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Unfair contract terms in small business contracts

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The unfair contract terms legislation

- *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (**UCT Legislation**)
- Enacted on 12 November 2015
- 12 month transition period before the regime comes into effect
- Applies to contracts entered into, renewed, rolled over or varied (but only to the parts varied) on or after 12 November 2016
- Echoes the existing protections for consumer contracts
- However, will apply regardless of whether the small business is supplying or acquiring the goods or services

Key definitions and elements

Amendment to s23(1) Australian Consumer Law:-

“A term of a consumer contract or small business contract is void if:-

- (a) the term is unfair; and
- (b) the contract is a standard form contract.”

“small business contract”

- At least one party is a small business
- A small business has less than 20 employees
- Upfront price does not exceed:
 - \$300k if 12 months or less
 - \$1m if greater than 12 months
- Assessed at the time the contract is entered, varied or renewed

“standard form contract”

- Not defined in the legislation
- s 27 of the ACL specifies the matters to be taken into account in making determination
- Burden on the party seeking to enforce an unfair term to prove that it is not a standard form contract

Calculation of the upfront price

Includes:

- The total consideration to be provided under the contract that is evident at the time the contract is entered
- May comprise a number of payments aggregated together
- Not confined to initial payments made at the outset of the contract
- Covers future payments over the course of the contract that can be determined with certainty at the time of entering the contract
- GST inclusive price

Does not include:

- The potential value of the contract (e.g. commissions, % royalties, bonuses) because amounts cannot be determined at the outset
- Interest (even on loan agreements)
- Payments which are contingent on the occurrence/non-occurrence of a particular event (ie transfer fee)

Indicators of a standard form contract

Section 27 of the ACL:

- Imbalance in bargaining power of the parties
- Contract prepared in advance by one party
- 'Take it or leave it' approach
- No effective opportunity to negotiate
- Not tailored to party / transaction
- Any other matter prescribed by the regulations

Exempt contracts

The following types of contracts have been specifically excluded from the regime:

- The constitutions of companies / managed investment schemes
- Certain types of shipping contracts (next slide)
- Insurance contracts regulated by the *Insurance Contracts Act 1984* (Cth)
 - This may include collateral insurance contracts used purely to insure goods in transit
 - Shipping company may be acting as an agent of an insurer or may be self-insured
- Minister can exempt a contract from the legislation

Shipping exemption

- In respect of the shipping industry, section 28 of the Australian Consumer Law provides that the UCT Legislation does not apply to:
 - (a) a contract of marine salvage or towage; or*
 - (b) a charterparty of a ship; or*
 - (c) a contract for the carriage of goods by ship.*
- The reference to a contract for the carriage of goods by ship includes a reference to any contract covered by a **sea carriage document** within the meaning of the amended Hague Rules referred to in section 7(1) of the *Carriage of Goods by Sea Act 1991* .
- No exemption for contracts in respect of freight forwarding by air i.e. shipping means shipping by sea vessel.

What is an unfair term?

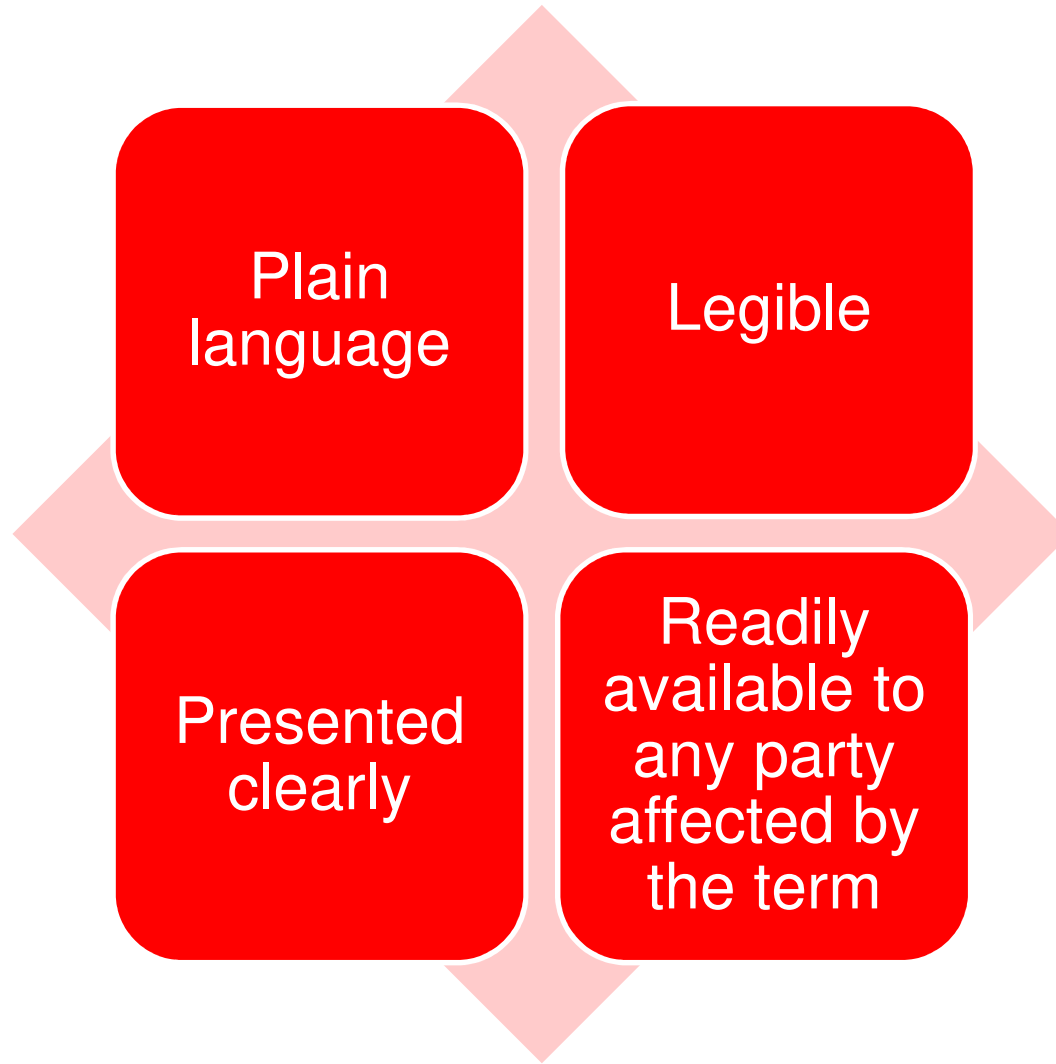
Elements of an unfair term

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

Applying the elements

- All three of the above elements must be proven
- A court must take into account the extent to which the term is **transparent** and must **view the contract as a whole**
- A term is transparent if the term is expressed in reasonably plain language, legible, presented clearly and readily available to any party affected by the term
- The burden of proof is on the party advantaged by a term to prove it is reasonably necessary in order to protect the legitimate interests of the party

Transparency – ACL



Consequences of an unfair contract term

If a provision is “unfair”, the provision is void.

The remainder of the contract remains in effect provided it is able to operate without the offending term or terms.

A party to a contract, and either the ACCC or ASIC (in respect of financial services) can make application to the court for a declaration that a term of a contract is an unfair term.

Examples of terms that may be unfair

- Section 25(1) of the ACL lists 14 examples of the kinds of contractual terms that may be unfair.
- Generic and of little practical assistance.
- 8 core areas identified by the ACCC.
- ACCC has also published a list scenario based examples of terms which it considers may be unfair. The examples can be found on the ACCC website at <https://www.accc.gov.au/business/business-rights-protections/unfair-contract-terms/determining-whether-a-contract-term-is-unfair#examples>

Core examples of unfair terms

Clause type	Example	ACCC concerns
Unilateral right of variation	Big Business has the right to vary the price of the goods or services without prior notice.	<ul style="list-style-type: none"> • Big Business has the right to unilaterally vary one of the most important terms of the contract - price • Small business has no right to terminate the contract even where the price increase is significant.
Early termination fees	Big Business imposes fee on small business seeking to terminate an equipment lease before end of the term	<p>Has there been sufficient disclosure re the fee?</p> <ul style="list-style-type: none"> • Is it transparent? • Does small business know it is in the contract? • Is the amount of the fee or method for calculating the fee clearly disclosed? • Has there been any variations to the fee
Automatic rollover	<ul style="list-style-type: none"> • Initial 12 month term • Automatic renewal for a further 12 month term unless small business provides 6 months' written notice of non-renewal • Large cancellation fee for early termination. 	<ul style="list-style-type: none"> • Is the small business aware of the rollover provision and the requirement to "opt out"? • High cancellation fees for terminating contract if the small business does not remember to opt out.
Limited or no liability	Removal company accepts no liability for any loss arising in an office relocation, including loss arising from the removalist's negligence.	<p>Unreasonable to shift liability where small business has no ability to influence outcome.</p> <p>Limits the rights of small business against the removalist.</p>

Core examples of unfair terms

Clause type	Example	ACCC concerns
Liquidated damages	Liquidated damages which have no correlation to the cost of the breach	The higher the liquidated damages, the higher the likelihood of the term being unfair. Unlikely to be reasonably necessary to protect Big Business' legitimate interests
Unilateral right to terminate without cause		Small business has no understanding of reasons for termination. Detriment to viability of small business where counterparty is a key customer. Unlikely to be reasonably necessary to protect Big Business' legitimate interests
Indemnities	Small business required to indemnify Big Business even where Big Business causes loss	Shifting of liability to small business is unfair where small business has not contributed to the loss.
Forfeiture clauses	Pre-loaded travel cards – any unused balance is retained by the issuer of the card.	Unfair for the issuer to retain funds Penalises the user of the card for not spending all of the money

Shipping examples

Clause type	Example	Possible concerns
Offshore arbitration	Must arbitrate in Singapore for a contract relating to Australia	Unreasonable cost for the small business to enforce its rights, particularly where services only supplied in Australia. This may be legitimate depending on the location and circumstances of both parties and if services are provided across borders.
Time bars	9 month time bar on making claims against supplier	Significantly reduces the standard limitation period under the existing legislative regime re 'statute of limitations'
Zero liability	Supplier accepts no liability for loss – either on a blanket basis or if no notice of incident within a certain timeframe	No recourse for losses under contract. Note that this may have a consequence for pricing and insurance costs

Exempt terms

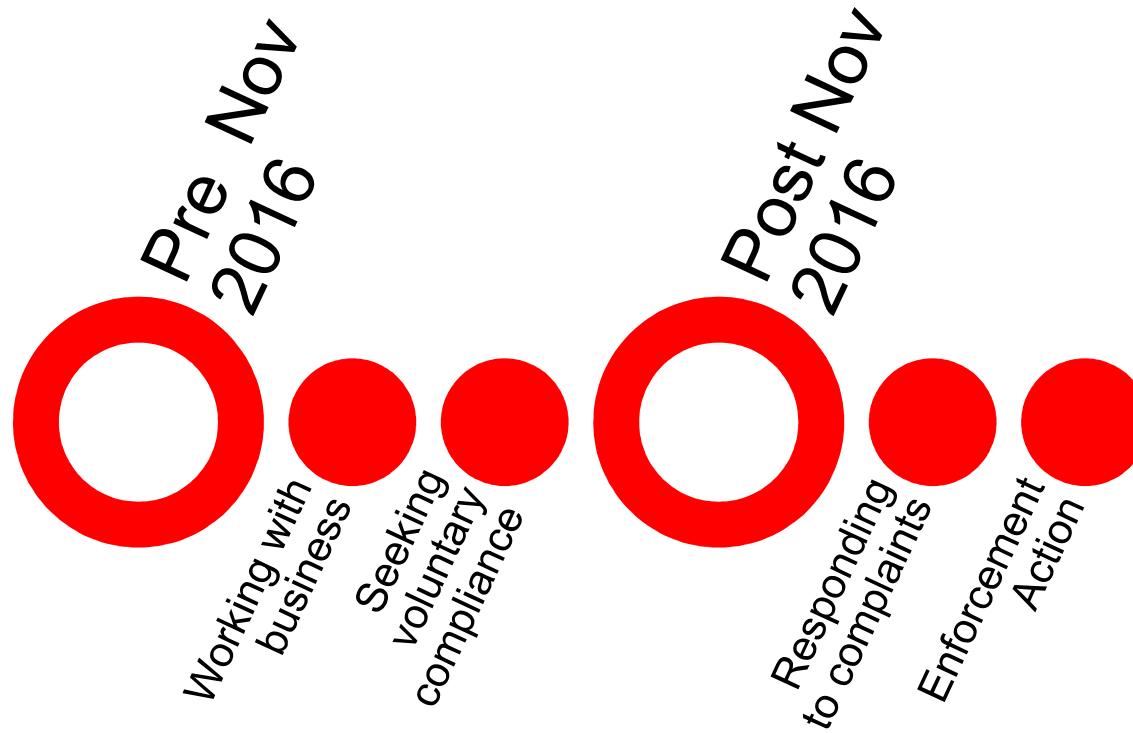
There are some terms to which the UCT Legislation will not apply. Section 26 of the ACL provides that the unfair contract term provisions do not apply to a term of a small business contract to the extent, but only to the extent, that the term:

Term	Explanation
Defines the main subject matter of the contract	The exemption ensures a small business cannot challenge a term concerning the very basis for the existence of the contract. Terms that are necessary to give effect to the supply, or without which, the supply could not occur would also be an exempt term.
Sets the upfront price payable under the contract	<p>Any amount or thing provided as consideration for the supply under the contract (including any future payments which are referable to the supply, sale or grant), which are disclosed at or before the time the contract is entered into.</p> <p><u>Note:</u></p> <ul style="list-style-type: none">• Terms which set commissions, royalties, bonuses are exempt terms. This is in contrast to calculating the upfront price where such amounts are excluded.• Terms which set contingent payments (e.g. termination fees, penalty interest) are not exempt terms.• A term which sets the interest payable under a financing agreement is an exempt term.
Is required, or expressly permitted, by a law of the Commonwealth, a State or a Territory	This exemption ensures a court is not required to determine the fairness of a term that is required to be included, or expressly permitted to be included, in small business contracts as a matter of public policy. For example, an Airway Bill incorporates the package, time bar and other limitation provisions of the <i>Civil Aviation (Carriers Liability) Act 1959</i> , such terms would not be unfair.

Options for dealing with unfair terms

- Remove clause
- Breakdown clauses
- Improve transparency
- Require counterparty to obtain legal advice
- Consider rights of termination for the counterparty
- Determine whether potentially unfair term will be relied on
- Document justification for key provisions
- Consider making unilateral clauses apply even-handedly, or only in specific and easily justified circumstances
- Ensure penalties, liquidated damages and other consequences of breach are reasonable and justifiable relative to the damage suffered or cost incurred
- Reconsider clauses that limit or disclaim responsibility or liability, inhibit the right to sue or otherwise attempt to change the legal position of a party
- Ensure, when considering the contract as a whole, that the rights and obligations of both parties are not significantly imbalanced

What the ACCC is doing



Issues in transportation contracting

Tiered contracts

- Liability gap between head contract and low level subcontracts
- Pass throughs could be protecting a legitimate business interest
- Leverage with head contractors?
- Relief if provision not enforceable downstream / indemnity for liability gap

Master services agreements

- Upfront fees not ascertainable
- Consider building in a minimum purchase commitment that is drawn down over time by separate orders

How to react to the legislation?

- **Avoiding the regime:**
 - In practice, it is going to be difficult to avoid the regime
 - Impose an upfront fee above the dollar threshold – easier said than done
 - Allow for genuine negotiation of contracts – but is this feasible or efficient?
 - Investigate size of contracting party – not practical and no immunity
- **Revising contracts:**
 - Pick up issues now in existing template contracts
 - Not a case of taking a machete to contracts and watering them down
 - Careful consideration of risky clauses and the contract as a whole - is the clause really necessary?
 - Draft carefully to allow clauses to be excised from agreement if deemed unfair
 - Consider other mitigations in the contract – mutual termination right may help
 - Competitive advantage vs disadvantage?
- **Enforcement and disputes:**
 - Where a clause could be deemed unfair, the client will need to determine whether or not to enforce/rely on it at the time
 - Disputes arising from relying on an unfair term could give rise to damages
 - Where a party terminates a contract in reliance on an unfair term – claim for wrongful termination

Game plan

- Assess what standard form contracts you currently have with small businesses
- Review the general nature of contracts to identify whether the contracts:
 - can be readily understood (ie are they simple and drafted in plain English);
 - are particularly onerous;
 - are one-sided, or reasonably even-handed; and
 - are negotiated, or provided on a take-it-or-leave-it basis.
- Review the transparency of current contracting processes (eg review template communications).
- Review complaint handling policies.
- Consider implementing training or a risk management strategy to ensure awareness of the issues and risks.

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