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INQUIRY INTO UNFAIR TERMS IN CONSUMER CONTRACTS

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UNFAIR CONTRACT TERMS IN CONSUMER CONTACTS: EXAMPLES, ARGUMENTS AND RECOMMENDATIONS FROM ONLINE INVESTING

A Submission for the Inquiry into Unfair Contract Terms in Consumer Contracts

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Abstract:

Online investing is now an important means by which Australians enter the investment markets. It provides a good case study of the complexity and opacity that have developed in consumer contract terms, especially those in standard form contracts. Not duplicating points already made to the Committee, this submission uses terms from online investing broker/investor contracts to recommend a number of changes in the area of unfair contract terms that could apply both in the online context and more widely. While most will be appropriate to consumer finance and investment contracts, they may also apply to services contracts generally and even to contracts for the supply of goods. In particular we recommend changes to the definition 'consumer', that all consumer contracts be 'clear, concise and effective' and set out in a fashion that makes their terms comparable. We also suggest some terms should be proscribed as being unfair by their very nature.

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I. Introduction

This submission will concentrate on the factual context of online investing agreements between brokers and their investor customers. There is however plenty of scope for the observations and arguments made here to extend to other mass marketed financing contexts (eg margin loans, online banking). It is likely that the relevance may extend even further to other sorts of e-commerce contracts and that some of the problems may be mirrored to a greater or lesser extent in other areas of commerce. The submission will also concentrate on just some of the terms, conditions and legal consequences of online investing contracts. To extend beyond these would likely duplicate other submissions and unfortunately would go beyond the time the authors have available.

We think that the issues raised here have high incidence because of the number of Australians now using online investing brokers, and bound by contracts substantially like those we examine. We think the issues also have high impact because of the need for most employed Australians to be active in the financial markets at some time in their lives. This is because the restructuring of state services over the last generation has seen individuals encouraged to rely more on their own financial resources for retirement income, education and medical provision. In particular, Australia's combination of superannuation choice and lump sum payment means that Australians will often use the online mode for both the contribution and the retirement investment phases of retirement income provision. This means that substantively unfair online investing customer contracts could have a high impact on retail investors both individually and as a class.

II. Facts and Context

Background

In recent years, the online revolution has brought global investment markets to the investor's sitting room. Although there was a drop in numbers of online investors after the 'tech-stocks bubble' burst in early 2000, the economies of online investing and the rise in the share markets has meant that investors are being drawn back to the medium. Online investing is

much cheaper than broker-advised transactions. It is presented, through investment advertising and online broker websites, as empowering investors by giving them control over investment decisions. In fact there are reasons to be careful about this perspective.

Research shows that investors who switch from traditional telephone advisory to Internet investing do worse. Recent insights from investor psychology show that, 'after going online, investors trade more actively, more speculatively, and less profitably than before' due to over confidence. [1] There are several other cognitive biases that cause investors to lose money and seem to be amplified by online investing.[2] Further, while online investing is a powerful, cost effective investment mode, it is characterised by incentives to trade frequently. Aggressive online advertising 'conveys a message of convenience, speed, easy wealth, and the risk of "being left behind" in the online era..'[3] This is intensified by the ease and immediacy of clicking the mouse to trade, rather than talking to a broker on the telephone. Further incentives to trade frequently come from online trading fees that decrease as the number of trades increases. The same is true of the ready availability of margin loans. These are funds borrowed from an online broker to increase the amount but also the risk of invested funds. Research also shows that many investors have little understanding of how an online transaction occurs. They do not know whether their trade goes straight through to the market when they click on the mouse. They do not know about time lags affecting the price at which they ultimately buy or sell.[4]

Another feature of online investing is the combination of discounted fees or commissions, and vast amounts of investment information delivered without personal advice. Low fees further increase the attractiveness of frequent trading. Huge amounts of information without advice, raises questions about the quality of investment decisions. Online investing sites also make available a variety of charting and portfolio management programs. These assume that online investors will do financial analysis for themselves. A decade ago analysts and brokers did this for them.

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[1] B.M. Barber and T. Odean 'Online Investors: Do the Slow Die First?' (2002) *The Review of Financial Studies* 15(2) 455, 455-487; Barber and Odean (2000) "Trading is Hazardous to your Wealth: The Common Stock Performance of Individual Investors", 55 *Journal of Finance* 773.

[2] R. Shiller and J. Pound 'Survey Evidence on Diffusion of Interest and Information Among Investors' (1989) *Journal of Economic Behaviour and Organisation* 12, 47-66. This is now extended to online investing: Barber and Odea (2000), (2002); Barber and Odean (2001) "The Internet and the Investor" 15(1) *Journal of Economic Perspectives* 41-54.

[3] Office of the NY Attorney General Eliot Spitzer, *From Wall Street to Web Street: A Report on the Problems and Promise of the Online Brokerage Industry* (22 November 1999) 4.

[4] Spitzer, ibid, ch I and passim; Phillips, "Avoiding Share Scams in Cyberspace", www.asic.gov.au 20 September 1999, p 6; ASIC (August 2000), *Survey of On-Line Trading Sites* http://www.asic.gov.au

The 1990s have seen the extension of investment technology, especially through the Internet, to the retail investor markets. In 2002, in Australia, half of the Australian adult population owned shares.[5] In 2001 nearly thirty percent of households enjoyed Internet access[6] and up to 20% of Australian Stock Exchange daily volume was traded online.[7] The rise of the individual investor, often trading online, has been one of the most powerful developments in the capital markets of the last decade. This introduces a significant retail investor or 'financial consumer' element to investment markets – a mass marketing of investment services.

This mass marketing of investor services has in turn promoted standard form retail investor and online broker contracts. Since most contracts must be printed out and signed and sent to the online broker, individual investors are given the theoretical opportunity to assent to the terms of their broking contract. In reality it is most unlikely that any online broker would consent to changes to terms at the instance of a potential customer. Further, there are a very small number of licensed online brokers in Australia, probably not more than 20. A review of terms and conditions of online broker/customer contracts shows there is also little likelihood of finding a provider which would offer significantly different terms. From this mass marketing context, there is a danger of a significant imbalance in the parties' rights and obligations arising under the contract, where terms are introduced that may be unfair to the online investor.

Documents in an online broker/ customer relationship

The documents constituting the online broker/customer relationship are numerous. Usually they include:

- A guide of a promotional kind to the broker's services and business;
- The Financial Services Guide, a statutory disclosure document about the broker's services, fees and dispute resolution required under s941A&B of the Corporations Act.
- Broker/Customer Terms and Conditions – this is the main agreement that governs the broker/customer relationship, and the service provision aspects of

[5] ASX, Share Ownership Survey 2002 (5 Feb 2003) at http://www.asx.com.au/shareholder/pdf/sharesurvey050203.pdf

[6] ABS, Australian Social Trends "Household Use of Computers and the Internet", http://www.abs.gov.au/ausstats/abs@.nsf/0/C1D866341D03D9E9CA256D39001BC362?Open

[7] Phillips, op cit., n. 6, 6.

any the Margin Loan agreement that might be entered. It also governs the bank account relationship between the banker, the broker and the customer. If they are to be effectively included it must expressly incorporate any website terms (ie terms found only on the broker's website but part of this agreement). It is the terms of this agreement that are the primary focus of this submission, though the significance of some cannot be understood without the bigger picture.

- The website terms, if incorporated as just explained.
- Margin Loan Agreement and Margin (Loan) Account Online Application. Documents under which loans are provided to the investor to increase the capacity to invest, and which are secured on the securities purchased. There is considerable cross-reference between this and the Broker/Customer Terms and Conditions. The parties to the margin agreement are usually broker, customer and funding banker, which may be a different bank to that with which the primary investment account is kept, which is governed by the Broker/Customer Terms and Conditions.
- The Chess Sponsorship Agreement terms and conditions and Chess Sponsorship Transfer Form – this is very complex but has the net effect that the broker sponsors the investor into the Chess system operated by the stock exchange, so that the investor's securities may be cleared and held electronically in uncertificated or dematerialised form.

These documents can be viewed on the websites of ComSec
https://www.comsec.com.au/Public/JoinNow/FormsAndBrochures.aspx
and E*Trade
https://www.etradeaustralia.com.au/Application/Index.asp?
the country's two leading online brokers.

III. Instances of Unfairness - Legal Discussion

1. Are Online Investors 'Consumers'?

A number of fine submissions have already dealt with questions such as unilateral changes of terms by a provider, incorporation of obscurely located terms or suspension of services while continuing to charge. While terms like this do appear in online investing customer contracts it is unlikely that the effects will be dramatically different from other contexts. So this submission will consider some other areas where unfair contract terms are common in online investing contracts.

The breadth of the terms of reference of the Committee are admirable, and completely vindicated by the submissions we have read. One issue not included in the terms of reference may be more of a problem in the area of online investing and credit contracts than other areas. We draw it to the Committee's attention because we see it as an important threshold question that may be an obstacle to both existing consumer remedies and those under consideration by the Committee for future implementation.

There are many protections for an online investor who has entered a 'consumer agreement', under Pt 2 Div 2 of the Australian Securities and Investment Commission Act (ASICA). These mirror the consumer protection provisions of the Trade Practices Act (TPA). The Part is headed 'Unconscionable Conduct and Consumer Protection in Relation to Financial Services'. Section s12BC (4) ASICA provides that it is presumed that a person is a consumer in relation to services provided, unless the contrary is proved. A person is a 'taken to have acquired particular financial services as a consumer' if 'the price of the services' is under $40,000 or 'the services were of the kind ordinarily acquired for personal, domestic or household use.' [8]

There is real doubt as to whether many online retail investors are consumers because of two questions. First, how should 'the price' not exceeding $40,000 be calculated? And, second, what does 'personal, domestic or household use' mean? The issue of whether a person is a 'consumer' for the purpose of this and similar provisions is

[8] s12BC(1) ASICA.

always problematic. However, the issue is further polarised in the context of online investing because of the specific nature of the transaction.

Section 12BC(3)(b) ASICA provides that 'the price' is the 'amount paid or payable by the person for the services'. A question which arises is whether 'the price' is just that for the dealing transaction eg the standard commission of around $30 per trade, or the amount of the commission as well as the value of the underlying parcel of securities. If it is the first, it is likely that almost all online investors will be consumers. If not, many, many transactions are likely to be either consumer or not, depending on whether they are for 'personal, domestic or household use'.

In *Westpac Banking Corp Ltd v Prelea* [9] Westpac sued the Preleas as guarantors of their company to which Westpac had provided trade finance. The Preleas cross claimed alleging that the bank had not supplied services with due care and skill which was a breach of the implied term to that effect under s74(2) TPA. The Bank raised the issue of whether the company was a 'consumer' in terms of s4B of the TPA (equivalent of s12BC ASICA). The Preleas argued that they were, on the basis that 'the price' of the services provided by Westpac was just the cost of establishing the bill facility -- providing a cheque account and opening a line of credit – well under $40,000. This was despite the fact that many millions of dollars of credit had been extended under the facility.

The court concluded that 'the charge which is made for the service does not stop at the cost of opening the cheque account; it includes the costs of the provision of the funds being the significant aspect of the services provided.' There was no provision of services to a consumer.

We might draw a parallel between this and online investing services, and wrap the transaction fee up with the cost of the underlying securities purchased. After all, there is no point in the transaction if it does not involve the provision of the underlying securities, although unlike the *Westpac* case, it might have the effect of frustrating the protective purpose of the legislation. Many online investors might be equated with

[9] (1992) ATPR (digest) 46-093 (SCNSW)

DIY handy-men, fixing up their share portfolios on the cheap, as people did their houses. Consumers, *par excellence*. Why shouldn't they have the protection of a statute that is manifestly meant to cover those who are not professionals – for many DIY investors will trade in parcels over $40,000.

That means we must turn to the second question. Whether these investors have the protection of being a 'consumer' will depend on whether the trade was for 'personal, domestic or household use'. This requirement focuses on the use to which the things acquired are 'ordinarily put' not the use to be made of them by the particular investor. Again, the law in this area may have a perverse effect in terms of the protective purposes of Div 2 of ASICA. Securities (in volume of trades and absolute value) are likely ordinarily put to the use of business investment. While businesses which acquire carpet[10] or air conditioners [11] may benefit from these being ordinarily put to domestic and household use, online investors may suffer from the reverse.

An opposing line of reasoning might go like this. While in terms of overall value of holdings securities might have a predominant ordinary use in business, there are still a very great many ordinary investor transactions – indeed the ASX tells us that over 50% of adult Australians hold shares. So there might be more than one 'ordinary use'. Owning shares (and therefore trading in them) is a contemporary form of individual or personal saving. For many, many people this is for retirement plans, children's education, saving for a home, leisure and holiday travel. All these uses are either personal, or 'pertaining to the home'[12] and therefore domestic or to do with the household. This line of reasoning might just be successful with the support of the presumption in favour of transactions being in relation to a 'consumer' in s12BC(4) ASICA. We must bear in mind however *Jillawarra Grazing Co v John Shearer Ltd*[13] where the court rejected the characterisation of an air seeder as personal, even though it was owned by a grazier. The position may be further complicated because some online brokers portray the customer as an 'empowered investor' – its advertising is all about 'choice', 'empowerment' 'its your money' etc. Professional trader

[10] *Carpet Cal P/L v Chan* (1987) ATPR (Digest) 46-025 (SCQLD).

[11] *Cinema Centre Services P/L v Eastaway Air Conditioning P/L* (1999) ASAL 55-034.

[12] *Metropolitan Water Board v Colley's Patents Ltd* [1911] 2 KB 38 at 40.

[13] (1984) ATPR 40-441.

packages are offered with tools that ‘only professionals usually have’. This may help brokers to argue that online investing services are not for ‘domestic, personal or household use’ but are for ‘day-traders’ or other semi-professional customers.

The very same difficulties are likely to be met under the Fair Trading Act 1999 (Vic), and any similar legislation adopted in NSW or elsewhere which uses a similar definition based on a capped figure/ objective purpose test[14]. The Victorian statute adopts a very similar definition of ‘consumer’ to that discussed above. Section 3 provides that a ‘consumer contract’ means an agreement, whether or not in writing and whether of specific or general use, to supply goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption, for the purposes of the ordinary personal, domestic or household use or consumption of those goods or services. There is no capped amount test here.

2. Using Contractual Terms to Characterise the Online Broker/Customer Relationship as Something Other Than it is.

Is This a ‘Consumer’ Contract?

Perhaps the most important way in which contractual terms are used to characterise the relationship and its effects, is in attempts to establish that the relationship between online broker and investor is not consumer in nature. If the relationship is characterised as being outside the consumer definition, the statutory implied terms do not assist the customer. Online investing contracts typically include wide exemption clauses and acknowledgements by the customer that even in the event of liability being established, the liability is limited to the re-supply of the services by the broker. Wide indemnity provisions are also seen, so that even if liability is established by the investor against the broker, the investor has to indemnify or reimburse that loss!

These terms rely on an implicit characterisation of the relationship as non-consumer, and are only possible because of the uncertainty just discussed, about whether online investing contracts are consumer or not. They dramatically affect the remedies available to investors. Terms limiting remedies to the re-supply of services and

[14] See for example TPA section 4B.

permitting indemnities are only permissible if the broker/investor relationship is not a consumer one.[15]

Is the Relationship Advisory or Execution Only?

Another dimension in which contractual terms are used to characterise the relationship and its effects, is in attempts to establish an agreement between the parties that the broker/customer relationship is non-advisory and involving execution only.

Traditionally there has been a distinction made between the advisory broker/customer relationship and the execution only (literally the broker only executing trades at the investor's direction). The law imposes significantly greater duties on the broker in an advisory relationship. One reason for the discount in commissions to online investors is that brokers do not spend time and research on providing advice. Another is that the broker's exposure to liability for negligent advice and recommending unsuitable investments is reduced. It is likely that there are other standard form contract contexts where the provider attempts to avoid liability by getting the customer to acknowledge or agree that one sort of relationship or set of facts applies, when in fact that is just not the case. Incompatibility between the expectations of the customer and the website/contractual wording creates asymmetry between the expectations of the customer and the obligations of the broker.

As noted already, online broking sites provide vast amounts of financial information, analysis tools, and encouragement to investors that they can perform their own analysis and make their own investment decisions. This is the marketing position. The contract position is different. It insists that the investor acknowledge that it is the investor's responsibility to obtain investment advice before making any investment decisions relying on the information provided by the broker. Warnings on the website (as required by s945B Corporations Act) that material provided there is incomplete or

[15] Since they 'have the *effect* of excluding, restricting or modifying' the liability of the person in breach of the implied warranty s12EB ASICA which is not permitted in a consumer contract. See also *Qantas Airways Limited v Aravco Limited* [1996] HCA 12 (22 April 1996) in relation to the indemnities question.

inaccurate and advice should be sought, involve the same gap between what is advertised to the investor and what they are required to accept. In a different take on the same problem, some contracts require the investor to agree that the material on the broker's site is only information and not advice. In fact the material is a combination of information and general advice, which the requirement of the s945B Corporations Act warning demonstrates.

Further, depending how it is presented and what analysis tools are provided (eg interactive investment selection questionnaires) sites may even provide personal advice or recommendations, a position that is fulsomely acknowledged by the NASD rules governing online brokers in the US.[16] The point then is that contract terms are being used in an attempt to get the investor to deny the facts of the relationship, and reduce the likelihood of the broker's liability for advising. Even if this technique does not hoodwink a court (statutory definitions of what amounts to providing advice *should* prevail for public policy reasons[17]), it may wrongly convince an investor that they have no case and deter them from pursuing their rights. Arguments to the contrary that there is a lack of contractual intention to constitute the relationship as including advice of any type, should be met with the argument that the online broker contract is un-negotiated and mostly addressed to people who have little knowledge and experience in the area.

These illustrations provide interesting examples of what could be called 'misrepresentation by non-binding innuendo'. That is, terms of the contract say one thing but their combination with other contract terms and surrounding circumstances mean that a very different impression is conveyed to the consumer by the totality of the arrangement. In fact there may be room for arguments based on section 52 of the

[16] Taking the NASD rules as an example: N Liblin & J Wrona 'The Securities Industry and the Internet: A Suitable Match?' 2001 *Colum.Bus. L.Rev* 601-681 at 654-5; NASD notice to Members 01-23 Suitability Rule and Online Communications, 03/19/2001, text surrounding endnote 15; NASD Conduct Rule 2210 'Communications With the Public' especially rule 2210.(d)(1) and 2210.(d)(2)(N). Also discussion in H M Friedman *Securities Regulation in* Cyberspace (2004 Aspen) at 16-28 to 29. For further comment see report from the staff of the Commission, SEC Office of Compliance Inspections and Examinations, 'Examination of Broker-Dealers Offering Online Trading: summary of Findings and Recommendations' 25 January 2001: http://www.sec.gov/news/studies/online.htm

[17] Section 766B Corporations Act

Trade Practices Act, misleading or deceptive conduct, based on the arrangement as a whole. This is because the individual clauses provide a great disincentive for action by a consumer, though they may have rights.

3. Terms Which Exclude Supplier Liability Even Though Some Would Arise at Law in Some Circumstances.

As well as the types of clauses referred to above, another distinct category of terms and conditions which apply in a more general contractual context are those which purport to set out in detail the totality of the rights and obligations of a manufacturer or service supplier. Here we raise both legal and practical issues about these clauses.

Failure by seller/supplier to define or implement statutory customer rights.

Some clauses exclude by implication the obligations which the law imposes by the Trade Practices Act and similar laws on the *seller* of goods to a 'consumer'. If one approaches the seller in these circumstances the seller will always refer the consumer to the manufacturer under the terms of the written warranty. Although there are issues in relation to risk allocation which suggest that it is fairer for the manufacturer to deal with the problem, the seller is under a legal obligation to the consumer and ought to be able to bring pressure to bear on the manufacturer to assist with the resolution of the issue. This almost never happens because sellers usually fail to understand that they have obligation, and systems to implement it.

Failure by seller/supplier to define statutory customer rights with precision

A similar outcome occurs in situations where there is some vague mention of the non-excludable statutory terms and conditions. The use in exclusion clauses of general language which purports to exclude all liability and limit redress, but contains some type of 'saving clause' is another example of the 'confusopoly' referred to in other submissions to the Committee. The saving clause routinely states that the limitations included in the contractual terms only apply to the extent that the particular rights can be legally limited or excluded, and affirms that no statutory rights have been excluded. A simple example of this type of clause is included in the submission of the Australian Consumers Association at p 10 as follows:

> *"We limit our liability to the extent permitted by the Trade Practices Act. Our maximum liability under the Agreement (except for breach of a term implied by the Trade Practices Act) is limited to the total Charges paid by You during the 1 month period prior to Your claim."*

There are many variations of clauses of this kind. The Trade Practices Act contains section 53(g), misrepresentations in relation to warranties and rights. There is also law on the issue of literal truth being misleading in the context of section 52, misleading or deceptive conduct. Most sellers are unable to describe to a customer the impact of these clauses in a particular situation. And it is clear from the earlier discussion on the 'consumer' definition that the question of what warranty will be applicable in many cases is difficult to answer. It takes a very knowledgeable and persistent customer to obtain redress from a seller or manufacturer where the application of the law is so unclear and ill defined, and deliberately so.

Use of contractual indemnities

Another issue about exclusion of liability is the extent to which contractual indemnities are enforceable when juxtaposed alongside the implied terms and conditions of "consumer" contracts. Where the contract is one for 'personal, domestic or household' use the terms and conditions are not able to be excluded, restricted or modified. But do indemnities 'have the *effect* of excluding, restricting or modifying' the liability of the person in breach of the implied warranty (s12EB ASICA)? This is relevant to the investing contracts which are the primary focus of this submission, but is also relevant to contracts for the supply of most other goods or services under the TPA.

In *Qantas Airways Ltd v Aravco Ltd*[18] for example, a contract was entered into between Qantas and Aravco for Qantas to carry out maintenance on an aircraft leased and operated by Aravco but owned by a third party named BAT Industries Plc. The maintenance had been carried out successfully but when the aircraft was being towed to a new location it was damaged due to the negligence of Qantas. The cost of the maintenance was in the vicinity of $5,000 while the

[18] *Qantas Airways Limited v Aravco Limited* [1996] HCA 12 (22 April 1996) available http://www.austlii.edu.au/au/cases/cth/HCA/1996/12.html

cost of repairing the aircraft was between $500,000 - $1,000,000. The contract between Qantas and Aravco included a clause stating that Aravco would indemnify Qantas against liability to third parties. One of the main issues in the case was whether the indemnity in the contract contravened section 68 of the Trade Practices Act, which provides that liability for implied terms and conditions under the TPA cannot be restricted, limited or modified. The majority of the High Court found that the indemnity was not relevant to Qantas' liability for breach of the section 74 implied warranty. This was because it did not exclude restrict or modify the extent of Qantas' liability to Aravco.[19] This means that even where liability may not theoretically be limited the device of an indemnity may be able to circumvent liability in a practical sense.

4. Terms Which Exclude Liability for Those Not a Party to the Contract.

One characteristic of the networked services economy is that a primary provider like the online broker may sub-contract for the provision of a bundle of other services that make up the primary service offered to customers such as investors. The list of documents above discloses banking and margin loan services, electronic securities clearing and registration services as part of the broker's service. The information, opinion and tools on the broker's website are supplied by a variety of Internet content providers such as financial analysts, data vendors and software suppliers.

Clauses in online investing contracts often contain wide exemption and indemnity clauses that not only exclude liability for the acts of the primary provider who has direct nexus with the investor. As well, the investor is required to agree to exempt and indemnify all the subsidiary suppliers and their officers. These may be outside the control of the primary provider and certainly well outside any employment relationship. It may well expose the investor to risks that even the primary provider might not know of. It passes on to the investor the risk of the primary provider's commercial relationships – surely already covered by insurance which the customer already pays for in the price of the transaction.

[19] *Qantas Airways Limited v Aravco Limited* of Brennan, CJ, Gaudron, McHugh and Gummow JJ paragraph 12.

These provisions which extend exclusions and indemnities to parties outside the contract are known as “Himalaya clauses” and stem from the decision in *Adler v Dickson (The Himalaya)* [1954] 2 Lloyd’s Rep. 267, [1955] 1QB 158. That decision gave rise to a type of exclusion clause that if worded appropriately benefits third parties. Himalaya clauses are traditionally used in contracts for carriage but the clause is not necessarily limited to those situations.[20] In Australia, Himalaya clauses received the seal of approval in the decision of *Port Jackson Stevedoring Pty. Ltd. v. Salmond & Spraggon (Aust.) Pty. Ltd.* [21]

5. Other Terms Which Limit Disputes and Realisation of Rights.

Terms Which Give the Broker Irrevocable Authority Over the Investors’ Bank Account, Even When There is a Dispute.

One factor which must be kept in mind in the determination of fairness in broker /investor contracts, is the absolute liability that the broker has to stock-exchange counter-parties to settle its customer’s transactions. This is regardless of whether the investor has put the broker in possession of the securities or the funds it needs to perform the settlement. This partially explains the presence in investing contacts of terms which permit unpaid amounts to be a lien over the investor’s securities and give the broker control over the investor’s bank account. The question is whether the control given to the broker by contractual terms goes further than is needed for the broker’s protection and is unfair.

While most of the broker’s protections (eg liens, rights of reimbursement from the bank account etc) are unobjectionable when all is going well, the problem of unfairness arises when these rights are used peremptorily by the broker against the investor when there is a genuine dispute. This has the effect of suppressing disputes, and denies the investor due process of law.

[20] *Trident General Insurance Co Ltd v McNiece Bros Pty ltd.* (1988) 165 CLR 107 available at http://www.austlii.edu.au/au/cases/cth/HCA/1988/44.html

[21] *Port Jackson Stevedoring Pty. Ltd. v. Salmond & Spraggon (Aust.) Pty. Ltd.* [1978] HCA 8; (1977) 139 CLR 231 http://www.austlii.edu.au/au/cases/cth/HCA/1978/8.html

Terms Which Deny the Evidential Value of Communications or Exclude Them.

Finally, online investing contracts employ a number of devices which make it more difficult for an investor to bring a dispute to court because contract terms require that the investor agree that communications are accurate unless notification of an objection to them is made within a short period, such as 48 hours. A term may provide that the broker may determine the validity of any objection raised, and that is final. It may go further and require the investor not to contest the validity or enforceability of any electronic communications between the parties or irrevocably waive any right to raise defenses. This too has the effect of suppressing disputes, and denies the investor due process of law.

III. Instances of Unfairness - Policy Discussion

Many of the other submissions have discussed the leading effects of unfair contract terms: loss of consumer confidence, market inefficiencies of information asymmetry and loss of competition especially where inability to compare terms is increased by the 'confusopoly'. We do not think we have anything further on those issues, except to say that the matrix of documents constituting the online broker/investor relationship is so intricate that it may well be a 'complexopoly' providing another dimension to the idea of the 'confusopoly'.

There are however some other questions raised by this submission which warrant separate policy discussion.

1. Policy Implications of the Definition of 'Consumer'.

Current thinking seems to be leading to the conclusion that the present definition of 'consumer' or 'consumer contract' is imperfect. The uncertainties surrounding whether online investors are included suggest this.

One alternative is to address the question of what constitutes the 'price' of a good or service, to take account of circumstances such as those raised above in relation to

investment contracts. Along with this might go a significant lifting of the threshold transaction limits to, say, $200,000. It has been a considerable time since the $40,000 limit was set under the Trade Practices Act and other matching legislation.

Another alternative is to provide that there is presumption that all contracts are consumer contracts, and place the onus on the provider (who will usually be the defendant) to establish this. The criteria for establishing that the contract is not a consumer one could be quite similar to the current tests – a price threshold and a familiar descriptor such as ‘personal, domestic or household use’. This could be accompanied by a further factor, that if the contract is a standard form one the presumption in favour of a consumer contract is strengthened.

This is in line with the modern approach to regulation which is generally to construct wide definitional categories and provide some exceptions. The approach then places the onus of proving that someone is not entitled to the protection of the beneficial category (eg consumer), on the party objecting to it, which will usually be the service provider or seller. This is the approach taken for example, in defining a ‘retail investor’ to bring them within the protection of the disclosure regime of Chapter 7 of the Corporations Act.[22]

Alternatively, there is the capacity to do away with the consumer definition completely. Issues relating to the definition of “consumer” were considered in the 2004 Discussion Paper[23], with particular consideration of the issue of the application of unfair contract terms regulation to B2B transactions**.** There are clearly issues of the importance of freedom of contract in general and particularly in the context of businesses dealing with one another on an equal footing. However, it may be that the time and cost of identifying the traditional consumer in the context of a standard form contract is just not worth the resources and energy. It may be appropriate that rules dealing with unfair terms should be applied across the board in the limited context of standard form contracts which are not or have not been susceptible to negotiation. As a point of policy, though businesses generally are often in a better position to

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[22] See section 761 Corporations Act.

[23] Standing Committee of Officials of Consumer Affairs Unfair Contract Terms Working Party, Discussion Paper, *Unfair Contract Terms,*January 2004 at p

negotiate, this is not empirically so in relation to standard form contracts, particularly in industries where the products or services are complex and the transactions are of low value.

2. Terms excluding liability and which limit disputes and realisation of rights.

Liability terms which are so opaque that the investor is unlikely to understand them border on the misleading but have their greatest significance in their capacity to deter claims by the consumer. Much the same should be said of terms which shift to the investor liability for conduct of suppliers not party to the broker contract with the consumer.

In both cases the investor has no practical chance to know the liability in question, which has long been a precondition of consumers being bound by exclusions, particularly in contracts of adhesion. There is also a serious likelihood that they may be misled by the terms of the clauses into thinking that they have no rights against any of the service providers, which may not be the case. Further it is likely that much of the cost of these types of liability have already been paid for through the inclusion of insurance costs in the price of the service. So these clauses are an attempt to make investors and other consumers pay twice if liability arises.

Finally, we think it brings the law into disrepute (and it is ultimately the law which the consumer is relying on for help here) to deny consumers statutory remedies by inserting self-help clauses in standard form contracts. We object to those that are unreasonably in favour of brokers and other suppliers or which are used to render redundant the process of resolving a genuine dispute. Where the legislature has seen fit to provide consumers with remedies such as implied warranties we think it is against public policy to allow bona fide disputes to be suppressed by resort to such self help in a contract of adhesion, and we think that most courts would agree with us. The same remarks apply in relation to contractual terms which deny or reduce the ability of a consumer to use communications with the supplier as evidence, in the conduct and resolution of any dispute. Again, there is an element of the misleading. If contractual terms specify these measures they suggest to the lay person that they have no rights. In fact the track record of the courts is rather the reverse – they have a long

history of objecting to devices to oust their jurisdiction or suppress evidence – the trouble is that these clauses make it much less likely that any disputes will ever get inside a court.

3. Clarifying Terms and Presenting Them in a Universal Format.

Much of the mischief which we have discussed is only possible because contractual terms are so opaquely worded, and presented in such complexity. We think there is much to be gained by consumers, from requirements such as in financial services disclosure documents, that consumer contracts be 'clear, concise and effective'. This requirement would make clear that deliberate or negligent attempts at confusing consumers is unacceptable. It would provide the policy basis for arguments that such clauses were misleading, raising the possibility of liability under the TPA, ASICA or Fair Trading legislation. In short we think that that where there is a choice between allowing suppliers to use opaque and unreasonable contact terms to limit liability (which can be insured against) and requiring clarity and conciseness to ensure meaning is effectively communicated in standard form contracts, that the latter policy should prevail.

This would apply not only to the wording of the terms, but effectiveness of communication should extend to the way terms are presented either on paper or screen. Consumer advocates have long deplored the contract terms printed in 9 point font arial narrow, in light grey ink on Bible paper. We should equally deplore the electronic equivalent: where text is small and light coloured, where whole clauses cannot be seen in one screen, and where printing out for closer scrutiny and record keeping is difficult or unavailable.

Finally, we think that if contract terms were required to be set out in a fashion that promoted comparability that suppliers would use standard form contracts more fairly. So for example, if some terms which are standard to most contracts had to be formatted in a certain order in the document, and all terms dealing with the one aspect collected together, this might improve consumer contracts. Again, we refer to the financial services disclosure area. There some cardinal terms of investment disclosure documents (which really supply the contract terms) must be set out in a fashion which promotes comparison. So, price, risk, description of the product features and details of

the term and the product provider must all be presented in a substantially similar fashion, so that investors can compare products and apply for those that best suit their preferences. The same applies to information about dispute resolution. We think that online investing broker/investor agreements and other consumer contracts could well benefit from the treatment given to disclosure documents.

IV. Recommendations

We recommend a number of initiatives related to the terms of reference of the Inquiry based on the comments set out in this submission. Although not included in the terms of reference, we also make some suggestions about the definition of consumer' and 'consumer contract'.

Legislation similar to the provisions of the Fair Trading Act 1999 (Vic) dealing with unfair contract terms should be enacted in New South Wales, with the following additional elements:

1. A number of options exist for addressing the current deficiencies in the definition of 'consumer'. Our recommendations on this aspect in order of preference are:
   - 1.1 The existing legislation should clarify what is meant by 'price' and this should be increased to a $200,000 application cap, as the cheapest and quickest resolution. That the cap should be increased not less than every 5 years.
   - 1.2 Alternatively, a consumer definition involving a significant reversal of onus should be employed, as set out in the body of the submission.
   - 1.3 Alternatively again, the legislation could do away with a definition of consumer altogether and define 'standard form contract' although we suspect that this might be capable of circumvention in a number of ways.

Whatever approach is decided upon, should apply to all relevant NSW legislation and steps taken should be taken by NSW Government officers in the hope that definitions in Commonwealth TPA and ASICA legislation might also be amended to follow suit. National uniformity is good both for business and for consumers.

2. A requirement should be provided that all contract terms should be 'clear, concise and effective.' This would not be a general proposition, but would be limited to either (a) consumer contracts however defined or (b) standard form contracts as defined, depending upon the limitations determined appropriate in response to paragraph one above.

3. The law should mandate that consumer contracts be collated in a way that allows for rational comparison. Details particularly relevant to a comparison exercise would include:

   - Details regarding the parties;
   - Descriptions of the goods or services the subject of the contract;
   - Price or terms of payment;
   - Term of the contract (if relevant);
   - Exclusion of liability;
   - Dispute resolution;
   - Termination.

4. There should be provision of funds for seller/supplier education particularly regarding issues such as exclusions and limitations of liability. While investor and customer education is important, many people only consider these issues at the time when they have the problem and often the supplier is unable to or not prepared to clarify their right at that stage.

5. The law should prohibit the use of 'Himalaya clauses' in the contracts covered by the legislation on the grounds that they will always be patently unfair in these circumstances.

6. The law should provide a mechanism for independent dispute resolution, such as an ombudsman system, in relation to individual disputes.