UNFAIR CONTRACT TERMS IN SMALL BUSINESS CONTRACTS

The prohibition on unfair terms in small business contracts is about to commence. Do you know what it means for your business? Does it affect you if you're not a small business?

The new laws apply from 12 November 2016 so the time is fast approaching to brush up, beware and make sure this important development in business to business contracting is on your radar and under control.

The new laws

The *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth) (**Act**) is about to commence. The Act broadens the protection currently afforded by unfair contract terms laws to not only consumers, but also to small business, by amending both the Australian Consumer Law (**ACL**)[1] and the *Australian Securities and Investments Commission Act 2001* (Cth).

In essence, where a term in a 'small business contract':

- is unfair, and
- contained within a standard form contract,

that unfair term is void.

Determining whether a term is unfair and therefore void is a decision of the Courts, on application by either a party to a contract, the Australian Competition and Consumer Commission (**ACCC**) or the Australian Securities and Investments Commission (**ASIC**).

Key concepts in determining what contracts the new laws apply to?

What is a 'small business' contract?

A contract will be a ***small business contract*** where:

- it is for a supply of goods or services, or a sale or grant of an interest in land, and
- it is a standard form contract, and

at the time the contract is entered into:

- one of the parties to the contract is a business employing less than 20 people; and

having regard to the duration of the contract, either –

- the upfront price payable under the contract does not exceed $300,000; or
    - for contracts with a duration of more than 1 year, the upfront price payable under the contract does not exceed $1 million.

How are the number of employees counted?

Broadly speaking it's a headcount; with the heads counted at the time the contract is entered into.

---

[1] The ACL is contained within a schedule to the *Competition and Consumer Act 2010* (Cth).

No adjustment occurs on account of staff working less than full time. Casual employees form part of the headcount, provided they are employed by the business on a regular and systematic basis.

Employees are counted only for the specific parties entering into the contract. So for corporate groups, the number of employees within subsidiaries, parent or related entities is not relevant to the headcount. This may mean that some larger businesses are actually caught by the laws if the corporate structure of the group is such that the contracting entity is, for example, a service company with less than 20 employees. So while technically, the business wouldn't be considered a "small business" because of its corporate structure it will be subject to the new law.

A definitive headcount may be difficult to obtain. Even if you seek verification from the other party to the contract on its employee numbers, should a term in the contract come into question in due course, the law may still apply if it turns out that the other party had less than 20 employees at the time the contract was entered into. Given this, the ACCC has stated the safest approach is to assume a contract will be subject to the law.

And remember – only one party to a contract need have less than 20 employees for the laws to apply.

And determining the upfront price?

Again, the ACCC has spoken on this point stating that the upfront price payable includes:

- any payments to be provided for the supply, sale or grant under the contract that are clearly disclosed at or before the time the contract is entered into, and

- any contingent payments which are referrable to the supply, sale or grant under the contract which are disclosed at the time the contract is entered into.

Some contingent payments will not be calculable at the time a contract is entered into – for example percentages based on an unknown sum, such as would be the case for commissions on a property sale, or a royalty due to a franchisor on the amount of future sales by a franchisee. As these figures cannot be determined with certainty at the time of entry into the contract they will not be included in determining the upfront price.

Is it a 'standard form' contract?

A standard form contract is usually one prepared by one party and presented to another party on a 'take it or leave it' basis, limiting or preventing the counterparty from negotiating the contract terms.

The ACCC states the following are factors that will be taken into account when considering if a contract is a standard form:

- whether one of the parties has all or most of the bargaining power

- whether the contract was pre-prepared before any discussions occurred between the parties

- whether the counterparty was, in effect, required to accept or reject the terms of the contract in the form in which they were presented

- following on from the previous point, whether the counterparty was given any real opportunity to negotiate the terms of the contract, and

- whether the terms of the contract take into account the specific characteristics of the other party or the particular transaction.

Some examples of standard form contracts:

- leases
- franchise agreements
- terms and conditions of sale
- supply and distribution agreements, and
- consultancy agreements.

Importantly, the onus of proof is that a contract will be presumed to be a standard form contract, unless the party seeking to uphold it can prove otherwise.

The ambit of the new law may also be broader than the contract itself. The ACCC has stated that if a contract refers to another document as being part of the agreement or requires a party to the contract to comply with another document, then that other document forms part of the contract and will also be subject to the new laws. For example, franchise agreements commonly require a franchisee to comply with an operations manual. The operations manual will form part of the contract and be subject to the unfair contract terms law in the same way as the principal franchise agreement.

And what terms may be considered "unfair"?

While not an exhaustive list, a term in a small business contract will be "unfair" where:

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

Examples of potential unfair terms are:

- a penalty for breach or termination that applies to one contractual party, but not another
- a right to unilaterally vary the contract, particularly where it involves a right to vary the upfront price payable with no commensurate termination right
- a limitation on a party's vicarious liability for its agents
- no refund rights for a deposit
- without cause termination rights, particularly when coupled with liquidated damages
- broad indemnity provisions, and
- liquidated damages.

The decision maker on the question of "unfairness" is a Court. The ACCC's guidance on unfair contract terms states that in deciding this question a Court must consider how transparent the term is, as well as the overall rights and obligations of each party under the contract. The Court is, of course, at liberty to take other relevant matters into consideration.

How transparent is a term?

Transparency requires that a term be:

- expressed in reasonably plain language
- legible
- clearly presented, and
- readily available to any party affected by the term.

Transparency itself is not definitive on whether or not a term is unfair. Terms must be considered in the context of the entire contract. In so doing, it may be that a term that may otherwise be considered unfair is actually found to be reasonable because the contract includes some benefits or other positives that serve to trade off or counterbalance the contractual term(s) in question.

Terms situated in fine print or schedules are unlikely to be considered transparent. The ACCC has also stated that expression has a role to play – terms that are phrased in legal, complex or technical language may not be regarded as transparent.

Strategies to minimise your exposure to the new law

If a Court finds a term to be unfair it will render that term void. As such, it will not necessarily affect the validity of the contract (assuming the contract can operate without the benefit of the term so voided). However, the scope of and application of the new law does create an environment of potential uncertainty particularly in respect of unilateral rights and the ambit of the new laws given that it may also capture associated documents, such as operations manuals.

Consider employing strategies to minimise your exposure to the new law:

- have your standard form contracts reviewed by Moores to highlight risks, identify terms that could be considered unfair and recommend strategies to address the risks
- have Moores redraft any existing standard form contracts for transparency – this is particularly important if you've adopted contracts from a foreign jurisdiction for use in your Australian business operations (e.g. the USA) and/or have structured the contract with schedules or fine print
- monetary thresholds are crucial
- make enquiries to ascertain if the counterparty is a small business or whether there are reasonable prospects that they could be a small business
- negotiate the agreement with the counterparty and provide a genuine opportunity for them to do so, even if they do not take advantage of it – negotiations will be important in establishing that a contract is not a standard form contract
- keep evidence of all negotiations and record all pre-execution correspondence, and

- genuinely consider all points or matters raised by the counterparty and make concessions where possible.

Moores
5 Burwood Road Hawthorn
Victoria Australia 3121
T 03 9843 2100
F 03 9843 2102
E info@moores.com.au
moores.com.au