



Further Comments on Unfair Contracts Terms Legislation

April 2009

On 17 February 2009, the Minister for Competition Policy and Consumer Affairs, Chris Bowen, released a consultation paper for the implementation of the Council of Australian Governments (COAG) agreement to enact a new consumer policy law and framework. The new consumer law will include a new provision to regulate unfair contract terms.

CHOICE strongly supports the introduction of national laws excluding unfair contracts terms and conditions from standard form consumer contracts. We provided detailed commentary on the composition of the new law in our submission dated 24 March 2009.

A number of issues have been raised by vendors who will be subject to the new Unfair Contract Terms Laws. While stakeholders have raised some legitimate questions about the practicalities of the new law, a number of the issues raised by vendors either misconceive Unfair Contract Terms Laws or use spurious information to oppose the laws.

We believe these laws are too important to be influenced by incomplete or inaccurate information. This supplementary submission responds to issues arising about Unfair Contract Terms Laws during the government consultation on *An Australian Consumer Law: Fair Markets - Confident Consumers*.

1. Is there a relationship between Unfair Contract Terms Laws and consumer confidence?

Yes. Unfair Contract Laws will deliver to consumers the capacity to demand a better deal from the parties with whom they contract.

Most consumer contracts are offered on a take-it-or-leave-it basis, and many contracts contain terms and conditions that unreasonably disadvantage consumers. A discerning consumer who seeks out an alternative contract with a competitor is likely to find the same contractual clauses as they're often industry-wide standards. The widespread use of standard form consumer contracts has delivered a mixed bag of efficiencies. On the one hand it delivers economies of scale and legal protections for traders, but on the other hand it removes the capacity for consumers to demand a better deal from the vendor. In reality consumers have been signing up to unfair standard contracts for years.

In common law there's a concept that a contract is a meeting of minds, something that's negotiated between two parties. Economists talk about the ability of consumers' preferences to drive patterns of consumption and production, contributing to the efficient allocation of resources. But consumers aren't given an opportunity to negotiate when it comes to standard consumer contracts. Nor are they being given real choice to take their business elsewhere.

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Unfair Contract Laws will change behaviour on the part of both the trader and the consumer. Traders will need to consider the position of the consumer under their contracts. And consumers will be empowered to demand changes to contracts where their rights and obligations are unfairly quashed.

2. Are resources better directed towards financial literacy and simplified disclosure rather than Unfair Contract Terms Laws?

The policy objectives of financial literacy, simplified disclosure and Unfair Contract Terms Law initiatives are complementary and interdependent. All three seek to enhance the efficient operation of retail financial markets by improving consumer confidence and addressing information asymmetries. However, better literacy and simplified disclosure need to be accompanied by rules requiring fairness in standard form consumer contracts. Having the skills to know something is unfair is good. But that knowledge is rendered useless if the consumer has no avenue of redress to challenge an unfair contract.

3. Will Unfair Contract Laws adequately define standard form consumer contracts?

It is appropriate, as proposed by government, that the Unfair Contract Laws are drafted so as to exclude genuinely negotiated contracts. The provision needs to be drafted so that negotiation of some aspects of the contract (including but not limited to price, time of delivery and applicability of contingent charges or risk of liability) does not mean that the contract is considered to have been negotiated for the purpose of exclusion.

4. What is the appropriate definition of “upfront price”?

COAG has determined that the “upfront price” of a standard contract should be excluded from the application of Unfair Contract Terms Legislation. It is proposed that this should be done by adopting the wording of Regulation 6 (2) of the UK Unfair Terms in Consumer Contract Regulations.

In contrast existing Victorian Unfair Contracts legislation does not exclude the upfront price from the operation of the legislation.

The policy rationale for excluding the upfront price has been variously stated as

- upfront prices are ‘clearly visible’ to consumers and thus cannot legitimately be seen as surprises veiled by complex contracts (Productivity Commission Report April 2008 “PC” p 162).
- Consumers can elect to avoid contracts with unfair upfront prices *unless there are major barriers to competition* (PC p 162)
- ‘it would be contrary to general contractual and economic principles to allow consumers to challenge easily understood upfront prices at a later time’ (Discussion Paper p 36).

It is important to note that the Productivity Commission did not envisage that the exclusion of the upfront price would exclude

- contingent charges (p 161)
- ‘charges that are less transparent’ (p 162).

The exclusion of the upfront price from the application of unfair contract laws should not apply to fees and charges which are not readily apparent to the consumer. The legislation should specifically provide that all contingent charges are within the scope of the legislation as they are particularly likely to be discounted by the consumer. The legislation should apply to charges that are not able to be readily ascertained by the consumer at the time of entering into the contract.

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A test that a charge should be excluded if it is capable of being ascertained by fully reading the contract as some submissions have proposed is not appropriate. The rationale for excluding charges from the ambit of the law extends only to those charges that are 'clearly visible'. It should be clear that excessively complex price structures are within the ambit of the law.

This does not mean that any such charges are necessarily unfair, only that they are potentially subject to review for fairness. Businesses can be confident that if their contracts impose a fee or charge of a reasonable amount in reasonable circumstances then it is unlikely to be challenged as unfair.

5. Will Unfair Contract Laws duplicate the Uniform Consumer Credit Code (UCCC)?

The UCCC is industry-specific legislation applying to all forms of consumer lending and to all credit providers. The UCCC is based on the principles of truth-in lending which allow borrowers to make informed choices when purchasing credit. It is designed to apply to a deregulated credit market and provide standards for the provision of credit which will not be overtaken by changes in the financial marketplace.¹ The objective of Unfair Contract Laws will complement the UCCC, but they will certainly not replace them.

Synergies between the two pieces of legislation can be observed in requirements for clear and legible language and print formats and requirements to place warnings on credit contracts urging customers to read the contract. Unfair Contract Terms Laws will ensure that the clear and legible terms are fair.

There are, however, other areas where the UCCC goes further than unfair contracts legislation in protecting the interests of borrowers under a credit contract. For example, the UCCC clearly goes much further than the proposed unfair contracts terms legislation in the protections it grants to borrowers in default and facing costs associated with enforcement action taken by the lender. It is entirely appropriate that industry specific legislation is in place to protect the interests of borrowers in default.

As a general rule, generic legislation (such as Unfair Contract Terms Laws) is preferable to industry-specific legislation. But there will be circumstances where industry specific legislation is warranted and necessary. Unfair Contract Terms Laws will complement the UCCC.

6. Do unconscionable conduct provisions or specific prohibition on unconscionable fees and charges in the UCCC already protect consumers from Unfair Contract Terms Laws and conditions?

Unconscionable conduct provisions (such as Trade Practices Act s 53) provide different protections to the proposed unfair contracts terms legislation. The former applies to a trader taking unfair advantage of the particular circumstances of a consumer – for example exploiting a 'disability' such as poor English language skills, or a temporary or permanent intellectual impairment. Unconscionable conduct laws may be used to seek redress where a trader takes advantage of the consumer's vulnerability to persuade the consumer to enter into a contract which is entirely fair on its terms, but because of the circumstances the consumer would be foolish to enter into the contract.

Section 72 of the UCCC is an entirely different case. It uses the language of unconscionability but is in effect a series of limitations on particular charges that may be made by the credit provider. The policy rationale for some of the provisions in section 72 is similar to that for unfair contracts legislation as we conceive it – that there is scope for unfair exploitation in the application of enforcement charges and termination charges.

¹ http://www.creditcode.gov.au/display.asp?file=/content/code_principles.htm

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It may be that if the unfair contracts terms legislation is drafted effectively then this provision of the UCCC may become unnecessary. For that to be so, the legislation would need to apply to all contingent and ancillary parts of the price and there would need to be an effective grey list or black list system in place with a regulator empowered to act on the fees and charges that are causing problems in the market.

7. Should credit contracts be excluded from the laws?

There is no legitimate policy ground for the exclusion of consumer credit from Unfair Contract Terms Laws. The responses to questions 5 and 6 above outline how Unfair Contract Terms Laws will operate alongside industry-specific regulation of consumer credit. As in all other consumer markets where standard form consumer contracts are used, Unfair Contract Terms Laws will provide an important confidence-boosting consumer protection in the consumer credit industry.

8. Should the laws operate retrospectively?

The law generally should not apply retrospectively to contracts of fixed and limited duration where there is no capacity for one party to unilaterally change any terms and conditions including price. Just like many other change to the law, the Unfair Contract Laws will need to apply to any ongoing contractual arrangements including continuing credit contracts and contracts for the supply of services such as telecommunications and utilities services.

Once the laws are in place, this will mean that:

- a) a consumers right to challenge a term as unfair will apply to existing
- b) any term that is placed on a blacklist will be ineffective
- c) any term that is placed on a grey list will be vulnerable to challenge and should not be utilised unless the business is certain that it will operate fairly.

Businesses will require a transition period to adjust existing standard contracts. Liability for using a term which is recorded on a black list should not commence for a significant period, perhaps 12 months from commencement of the legislation or 15 months from assent whichever is the shorter. The consumer's right to challenge a term should not be subject to a transition period. A court should be empowered to declare that a term is an unfair term from commencement. However in recognition of the impact of the changed law on business, a court should be entitled to reduce the impact of the finding of unfairness in relation to a short transition period, perhaps six months.

The introduction of Unfair Contracts Terms Laws will require businesses to review their contracts. To increase business certainty it is desirable that terms which are considered unfair in all circumstances should be placed on a blacklist from inception of the law and that business should have a reasonable period of notice of the terms that will be on the blacklist.

It is also desirable that the regulator publish guidance as to its approach to enforcing the law.

However the burden on business should not be overstated. We have many years experience of the operation of similar laws in the UK, Europe and Victoria. Any business operating nationally outside the financial service field will have been required to ensure their contracts were fair for a number of years to comply with the current Victorian legislation.

9. Does a requirement for independent legal advice absolve the trader of their obligations under Unfair Contract Terms Laws?

No. Unfair Contract Laws provide for an objective test of the detriment associated with the terms and conditions of a consumer contract. The vendor would have nothing to gain and no incentive to require consumers to seek independent legal advice prior to accepting a standard form consumer contract. The consumer's understanding of the contract is more likely to be relevant in determining

whether the trader is engaged in unconscionable conduct rather than whether any of the terms are unfair.

10. Will Unfair Contract Laws increase legal risks for banks with consequential capital adequacy implications?

Unfair Contract Laws will require that vendors ensure their standard consumer contracts are fair. Normal risk management techniques will be adequate to this task. Further, to the extent that these laws create some legal risks vendors will be assisted in risk mitigation by the use of a 'black list' of terms deemed unfair and an extensive 'grey list' of terms and conditions that are *prima facie* unfair. No evidence has been provided that Unfair Contracts Laws will undermine capital adequacy requirements.

11. Will Unfair Contract Terms Laws create uncertainty in revenue streams?

It will be incumbent on the vendor to ensure their contracts are fair and, in doing so, minimise any uncertainty attached to their contractual arrangements. The use of 'black list' and 'grey list' unfair terms will substantially assist vendors in minimizing uncertainty.

12. Will Unfair Contract Terms Laws impose unnecessary costs?

No. Evidence from Victoria suggests there is no excessive cost burden on industry to comply with the laws. Moreover, the economy-wide benefits that will flow from the laws will extend to vendors as well as consumers.

13. Will Unfair Contract Terms Laws make standard form consumer contracts unattractive to vendors?

No. Unfair Contract Laws do not make it any more difficult for vendors to use standard form consumer contracts. The laws provide for consumers to be protected under such contracts and thus increase consumer confidence in their use. The significant financial incentives for businesses to use standard form consumer contracts arising from business efficiency will remain under the laws. These efficiencies far outweigh the very slight risk that a well run business may incur under Unfair Contract Terms Laws and so it is unlikely that we will see a reduction in the popularity of standard form consumer contracts.

14. Will vendors be uncertain about the validity of their contracts?

No. Only unfair terms and conditions in standard form consumer contracts can be ruled invalid or deemed to be void. A contract will remain valid even where a particular term has been found to be unfair. Given that term will not relate to the price or main subject of the contract, the contract as a whole will remain enforceable.