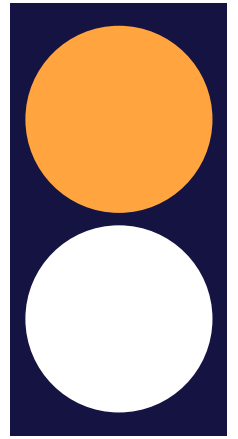


COMMERCIAL LAW

ARTICLE: UNFAIR CONTRACT TERMS

FEBRUARY 2024



Overview

Unfair contract terms (UCTs) are now unlawful

Under the new Unfair Contract Term regime, which amend parts of *the Competition and Consumer Act 2010* and the *ASIC Act 2001*, any person who proposes, applies, or relies on a contract found to contain unfair contract terms may face significant civil penalties.

This significantly changes the risk considerations parties should seek advice on, as previously, if a contract was found to be unfair, it would be ruled void. However, with these new civil penalties, running the risk of having unfair contract terms may have more serious implications.

With such a significant shift in contract law, many organisations must now reconsider their risk threshold, and any contracts that could contain what may deem to be “unfair” contract terms must now be reviewed.

This article gives a very clear picture of what these changes may mean for you as an individual, your organisation, and the future implications of these changes.

Introduction

Amendments to the unfair contract terms (UCTs) legislation commenced on 9 November 2023 make UCTs unlawful.



Unfair Contract Terms

Background

The UCT legislation was introduced on 1 January 2011 for consumer contracts (such as those used in domestic and household goods and services). In November 2016, it was extended to small business contracts and in April 2021, insurance contracts (previously exempted) came under the UCT regime.

The UCT provisions are found in the Australian Securities and *Investments Commission Act 2001* (Cth) (ASIC Act) for financial products and services and the Australian Consumer Law (ACL) for other products and services. The two laws mirror each other in parts, although recent amendments create an important point of divergence on the scope of the two laws, which we discuss below.

Financial services providers will be primarily concerned with the ASIC Act provisions in relation to contracts with their customers but may also have to contend with the ACL provisions when dealing with small business suppliers and distributors.

Prohibition and its effect

Under the new UCT regime, a person must not propose, apply, or rely on, or purport to apply or rely on, a UCT. Civil penalties may apply if a contract is found to contain a UCT and the penalties can be significant. Whether or not a clause in a contract is a UCT is a complex and case-by-case question depending on a variety of factors.

Making contract terms illegal changes the risk parties should weigh. In the past, businesses may have decided to run the risk of having the contract terms being found unfair because the only consequence was that the term would be void. This is no longer a tenable position, which has led to financial services

providers revisiting their standard form contracts and taking a more conservative approach to identifying and then removing or modifying, potentially unfair terms.

Scope

A contract must meet two conditions in order to be subject to the UCT regime:

- It must be a standard form contract; and
- It must be either a consumer contract or a small business contract.

The legislation does not define a standard form contract but includes a presumption — if a party to a proceeding alleges that a contract is a standard form contract, the contract is presumed to exist unless another party proves the contrary. There are factors listed that the court must take into account when determining whether a contract is standard form which includes, among other considerations:

- the bargaining power of the parties;
- how the contract was prepared; and
- whether the other party was given an opportunity to negotiate the terms of the contract

The amendments include some changes designed to make it harder to assert that a contract is not a standard form contract.

Types of contract

<p>Consumer contract</p>	<p>A consumer contract is one where a party to the contract is an individual, and that individual acquires what is supplied under the contract wholly or predominantly for personal domestic household use or consumption. The test for a consumer contract, which has not changed with the amendments, is a purpose test which is similar to the test for determining whether credit is regulated under the National Credit Code. However, it does not include a residential investment property purpose, unlike the National Credit Code, and so loans for this purpose appear to fall outside the UCT regime.</p>
<p>Small business contract</p>	<p>Before the amendments, the definition of a small business contract was the same under the ASIC Act and the ACL: one party must be a business that employs fewer than 20 people and the upfront price payable under the contract must not exceed \$300,000, or \$1 million if the contract had a duration of more than 12 months.</p> <p>The amended definition provides that a small business contract is one where one party to the contract is a business that either employs less than 100 persons or has a turnover in the last income year of less than \$10 million, but in the case of the ASIC Act provisions, the upfront price payable under the contract must not exceed \$5 million. Interest payable under a credit contract is to be disregarded in working out the upfront price in relation to this cap. Therefore, the ASIC Act UCT regime could apply to a single loan of up to \$5 million.</p> <p>The definition of a small business contract does not stipulate that the small business party must be the customer rather than the supplier of the goods or services provided under the contract. The enhanced UCT regime intended to better protect small businesses, therefore also imposes on small businesses as suppliers the same obligation that applies to other businesses to ensure that they do not have unfair terms in their standard form contracts, with potentially significant penalties if they do not comply.</p> <p>The amended small business contract definition does not completely align with (and is broader than) the definition of a small business for the purposes of the Banking Code of Practice and the Customer Owned Banking Code of Practice. This creates a drafting challenge for financial services providers subject to those codes when deciding whether particular terms to cater for small businesses should be limited to contracts with a small business as defined in the codes or apply to all small business contracts under the UCT regime.</p>
<p>Security documents and guarantees</p>	<p>A mortgage and a guarantee are both defined as a credit facility under the regulations, and a credit facility is a financial product under the ASIC Act. Therefore, the UCT regime applies to both mortgages and guarantees.</p>
<p>Exclusions</p>	<p>There are specific clauses and types of contracts which are excluded from</p>

	<p>the UCT regime. A term that defines the main subject matter of the contract or which sets the upfront price payable under the contract will fall outside the UCT regime. For a loan contract, the upfront price includes the principal, the interest rate, and any establishment fees disclosed when the contract is entered into but does not include contingent fees such as loan default fees.</p> <p>The recent amendments have added some financially related contract types to those excluded, including the operating rules of licensed financial markets and licensed clearing and settlement facilities, real-time gross settlement systems approved as payment and settlement systems by the Reserve Bank of Australia, and certain existing life insurance contracts.</p>
Transitional	<p>The amendments to the UCT legislation apply to contracts entered into on or after 9 November 2023 and to contracts entered into before that date but renewed or varied from that date; in the case of a variation, the amendments only apply to varied terms.</p>

What makes a contract term unfair?

A contract term will only be unfair under the UCT regime if:

- it would cause a significant imbalance in the parties' rights and obligations under the contract
- it is not reasonably necessary for the protection of the legitimate interests of the party advantaged by the term and
- it would cause financial or other detriment to a party if it were applied or relied on

If any of these elements are not present, the term cannot be unfair within the statutory definition.

This definition of a UCT has not changed in the amendments.

A contract term is presumed not to be reasonably necessary for the protection of the legitimate interests of the party who would be advantaged by the term unless that party can prove otherwise.

Given the illegality of UCTs under the amended UCT regime, we note that the key concepts making up the definition of a UCT are yet to be defined. There is no definition or test for a "significant imbalance" or for what is "reasonably necessary" to protect "legitimate interests" or for "detriment". We have to rely on court decisions, and these must be treated with some caution because some of the key decisions on similar terminology to date have involved consent determinations. It is likely that there will be more contested proceedings in the future, given the higher stakes under the amended law.

Significant imbalance

The concept of a "significant imbalance" in the parties' rights and obligations was discussed in *Australian Competition and Consumer Commission (ACCC) v CLA Trading Pty Ltd*, where the court held that the requirement is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in its favour, which may be by the granting to the supplier of a

beneficial option or discretion or power, or by the imposing on the consumer of a disadvantageous burden or risk or duty.

Not reasonably necessary for the protection of legitimate interests

The courts seem reluctant to nail down a clear definition of “legitimate interests” in the context of UCTs. In *Australian Competition and Consumer Commission (ACCC) v Smart Corp Pty Ltd (No 3)*, the court decided that it was not appropriate to attempt to define legitimate interests:

“... as it will depend on the nature of the particular business of the relevant supplier, the particular circumstances of the business, and the context of the contract as a whole. A legitimate interest may not be purely monetary and may not be confined to reimbursement of expenses directly occasioned by the customer’s default. It may be intangible and unquantifiable”.

The legitimate interests of one particular supplier could therefore be different to the legitimate interests of another supplier.

A legitimate interest may not be purely monetary and is not limited to reimbursement of expenses directly occasioned by the customer's default. A supplier party may have an interest in contractual performance by the customer which is intangible and unquantifiable.

It appears that the same form of words in one standard form contract could be reasonably necessary for the protection of the legitimate interests of the supplier in one contract but not in another contract. This poses obvious challenges for financial services providers trying to standardise contract wording so that it is not unfair.

Detriment

The concept of “detriment” in the definition of a UCT seems more straightforward and simply means that there would be some adverse impact on the consumer if the term was relied upon (even if the term is never actually relied upon in the particular case).

Mandatory considerations

When deciding if a term is unfair, the court must take into account the extent to which the contract term is transparent. A term is transparent if it is expressed in reasonably plain language, legible, presented clearly, and readily available to any party affected by the term. The legislation does not say how transparency is to be taken into account but presumably the less transparent a term, the more likely it would be at risk of being unfair. The court must also take into account the contract as a whole. This means that a term must not be assessed in isolation — one particular term may not be unfair if it is modified or counterbalanced by another term.

Grey list

The UCT legislation includes a list of types of contract terms which may be unfair. These example terms are not conclusive but provide an indication of the types of terms that will be at risk of being found to be unfair. The common characteristic of these example terms is that they are one-sided, giving rights to one party but not another.

Powers of the court

The amendments expand the powers of the court. Among other things, the court no longer has to consider whether the orders it makes will redress actual loss or damage and will have the power to make orders to prevent the respondent in the action from using the same or substantially similar in effect to a term that has been declared as unfair in any future standard form small business or consumer contracts.

Practical considerations when drafting

Default, unilateral variation, and indemnification clauses are widely used in lending contracts and have been a particular focus of regulatory scrutiny. Financial services providers have been giving them close attention when reviewing (or re-reviewing) their standard form contracts for UCTs.

Most standard form contracts have a severability clause which provides that if any term of the contract is unlawful or not enforceable, it has to be read down in a way that it is valid and enforceable and if it can't be read down, then it is to be excluded from the contract. In the regulated lending space, consumer credit contracts typically also include a special reading down clause relating to compliance with the National Credit Code. To assist in protecting their standard form contracts from UCTs, financial services providers may wish to consider including a general clause on similar lines for unfair contract terms, such as a clause that would prevent the provider from applying a term to the extent that the term was not reasonably necessary to protect its legitimate interests.

Contact Information

For any questions or clarifications, please reach out to:

Damian McGrath

Special Counsel

T: (08) 8231 6100

E: dmcgrath@ezralegal.com.au

Ezra Legal.
we're here to help

