

# ARE YOU READY FOR THE EXTENSION OF THE UNFAIR CONTRACT TERMS REGIME TO SMALL BUSINESS?

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**Antitrust, Competition & Trade Regulation Alert**

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## IN BRIEF:

Since 2010, the Australian Consumer Law (**ACL**) and the ASIC Act have prohibited and made void terms in standard form contracts with consumers that were unfair.

From 12 November 2016, the Unfair Contract Terms regime (**UCT Regime**) will be extended to standard form contracts entered into with small business.

All businesses need to ensure that the terms and conditions of their standard form contracts are not at risk of being alleged to be unfair and hence void and unenforceable.

Businesses in the following industries need to be particularly vigilant as the ACCC has stated that these industries are the subject of the ACCC's initial compliance activities and are likely to be focused upon in future investigations / enforcement activities:

- franchising
- retail leasing
- advertising services
- telecommunications services
- independent contracting (e.g. IT consultants and architects).

## THE UCT REGIME

Under the ACL, a term of a consumer contract (and shortly, a small business contract) is void if the term is unfair and the contract is a standard form contract.

This article will focus on the impact of the extension to small business and its meaning, rather than on each element required to found an unfair term, but in brief:

- the law presumes that the contract under scrutiny is "standard form". It is up to the party that prepared the contract to prove that it is not "standard form" taking account factors such as:

- whether the contract was prepared by one party prior to discussions with the other party
- whether there was a real opportunity to negotiate the terms of the contract, particularly the terms being examined, or whether the contract took account of the specific characteristics of the counterparty.

A term is unfair if:

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

Further, in considering whether a term is unfair, regard has to be given to the whole contract (i.e. the other rights and obligations under the contract) and the extent to which the relevant term was transparent (including whether it was expressed in plain English and readily available to any party affected by the term).

## WHAT IS A SMALL BUSINESS CONTRACT AND WHICH CLAUSES ARE SUBJECT TO THE UCT REGIME?

The UCT Regime will apply to small business contracts entered into after 12 November 2016, or renewed after that date, or amended after that date (although the regime only applies to the terms amended after that date).

A small business contract is:

- a contract for the supply of goods and services, or a sale or a grant of an interest in land
- at the time the contract is entered into one party to the contract is a business that **employs fewer than 20 persons**; and either the **upfront price** payable under the contract:
  - is AUD300,000 or less or
  - AUD1 million or less where the duration of the contract is greater than 12 months.
- As per the existing provisions, a term that sets the upfront price payable under the contract cannot (itself) be considered as an unfair term.

We provide further commentary about these terms below.

The UCT Regime does not apply to:

- most insurance contracts, including car insurance, home and contents insurance and consumer credit insurance contracts, although some insurance contracts (including private health insurance) will be covered
- constitutions, including the constitutions of many superannuation funds, companies, and managed investment schemes
- contracts for the carriage of goods by ship.

## WHAT IS A "SMALL BUSINESS" AND THE "UPFRONT PRICE"?

*"a business that employs fewer than 20 persons"*

The above phrase raises some uncertainty including what is a "business", whether only "employees" are included or whether contractors / labour hire personnel are included, whether it applies to full-time / part-time personnel and how the larger business will know at the time of entering into the agreement the number of employees of the small business?

From a risk management / compliance perspective, and anticipating that for the most part it is likely to be the ACCC rather than counterparties that will be investigating / taking action, our views are as follows:

- Both the legislation as well as the guidance from the ACCC refers explicitly to "employees". Accordingly, the starting position is seeking to ascertain the number of employees.
- The legislation states that both permanent and casual employees are to be included in the headcount, as long as the casual employees are employed on a regular and systematic basis. The legislation is silent on part-time employees. The ACCC takes the view that a part time employee is still counted as an employee for the purposes of this definition.
- Accordingly, a company has two options:
  - It could take the more conservative or risk averse approach of assuming that all of its counterparties have less than 20 employees and ensuring that the terms of its standard form agreements are compliant with the unfair contract terms regime. Clearly, this reduces risk and is administratively "easier" for the company, as there is one standard set of terms. However, it may have commercial and legal implications. In particular, it may provide rights and benefits to companies having more than 20 employees, where it would not be in the company's commercial interests to provide such rights to its counterparties. The company will therefore "leave money on the table".
  - It may, as part of entering into the relevant standard form agreement, and at each renewal, seek written confirmation that the company has greater than 20 employees – and if it wishes to do so can have a different set of terms depending on the response. While the ACCC states that the response of the smaller party is not determinative if in fact the company had less than 20 staff at the time of entering into the agreement, it will have a significant impact of the ACCC's decision-making process about investigation and enforcement (on the basis the company took reasonable steps and acted in good faith).

### What is Included in the "Upfront Price"

The ACL defines this term as the consideration that is provided for the supply, sale or grant under the contract, which is disclosed at or before the time the contract is entered into, excluding any other consideration that is contingent on the occurrence or non-occurrence of a particular event.

In seeking to give examples as guidance for this calculation process, the ACCC sets out a number of "franchising" examples, which we have combined for the purposes of this article as follows:

- A franchisor and a franchisee enter into a five year agreement. Under the agreement, the franchisee agrees to pay an upfront fee of AUD500,000 and a monthly royalty based on 5% of the franchisee's sales. The agreement also provides for a AUD6,000 termination fee.

- The ACCC's view is that in seeking to determine whether the upfront price falls below AUD1 million, the AUD500,000 will be included, but not the royalty payments as they are contingent on prospective and unknown levels of sales. The AUD6,000 fee is also not included as that is not referable to the supply or a sale under the agreement.
- Accordingly, if the franchisee had fewer than 20 employees:
  - the agreement is subject to the UCT Regime
  - the fee of AUD500,000 is not to be considered under the UCT Regime, however
  - the royalty and termination payments can be considered under the UCT Regime.

### ***What Types of Terms will be Subject to Most Scrutiny?***

The legislation (provides 14 examples of terms that may be unfair), guidelines by the ACCC, as well as a small number of judgments have provided good guidance as to the types of terms at risk. Many of the examples provide for one party having a right that the other does not have, as opposed to a reciprocal right. Some examples that the ACCC has particularly focused on are:

- the right to unilaterally vary the contract, including in particular, to vary the price or the characteristics of the goods or services to be supplied
- early termination fees
- limitation of liability (or no liability clauses)
- automatic rollover clauses
- forfeiture clauses
- termination without cause clauses
- broad indemnity clauses.

The fact that the ACCC is focusing on the types of clauses above does not necessarily mean that they are unfair. It will always depend on the particular circumstances of each case.

The regulators are more likely to intervene when they consider a term is likely to cause a detriment to a material number of counterparties to the larger party. It will be important to ensure that you consider carefully whether you have a legitimate business interest in including such a term in your contracts - and having evidence in place to support the claim of a legitimate business interest.

It is also important to take care about the claims / representations you make. For example, in Frequently Asked Questions on websites, in promotional material and other communications with potential counterparties. While such documents are not subject to the UCT Regime (unless incorporated into the contract) if you misrepresent the rights and obligations under the contract, the ACCC, in addition to taking enforcement action on the basis of unfair terms, can also allege that you are making misleading or deceptive representations. Breaches of these provisions can lead to very significant penalties.

### ***What to Do / Practical Risk Management Tips***

Clearly, companies must review their standard form contracts to ensure that they are compliant with the UCT Regime. Where there are potentially unfair terms, consider the rationale for the terms and whether the terms are necessary to protect the legitimate interests of the company – and evidence the necessity for these terms.

While all agreements may ultimately need to be considered from the perspective of unfair terms if you are doing business with small businesses, in terms of prioritising your review, focus on:

- the agreements that are core to the operation of your business
- the agreements and the terms most likely to be alleged to be unfair
- the need for each of these terms, and the importance of these terms to your business system:
  - consider the extent to which you have had to rely on the term
  - consider the implications for you if the terms are not included in the agreement
  - consider any push-back and complaints from businesses about the term and the manner in which you have resolved such complaints,

and having regard to the above, come to a view as to whether the term requires amendment or deletion. If the term is in your view necessary to protect your interests, proactively evidence, for your internal purposes, the nature of the interests necessary to be protected.

In addition, again prioritising your core / more important agreements, as part of the same process, consider how transparent / plain English are the terms and conditions of your agreements and whether you need to take any steps to make more transparent or highlight the terms that may be alleged to be unfair, but which you consider are necessary to protect your legitimate interests. The more transparent / highlighted the better placed you will be in any negotiations with the ACCC in the future.

As stated above, in addition to considering your agreements, consider the statements made in supporting or related documents that are provided to small businesses to ensure that they are not likely to be alleged to mislead them as to their rights and obligations.

Finally, implement processes into your organisations such that future agreements or amendments to agreements, where the counterparties are likely to be small business, are considered from the perspective of unfair contract terms and at the time of inclusion of terms that may be alleged to be unfair, provide for/evidence the rationale for such terms.

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