

VACC submission

Review of Unfair Contract Terms for Small Business – Discussion Paper November 2018

December 2018



About VACC

The Victorian Automobile Chamber of Commerce (VACC) is Victoria's peak automotive industry association, representing the interests of more than 5,300 members in over 20 retail automotive sectors that employ over 50,000 Victorians.

VACC members range from new and used vehicle dealers (passenger, truck, commercial, motorcycles, recreational and farm machinery), repairers (mechanical, electrical, body and repair specialists, i.e. radiators and engines), vehicle servicing (service stations, vehicle washing, rental, windscreens), parts and component wholesale/retail and distribution and aftermarket manufacture (i.e. specialist vehicle, parts or component modification and/or manufacture), and automotive dismantlers and recyclers.

In addition to VACC, its sister organisations – the Motor Trade Associations, represent the automotive industry for their respective states, the majority of which are also supported by the association's peak body, the Motor Trades Association of Australia (MTAA).

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Contents

- About VACC 2
- Recommendations..... 4
- Background – Automotive Industry 5
- VACC response to Discussion Paper..... 6
- Changes required to business-to-business unfair contract law..... 6
- Definition of a standard form contract 7
- Thresholds 7
- Contracting practices designed or undertaken to avoid the UCT protections..... 9

Recommendations

Recommendation 1:

That unfair contract terms should be declared illegal, and that appropriate penalties and infringement notices that are enforceable by the ACCC should apply to all standard form contracts.

Recommendation 2:

That a clear definition concerning the legal coverage of standard form contracts be developed in regard to unfair contract term protections, for the benefit of small business.

Recommendation 3:

That the current monetary threshold for unfair contract terms be abolished and that a single threshold for small business be established based on a headcount of less than 100 employees;

Or alternatively,

The establishment of a new system that is devoid of thresholds and is based on the relative bargaining power of each party and the misuse of that bargaining power through the imposition of unfair contract terms. The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) could be invested with the power to mediate and arbitrate in this system.

Background – Automotive Industry

VACC welcomes the opportunity to provide a response to Treasury's *Review of Unfair Contract Term Protections for Small Business* - Discussion Paper.

Australia's automotive industry is diverse and encompasses a variety of sectors. Table 1 shows that in aggregate the industry employs 379,365 people across 69,365 individual businesses and contributes over \$37 billion in industry value-added to Australia's economy.

Of the 69,365 businesses representing Australia's automotive industry, most are small and family-owned businesses. Many of these businesses however, especially those within the automotive retail, service and repair sectors of the industry, are effectively excluded from the unfair contract term (UCT) protections as contained within the Australian Consumer Law (ACL). This represents a key anomaly and a major source of frustration for thousands of business operators across the automotive industry.

As the peak automotive body in Victoria, VACC is charged with a responsibility to communicate to government where legal matters adversely affect operations within industry, and in particular amongst VACC member businesses.

This submission therefore addresses the key limitations of the current UCT regime as they apply to the retail motor industry and small business more broadly, as well as proposing solutions to better strengthen UCT law for the benefit of small business.

Table 1: Australian Automotive Economic Summary – 2015/16

Automotive Sector	Employment year ending June 2016	Number of businesses as at 30 June 2016	Industry Value Added (\$m)
Motor Vehicle and Parts Manufacturing	43,627	3,054	3,826
Motor Vehicle and Parts Wholesaling	22,081	5,282	5,871
Motor Vehicle Retailing	66,002	5,752	7,707
Motor Vehicle Parts and Tyre Retailing	28,295	4,288	2,211
Fuel Retailing	34,728	4,136	2,851
Automotive Repair and Maintenance	142,632	37,406	9,452
Passenger Car Rental and Hiring	7,997	1,624	1,705
Bicycle Retailing	4,500	987	950
Marine Equipment Retailing	3,365	829	219
Outdoor Power Equipment Retailing*	4,670	1,290	250
Towing Services	3,052	2,465	203.8
Agricultural Machinery Retail and Repair*	6,916	1,403	n/a
Other specialised machinery manufacturing	11,500	849	1,900
Total Automotive Industry	379,365	69,365	37,148

Source: VACC - Directions in Australia's Automotive Industry: An Industry Report 2017

VACC response to Discussion Paper

In principle, VACC supports the concept that small business should be protected from large business who use unfair contract terms on a take it or leave it basis. From an automotive industry context however, the past two years has shown that the current legislation in this area has proven to be largely ineffective.

The experience of the automotive industry demonstrates a failure of the UCT legislation to protect small business in contractual relationships with large businesses. This is evident through the following:

- That the use of clauses in contracts that are clearly unfair, remains rife within franchise agreements between motor vehicle, motorcycle and farm machinery dealers and franchisors. This stems from a significant imbalance between the rights of franchisees and the obligations to the franchisor
- That the cost of challenging contracts in court is prohibitive for the majority of VACC members who cannot hope to match the financial strength of multinational companies who create the contracts
- That the UCT legislation remains vague and complicated, and requires the use of courts to make key determinations before substantive matters can be addressed
- That the financial and employee thresholds form a barrier to the use of legal remedies that preclude small businesses from accessing them
- That there is as strong inequality in the relative bargaining power between small and large firms. This is evident through recent announcements by Caltex to terminate its agreements with affiliated fuel retailers by 2020, as well as decisions by Holden to terminate 30 dealerships from their franchise agreements nationally, irrespective of their profitability. Affected business operators have been powerless in these circumstances with little recourse under the UCT law or current Franchise Code
- Small businesses are effectively deterred from seeking legal remedies to UCTs due to the significant cost of undertaking legal action and the perception and knowledge that these issues are unlikely to be resolved in their favour. Franchisors have the resources to engage tier-one lawyers in such disputes, as well as the capacity to prolong legal action which small businesses simply cannot afford to pursue. This is a common tactic used to wear down small business
- Reports received by VACC across its membership show that there has been no decrease in the use of unfair contract terms in franchise agreements drafted by large multi-national franchisors, nor within other contractual arrangements involving VACC members and larger industry players over the past two years.

Changes required to business-to-business unfair contract law

VACC believes that the operation of UCT law requires considerable strengthening to overcome many of its observed limitations and failures.

Foremost, VACC believes that unfair contract terms should be illegal in the first place. The fact that they are not illegal allows large firms to continue to use unfair clauses indiscriminately against small business, with the knowledge that that are unlikely to be challenged in a court.

On the rare occasions where disputes over unfair contract terms go to dispute resolution processes regarding the Franchise Code, VACC has observed that they are rarely successful.

Invariably, VACC members are unable to match the legal and financial weight of franchisors in the mediation process.

Along with making unfair contract terms illegal, VACC also believes that appropriate penalties should apply if unfair contract terms are included in standard form contracts, and that these penalties should be enforceable by the ACCC.

Both these initiatives would act as an incentive for large businesses to change their practices. Furthermore, they would also allow for UCT laws to be brought into line with other provisions contained within the Competition and Consumer Act (CCA).

Recommendation 1:

That unfair contract terms should be declared illegal, and that appropriate penalties and infringement notices that are enforceable by the ACCC, should apply to all standard form contracts.

Definition of a standard form contract

Currently, there is no legal definition within the ACL or the ASIC Act for what is a standard form contract. Rather, there are a number of factors that must be taken into consideration by a court to determine whether a contract is a standard form contract.

One of these factors includes whether another party was given an effective opportunity to negotiate the terms of the contract. It is not clear whether this factor can be satisfied by showing that the term was varied in relation to other consumers or small businesses. If it can, then this may push contracts, which were intended to be covered by the UCT protections, outside of them, which would be an undesirable outcome. This raises into question as to whether the full suite of contracts that are in fact standards form contracts, are covered under the law.

VACC therefore believes that small businesses, when entering into a contract, may benefit from greater certainty as to whether the contract they intend to sign is likely to fall within the protections of the UCT regime where a claim that a contract is a standard form contract may be challenged. A clear legal definition would be of great assistance in such cases.

Recommendation 2:

That a clear definition concerning the legal coverage of standard form contracts be developed in regard to unfair contract term protections, for the benefit of small business.

Thresholds

When the UCT provisions were extended to cover small businesses from 12 November 2016, it was envisaged that both a headcount of less than 20 employees and a monetary threshold of an upfront contract price of less than \$300,000, or \$1 million if the contract ran for more than 12 months, would cover most small business transactions in the economy.

The reality however, is that this has not been the case, and there is a plethora of small business models operating in the economy of which a large proportion are excluded from UCT protections because of the current legislated thresholds. Key examples of business exclusions include:

- Car dealers
- Motorcycle dealers
- Farm machinery and power equipment dealers
- Commercial vehicle dealers
- Marine equipment dealers
- Car rental firms

These businesses are characterized by the high value of the products sold, and irrespective of their employment levels, the value of stock traded by these businesses can run into tens of millions of dollars annually thereby excluding them from UCT protections.

The omission of motor vehicle dealers and from UCT protections represents a key anomaly within Australian Consumer Law, and this issue was specifically raised by ACCC Chairman Rod Simms in a recent speech to the Council of Small Business Organisations Australia (COSBOA) National Small Business Summit in August 2018¹.

Many of these affected businesses are small and rural-based single franchise operators, that are critical to the economic and social well-being of their local communities, yet they lack the appropriate bargaining power in negotiating their respective franchise agreements with franchisors and are thus susceptible to unfair contract terms. Collectively, there are many thousands of small businesses across the automotive industry nationally, that are denied UCT protections. There is no logical reason as to why these businesses should be excluded, and this issue needs to be considered as a matter of priority.

VACC proposes a couple of measures that would address the limitations posed by the current UCT thresholds.

The first proposal involves abolishing the concept of a monetary threshold and basing the small business definition on a headcount of less than 100 employees. This would allow many automotive business operators the protections afforded by the UCT law, which they are currently denied.

Furthermore, a single UCT threshold based on a headcount of less than 100 employees aligns with the small business definition used by the Australian Financial Complaints Authority (AFCA), and also that contained within the *Australian Small Business and Family Enterprise Ombudsman Act 2015*.

The second option involves establishing a new regime that recognizes the following:

- that there is substantial inequality in the relative bargaining power between small and large firms
- This inequality cannot be stipulated through thresholds as it is relative to the respective sizes of the organisations involved.
- This means that discussion on the size and efficacy of the employee and monetary thresholds is therefore superfluous.
- There are significant cost implications for small business in seeking legal remedies to UCTs that are unlikely to be resolved in their favour, and this acts as a deterrent to their use.

The proposed approach would involve the creation by government of a presumption of likely misuse of bargaining power that is borne by the relatively larger party, where there is substantial inequality. The purpose here would be to allow parties to reasonably negotiate in good faith.

This would place the onus on the larger party to prove that it had not used its relative bargaining power to impose UCTs, regardless of whether it was in take it or leave it circumstances. This could be applied to agreements currently in place instead of those signed after the commencement, as many of the agreements roll over. The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) could be invested with the power to mediate and arbitrate in this system, identifying both issues of misuse of bargaining power and the use of unfair contract terms.

The benefit of this approach is that it would reduce the cost to smaller businesses for seeking legal remedies and allow for greater data to be collected on how prevalent UCTs are without imposing a financial cost on VACC members. It would also allow for case law to be developed. This system could operate as a stand-alone mechanism or as part of an Automotive Code of Conduct, or ideally both.

¹ <https://www.accc.gov.au/speech/major-changes-needed-to-get-rid-of-unfair-contract-terms>

Recommendation 3:

That the monetary threshold be abolished and that a single threshold for small business be established based on a headcount of less than 100 employees;

Or alternatively,

The establishment of a new system that is devoid of thresholds and is based on the relative bargaining power each party and the misuse of that bargaining power through the imposition of unfair contract terms. The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) could be invested with the power to mediate and arbitrate in this system.

Contracting practices designed or undertaken to avoid the UCT protections

VACC has received reports of various practices undertaken by manufacturers and franchisors that are designed to avoid UCT protections. Franchise agreements are commonly drafted by tier-one lawyers on behalf of franchisors, and often contain potentially unfair contract terms.

One major practice used consistently by manufacturers/franchisors includes terms that allow the franchisor to unilaterally vary the operations manual. The motor industry is extremely complex. Franchisors have not been able to provide a “McDonald’s” franchise system which has clearly defined operations. To address this, franchisors construct ‘operations manuals’ in which they try to define the sales, parts and after sales policies and procedures. Significant problems occur in franchise relationships through franchisors unilaterally varying the operations manual during the term of the contract. The term ‘from time to time’ is used regularly. Changes can, in many cases be detrimental to franchisees, impacting on their earnings capabilities.

Small business operators often lack the financial resources to contest these matters before a court and are also fearful of reprisals from franchisors, such as termination of the franchise agreement itself. This imbalance of power means that franchisees are often susceptible to these practices.