

Competition Law News

Unfair contracts regime extended to dealings with small businesses

21 October 2015

What you need to know

- Businesses that use "standard form contracts" when dealing with "small businesses" have 12 months to ensure that none of the terms of those contracts are "unfair". Any term that is "unfair" may be declared void once the extended unfair contracts regime takes effect in October 2016.
- It may not be easy to determine whether or not a business is a "small business". Under the extended regime, a "small business" is any business with 20 or fewer employees (excluding casual employees, unless they are employed on a regular or systematic basis). It is unlikely to be enough to simply ask a party to confirm whether or not it is a small business for the purposes of the regime.
- The regime applies to standard form contracts with small businesses that are worth up to \$300,000 (if for a term of less than 12 months), and \$1 million for contracts of longer duration.

What you need to do

- **Consider whether the regime would apply to your standard form contracts.** For example, do any of the contracting parties employ less than 20 persons? Does the upfront price payable under the contract fall below the upfront price thresholds?
- **Identify whether any terms of the standard form contracts would be susceptible to challenge under the proposed regime.** Critically, this should involve considering whether particular terms are reasonably necessary to protect the business' legitimate interests. Review any new contracts and existing contracts that will be renewed or varied after the commencement of these reforms.
- **If terms are identified as potentially susceptible to challenge, consider whether they should be amended or removed from standard form contracts captured under the new regime.** This may involve particular challenges where the same standard form contract is used both for contracts which would fall under the regime, and contracts with larger businesses or higher value contracts which would fall outside the regime.

What type of contracts will be covered?

The new legislation applies to terms in a contract where:

- **the contract is a standard form contract** – there will be a rebuttable presumption that a contract is a standard form contract unless proven otherwise. Factors that a court must consider include whether the contract was prepared by one party before discussion between the parties, whether there was an opportunity to negotiate the contract terms, whether one party was required to accept or reject the terms as presented, whether one party had "all or most of the bargaining power" in relation to the contract, and whether the terms of the contract took account of the specific characteristics of the party to whom it was offered or the particular transaction;
- **at least one party to the contract is a small business when the contract is entered into** – a small business is defined as a business that employs fewer than 20 persons (excluding casual employees, unless they are employed on a regular and systematic basis). The regime would apply to contracts between small businesses and larger businesses, as well as contracts solely between small businesses. Additionally, the regime would apply both where the small business is the acquirer (ie the customer) and where the small business is the supplier of the goods or services; and

- **the upfront price payable under the contract is lower than the prescribed thresholds** – the upfront price is the consideration under the contract which is disclosed at or before the time the contract is entered into, but excludes any other consideration which is contingent on the occurrence or non-occurrence of a particular event.

The **prescribed thresholds** (which were increased by the Senate and accepted by the House of Representatives) are as follows:

- for contracts of **12 months or less** - the regime will apply if the upfront price does not exceed \$300,000;
- for contracts of **12 months or longer** - the regime will apply if the upfront price does not exceed \$1 million.

What terms would be unfair?

The Bill adopts the same concept of an "unfair term" that is used under the current regime for consumer contracts - ie a term will be unfair if it:

- causes a **significant imbalance** in the parties' rights and obligations under the contract;
- is **not reasonably necessary to protect the legitimate interests** of the party who would benefit from the term (there is a rebuttable presumption that a term is not reasonably necessary for this purpose); and
- would cause **detriment** (financial or otherwise) to a party if it were relied on.

In determining whether a contract is unfair, a court considers the contract as a whole, including whether a particular term was expressed in reasonably plain language, presented clearly, and readily available to the affected party.

The ACL and the ASIC Act both provide a number of examples of potentially unfair terms (known as the "**grey list**"), such as terms that permit only one party to terminate, limit performance of, vary, renew or avoid, the contract, penalise only one party for breach or termination of the contract, or limit a party's rights to sue another party or otherwise conduct any proceedings in relation to the contract.

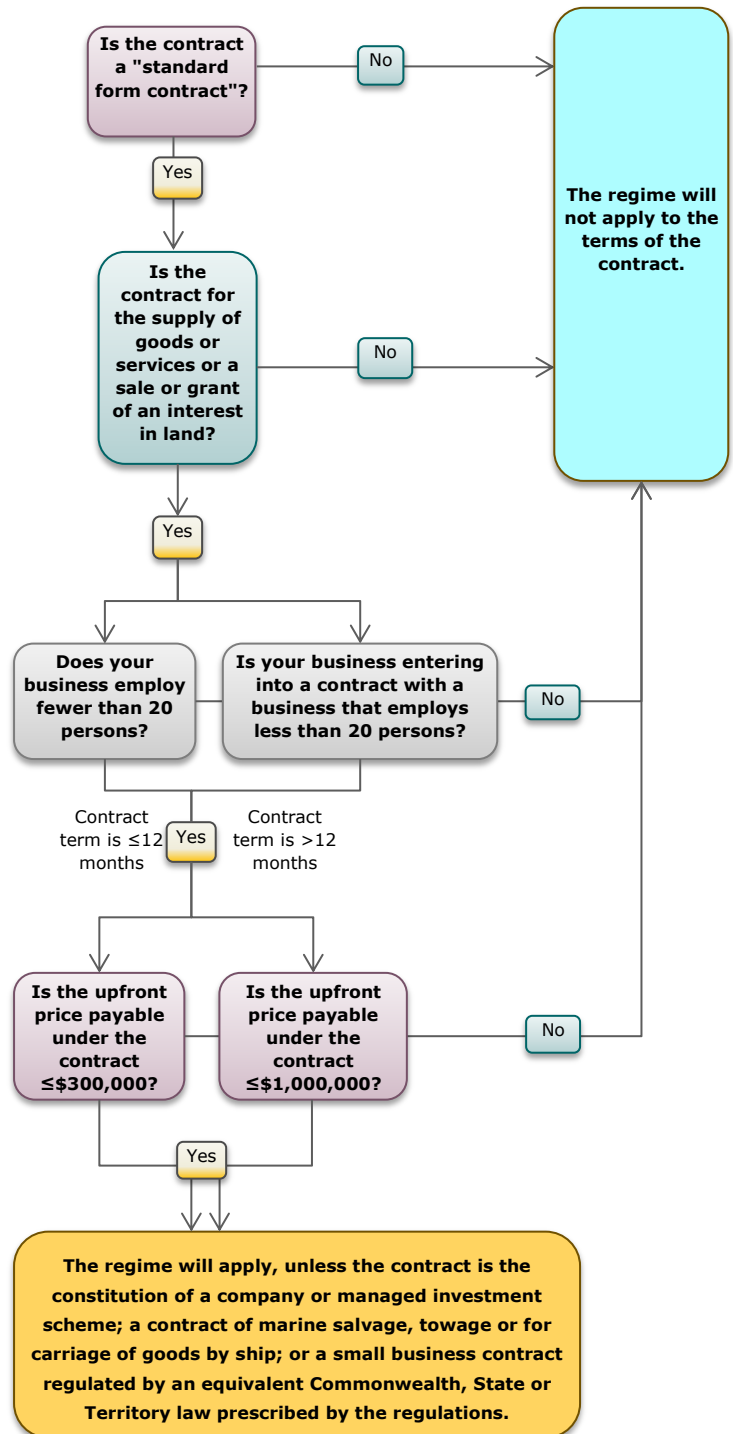
Are there any exemptions?

The regime will **not** apply to a term of a standard form contract that:

- sets the upfront price payable under the contract (using the same definition of "upfront price" described above); or
- is expressly required or permitted by law.

Further, the proposed regime will also **not** apply to:

- the constitution of a company or managed investment scheme;
- contracts concerning marine salvage, towage or the carriage of goods by ship; or
- small business contracts regulated by an equivalent Commonwealth, State or Territory law which is prescribed by the regulations. (At this stage, the extent to which this exemption will operate in practice is unclear; however the regimes under the *Independent Contractors Act 2006* (Cth) and the *Motor Dealers & Repairers Act 2013* (Cth) have already been identified as regimes that may fall within this exemption.)



Insurance contracts covered by the Commonwealth *Insurance Contracts Act 1984* (Cth) are also likely to be exempt. This is because section 15 of that Act exempts insurance contracts from Commonwealth, State and Territory laws that apply relief in the form of "judicial review of a contract on the ground that it is harsh, oppressive, unconscionable, unjust, unfair or inequitable". Public submissions about the new regime called for this to be expressly clarified in the legislation, but Parliament has not done so.

What would be the consequences of using an unfair term?

As is the case for consumer contracts under the existing regime, an "unfair term" in a small business contract could be declared void and unenforceable on application to the Federal Court or a State Court, with the remainder of the agreement continuing to bind the parties if it is capable of operating without the unfair term. If a term is declared unfair, a party may seek an injunction preventing the other party from enforcing the unfair term, and an injured person could seek a compensation order against a party that attempts to enforce the unfair term.

It remains to be seen what approach the ACCC would take to enforcement under the new regime. However, even if the time and cost associated with court proceedings mean that relatively few cases under this regime ultimately proceed to litigation, the existence of this avenue will offer small businesses greater bargaining power in dealings with businesses using standard form contracts.

Challenges in complying with the proposed legislation

Businesses are likely to face some challenges in ensuring that they comply with the revised regime. For example:

- businesses will need to determine what due diligence or other disclosure practices they will adopt when seeking to identify whether their counterparty is a small business (eg in order to identify the number of employees of the counterparty, including where the counterparty is part of a larger corporate group);
- businesses will need to consider how the regime would apply to existing contracts that are renewed, or terms of existing contracts that are varied, after the regime takes effect; and
- the concept of "upfront price" will need to be considered carefully when forming a view on whether the regime would apply to particular contracts, given the lack of detail in the legislation concerning what would constitute consideration which is contingent on the occurrence or non-occurrence of a particular event, and as such would be excluded from the "upfront price".

What should businesses be doing to prepare for the proposed regime?

Companies that deal with small businesses should be reviewing their standard terms of trade with small businesses, on the procurement side and the supply side, to ensure they do not contain unfair terms.

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