Submission No 23

INQUIRY INTO UNFAIR TERMS IN CONSUMER CONTRACTS

Organisation: Centre for Credit and Consumer Law, Griffith University

Name: Ms Nicola Howell

Position: Director

Telephone:

Date Received: 12/10/2006

Griffith UNIVERSITY

Submission to:

Standing Committee on Law and Justice, NSW Parliament

Inquiry into unfair terms in consumer contracts

Centre for Credit and Consumer Law, Griffith University

October 2006

The Centre for Credit and Consumer Law is funded by the Queensland Government through the Consumer Credit Fund (administered by the Office of Fair Trading) and Griffith University.

About the Centre for Credit and Consumer Law

The Centre for Credit and Consumer Law is an academic centre, hosted by Griffith University Law School.

The Centre for Credit and Consumer Law was established in March 2004 to be a source of expertise, and a centre of excellence, on credit and consumer law issues, and it has the overall objective of promoting the attainment of a fairer, safer, and more efficient marketplace, particularly for low income and vulnerable consumers.

The Centre for Credit and Consumer Law is funded by the Queensland Government's Consumer Credit Fund (administered by the Office of Fair Trading) and Griffith University.

Introduction

The Centre for Credit and Consumer Law is pleased to provide a submission to the Law and Justice Committee of the NSW Parliament. The issue of unfair contract terms is one that has been of great interest to the Centre since its inception in 2004, and we have regularly published material on the topic, including:

- Submission to the Standing Committee of Officials on Consumer Affairs Unfair Contract Terms Working Party (March 2004);
- Unfair contract terms: do we need regulation? Workshop summary (May 2004);
- Unfair terms in consumer contracts: The issues and the UK solution (*Consuming Interest*, September 2005);
- An update on unfair contract terms legislation – examining the need for nationally consistent regulation of unfair terms in consumer contracts (presentation to the Credit Law Conference, September 2005);
- Unfair terms in consumer contracts – why do they deserve special attention (presentation to the Queensland Law Society / Law Council of Australia seminar on unfair contract terms, July 2006);
- Catching up with consumer realities: the need for legislation prohibiting unfair terms in consumer contracts (*Australian Business Law Review*, forthcoming 2006);
- Unfair contract terms and the consumer: regulating substantive unfairness (CCCL Research Paper, forthcoming).

Most of these papers are available from the Centre's website (www.griffith.edu.au/cccl), and we can provide hard copies if required.

Time constraints prevent us from providing a extended response to the terms of reference, however, we have reiterated relevant sections from our previous work in this submission, and we would be happy to expand on any of our comments in more detail should the Committee require it.

Response to the Terms of Reference

(a) Whether consumer contracts contain terms which cause a significant imbalance in the rights and obligations arising under a contract, to the detriment of the consumer.

In our view, there is a range of evidence suggesting that unfair terms in consumer contracts are commonplace, both in Australia and in other jurisdictions. Submissions by consumer groups to recent inquiries have highlighted the range of unfair terms in contracts for financial services, telecommunications, software and digital products, vehicle rentals, gym memberships, and other goods and services.[1] A concrete example is also given in the recent case of *Director of Consumer Affairs v AAPT Ltd*[2]. Consumer Affairs Victoria has also issued guidelines for the vehicle rental market, highlighting typical unfair terms in that sector,[3] and entered into negotiations with traders in relation to loyalty contracts and other contracts.[4]

Similarly, the work of the Office of Fair Trading in the United Kingdom highlights the range of unfair terms that can be found in consumer contracts in that country.[5] Given increasing globalisation and economic pressures, there is no reason to suspect that traders in Australia are less likely to use unfair terms.

It is argued that healthy competition will eliminate unfair terms in consumer contracts. However, as CCCL Director Nicola Howell has noted:

> While some markets may be competitive on price, I think that it is more difficult to argue that traders compete on their terms and conditions. The detail of terms and conditions of consumer contracts rarely form part of the advertising or promotion of a product, perhaps with the exception of refund policies. For competition to exist, consumers need to be aware of the terms and conditions. In practice, however, while we might argue that consumers should read their contracts prior to signing, it is likely that few consumers do so. Studies on behavioural economics and consumer decision-making also suggest that consumers act under conditions of bounded rationality, trading off the costs of search with the benefits of gaining extra information. Where there is no chance of changing the terms, and where, in any case, most traders in an industry use similar terms, it could be argued that it is rational for consumers *not* to read their contracts. Consumers may also assume that governments and regulators have some oversight of contracts, and would ensure that terms are fair and reasonable.[6] Legislation and

[1] For example, Australian Consumers Association submission to the Committee of Inquiry into the Competition Provisions of the Trade Practices Act; Consumer Credit Legal Service (Vic) and Consumer Credit Legal Centre (NSW) submission to the Uniform Consumer Credit Code Management Committee on Universal Change clauses.

[2] [2006] VCAT 1493 (2 August 2006), available from http://www.austlii.edu.au//cgi-bin/disp.pl/au/cases/vic/VCAT/2006/1493.html?query=aapt.

[3] See Consumer Affairs Victoria (2005) *Fair trading: Unfair terms in vehicle rental agreements,* available from http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Fair_Trading/$file/guidelines_unfairterms_carrental.pdf.

[4] See http://www.consumer.vic.gov.au/CA256F2B00231FE5/page/Listing-cavOctober2006-04-10-2006+-+VICTORIAN+CONSUMERS+PROTECTED+ON+LOYALTY+CONTRACTS?OpenDocument&1=73-2006~&2=12-October~&3=~&REFUNID=50037C69E8E5280BCA2571FB0023A341~.

[5] See the OFT's guidance and views at http://www.oft.gov.uk/Business/Legal/UTCC/guidance.htm.

[6] Ian McAuley 'But do we need the "nanny state"?', in *Consuming Interest*, No 101, Spring 2004, p 9.

> regulation needs to be based on what consumers really do, not what we think they should do.[7]

Measuring the detriment caused by unfair terms in a financial sense is more difficult, for a number of reasons.

- Consumers generally have little awareness of their rights, and available options for redress, and formal complaints to fair trading agencies and others are unlikely to reflect the level of dissatisfaction. As Iain Ramsay notes:

  > Existing empirical evidence suggests that consumers do not bargain in the shadow of the law and are less likely to seek third party advice than in other everyday problems…[8]

- The mere existence of a term in a contract permitting conduct that a consumer perceives to be unfair is likely to dissuade consumers from making a complaint.

- Individual complaints to a trader about an unfair term are likely to be met with the response that the contract signed by the consumer permits the conduct.

- Where the regulatory framework is based on the notions of freedom and sanctity of contract, the likelihood of successfully challenging an unfair term is remote (see below). There are therefore few incentives for consumers to make formal complaints.

- Unfair terms in consumer contracts give businesses a discretionary power – they can choose whether or not to enforce a term, depending on the customer and the nature and value of their business.

A hypothetical example illustrates the risk in relying on consumer complaints as evidence of detriment:

> Say, for example, that a consumer defaults on her contract by making a payment a day late. She is charged a $100.00 default fee. She might think this is a little excessive in the circumstances, and so rings up the business to complain. She will probably be informed that there is provision for this default fee in the contract, and that the contract terms are binding, and can't be disputed. Many consumers would give up pursuing the issue even at this preliminary stage. A more determined consumer might attempt to negotiate to pay a lesser amount, or for the fee to be waived in the circumstances, but any decision by the business would be entirely discretionary.
>
> If the business doesn't change its position, the consumer has to choose what to do next. She might obtain some advice, or even assistance, from an intermediary such as a lawyer or a financial counsellor, or even an ombudsman service. This assistance might prompt a compromise from the business, but if it doesn't, the consumer would then need to decide whether to start a claim in court.

[7] N Howell (2005) 'An update on unfair contract terms legislation – examining the need for nationally consistent regulation of unfair terms in consumer contracts', Presentation to the Credit Law Conference, September 2005, p 6.

[8] I Ramsay 'Consumer Law, Regulatory Capitalism and the 'New Learning' in Regulation' 28 *Sydney Law Review* 9, p 23.

> In Australia, she would almost certainly be given legal advice that her chances of success are slim because of the narrow interpretation of unconscionability. In either jurisdiction, she would probably be informed that the cost of commencing an action, and the stress involved in pursuing it, would far outweigh the $100 fee in question. The business (particularly a big business, or one with a particular interest in maintaining the term) would defend any challenge vigorously. It may very well appeal decisions to higher courts if a decision of a lower court was against it. Even if the consumer were successful in the High Court, the judgment would only benefit her – no other consumer who had been charged the fee would benefit. Further, the business might even choose to continue charging the fee in other contracts (in the absence of an injunction to the contrary), assuming that the numbers of consumer who will pay it will far outweigh those who challenge it. (Obviously, there might be sound business considerations such as reputation which would influence such a decision). In summary, attempting to fit standard form contracts within existing contract law not only results in a mismatch of theory and reality, but it also creates a chasm between a consumer's right to justice and her ability to access justice.[9]

The mere existence of these unfair terms is evidence of potential detriment, often with quite significant financial consequences if the trader chooses to enforce the term.

In 2004 submission to the SCOCA working party, we discuss the cost/benefit analysis of unfair contract terms regulation in more detail:

> Failure to provide for regulation of unfair contract terms is likely to result in continued use of unfair contract terms by businesses across Australia, to the detriment of consumers.
>
> Consumers will continue to have limited recourse to legal remedies for unfair contract terms, particularly when there is an issue of substantive unfairness. They will have to choose between accepting the unfair terms, or choosing not to purchase the particular good or service.
>
> In such an environment, there will be minimal incentives for businesses to ensure that their contracts balance the rights and obligations of both parties to the contract.
>
> This is the case even if the unfair terms are not actually enforced, or are not able to be enforced because they conflict with, for example, statutory warranties provided by the Trade Practices Act, ASIC Act, and State and Territory Fair Trading Acts. As noted in the Australian Consumers' Association submission to the Dawson Inquiry into the Trade Practices Act[10], the mere existence of terms that give extensive rights to the supplier of a good or service can operate to dissuade consumers from making a complaint or taking legal action to dispute the enforceability of the contract or of such a term.
>
> Failure to regulate will also have an impact on the competitiveness of markets for consumer goods and services. Consumers generally do not choose between suppliers on the basis of their contractual terms. Instead they focus on price and quality. If businesses are able to reduce their costs by the use of unfair contract terms (often hidden in the fine

[9] R Rimmer, Centre for Credit and Consumer Law, 'Unfair terms in consumer contracts – why do they deserve special attention?' Presentation to the Queensland Law Society / Law Council of Australia seminar on unfair contract terms, July 2006, p 8-9.

[10] Australian Consumers Association submission to the Committee of Inquiry into the Competition Provisions of the Trade Practices Act, p 36.

print) they may be able to offer a lower price and quality than can competitors that operate with fairer contracts.

On the other hand, the benefits of introducing regulation to prevent unfair contract terms would include:

- A more balanced sharing of risks between suppliers and consumers.
- A fairer market, with increased confidence in the market by consumers.
- Reduced opportunities for trader exploitation of consumers, especially vulnerable and disadvantaged consumers.
- A clear mechanisms for ensuring that issues of substantive unfairness can be addressed.
- More competitive marketplaces, as businesses cannot fund discount prices by effectively increasing the hidden costs through unfair terms in the contract.
- A more systemic way of dealing with unfair terms either within a business or across an industry sector.
- If Option 5 is adopted (as we recommend), a clear delineation of the issues relevant to claims based on procedural unfairness, and claims based on substantive unfairness.

Regulation could also lead to improved quality of contracts, as the extent to which a contract term is drafted in plain, intelligible language will be relevant to an assessment of its fairness or otherwise.

From a policy perspective, the implementation of unfair contract terms regulation could also improve the quality and quantity of information about the market. For example, regulators would become more aware of the types of terms that are being used by different businesses and players, and the extent to which particular terms or types of terms are being used. Collection and monitoring of this information will be highly relevant for the development of effective consumer policy.[11]

(b) Whether the use of standard form contracts has increased the prevalence of the above terms in consumer contracts

In our view, the use of standard form contracts facilitates the inclusion of unfair terms in consumer contracts.

A feature of a typical standard form contract is its one-sidedness. The contract is developed by the business to safeguard the interests of the business. This is a legitimate thing to do, provided that the safeguards are reasonable. However, in many cases, the terms of standard form contracts are so one-sided that, in effect, they place all risk and responsibility on the shoulders of consumers – who may not be best placed to carry the burden. This shifting of risk and responsibility is usually achieved by the use of one or more 'unfair' contract terms. This idea of unfairness is supported by section 32W of the Fair Trading Act 1999 (Victoria) which defines a term as unfair if "contrary to the requirements of good faith and in all the circumstances, [it] causes a significant imbalance in the rights and obligations arising under the contract to the detriment of the consumer."

Unfair terms in a one-sided contract might not require regulatory intervention if these were able to be managed by consumers, or by the effective operation of a competitive

[11] N Howell and P O'Shea (2004) CCCL Submission to the Standing Committee of Officials on Consumer Affairs Unfair Contract Terms Working Party, p 8-9.

> market. A feature of standard form contracts is their 'take it or leave it' nature. … A consumer [who wants the product/service being offered] has no practical choice but to accept the contract. The one-sidedness of a typical consumer contract cannot be easily counterbalanced without some change to contract law.[12]

However, as we have previously noted:

> There is nothing inherently objectionable about the use of standard form contracts. As noted in industry submissions [to the SCOCA working party], standard form contracts are a practical necessity in most consumer markets. For example:
>
> - national and even local businesses cannot realistically negotiate with large numbers of customers;
> - standard form contracts reduce transaction costs for both the supplier and the purchaser;
> - standard form contracts ensure that legislative and other regulatory requirements are complied with. [13]

We do not argue that standard form contracts should be prohibited; instead we believe that there is a strong case for prohibiting unfair terms in consumer contracts, including standard form contracts. In such an environment, a regulator (or consumer agency) can act as a bargaining agent for consumers generally, ensuring that there is 'reasonable' understanding or interpretation of a term that reserves a blanket discretion to business.[14] The regulator can thus act as a proxy for the broad consumer interest in circumstances where actual bargaining is non-existent.

(c) the remedies available under common law and statute with respect to the above terms in consumer contracts

A key issue in this debate is the distinction between substantive and procedural unfairness. Unfair contract terms legislation tends to focus on substantive unfairness, which is about the substance of the terms of the transaction, rather than the individual circumstances under which the transaction came about (the procedural issues). In its broadest sense, substantive unfairness can be assessed on the face of the contract itself, without needing to have regard to the characteristics and actions of the parties to the contract.[15]

It has been argued that specific unfair terms legislation is unnecessary, because existing legislative protections against unconscionable conduct (eg Trade Practices Act 1974 (Cth), s 51AB), unjust contracts (Contracts Review Act 1980 (NSW), s 7), and unjust credit transactions (Consumer Credit Code 1996, s 70) provide sufficient remedies for consumers complaining of substantive unfairness. There is no specific requirement in the statutory provisions that procedural unfairness must be involved before relief can be granted, and the 'shopping lists' contained in each piece of legislation include at least some factors that point to a concern with substantive unfairness alone.

---

[12] Rimmer (2006), above n 9 , p5.
[13] Howell (2005), above n 7, p 6.
[14] Ramsay (2006), above n 6, p 23.
[15] N Howell (2006) Catching up with consumer realities: the need for legislation prohibiting unfair terms in consumer contracts, *Australian Business Law Review,* forthcoming.

However, in practice, the potential for consumers to use these provisions in cases involving substantive unfairness alone does not seem to have been realised. For example, in assessing claims under the statutory provisions against unconscionable conduct, the courts have been strongly influenced by the approach taken in the equitable jurisdiction, with its focus on procedural, rather than substantive, issues.[16] A similar situation appears to have arisen in the context of the *Contracts Review Act*. In 2001, Carlin analysed 60 cases decided under this Act between 1982 and 2000, and he noted that:

> in only one of 18 mortgage or guarantee cases in which relief was granted and to which a financial institution was a party was a contract held to be unjust by reason of the harshness or oppressiveness of the terms of the contract itself.[17]

In another article reviewing *Contracts Review Act* cases, Zipser has suggested that the observation of McHugh J, that 'most unjust contracts will be the product of both procedural and substantive injustice', has been proven correct.[18]

In Howell (forthcoming, 2006), further analysis of cases decided under the *Contracts Review Act*, *Consumer Credit Code*, and *Trade Practices Act* provisions shows that:

> …there are some circumstances where a court *may* grant relief for substantive injustice in consumer credit contracts, even in the absence of procedural injustice. For example, the fact that a fee or charge is illegal might be a ground for relief. An 'horrendous disparity' in price or value might also be enough, although it is difficult to know what size the disparity needs to be before it is considered horrendous. Similarly, transactions structured so as to result in an unjust outcome might be sufficient to ground relief, including transactions structured in such a way that the borrower simply has no capacity to pay within its terms or where the lender is relying on the value of the security alone.
>
> Finally, terms that are not reasonably necessary for the protection of the legitimate interests of the trader might be sufficient to ground relief. However, in this latter circumstances, courts seemed to have focused on cases where the lender received more security than it actually required or that the parties expected. These cases may therefore also have elements of unfair surprise and procedural injustice.
>
> The suggestion that courts will not provide relief for substantive unfairness unless there is also procedural unfairness receives support from a review of consumer credit cases as the cases providing relief for substantive unfairness seem to be in the minority, and many decisions continue to place high reliance on procedural issues in order to grant relief. Given the difficulties and costs for individual consumers in litigating on consumer protection legislation,[19] prudent legal advice would be to commence litigation seeking

[16] F Zumbo (2005) "Dealing with unfair terms in consumer contracts: Is Australia falling behind?" 13 *Trade Practices Law Journal* 70, p 83.
[17] TM Carlin (2001) "The Contracts Review Act 1980 (NSW) – 20 Years On" 23 *Sydney Law Review* 125, p 133, referring to *Cook v Bank of New South Wales* [1982] ASC 55-223 . However, in that case, the judge did not make a firm finding that the term (providing that a certificate as to the amount owing was conclusive against the mortgagor) was unjust because the matter was not fully argued (at [57,060]).
[18] Zipser B, "Unjust Contracts and the Contracts Review Act" (2001) 17 *Journal of Contract Law* 76, p 79.
[19] Justin Malbon suggests that 'it is time consuming, expensive and just plain risky for a consumer to contest a provision under section 70 in a court or tribunal': Malbon J, "Predatory Lending" (2005) 33 ABLR 224 p 237.

> relief from unjust contracts or transactions only where there is an element of procedural injustice.[20]

In addition, there are considerable access to justice and systemic issues associated with reliance on individual litigation under these provisions, including the costs and risks of taking legal action.

> In contrast, unfair contract terms legislation in both Victoria and Europe enables a systemic response to an identified problem. A finding that a term is unfair in one case can be automatically applied to all other affected consumers, without the need for individual legal actions. The characteristics of individual consumers, and the context of individual transactions become irrelevant and do not need to be scrutinised. Similarly, prescribing a term as unfair will have an effect on all relevant contracts, without individuals needing to pursue their own legal actions.[21]

(d) the effectiveness of specific purpose legislation such as the UK Unfair Terms in Consumer Contracts Regulations 1999 and the Victorian Fair Trading Act 1999 (Part 2B – Unfair Terms in Consumer Contracts)

In our view, it is clear that specific purpose legislation such as the UK and Victorian legislation can provide a very effective outcome for consumers, particularly given the limitations of the unconscionability-type provisions discussed above. In a draft CCCL report comparing the UK and US regimes for dealing with substantive unfairness in consumer transactions, James Davidson has summarised the position as follows:

> Evidence from overseas jurisdictions suggests that the problem of substantive unfairness can only be successfully addressed with dedicated legislation and the proactive administrative arrangements to enforce it. The UK's Unfair Contracts Regulations as administered by the UK Office of Fair Trading has delivered very beneficial consumer outcomes in invalidating thousands of terms in standard form contracts since its inception in 1999. Most popular amongst these were terms that sought to limit the availability of consumer remedies and impose variations and penalties. Conversely the US uses a more traditional approach to substantive unfairness relying most heavily on a more liberal unconscionability doctrine than its Australian counterpart. The doctrine has seen relatively few instances of successful consumer use. The relative scarcity of case law where substantively unfair contract terms have been invalidated seems not to demonstrate the theoretical limitations of the doctrine but rather the impetus for consumers to invoke it. Further, it is seen that a case by case resolution of substantive unfairness provides no motivation for suppliers to alter the substance of their contracts even in the face of successful litigation. It would seem therefore that Australian consumers' interests would best be served through dedicated statutory mechanisms addressing the problem of substantive unfairness and not a piecemeal common law approach with a relaxed requirement of procedural unfairness.[22]

The impact that this legislation, together with a proactive regulator, has had on the nature and terms consumer contracts in the UK, and now also in Victoria, is very significant.

---

[20] Howell (2006), above n 15.
[21] Howell (2005), above n 7 , p 8.
[22] J Davidson (2006) DRAFT Unfair contract terms and the consumer: regulating substantive unfairness (CCCL Research Paper, forthcoming).

(e) any other relevant matter

As the experience in the UK and Victoria shows, the granting of appropriate powers and resources to the regulator is central to ensuring the effectiveness of unfair contract terms regulation. As we noted in 2004:

> In determining the appropriate powers and remedies, the focus should be on ensuring that there are:
>
> - appropriate incentives for consumers to challenge unfair terms,
> - structures to dissuade traders from using unfair terms; and
> - procedures to ensure that the systemic use of an unfair term can be halted.[23]

We also suggested that:

> An additional option to consider is to give individual consumers, and/or consumer agencies, the right to seek the imposition of a penalty for the use of a prescribed unfair term, ie some form of civil penalty. The question of whether or not a term used in a contract has been prescribed would not normally require the Tribunal to consider or weigh up oral evidence.[24]

And that the SCOCA Working Party:

> … should also consider the possibility of enabling other agencies – including appropriate consumer organisations – to seek an injunction to prevent the use of a particular unfair term or terms. Given the resource constraints facing regulators and enforcement agencies, such an approach might be an effective way of increasing the overall capacity to take action against unfair terms. The UK experience provides an example of how such an approach could be effectively implemented.[25]

The issues of enforcement, monitoring, and compliance are as important as the detailed legislative proscriptions against unfair terms, and we would encourage the Committee to give considerable regard to these issues in its deliberations.

Contact for further information

For further information in relation to this submission, or for copies of any of CCCL's publications on this issue, please contact:

Nicola Howell
Director, Centre for Credit and Consumer Law
Griffith University South Bank campus
PO Box 3370
South Brisbane Qld 4101
Tel: (07) 3735 3243
Fax: (07) 3735 3272
Email: N.Howell@griffith.edu.au

[23] N Howell and P O'Shea (2004) CCCL Submission to the Standing Committee of Officials on Consumer Affairs Unfair Contract Terms Working Party, p 16.
[24] Howell and O'Shea (2004) above n 23, p 17
[25] Howell and O'Shea (2004) above n 23, p 17-18