8 April 2009

By email: australianconsumerlaw@treasury.gov.au

SCOCA Australian Consumer Law Consultation
Competition and Consumer Policy Division
Treasury
Langton Crescent
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Dear Sir/Madam

Australian Consumer Law – submission on unfair contract terms regulation

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to provide comments to the Standing Committee of Officials of Consumer Affairs' (**SCOCA**) on its consultation and information paper *An Australian Consumer Law: Fair markets – Confident consumers* (the **Paper**).

Below we comment on the matters set out in Chapter 6 of the Paper, namely unfair contract terms regulation. We will provide separate comments regarding other matters raised in the Paper. We apologise for the delay in providing our comments on the Paper to SCOCA.

In summary, we strongly support effective national unfair contract terms regulation. However, we hold some significant concerns about the ability of the current proposals set out in the Paper to deliver this effective regulation.

In particular we are concerned that the current proposed model is unclear with regard to implementation and enforcement by regulators. In our view, it appears that SCOCA proposes regulators will not have the ability to undertake their own actions to prevent the inclusion or use of unfair terms in consumer contracts, and will only be able to act where they are doing so on behalf of a consumer or consumers who have suffered detriment or the substantial likelihood of detriment. If this understanding is correct, we cannot support the current proposals on national unfair contract terms regulation.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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National unfair contract terms regulation

Consumer Action has advocated for effective regulation of the use of unfair terms in consumer contracts to be introduced nationally for a number of years. For example, we strongly supported the development of national unfair contract terms regulation in submissions to the SCOCA Working Party on Unfair Contract Terms in early 2004 and made detailed submissions to the Productivity Commission's inquiry into Australia's consumer policy framework in June 2007 and March 2008, including strongly recommending national regulation of unfair contract terms.

The reasons for our support of national unfair contract terms regulation have been explained in detail in these and other documents, as SCOCA is no doubt aware. Therefore, we do not propose to repeat this material. It seems sufficient to note here that we agree with SCOCA's comment in the Paper that the use of unfair contract terms is widespread in consumer contracts and causes consumer detriment (p29). We also endorse the statements made by the Federal Minister for Competition Policy and Consumer Affairs' in releasing the Paper that:

> What we're talking about are situations where businesses use their position to remove all risk from a transaction and push it on to the consumer. For example, it's not uncommon to find terms where the supplier can vary a contract unilaterally, exclude the supplier's liability, or prevent consumers from cancelling contracts.
>
> There are rarely any legitimate business reasons for terms like these, and in many cases they serve only to subordinate the interests of consumers to the whim of businesses.
>
> Though many contracts containing unfair provisions may never give rise to any substantive unfairness, many do.
>
> The existence of these unfair contracts leaves consumers in a vulnerable position, and this isn't conducive to the effective participation of consumers in the market.
>
> This reduces competition and innovation, and compromises the effectiveness and efficiency of markets. This is all bad news for consumers.[1]

Australia currently lags behind world's best practice in consumer policy in its lack of national unfair contract terms laws and we welcome their introduction.

However, we are concerned that the model for national unfair contract terms regulation described in the Paper contains several elements that do not accord with best practice and, in fact, would substantially undermine the effectiveness of the regulation. Our comments on specific elements of the proposed model are set out below.

Definition of 'unfair'

We are broadly supportive of the proposed definition of when a term will be considered unfair, as set out in the Paper (p30). We agree that a reference to 'good faith' is not necessarily helpful and that the concept of 'not reasonably necessary to protect the legitimate interests of the supplier' arguably better captures the intent of ensuring assessment is made of whether it was

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[1] The Hon Chris Bowen MP, Minister for Competition Policy and Consumer Affairs, *Australian Consumer Law - The Future*, Address to the Monash Centre for Regulatory Studies, 17 February 2009.

reasonable for a supplier to include a term in a consumer contract. It also makes explicit the necessary balance between supplier and consumer interests that are properly considered in determining whether a term is unfair in all of the circumstances.

However, we also strongly recommend that the definition provision in the national law follow the two-fold approach to determining whether a contract term is unfair taken in the European Union (**EU**), United Kingdom (**UK**) and Victorian models, by including both a general definition of unfairness and an indicative and non-exhaustive list of terms that may be considered unfair under the general definition. The Paper sets out in a break-out box the sorts of terms that could be included in such a list (p31). This two-fold structure reflects best practice in consumer protection regulation by following a "general-plus-specific" model that allows for flexibility to address changing conditions or practices but also incorporates clarity in relation to known current problems as well as guidance in the interpretation of the general provision or obligation.[2]

In our view, a failure to include an indicative list of terms could render the law open to criticisms of uncertainty. Further, an approach by which a regulator effectively developed such a list in the form of guidelines, in the absence of clear guidance in the legislation, would risk accusation that the regulator was making or interpreting the law.

Application only to standard-form, non-negotiated contracts

We agree that the problem of the widespread use of unfair terms in consumer contracts principally arises due to the widespread use of standard-form, non-negotiated contracts by suppliers. However, the inclusion of this exemption in the coverage of the national law will inherently give rise to a potential "loophole". We believe it is highly likely that this loophole will be targeted by unscrupulous suppliers who will attempt to establish procedures for limited or sham "negotiations" with consumers over what remain in essence standard-form contracts drafted by those suppliers.

SCOCA proposes to deal with the obvious law-avoidance problem this exemption will create by providing for a reverse-onus that will require a supplier alleging a contract is not a standard-form contract to prove that is the case. If SCOCA proceeds with this exemption, which we do not advise, we strongly support such a reverse onus requiring the supplier to prove that a contract was not standard-form and/or was negotiated. However, it will also be critical that the definition of 'negotiated' be carefully drafted to exclude trivial, limited or sham negotiations.

We note that the current Victorian unfair contract terms laws have dealt with this issue more sensibly by removing the potential for law-avoidance created by a "negotiated contract" exemption. Instead the Victorian *Fair Trading Act 1999* provides that, in determining whether a term is unfair, assessment may be made not only of the indicative list of terms but also whether the term was individually negotiated (s.32X). While we accept that regulation of genuinely negotiated contract terms is not generally required and poses a theoretical risk, the reality is that there has hardly been a flood of consumer litigation under the Victorian unfair contract terms laws and we are aware of only one case in which the issue of whether a term or contract was

[2] For further discussion see Consumer Action Law Centre, *The consumer protection provisions of the Trade Practices Act 1974: Keeping Australia up to date*, May 2008, pp 116-17, 138-41.

individually negotiated has even been raised (half-heartedly) by a supplier.[3] It is similarly highly unlikely that there will be a flood of consumer actions under the new national laws, let alone in relation to negotiated contracts, given the general barriers to consumer-initiated legal actions. Thus we consider that the proposed exemption/loophole for negotiated contracts carries far greater risks than the current Victorian approach to this issue.

Exclusion of upfront price of the good or service as per the UK approach

This element is based on the corresponding feature of the Productivity Commission's recommendation.[4] We agree that the general rationale for unfair contract terms regulation does not apply as readily to core contract terms about the upfront price of a consumer good or service being purchased, which consumers are much more likely to be aware of and consider.

However, as with the proposed "negotiated contract" exemption discussed above, this exclusion risks creating a loophole that suppliers may attempt to rely on – in this case to avoid scrutiny of contract terms that impose additional fees and charges. The new national laws must therefore be drafted not only on the basis of the current UK provisions but, additionally, to clarify that only the core upfront and, importantly, *non-contingent* price of a good or service is excluded from coverage under the unfair contract terms provisions. Indeed, the Productivity Commission also made this point in reaching its recommendation:

> Charges that are less transparent should still be potentially subject to regulatory action under the new provision. For example, this could include charges triggered by various contingent events after activation of the contract — 'contingent prices'. Accordingly, regulation would extend to such matters as unreasonable cancellation charges, but not to prices deemed as unfairly high.[5]

Current legal proceedings in the UK between the UK Office of Fair Trading (**OFT**) and the major UK banks in relation to this very question confirm the difficulties that arise if it is not made explicit in the legislation that contingent fees and charges are not covered by this exclusion.[6] While it might seem clear that contract terms imposing subsequent and contingent fees are not intended

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[3] See *Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd* (Civil Claims) [2008] VCAT 2092, §§ 64-71. Further, it is clear that the Victorian approach to the issue of how negotiated terms should be treated is sufficiently well-understood by the courts. For example, in the Supreme Court of Victoria Cavanough J has stated: 'Plainly, individual negotiation of the term is meant to be a factor tending strongly against a finding of unfairness. That is fully consistent with the underlying policy of Part 2B, which respects true freedom of contract and which seeks principally to prevent the abuse of standard form consumer contracts which, by definition, will not have been individually negotiated.' *Jetstar Airways Pty Ltd v Free* [2008] VSC 539 at §112; and in VCAT see the statements of Harbison J in *Director of Consumer Affairs Victoria v Craig Langley Pty Ltd & Matrix Pilates & Yoga Pty Ltd* (Civil Claims) [2008] VCAT 482 at §§ 66-67: 'Section 32X requires me to consider whether or not the terms have been individually negotiated. Although no guidance on how this should be applied is found in the Act, it appears to me to reflect the commonsense view that terms of a consumer contract which have been the subject of genuine negotiation should not be lightly declared unfair. This legislation is designed to protect consumers from unfair contracts, not to allow a party to a contract who has genuinely reflected on its terms and negotiated them, to be released from a contract term from which he or she later wishes to resile. I can visualise that it might be very difficult to argue that a term was unfair if it had been arrived at after genuine negotiation, and represented a compromise between the positions of both parties.'

[4] Productivity Commission, *Review of Australia's Consumer Policy Framework: Productivity Commission Inquiry Report Volume 2 – Chapters and Appendixes*, No. 45, 30 April 2008, pp 161-62, 168.

[5] Productivity Commission, above n4, p 162.

[6] Abbey National plc and Others v Office of Fair Trading [2009] EWCA Civ 116; Office of Fair Trading v Abbey National plc and Others [2008] EWHC 875 (Comm).

to be excluded from assessment for unfairness, the reasoning of the UK courts on this question has been reasonably complex and those courts had the benefit of being able to draw on European legal material that would not necessarily be available to Australian courts. Further, the question remains subject to a live appeal. It must be made clear that the Australian unfair contract terms laws are intended to apply in relation to contingent fees and charges.

All of the circumstances of the contract to be taken into account including broader impacts

Consumer Action agrees that it is appropriate that all relevant circumstances be taken into account in determining whether a term in a consumer contract is unfair or not. This is already a feature of the current Victorian laws. We agree with the Productivity Commission, however, that an explicit public benefit test would be inappropriate for inclusion in the legislation, especially given it is largely without precedent in the consumer law area and might create a large amount of uncertainty.

We also note that the inclusion of a broad requirement to consider ‘all the circumstances’ provides further safeguards against a finding that a term is unfair in a situation where it was genuinely negotiated or related to an upfront price that a consumer clearly understood and considered before entering into a contract. It militates against the need to provide for blanket exclusions for specific situations such as these, which create loophole risks.

Remedies available only where the claimant (individual or class) shows detriment or substantial likelihood of detriment – remedies of term voided only for the contracts of consumers subject to detriment, potential damages for detriment and other remedies available under the Australian Consumer Law

Our understanding is that this element would allow consumers, a group or class of consumers, or a regulator acting on behalf of consumers, to seek a remedy for the inclusion or use of an unfair term in a consumer contract, but that it would not allow a regulator to undertake its own action against an unfair contract term.

Regulator-led representative actions are a different type of legal action to regulator own-motion actions. We note also that, as a matter of practice, representative actions by regulators are exceedingly rare. While we support the new regulation providing the capacity for regulators to take representative action on behalf of consumers, we cannot support SCOCA’s proposals for national unfair contract terms regulation if they do not also provide for the regulators, federal or state, to undertake their own actions to address the inclusion of unfair contract terms in standard-form consumer contracts, including by seeking declarations or injunctions to prevent their ongoing inclusion and use in contracts.

This proposed element is based on the Productivity Commission’s recommendation that an *ex post* enforcement model is preferable to an *ex ante* enforcement model,[7] although SCOCA has agreed that action should also be able to be taken not only when a consumer or consumers have already suffered detriment but when a consumer or consumers (or regulator representing consumers) can prove a substantial likelihood of detriment. It is clear in the Productivity

[7] Productivity Commission, above n4, pp 165-68.

Commission's final report that the capacity of a regulator to pre-emptively rule out unfair terms that could cause (future) detriment to consumers is what it considers to be the *ex ante* model.

As noted earlier, the mischief unfair contract terms laws are intended to address is the widespread inclusion of unfair terms in standard-form contracts, a ubiquitous feature of the modern marketplace. Corresponding to the nature of the problem as a market-wide problem, one of the principal benefits – in fact, arguably the single most important feature – of all existing models of unfair contract terms regulation (whether the EU, UK or Victorian laws, for example) is that they allow the regulator to take proactive action to address the inclusion or use of an unfair term in a standard-form contract in use in the marketplace, and do not merely bestow legal rights on the individual consumers affected by a contract term to take legal action.

Further, one of the other benefits of unfair contract terms regulation is their strong pro-competition effect in promoting consumer confidence and increased market participation and in addressing sub-optimal consumer contracting decisions, but these benefits will not flow if the effect of the law is limited to remedies after the fact, rather than pre-emptive regulator action to weed out unfair terms. Under such a model, for consumers the risk of encountering unfair terms essentially remains high, and with the burden on the consumer to seek a remedy. Consumers cannot have confidence that they will not be placed in this situation and this leads to a range of inefficiencies. We attach a cost/benefit analysis of unfair contract terms intervention that discusses these issues in more detail. As the Paper notes in discussing current consumer law penalties, remedies limited to losses suffered or gains made through offending conduct do not always provide an effective deterrent to poor conduct (p44), and the same is undoubtedly true with regard to the use of unfair contract terms by suppliers. In any circumstances it would be unfortunate to miss the opportunity to improve consumer confidence and hence consumers' ability to drive competition in the market, however, in the present circumstances it would be a particularly surprising decision given the recognised need to actively support ongoing consumer confidence and competition in markets that are under pressure due to current difficult economic conditions.

The EU 1993 Directive on unfair terms in consumer contracts, which the UK's and all other EU member states' unfair contract terms laws implement into their national laws, is explicit on this issue. It requires *both* that individual consumers be granted relief from unfair terms and that adequate and effective means be implemented under the law to prevent the continued use of unfair terms in consumer contracts.[8]

In the UK and Victoria, it is this feature of the unfair contract terms laws that has been effective in producing benefits for consumers. For example, the UK OFT has tackled unfair terms in contracts across a number of industries and markets including package holiday contracts, entertainment contracts, tenancy agreements, health club agreements, aged-care home contracts and default charges in credit card contracts.[9] In the 04/05 reporting year it received nearly 1,700 complaints about unfair terms, achieved changes to over 1000 unfair terms and

[8] European Union, *Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts*, Preamble and Articles 6-7.
[9] See, eg, the list of guidances issued by the OFT: www.oft.gov.uk/advice_and_resources/resource_base/legal/unfairterms/guidance.

obtained more than 60 undertakings from businesses.[10] In the 05/06 year, the OFT received closer to 1,300 complaints, and obtained over 50 undertaking including from such notable businesses as BP, British Airways, GE Capital Motor Finance, Eurostar (UK), Travelodge and Tesco.[11] By the 06/07 year, complaints were down to just over 1000 and only nine undertakings were obtained.[12] In the 07/08 year, the OFT received only 113 complaints about unfair terms.[13]

In Victoria, Consumer Affairs Victoria (**CAV**) has negotiated numerous changes to terms in consumer contracts across several industries since unfair contract terms laws came into effect in late 2003, including the hire car, fitness, mobile phone, pay TV and carpets and curtains industries.[14] In the last financial year it secured further changes to contract terms relating to window and floor coverings, car hire, health and fitness centres, pay TV, cruise ships and racing clubs.[15] It is also notable that the capacity of the regulator to take its own actions could hardly be said to have resulted in a deluge of court cases, with only three reported cases in the Victorian Civil and Administrative Tribunal (**VCAT**) brought by the Director of CAV.[16] Further, CAV was successful in all of these cases. By contrast, in over five years there have been only five reported VCAT cases brought by individual consumers and in only one was the consumer successful. In her case the business appealed to the Supreme Court of Victoria, at which point CAV stepped in to represent her.[17]

The importance of unfair contract terms laws granting capacity to the regulator to take proactive action is well summed-up by the NSW Commissioner for Fair Trading's comments to the 2006 NSW parliamentary inquiry investigating unfair contract terms laws:

> I think the important thing about the Victorian and United Kingdom models is that they do not rely on an individual consumer going forward with litigation; they allow a regulatory authority to take action. You get a systemic change to the contract that benefits all, rather than just a remedy for the person who complained and who actually had the money to go to court.[18]

The Productivity Commission appears to have recommended an *ex post* model of enforcement because it was worried about a theoretical greater risk of regulatory overreach under the *ex ante* model. However, it details no evidence of regulatory overreach and, in fact, notes that the

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[10] OFT, *Web Annexe A: Summary of OFT Consumer Law Casework 2004 to 2005 Excluding Consumer Credit*, pp 4-6.

[11] OFT, *Annual report 2005-06 Web Annexe A: Summary of OFT consumer law casework 2005 to 2006 excluding consumer credit*, pp 3-4.

[12] OFT, *Annual report and resource accounts 2006-07 Annexe A: Consumer law casework 1 April 2006 to 31 March 2007 – excluding consumer credit*, at 2-3.

[13] OFT, *Annual Report and Resource Accounts 2007–08 – Annexe A of HC836: Consumer law casework 1 April 2007 to 31 March 2008 – excluding consumer credit*, p 3.

[14] See, eg, CAV, *Report to the Minister for Consumer Affairs for the year ended 30 June 2007*, November 2007, pp 20-24; Minister for Consumer Affairs media releases: 'Telcos warned again over unfair contract terms' (18 October 2004); 'Victoria drives hire car contract reform' (22 April 2005); 'Victoria continues charge for fairer contracts' (16 August 2005); 'Foxtel revises digital pay TV contracts' (4 May 2006); 'VCAT disconnects unfair mobile phone contracts' (2 August 2006); 'Victorian consumers protected on loyalty contracts' (4 October 2006).

[15] CAV, *Annual Report 2007-2008*, October 2008, pp 10-12.

[16] *Director of Consumer Affairs v AAPT Ltd* (Civil Claims) [2006] VCAT 1493; *Director of Consumer Affairs Victoria v Craig Langley Pty Ltd Matrix Pilates Yoga Pty Ltd* (Civil Claims) [2008] VCAT 482 and 1382; *Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd* (Civil Claims) [2008] VCAT 2092.

[17] *Jetstar Airways Pty Ltd v Free* [2008] VSC 539.

[18] NSW Legislative Council Standing Committee on Law and Justice, *Unfair terms in consumer contracts*, Report 32, November 2006, p 71.

practical feasibility and successful application of the *ex ante* approach has been demonstrated. It also noted some significant drawbacks of a model that allows for action only if detriment is already suffered by a consumer and where the remedy is that the term is voided only for consumers who have suffered detriment.[19]

Further, the Productivity Commission explicitly noted that the *ex post* model effectively represents merely an extension to the consumer unconscionable conduct provision of the *Trade Practices Act 1974* but allowing broader action on unfair terms. However, as Consumer Action has pointed out on several occasions, one of the reasons why unfair contract terms regulation is needed is that unconscionable conduct prohibitions are ill-suited to tackling market-wide problems such as unfair contract terms for a number of reasons, including that they rely on individual consumer legal action and turn on evidence of harm in particular circumstances.[20]

We recognise that the SCOCA proposals broaden the Productivity Commission's recommendation by permitting action where a substantial likelihood of detriment can be proved, not just actual detriment. However, in our view this remains a significant evidentiary hurdle and almost certainly will curtail regulator action in practice, particularly as it appears that regulators will only be able to act in representative actions on behalf of consumers meaning they must, in practice, collect evidence about the effect of a term on consumers and present this consumer evidence in such actions. We therefore consider that the current proposals do not represent a material departure from the Productivity Commission *ex post* enforcement model, which is manifestly flawed.

We strongly recommend that the proposed national unfair contract terms regulation explicitly provide regulators with the capacity to initiate their own legal actions in relation to contract terms, in which they may seek remedies that do not turn on detriment to consumers and thus enable pre-emptive action.

Application to financial services and consumer credit

It is critical that national unfair contract terms regulation applies economy-wide, including to financial services and consumer credit contracts.

We support the commitment by all Australian governments that national consumer laws should apply to all sectors of the economy, including financial services and consumer credit, as noted by the Paper (p24). We also understand that the application of unfair contract terms regulation to financial services may need to be enacted by way of mirror provisions in the national financial services and consumer credit laws and, if this is the case, support capacity being allocated to the Australian Securities and Investments Commission to act as the relevant regulator.

Banning certain types of unfair contract terms

It is proposed that the national unfair contract terms regulation will provide the capacity for particular types of contract terms to be banned from use on the basis that they are always unfair.

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[19] Productivity Commission, above n4, p 165-66.
[20] See, eg, Consumer Action Law Centre, *Submission to the Productivity Commission Inquiry into Australia's Consumer Policy Framewor*k, June 2007, pp 26-32; Consumer Action, above n2, pp 149-55, 158-70.

Given this commitment, the Paper asks for views on whether particular types of contract terms should be banned in the initial text of the new Australian Consumer Law.

As a preliminary matter, Consumer Action notes that the Victorian *Fair Trading Act* contains similar provisions enabling unfair terms to be prescribed in regulations, in which case their use in a standard-form contract or attempted enforcement is an offence (s.32Z). However, it is hard to ignore that no terms have ever been prescribed under these provisions. We therefore strongly suggest that at least some recognised categories of always-unfair terms be banned in the initial law to ensure that this element is, in fact, in use and is able to build a case for further (or less) use of it in future as appropriate.

Consumer Action agrees that the types of terms described in the Paper are generally unfair. Some of the types of terms listed in the Paper stand out as always unfair and we recommend they be banned in the initial text of the new laws. We also recommend that some types of terms not listed in the Paper be banned as always unfair. Our comments on the banning of certain terms are as follows:

- Terms denying existence of pre or post contractual representations; entire agreement terms; terms deeming facts; terms under which consumers acknowledge they have read or understood the contract; conclusive evidence terms

  The Paper points out that these types of terms have the object or effect of deterring consumers from pursuing claims based on evidence extraneous to the written contract between the consumer and the supplier.

  Such terms are of doubtful legal effect because whether or not additional factual or evidentiary matters exist and are relevant to a dispute are questions of fact to be determined regardless of what the written contract states. Therefore, the principal reason for the inclusion of such terms is to deter consumers from pursing claims based on conflicting evidence, not to exclude such evidence in the event a dispute did proceed to a legal hearing. Further, even if they could be of effect it would be manifestly unfair for a supplier to be able to exclude relevant evidence from judicial consideration of a dispute simply because it was not favourable to the supplier. Indeed, the rules of evidence generally require parties to disclose (discover) relevant evidence in their possession to opposing parties even if such evidence is not favourable to the disclosing party. Such terms are always unfair and should be banned.

- Terms that are void under laws that imply terms into contracts

  As the Paper acknowledges, the inclusion in a consumer contract of terms limiting or excluding supplier liability – that a supplier knows are of no effect due to the operation of laws implying certain terms into contracts – is done to deter consumers from pursuing statutory rights, given most consumers do not know what their legal rights are. This applies equally to terms that include a final caveat such as ‘to the extent permitted by law’, as rightfully noted by the Paper. Such terms are always unfair and have been an ongoing problem undermining the awareness and effectiveness of existing statutory warranty rights. They should be banned.

- Flat/fixed early termination fee terms and accelerated payment terms

  We agree that early termination fees are not in themselves unfair, but the Paper correctly notes that a term that provides for a *fixed* or *flat* early termination fee (including paying out the remainder of the contract price) if a consumer exits a contract early is unfair because it inherently does not and cannot take account of the supplier's reasonable costs in such a situation and must therefore represent an arbitrary windfall to the supplier. Such terms also remove the need for the supplier to assess their costs or losses or to mitigate their loss. Such terms should be banned.

- Terms requiring payment of supplier's enforcement costs

  As with early termination fees, the requirement to pay some enforcement or collection costs if a consumer defaults under a contract is not in itself unfair, but the requirement to pay all such costs will always be unfair. Such terms do not limit the consumer's obligations to the supplier's reasonable enforcement or collection costs nor do they provide any incentive for the supplier to undertake reasonable or efficient enforcement action.

  Further, as the Paper notes, legally such terms are in effect subject to an implied limitation to costs incurred reasonably and good faith. However, consumers are highly unlikely to be aware of such legal matters and these terms can therefore be used by suppliers to pressure consumers into paying additional enforcement costs they would not be required to pay if they disputed the claim in court. This is particularly the case given such terms are prevalent in relation to debt collection and consumers already struggling to pay debts are unlikely to be in a position to be able to support legal action against claimed additional enforcement costs. These terms should be banned.

- Terms requiring pre-payment of the majority of the price before delivery, installation or performance

  Terms requiring the payment of genuine deposits are a reasonable feature of all sorts of everyday consumer transactions. However, a contract term that requires majority pre-payment upfront shifts most of the risk of non-performance of the contract to the consumer even though it is the supplier that controls most of that risk. As the Paper notes, such terms also remove the consumer's sole basis for any bargaining power in the relationship, being the fact that a supplier desires payment.

  Such terms are a clear exception to ordinary business practices and in reality, are used principally in situations in which goods or services are targeted towards vulnerable consumer classes that are more likely to submit to demands for upfront pre-payment. They are never fair but this additional feature of their use makes them particularly undesirable. They should be banned.

- Terms mandating compulsory arbitration

  Arbitration is a dispute resolution procedure designed almost solely for commercial or business-to-business dispute resolution. An attempt to mandate its use in a consumer contract is a clear attempt to limit a consumer's access to an affordable, and therefore any, dispute resolution process. This is one of the clearest examples of a term that is always unfair in a consumer contract. They should be banned.

- Terms that allow continued debits after the expiry of a fixed term contract

  The Paper does not include this type of term in its list of terms being considered for banning. However, such terms have become common in certain industries despite their obvious unfairness to consumers and the fact they essentially allow suppliers to collect additional funds from consumers without any legitimate basis for doing so. Consumers who enter into a fixed term contract and agree to a debit arrangement reasonably assume that their payment obligations continue only while the contract continues. If a supplier wishes to continue providing goods or services to a consumer, and thus continue debiting a consumer's account, after the expiration of a fixed term contract there is nothing to prevent the supplier from obtaining further agreement from the consumer to continue with arrangements or to enter into a new fixed term. At the very least, such terms should be banned if they require a consumer to cancel ongoing debits by notice in writing and/or if cancellation is purported to take delayed effect.

- Terms that allow unilateral variation of any term at any time for any reason; terms that allow unilateral variation of the price, fees or charges by a supplier under a fixed term contract without a consumer right to cancel the contract at no charge

  Again, the Paper does not consider these types of term, however, they are principal examples of the types of terms that have been identified as unfair across a range of contracts, including by CAV.[21]

  Unilateral variation by a supplier is often unfair but it could not be said to be always unfair. However, unfettered supplier ability to unilaterally vary any term of a contract for any reason is clearly going beyond the protection of a legitimate business interest. For example, such a term was noted as being unfair in the AAPT case brought by CAV under the Victorian unfair contract terms laws.[22]

  In addition, in particular the ability to unilaterally vary the price under a fixed term contract is unfair. As discussed earlier, price terms are one of the few terms of a consumer contract that consumers are likely to be aware of and take into account in making a decision about entering into a contract. To vary such a core part of the bargain when a consumer is "locked in" to a contract is manifestly unfair. Unilateral variation may be fair in some circumstances but this sort of unilateral variation term should be banned. An exception should, however, be made for contracts in which it is *explicitly contemplated* that the supplier may unilaterally vary the price based on reasonable considerations, for example variable rate home loan contracts.

[21] See above, n14.
[22] *Director of Consumer Affairs v AAPT Ltd* (Civil Claims) [2006] VCAT 1493 at §50.

We thank SCOCA for the opportunity to provide our comments on the proposed national unfair contract terms regulation and would welcome further discussion about any of the matters raised in this submission. As noted above, we will provide separate comments on other matters discussed in the Paper. Please contact Catriona Lowe on 03 9670 5088 or at ceo@consumeraction.org.au if you have any questions.

Yours sincerely
CONSUMER ACTION LAW CENTRE

Catriona Lowe
Co-CEO

Nicole Rich
Director – Policy & Campaigns

Attach.

CONSUMER ACTION LAW CENTRE

Supplementary Submission

Unfair Contract Terms*

Costs and Benefits of Intervention in Relation to Unfair Contract Terms

Competitive markets, free from regulatory intervention will perform efficiently and this will benefit not only producers but also consumers – the market will supply the products that consumers most value at prices that reflect the value of the resources used to produce them and producers will be responsive to changes in demand and supply conditions. In such markets buyers and sellers are free to enter into contracts relating to the supply of goods and services and they will do so where such arrangements are mutually beneficial and so those contracts will be efficient. Contract provisions are legally enforceable by either party and this is important to ensure efficient outcomes.

Thus, Vickers observes:

'…with symmetric information between a buyer and a seller…freedom of contract should lead to an efficient outcome – the gains from trade should be maximised. Sellers would have every incentive to offer terms that deliver value for money to consumers as efficiently as possible. If a sales contract contained a term that benefited the consumer less than it cost the seller – or harmed the consumer more than it benefited the seller – then the term would be inefficient and would go. Without the inefficient term the seller would be able to offer a deal that would be better both for the seller and the consumer. Likewise there would be every incentive to include efficient terms. In short, deals would be tailored efficiently by unfettered market participants.'[1]

As noted in the original submission by the Consumer Action Law Centre to the Productivity Commission, standard form contracts, as a process, are efficient and may benefit consumers because in competitive markets reduced transaction costs will be reflected in lower prices or other improvements in sales terms. Thus,

'Standard form contracts can have advantages to both supplier and purchaser provided that a fair chance is achieved between both parties to the contract. They reduce transaction costs for the supplier which would otherwise be passed on to the purchaser. They allow for lengthy and detailed contracts to be finalised with the

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* This paper was prepared by Rhonda Smith, Economics Department, University of Melbourne at the request of , and with participation from, the Consumer Action Law Centre. It forms part of a broader research task which examines Part V of the Trade Practices Act and considers whether it has kept pace with developments around the world and within other Australian jurisdictions.

[1] John Vickers (2003), Economics for consumer policy, p.8, available at www.oft.gov.uk/shared_oft/speeches/spe0503.pdf. See also Russell Korobin (2002), Bounded Rationality, Standard Form Contracts, and Unconscionability, *University of Chicago Law Review, Vol 70, pp1203- 1295* for a discussion of how market structure and willingness of purchasers to acquire information influences the presence of unfair contract terms.

minimum of time and by lay persons who only need to negotiate the specifics such as price, description of goods and services and delivery times. Over a period of time, people become familiar with the contracts because they are standard and may encourage a general understanding of trading practice.'[2]

Arguably, those who desire and are willing to pay the extra costs of non standard contracts, are free to do so and it might be assumed that under competitive conditions firms would respond to such requests. Frequently, it seems that, for various reasons, the reality is otherwise. It is not unusual for purchasers to enter into contracts into which they have had little or no input and frequently these contracts contain terms that are not necessarily fair and may not produce efficient outcomes.[3] Although the discussion of unfair contract terms typically relates to standard form contracts, it may be more appropriate in the present context to consider more generally contracts that are not negotiated between the parties. This is because word processing enables suppliers to customise contracts for particular purchasers quickly and at very little cost but the purchaser still has no input in to the contract terms.

Although many contracts contain unfair terms whether as a consequence regulatory intervention of some sort is necessary or justified requires that the benefits from intervention exceed the cost that intervention imposes on various parties. This in turn raises a question of the welfare standard against which such an assessment is to be made.[4] Having resolved this issue, if the cost of unfair contract terms is likely to exceed any benefits from non intervention, there are two other issues to be considered. The first is whether there are already adequate provisions in place to address the problem and, if not, what form should any intervention take, recognising that the costs and benefits associated with intervention are likely to be influenced by the particular policy instruments selected. This paper focuses on the costs and benefits of addressing unfair contract terms, and only briefly considers the form that such intervention might take.

The Costs Resulting From Addressing Unfair Contract Terms

Clearly there are costs associated with regulatory intervention in relation to contract terms. They include:

i. an increase in transaction costs - standard form contracts are efficient as they reduce the transaction costs of buyers and sellers associated with negotiating

[2] Standing Committee of Officials of Consumer Affairs (2004), Unfair Contract Terms, A Discussion Paper, January, p.16. (hereafter SCOCA)

[3] The Consumer Action Law Centre submission to the Productivity Commission.

[4] In the context of an exemption from Part IV of the Trade Practices Act, the Australian Competition Tribunal canvassed the issue of the relevant welfare standard to apply in the Qantas-Air New Zealand matter. It concluded that the appropriate standard was a modified total welfare standard, a standard that could just as well have been described as a modified consumer welfare standard. In the present context the aim of the proposed intervention is to ensure consumer sovereignty and to avoid certain detriments to consumers. Therefore a consumer welfare standard would appear to be appropriate. However, this should be modified to recognise that the impact on consumer welfare of producer conduct may be indirect rather than direct (for example, efficiency increases free up resources for other uses and so benefits consumers even when there is no direct pass through of benefits in the form of lower prices or improved quality).

and drawing up a sales contract. In discussing unfair contract terms it seems that often the counterfactual is incorrectly assumed to be ceasing to use standard form contracts so that contracts must be individually negotiated. However, the issue is not standard form (or non negotiated) contracts, it is the terms that are inserted into them. If these contracts do not contain unfair terms, they may still be used;

ii. adjustment costs, that is, the cost of amending and re-negotiating existing contracts. The extent of such costs depends on whether there are unfair terms in the contracts, the length of time before the contract expires and the time allowed for the removal of such terms. Word processing facilities mean that these contracts can be readily altered and at little cost so compliance costs and future transaction costs should not be as significant as they may have been in the past;

iii. a one-off cost to amend contracts offered in future so that they will be compliant (see ii above), as well as the costs associated with monitoring the firm's own compliance in future;

iv. the monitoring and enforcement costs of the regulator. The extent of the former depends in part on whether an existing body is charged with this responsibility as there are likely to be economies from shared overheads and even from better/fuller use of staff.

The costs associated with addressing unfair contract terms are affected by whether such regulation replaces some existing requirements (such as disclosure requirements). If so, the relevant cost is the cost of the new provisions net of the costs of existing, but now redundant, requirements. In addition, in determining the cost of new regulation, the cost savings of having a national regime for firms that operate nationally should be netted out. Further, to the extent that new regulation causes changes that avoid litigation under the existing, but perhaps not very satisfactory, provisions, the consequent saving of enforcement costs should be taken into account.

In his oral evidence to the Productivity Commission Inquiry, Professor Field discussed the costs associated with addressing unfair contract terms.[5] In particular he argued that remedying the problem may deprive consumers of benefit, at least in part because it may reduce competition between rival suppliers. He stated:

'...there's a potentially much more significant cost that's involved than compliance costs and its around the interference with what I would call the complex balance of the contractual bargain. Put simply, the deletion of one term as unfair may see another term which the consumer values affected adversely. What, of course, then seems on its face attractive, which is the protection of powerless consumers from the excessive power of business, may in fact upset the complex balance of the contractual bargain in a way that's harmful to consumers.'[6]

[5] Productivity Commission, Transcript
[6] Productivity Commission, Transcript.

However, reference to the contractual bargain is hardly relevant in that essentially the issue of unfair contract terms arises where purchasers lack input into those terms and, as a consequence, the terms unduly favour the supplier. It is indeed the market power of the business with respect to those terms which is the problem.

Professor Field illustrates his comments with an example relating to contracts containing a term that creates a cost disincentive to discourage consumers from changing from one telecommunications supplier to another early in the contract. He states:

'The pricing offered to consumers to enter into those contracts is premised on the fact that consumers will stay in that contract for a period of time…If you take that clause out, they'll probably act rationally and that is, two months after they've entered that contract they may well find the next contract offered in the market at a cheaper price and they'll move to that.'

He concludes that this may lessen competition in the market.

There may be circumstances where removal of a particular term from a contract has implications for the commerciality of the contract. Nevertheless, the example provided is not appropriate on a number of levels and the conclusions drawn from it are not valid. Thus,

i. a customer who signs up to a contract generally does so for a specified period and so is committed for this period without any need for penalty clauses. Indeed the suggested outcome can be avoided by offering the potential purchaser alternative contract periods with corresponding adjustments to the price;

ii. ignoring (i) and accepting that customers could legally terminate contracts early,[7] it is exactly that risk of losing customers that is the essence of what makes a competitive market work. That risk forces a firm to 'sharpen its pencil', to offer the best possible deals and to engage in innovation to achieve that outcome;

iii. although the statement seems to accept that the penalty clause in the contract is unfair, it implies that if correcting it means additional changes then it should not be changed. One might think that at the very least the relative costs and benefits of the two scenarios would be relevant.

As a consequence of these costs Professor Field's line of reasoning leads to the conclusion that regulatory intervention in relation to the terms of standard form or non negotiated contracts will reduce the net efficiency with which markets operate, resulting in misallocation of resources (including the deadweight loss associated with responding to, complying with, and enforcing the regulation) and reducing the incentive to innovate and respond to changing market conditions due to any increase in uncertainty/risk and reduced profitability. However, regulation of unfair contract

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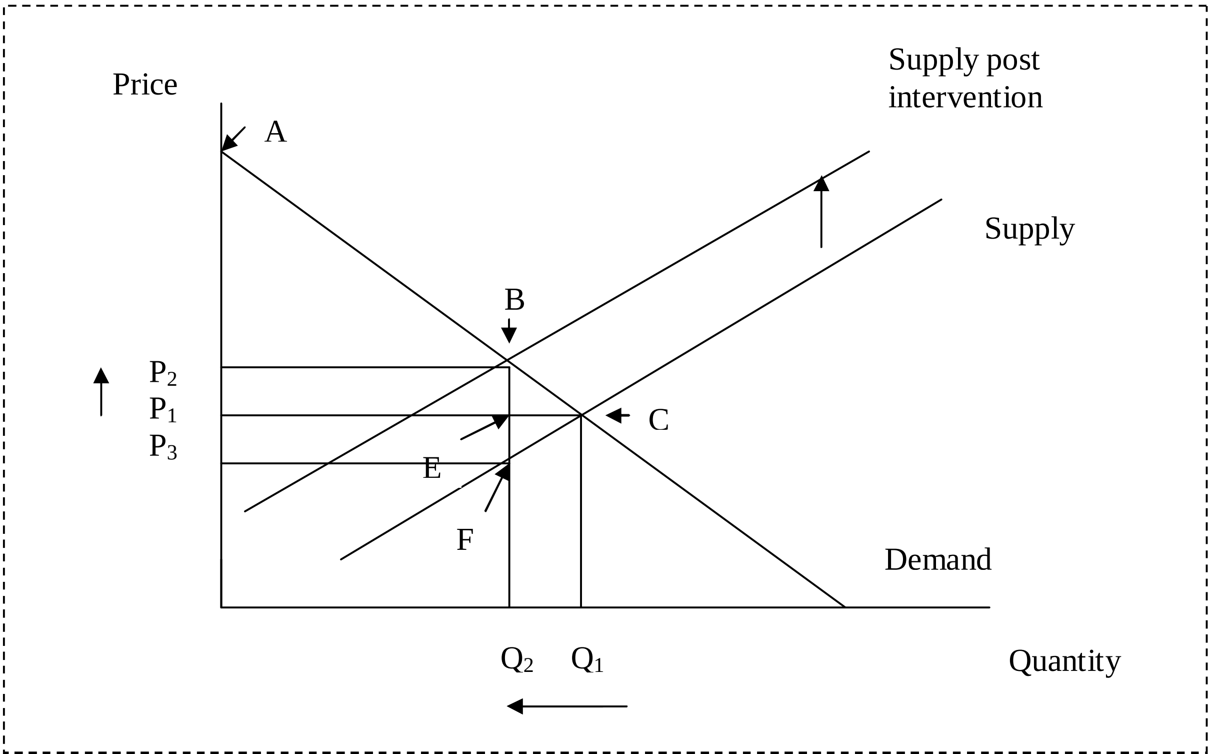
[7] Perhaps because there is a 'meet the competition' clause in the contract. This is unlikely in a 'take-it-or-leave-it' contract as it is in the interests of the purchaser rather than the supplier.

terms is unlikely to have such effects if contract terms are mutually beneficial and hence efficient rather than unfair.

The effect of regulatory intervention in relation to unfair contract terms is illustrated in Diagram 1.[8] From the initial equilibrium C, the introduction of regulatory measures in respect of unfair contract terms increases the costs incurred by suppliers (implementation and compliance costs), represented by P_3FBP_2, and this has the effect of shifting the supply curve to the left. The share of that cost passed through to consumers is P_1EBP_2. The result is reduced supply and assuming that the demand curve is unchanged,[9] increased prices for consumers and a reduction in consumer surplus (by P_2CBP_1) and in producer surplus (by P_3P_1CF). In addition, a deadweight loss of BCE is created. This represents an overall loss of P_1P_2BCF. The significance of these responses from a policy perspective depends largely on the extent of the increase in costs to suppliers, the impact of this on quantity and price (which depends on the relative elasticity of supply and demand) and the size of the deadweight loss. Further, it assumes that currently there is no exercise of market power in relation to the unfair contract terms (see below). If this is not the case, then account must be taken of the reduction or elimination of monopoly rents through regulatory intervention, and the net impact of intervention on the size of the dead weight loss. In addition to the changes represented on the diagram, there may be adverse effects on the incentive to invest (dynamic efficiency), as well as increased costs for government of implementing the regulatory provisions and enforcing them.



[8] An issue is whether the cost associated with regulatory intervention is an additional variable cost or an additional fixed cost. The diagram and discussion could be taken to assume that it is a variable cost. Nevertheless, in the long run (the relevant time period) if the market is competitive the additional cost may result in some smaller firms (or firms with more favourable alternatives) exiting the industry, thereby restoring normal profits but causing the supply curve to shift to the left (as in Diagram 1).
[9] This assumption is relaxed below.

Diagram 1

Whether the above scenario is realistic depends on whether certain conditions are satisfied. The first of these is that:

'…the parties are able to negotiate on an equal footing, have equal bargaining power, are equally able to look after their own interests and have a full understanding of the consequences of their actions and the terms of the contract. In reality, this is not always the case.'[10]

In order to assess the implications of regulating unfair contract terms, the relevant 'price' is not simply the 'ticket price' but the price that takes into account all of the terms and conditions associated with supply, including any that may come into effect in the future. The second condition is that efficient outcomes are conditional on the absence of significant market failures. Yet, in reality, this is rarely if ever the case and so, even when markets are highly competitive, competition may not result in a market that operates efficiently. In relation to unfair terms in contracts, neither of these conditions may be satisfied.

Unfair Trading Terms and Consumer Sovereignty

Ensuring consumer sovereignty is an accepted justification for consumer protection policy.[11] Informed consumer choice is the distinguishing feature of consumer sovereignty, and it is a necessary condition for markets to function effectively.[12] Consumer sovereignty requires that the market offers a range of options to consumers, and that consumers are able to formulate preferences and choose effectively between the options available.[13] For various reasons (see below), consumers often fail to account fully for non core contract terms[14] when making purchase decisions. Consequently, even if initially suppliers offer different terms, lack of competition on non core terms, is likely to mean that the non core terms of contracts within an industry become standardised to the least favourable terms for consumers – this is analogous to bad products driving out good products as explained by Akerlof.[15] Thus, this has the effect of reducing consumer options and it means that there is little incentive for innovation in respect of the risk resulting from the contingencies to which these terms relate. Unfair contract terms may impair consumer sovereignty.

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[10] SCOCA, p.16

[11] For a discussion of this issue see Rhonda L. Smith and Stephen King (2007), 'Does Competition Law Adequately Protect Consumers?' *European Competition Law Review,* Vol 28, No 7, July, pp 412-424, at pp 413-414.

[12] Michael Waterson, "The Role of Consumers in Competition and Competition Policy", *Warwick Economic Research Papers*, No. 607, Dept of Economics, University of Warwick, 2001, p.2.

[13] Averitt, Neil W. and Robert H. Lande, "Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law", *Antitrust Law Journal*, Vol 65, 1997, p 713-756, at pp. 713.

[14] Core terms are price and quality attributes; non core terms are all other contract terms such as the terms and conditions of cancellation, quality guarantees, provision for refunds and the like.

[15] George A. Akerlof (1970), `The Market For Lemons: Quality Uncertainty and the Market Mechanism', *Quarterly Journal of Economics,* Vol 84, pp488-500. This may hurt the producers of good products as well.

Although in many situations consumers face a price which they do not negotiate, in imperfectly competitive markets consumers generally are able to choose between suppliers who may offer different price/quality bundles. In many cases these are products that are purchased repeatedly, if not regularly. Consequently, if the consumer is not satisfied with a particular purchase, subsequent purchases may be made from a different supplier. However, in the case of unfair contract terms, even if there is competition in relation to core terms (price/quality attributes), generally there is little or no competition with respect to non core terms, as noted above. Although there are alternative suppliers, this confers market power on suppliers (similar to the effect of a cartel on price) and so the allowance for risk associated with particular contingencies is not reflective of the likely cost associated with those events if they occur and this represents a misallocation of resources. Consumers have the choice of accepting contracts that contain unfair terms or not purchasing the particular good or service at all.

From the perspective of individual buyers, the cost associated with unfair contract terms is not, and indeed cannot, be accurately factored into the price of the product. While the probability of a particular event occurring is relevant for firms when determining their risk exposure and may be objectively available, it is not of much assistance to individuals in relation to consumption decisions – they are unlikely to be aware of the probability of such an event occurring, and even if they are, they cannot know the probability of it occurring in relation to themselves. The inherent problems of predicting and assigning a value to the risk of a particular contingency are illustrated by the use of unilateral variation clauses to fundamentally alter the nature of the supply conditions. For example, Telstra offered 'unlimited' download of its Big Pond product but later imposed a download limit on existing customers without providing consumers with an opportunity to exit the contract. Similarly, Citibank marketed a fee free credit card but subsequently introduced a one off fee of $165 on existing customers (the fee could be avoided by spending money on the card). It was not until ASIC intervened that consumers were offered the option to exit the contract (though even this was imperfect given that the offer had enticed consumers to make balance transfers to the Citibank card from other cards, so they had to pay out the balances to achieve exit.

In circumstances where these probabilities and costs are unknown (and unknowable), individuals are likely to discount the likelihood that such an event will occur in relation to their own purchase, especially when it has a low probability of occurring, and so triggering a clause in a contract that may be detrimental to them.[16] This can be illustrated with respect to the inclusion of penalty fees in banking products. Assume that there are 6 million bank accounts, and that each account holder incurs one penalty fee per annum of $20 (this may be fairly conservative as fees can be as high as $50 in the mainstream banking market and much higher in some fringe markets). This represents a cost of $120 million to consumers per annum and is likely to hugely exceed the costs to the bank of the conduct that resulted in the penalty. If these types of terms are being ignored, the product price is underestimated and consequently consumers overbuy the product relative to the position if there were no unfair contract

[16] See for example the discussion of hyperbolic discounting in the Consumer Action Law Centre's Submission to the Productivity Commission Inquiry.

terms. The significance of the failure to take non core contract terms into account is shown in Diagram 2.

Before considering Diagram 2 (and 3), certain qualifications in relation to the diagrammatic representation should be made explicit. First, the implications of regulatory intervention for price and quantity, for the deadweight loss and so on, depend in part on the absolute shifts of the supply and demand curves. Second, while the implications of these changes for quantity are unambiguous, this is not the case for price, and the new equilibrium values post intervention will be influenced by the relative price elasticity of demand and supply. Not withstanding these qualifications, the general result that intervention to address unfair contract terms is likely to lessen inefficiency is justified. The appropriate comparisons are the pre-intervention equilibrium and the post intervention equilibrium that reflects the actual price rather than the ticket price.

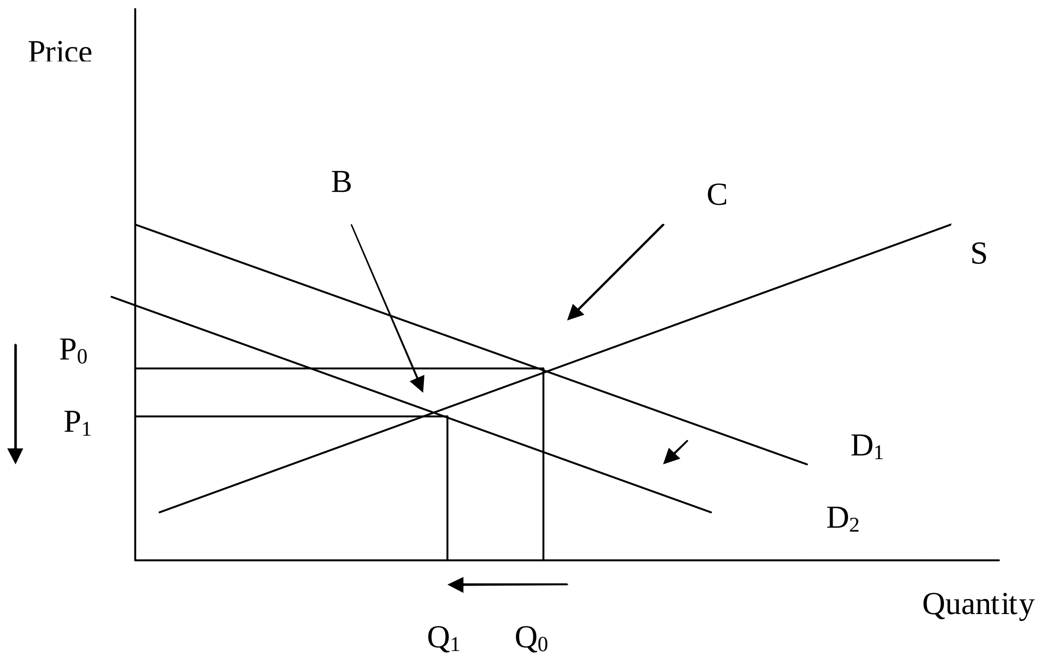

Diagram 2

If consumers fail to account fully for the cost to them of unfair contract terms, then the demand curve in Diagram 1 while representing actual willingness to buy based on the 'ticket price', overstates what that willingness would be if consumers took account of those costs, that is, it misrepresents consumer preferences. As shown in Diagram 2, the true demand curve consistent with consumer preferences is D_2 rather than D_1. As a consequence with demand represented by D_1, the product price is lower than it would otherwise be (it fails to take account of the non core terms) and the equilibrium quantity traded is greater. The efficient equilibrium is B rather than C with Q_1 rather than Q_0 and P_1 rather than P_0.

Given this correction, Diagram 3 re-introduces regulatory intervention to address unfair contract terms, thereby shifting the supply curve to the right (S_1). As a result of reducing or eliminating unfair contract terms, the 'correct' demand curve D_3 will be to the right of D_2 but to the left of D_1, its exact position depending on the cost to consumers of fairly addressing the relevant contingencies. The new equilibrium would be C (the intersection of D_3 and S_1, although if consumers still fail to take account of these costs the actual equilibrium will be the intersection of S_1 and D_1, that is, at B. Nevertheless, this is an outcome that is more efficient than if the unfair contract terms were not regulated in some way. At B, quantity exceeds the efficient level by Q_1Q_2 whereas without intervention quantity exceeds the efficient level by Q_0Q_2 . The effect on price is uncertain as the supply response tends to increase price (reflecting increased costs) but the demand response puts downward pressure on price.

In addition, but not shown in the Diagram, regulatory intervention may make buyers more aware of non core contract terms and this may stimulate competition in respect of those terms which will further increase efficiency.

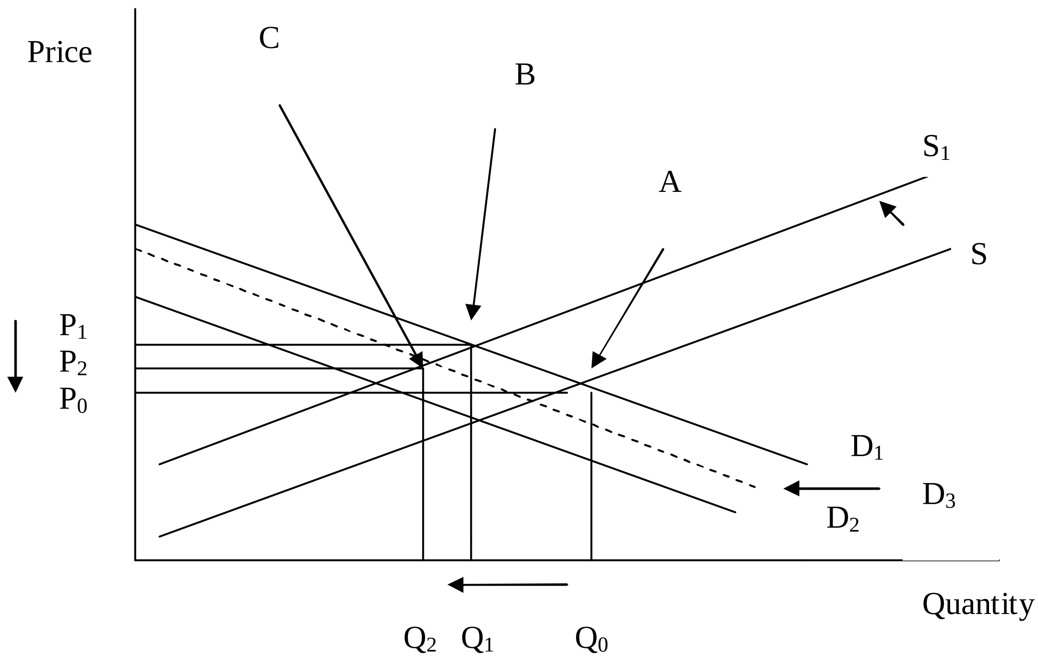

Diagram 3

Some additional considerations

First, publicity may alert consumers to the existence of problems resulting from unfair terms in contracts in particular industries (such as in relation to mobile phone contracts), although they may be only vaguely aware of the specific nature of the problem. In relation to that market at least a proportion of consumers will be more wary than they otherwise would be and may over-invest in seeking information about the nature of the contract in that specific market. The effect will be to move the demand curve to the left of D_1. To the extent that the concern is unwarranted or overstated, the relevant demand curve will be to the left of D_2, resulting in under-consumption compared to a situation where no such uncertainty exists.

However, the adverse effects of unfair contract terms may not be confined to the market in which the contracts exist. Concern about contracts in one market, such as mobile phones, may spillover into other markets, such as those for the supply of electricity or gas. This may mean over-investment in seeking information in these markets as well and/or failure to respond to welfare-enhancing offers available from alternative suppliers. Further, the consequence may be to dampen competition in these markets not just in relation to the non core terms of the contract, but also in relation to core terms. This is because uncertainty makes consumers reluctant to switch suppliers even when an alternative supplier actually offers a better deal.[17]

Second, if businesses are able to reduce their costs by the use of unfair contract terms, they may be able to offer a lower price for a given product quality than can competitors that operate with fairer contracts.[18] As a consequence consumers may find themselves locked into a supplier for a considerable period because to switch to another supplier will trigger those terms and significantly increase the effective purchase price post purchase.[19] Examples of such terms include penalties for early re-payment of a loan, and terms stating that there will be no refunds in relation to cancellation of pre-booked holiday packages. Consumers often fail to realise that post purchase the contract terms convert the bargain into a rip-off. Awareness of such an outcome may cause at least some consumers to accept a somewhat higher price in exchange for greater flexibility in responding to changes in the market. As noted above, supplier conduct of this type tends either to result in all suppliers offering unfair terms or to drive out those offering fair terms. While the former reduces competition in relation to non core terms, the latter reduces competition in relation to core terms. Thus, removal of unfair contract terms protects competition and more efficient outcomes may result.

Equity benefits from intervention

Although competitive markets can be expected to operate efficiently, absent market failure, there is no reason to expect that they will produce equitable outcomes. Economists are prone to respond to concerns about equity by arguing first that competition should be unimpeded by concerns about equity because other policies such as taxation and welfare are superior instruments to address distribution issues. Second, they may suggest that if markets are efficient they will result in a higher level of economic activity and so everyone will be better off and there will be more wealth to redistribute.

Irrespective of whether these arguments are valid in competitive markets, the counterfactual to intervention to address unfair contract terms is not about interfering with such markets so that contracts contain unfair terms and markets are less

[17] However, the adverse effects of unfair contract terms may not be confined to the market in which the contracts exist.
[18] See for example, Centre for Credit and Consumer Law, submission to SCOCA March 2004, p.8.
[19] See earlier discussion of Professor Field's evidence to the Productivity Commission.

competitive in relation to core terms and not competitive in relation to non core terms, so that they do not operate efficiently. Further, redistribution policies frequently focus on redistribution of income from high income to low income groups, although some policies such as education and health, attempt to address the cause of inequity. In relation to unfair contract terms exposure to such terms is not determined by income level, but rather by the desire to purchase a particular product, that is, by being a purchaser.[20] If intervention is justified in these circumstances, it should be preventative and pro-active rather than reactive.[21]

Lack of consumer response to unfair contract terms

In the face of unfair contract terms, consumers typically continue to base their purchase decisions primarily on core terms and fail to take account of non core terms, although as noted above purchase decisions may be affected when there is awareness of the potential for unfair terms; and do not utilise existing means of redress. These responses (or the lack of them) could be taken to indicate that consumers do not consider unfair contract terms as significant enough to cause them to respond. However, the actual position seems to be otherwise. In order to understand the lack of consumer response it is important to consider why these unfair terms exist (this is also important for determining the nature of any regulatory intervention) and to understand the likely cost of remedial action.

Just as consumer protection problems were, and still are, often attributed to a lack bargaining power on the part of consumers, so too is the presence of unfair contract terms. Consequently, this is a problem that is assumed to arise in markets characterised by limited competition. In such markets consumers have little or no choice of supplier and so have limited bargaining power. The solution is therefore aggressive competition policy.[22]

In perfectly competitive markets consumers are protected because they have plenty of choice of supplier and are they fully informed. This same choice constrains suppliers, depriving them of market power. Thus, perfect competition prevents an imbalance of bargaining power between buyers and sellers, and so competition is perceived by many as the best form of consumer protection, including protection from unfair contract terms. However,

i. although markets may be competitive, few are perfectly competitive, and in such markets competitive pressure may result in consumer exposure to risk, including in relation to unfair contract terms (see discussion of switching costs);

ii. nor are consumers fully informed. Information deficiencies, including asymmetry of information, confer power on the party possessing information, and lack of access to relevant information or the cost of

[20] All purchasers of the product are exposed to risk and it may be that those who are time poor, but income rich, can afford to engage in less search and so are more likely to realise the consequences of unfair contract terms.
[21] See, for example, Frank Zumbo (2007), 'Promoting fairer consumer contracts: Lessons from the United Kingdom and Victoria, *Trade Practices Law Journal* , vol 15, pp 84-95, at p.88.
[22] For a discussion of this see Smith and King, supra note 10, pp 418-420.

obtaining it, may prevent consumers responding so as to avoid or reduce the impact of unfair contract terms. Consumers may make inappropriate choices because the costs of acquiring information and/or using it are too great relative to the expected benefits likely to result.[23]

iii. The findings of behavioural economics indicate that quite frequently consumers fail to acquire and/or to use fully relevant information about transactions. Apparently irrational consumer behaviour may result from inertia, incapacity to process the complex information required to make the decision to switch or, faced with choice, the fear of making the wrong choice.[24] Thus, even when consumers are aware of the potential for consumer detriment as a result of unfair contract terms, frequently they do not respond to that risk but this does not mean that the cost is insignificant. In such circumstances, addressing information deficiencies is not likely to overcome consumer problems of this sort.

Addressing consumer detriment from unfair contract terms

It may be argued that if individual consumers are aggrieved in relation to contract terms, they already have avenues of redress and so specific regulation directed at unfair terms simply duplicates regulatory costs. However, to the extent that there may be avenues that individual consumers can currently pursue, the cost incurred by an individual as a consequence of the terms is unlikely to justify the legal costs of seeking redress. In the context of consumer protection policy generally and as applied to the US but equally applicable to unfair contracts terms:

'…for consumer transaction going to court is usually not economically feasible. When disputes involve small losses to consumers, private lawsuits will not work. Nor have class actions evolved to provide adequate enforcement. Further, small claims courts do not sufficiently reduce the costs of litigation. Thus, government consumer protection agencies have become part of the process to enforce the basic rules as well as to provide modification and amplification.'[25]

Yet collectively, the cost to consumers of unfair contract terms may be very large (or to put it slightly differently, the benefit derived by business from such terms may be very substantial). Regulation against such terms provides the basis for collective action that may improve the position of consumers affected by the terms and may reduce the incentive to impose such terms by necessitating that the costs associated

[23] Smith and King, supra note 10, pp 415-416.

[24] Eldar Shafir (2006), A behavioural perspective on consumer protection, paper presented to OECD Rountable On Demand-side Economics For Consumer Policy: Summary Report, 2006, available at www.oecd.org/dataoecd/31/46/36581073.pdf. Griggs points out that 'Increasingly the good or service being purchased encompasses the contract as an essential feature of the product or service.'[24] For example, the firm supplying Pay TV supplies the installation services, and associated equipment under a single service contract. Consequently, '…the rational consumer does not and cannot be expected to fully appreciate the embedded contractual complexity…'(Lynden Griggs (2005), 'The [ir]rational consumer and why we need national legislation governing unfair contract terms, CCLJ, Vol 13, pp 51-72, at p.52.)

[25] Timothy J. Muris (1991), 'Economics And Consumer Protection', *Antitrust Law Journal*, vol 60, no 1, pp 103-121, at p.105.

with such actions (after factoring in the probability of being caught) be taken into account by firms when determining a course of action.

Unlike the labour market where there are concerns about unfair employment terms in contracts, there is little potential for effective collective action in relation to consumer acquisitions (and possibly not even in relation to businesses purchasing inputs). Other potential remedies also appear flawed or incomplete[26] – for example, it seems that the Australian courts are not prepared to interpret unfair terms in contract as unconscionable conduct; while Victoria's prohibition on certain unfair contract terms has limited cover (it excludes the financial sector) and, of course, is confined to Victoria.

A Proposal to Address Unfair Contract Terms

It is apparent that the actual costs and benefits resulting from addressing unfair contract terms depend in part on the nature of the process to be employed. Victoria introduced regulation in respect of these terms in 1999 and through the SCOCA process other states are involved, at least to some extent, in consideration of the issue. An outcome likely to result in more significant compliance and administrative costs is for each state to introduce slightly different provisions. A more cost effective outcome is a national approach. This might involve inclusion in the Trade Practices Act of a new provision (for examples 51AAA) which prohibits unfair contract terms and it would apply not only to business dealings with consumers but also with large business dealings with small businesses. This might identify certain types of terms as unfair, while providing a basis for assessing whether other terms are unfair. Assessment of whether a particular term is unfair could be undertaken by the ACCC (or some other body) either at its own instigation or in response to complaints by purchasers. Alternatively, a company could request an administrative decision from the regulator in respect of a particular clause/s or for an entire contract, in a process akin to notification. An appeal process in relation to these administrative decisions should be available (as for authorisation and notification decisions). On legal issues this would be to the Federal Court but otherwise to a tribunal.[27] The remedy for unfair contract terms would be to void those terms in the contract, but not the entire contract. Only where the supplier failed to comply with this requirement would a pecuniary penalty be imposed.

[26] This issue has been explored in detail in numerous submissions to the Productivity Commission and in oral presentations and so is not elaborated here.

[27] Although this role could be filled by the Australian Competition Tribunal, it would need to be differently constituted when considering cases relating to unfair contract terms, that is, its membership should include a consumer representative.