention**: ▪ for businesses,	Introducing civil penalties for UCT contraventions will increase deterrence. However, there is often uncertainty as to whether a clause is 'unfair'. This uncertainty may deter businesses from entering into 'legitimate' contracts

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		the greater of AU$10 million, three times the value of any benefit from the contravention and (if the value of the benefit cannot be determined) 10 per cent of the contravening businesses' Australian turnover in the 12 month period prior to the contravention; and ▪ for individuals, AU$500,000.	and could restrict some business activities.
2. Scope for business-to-business contracts	A 'small business' is defined as employing less than 20 people, with an upfront payable price under the contract of no more than AU$300,000, or AU$1 million if the contract is for more than 12 months.	The definition of 'small business' is expanded, with UCT provisions applying to any standard form contract where one party has up to 100 employees or an annual turnover of up to AU$10 million. The dollar value test for the size of contract has been removed altogether – all contracts with a 'small business' have to comply.	A much broader class of business contracts will be 'caught' by the UCT regime.
3. Broader, more flexible remedies	A court may make orders: ▪ where a person has suffered,	In addition to current powers, a court may make orders: ▪ where a person	The lower threshold of 'may', and the broader categories of contracts over which orders can be made, will have broad

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	or is ***likely*** to suffer, loss or damage because of an UCT; ▪ to void, vary or refuse to enforce the term or the entire contract; and ▪ preventing a party from applying or relying on (or trying to apply or rely on) a term of a contract that has been declared unfair.	has suffered, or may suffer, loss or damage because of an UCT. Those orders can also extend to loss or damage relating to a same or substantially similar term in: ▪ any current contract the person is a party to; or ▪ any future contract the person will be a party to.	implications. These changes will allow the courts greater flexibility in compensating wronged parties. However, that flexibility will increase the uncertainty for larger businesses as to both the breadth and magnitude of the 'downside risk' associated with losing such proceedings.
4. Introduction of a rebuttable presumption for similar terms	No equivalent	Unless a party proves otherwise, a contract term will be presumed to be unfair if the same or a substantially similar term has been deemed unfair in another proceeding in similar circumstances (i.e. proposed by the same entity or in the same industry).	If a term is claimed to be an UCT, and a court has previously declared a similar term to be unfair, the defendant will have to prove why their contractual term is not unfair in these circumstances. This will incentivise the quick removal of unfair terms without the need for repeated litigation. However, it will increase the regulatory burden and uncertainty on larger businesses to stay abreast of UCT cases.
5. More clarity on the	In determining whether	In addition to current	Currently, Courts analyse

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meaning of a "standard form contract"	a contract is a 'standard form contract', the Court must take into account a number of matters including whether one party was: ▪ required to reject or accept the terms of the contract in the form it was presented; or ▪ given an effective opportunity to negotiate the terms of the contract.	factors, the Court must also consider whether a party has used the same or a similar contract before, and the number of times this has been done. The court must not consider: ▪ whether a party had an opportunity to negotiate minor or insubstantial changes; ▪ whether a party had an opportunity to select a term from a range of options; or ▪ the extent to which a party to another contract or proposed contract was given an effective opportunity to negotiate terms of the other contract or proposed contract.	a series of factors in determining whether a contract is a 'standard form contract', which have been criticised as providing insufficient guidance to businesses. The proposed amendments would assist a court in determining whether a 'standard form contract' has been used by providing further guidance in determining whether an 'opportunity to negotiate' has taken place, and allowing a Court to look at a business' contextual usage of a particular contract.
6. Exclusion of "minimum standards" provisions	No equivalent	UCT provisions will not apply to terms that include 'minimum standards' or other industry-specific legislative requirements.	Businesses will not need to worry about contravening the UCT regime in respect of terms relating to 'minimum standards' or industry-specific requirements contained in Commonwealth, state or

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			territory legislation.

WHY ARE THE CHANGES REQUIRED? ARE THEY ALL REQUIRED?

In recent years, there have been numerous calls from government, the ACCC, and various consumer rights groups to strengthen the UCT regime. It is argued that this is due to the relative inefficiencies in the current regime, such as the lack of financial penalties undermining deterrence. Despite, or perhaps because of, these inefficiencies, consumer protection bodies have received over 5,000 UCT complaints in the last few years, relating to both B2C and B2B transactions.

In December 2019, the Treasury announced a consultation into the UCT regime following concerns that the regime:

- did not provide sufficient deterrence to businesses using unfair terms in standard form contracts due to the absence of penalties;
- did not provide sufficient coverage to many small businesses which would benefit from being included;
- was undermined by ambiguity with certain compliance aspects of the law; and
- required more flexible remedies and means of addressing UCT than only being able to declare the term void.

The Government has accepted the Treasury's conclusion that the absence of penalties is a deterrence problem with the current UCT regime. Because UCT are not *prima facie* illegal and do not attract any penalties, businesses are incentivised to include them and see whether they can "get away with it", only changing the terms "on the court steps" when challenged by the ACCC. Having the term merely declared void does not serve a deterrent purpose and is arguably not an efficient use of the public funds allocated towards the ACCC's investigation and litigation of the matter.

However, as referred to in the "Implications" in the above table, the proposed changes, in circumstances where the "unfairness" of a term is situational (the "unfairness" of a term being "situational"/having regard to the totality of the rights/obligations in a contract) are likely to result in considerable uncertainty and risk for businesses that need to engage with counterparties via standard form contracts – particularly given proposed "rebuttable presumptions" and the size of potential penalties.

The Competition and Consumer Committee of the Law Council of Australia raised these issues/concerns in its submission to Treasury, to which K&L Gates contributed. The link to the submission is here.

WHAT DOES THIS MEAN FOR YOUR BUSINESS?

Review and update your standard form contracts

The proposed UCT regime foreshadows additional scope, remedies, and penalties. Businesses should act now to ensure their small business and consumer contracts are compliant with UCT provisions.

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The ACCC's recent proceedings against Fuji Xerox provide guidance for businesses on the kinds of contract terms that the ACCC will consider to be unfair in the first instance, such as:

- unilateral variation terms;
- automatic renewal terms;
- excessive exit fees;
- unilateral price increases;
- unilateral liability limitation terms;
- disproportionate termination terms; and
- unfair payment terms.

Recent ACCC investigations also suggest that terms governing payment and supply chain finance for small businesses (discounting amounts due in exchange for earlier payments) can also attract under scrutiny.

Ignorance is risk

The UCT regime interacts with a number of other protections under the ACL, meaning a breach of the UCT regime could also breach other parts of the ACL. Some of these other provisions *are* subject to pecuniary penalties, significantly increasing the risks of non-compliance:

- **Misleading and deceptive conduct** - Misrepresenting the rights of consumers and small businesses to negotiate contracts, or argue against the inclusion of and reliance on unfair terms, can be deemed misleading and deceptive conduct.
- **Unconscionable conduct** - The inclusion of implied terms, terms hidden in fine print, terms hidden in a schedule or in another document, or terms written in legalese can expose a business to contravention of both unconscionable conduct and UCT laws.

  A systemic policy of employing UCT in a business' contracts may also amount to unconscionable conduct. The ACCC investigated UGL in 2020 regarding extensions of payment terms in supply chain financing.

- **Consumer guarantees** - Terms that interfere with a consumer's rights under Australia's Consumer Guarantee laws may be deemed to be UCT, and thus void.

The ACCC expects businesses to be aware of their negotiation practices with consumers and small businesses, and understand the presence and effect of any unilateral terms to avoid falling foul of the new regime.

UCT regime also applies to insurance contracts

From 5 April 2021, UCT laws apply to insurance contracts that are entered into, varied, or renewed on or after 5 April 2021.

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If your business is in the practice of entering into insurance contracts, it is important that you review your terms so that they comply with the new UCT regime.

If you wish to have any more detail about the above issues or discuss them further, please do not hesitate to contact a member of the K&L Gates Competition & Consumer Law team. We have experience advising on UCT issues and can assist your business in its contract review and staff training.

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