Submission No 22

INQUIRY INTO UNFAIR TERMS IN CONSUMER CONTRACTS

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Submission

Inquiry into unfair terms in consumer contracts

on behalf of the
Legal Aid Commission of New South Wales
to the
Standing Committee on Law and Justice, Legislative Council,
New South Wales

The Legal Aid Commission of New South Wales (the Commission) is established under the *Legal Aid Commission Act* 1979 (NSW) and is an independent statutory body. It provides legal services to socially and economically disadvantaged people. Legal services include representing them in federal and state courts and tribunals. It also works in partnership with private lawyers in representing legally aided people.

The submission is provided to the Inquiry currently being conducted by NSW Legislative Council Standing Committee on Law and Justice into unfair terms in consumer contracts to examine the incidence and impact of unfair terms in consumer contracts for the supply of goods and services of a kind acquired for personal, domestic or household use or consumption.

The submission, set out below, adopts the Terms of Reference as headings.

Experience in consumer protection matters

Consumer law is one of the Commission's specialist areas and the Commission's solicitors frequently advise clients and litigate matters under a range of consumer protection legislation. In the 2005–2006 financial year the Commission provided approximately 3,000 consumer law legal advice and representation services to citizens of New South Wales. It also either acted in or funded more than 160 new consumer law litigation matters.

The Commission's practical experience in assisting so many consumers both by way of advice and by representation, and its recognised expertise in consumer law, places it in a strong position to comment on the matters under inquiry.

Executive Summary

Unfair terms in consumer contracts are an endemic problem for consumers in society today. Examples can be found across the board; in the provision of financial services to insurance to car hire agreements to mobile phone

contracts to computer sales and on and on. The experience of the Commission is that unfair contract terms in consumer contracts are so widespread and have such an impact that legislative reform is demanded.

The present law, unfortunately, does not adequately deal with the problem. Common law and equity do not do so and despite the introduction of beneficial legislation such as the *Contracts Review Act 1980* (NSW) and *Consumer Credit* Code, *Trade Practices Act 1975* (Cth), unfair terms in contracts remain as prevalent an issue today as when this legislation was enacted.

For this reason the Commission's supports the introduction of national or uniform state and territory legislation specifically aimed at substantive unfair terms in consumer contracts to address the issue; in the alternative legislation in this state would greatly assist all NSW consumers.

Whilst the Commission's supports present similar legislation in Victoria and the United Kingdom on unfair terms in consumer contracts in principle, it is submitted that there is scope to improve that legislation in its definition of unfair terms. The Commission's believes that there will be greater impact and certainty if the legislation focuses exclusively on objectively determined substantive unfairness. It is proposed that the tests for unfairness in consumer contract terms should concern whether a particular term is not reasonably necessary to protect the legitimate interests of the supplier and/or whether the term imposes conditions which are unreasonably difficult to comply with.

For the proposed legislation or indeed any legislation, to have an impact, it will require clear powers being given to the regulator to intervene where necessary and more importantly it will require a significant commitment of resources to that regulator. The remarkable success of the UK experience with unfair terms is largely based upon the powers provided to the UK Office of Fair Trading and the work that they have been able to do.

The envisaged end result from the above proposed intervention is an improved market place; with less disputes, less costs for industry and enhanced consumer confidence.

(a) Whether consumer contracts contains terms which cause a significant imbalance in the rights and obligations arising under a contract, to the detriment of the consumer, including the incidence of:

i) terms which allow the supplier to unilaterally vary the price or characteristics of the goods or services without notice to the consumer;

ii) terms which penalise the consumer but not the supplier when there is a breach of the agreement;

iii) terms which allow a supplier to suspend services under the contract while continuing to charge the consumer; or

iv) terms which permit the supplier but not the consumer to terminate the contract.

Our experience and research supports the view that terms that cause a significant imbalance in contractual rights and obligations to the detriment of the consumer are widespread in consumer contracts and that that these terms are found across the board including in the provision of financial services, insurance, retail, real property, mobile phones, telecommunications generally, computer sales, travel, transport and home care.

Set out below, using the headings of the Terms of Reference, are examples of types of such terms that we have come across in our work. The number of examples unfortunately is limited and is a reflection of the limited time available to prepare this submission and certainly does not nearly reflect the number of these terms that are out there.

i) **Terms which allow the supplier to unilaterally vary the price or characteristics of the goods or services without notice to the consumer**

- A major bank's usual terms and conditions for consumer lending contained a clause that, apart from the usual right to change interest rates and fees, permitted the bank to 'change any other terms and conditions' of a consumer loan.

- A mobile phone contract contained a clause which stated that the consumer understood that the supplier may vary the terms in the manner set out in the booklet, which may result in changes to the terms and pricing of the phone plan and the supplier mobile service, including in the form stating this, in the booklet and in any promotional brochures.

- In a credit contracts where a vendor was financing the purchase of real property, a clause permitted the vendor to vary the annual rate of interest outside of any period during which the rate was fixed.

- In a contract about website services a company reserved the right, at its sole discretion, to change, modify, add or remove any portion of the agreement in whole or in part, at any time. Changes in the agreement were to be effective when notice of such change was posted and continued use of the site after such changes to the agreement were posted was to be considered acceptance of those changes. Under the same agreement the company could also terminate, change, suspend or discontinue any aspect of the company's site, including the availability of any features of the site at any time. The company also could impose limits on certain features and services or restrict access to parts or the entire site without notice or liability.

ii) **Terms which penalises the consumer but not the supplier when there is a breach of the agreement;**

- A credit contract which contained a clause which permitted the vendor, after the termination of the contract, to keep the deposit and all instalments paid under the contract as liquidated damages for non-performance of the contract, without necessity for the vendor to give notice or to do any other thing.

iii) **Terms which allow a supplier to suspend services under the contract while continuing to charge the consumer**

- In a contract about website services it allowed the service provider to from time to time without notice suspend the service or disconnect it or deny access to it including during any technical failure, modification or maintenance involved in the service provided that the service provider was to use reasonable endeavours to procure the resumption of the services as soon as reasonably practicable. Notwithstanding any suspension of the service under this clause the consumer was to remain liable for all charges due throughout the period of suspension.

- An insurance company included a term in its motor vehicle insurance policy that obliged a policy holder to pay the insurer the premium for the full year in circumstances where the insurer had some time during the first year paid out a policy on a written off vehicle.

- A car rental contract contained a clause under which if the rental agreement was terminated early for any reason other than a breach by the supplier, the customer agreed to pay rental charges that reflect the actual duration of the rental.

- A fitness club contract allowed a refusal of a refund to a customer who was unfit to exercise due to medical reasons arising after joining the club.

iv) Terms which permit the supplier but not the consumer to terminate the contract.

- A car rental contract contained a clause which enabled the supplier to request the immediate return of the vehicle, or re-take the vehicle, without notice, including if the supplier reasonably suspected that the customer had breached any term or condition of the rental agreement

- In a contract for website services which permitted the service provider to end the agreement and cease providing services for any reason, on 30 days written notice.

The Commission has also encountered other examples of such terms in contracts which fall outside the above 4 categories as follows:

- A credit contract containing a clause which stipulated that the purchaser should retain no title to the improvements to the property and replacement to fixtures (all of which were to remain with the

property) and the purchaser should have no claim against vendor for the cost or value of any improvements or replacement to fixtures made by him/her to the property.

- In an insurance policy an exclusion clause that the policy was not to cover any incident resulting in a claim where at the time of the incident the driver or the person in charge of your vehicle or a substitute vehicle was not truthful in any statement made in connection with a claim or where they had not taken all precautions to avoid the incident.

- In a website service contract a clause limiting damages so that the supplier or any of its subsidiaries were in no event be liable to any entity for any direct, indirect, special, consequential or other damages (including, without limitation, any lost profits, business interruption, loss of information or programs or other data on your information handling system) that are related to the use of, or the inability to use, the content, materials, and functions of the site or any linked website, even if the supplier is expressly advised of the possibility of such damages.

- In a credit contract the borrower had to pay a file access fee to the lender if the borrower requested copies of any part of their file or additional documents or information from the lender, calculated at the hourly rate fixed by the lender from time to time for this purpose, multiplied by the time taken to comply with the request plus any actual costs incurred by the lender in complying with the request.

- In another credit contract the borrower was to be regarded as being in default if he/she defaulted under any other contract between the borrower and the lender.

- In another credit contract the terms and conditions contained a clause that a credit card facility would be in default if the borrower breached any other credit contract with the lender, such as a home loan.

- A computer rental contract contained a clause stating that an early termination fee in respect of goods would be calculated as 80% of the monthly rental payments that otherwise would have been payable.

- A federal agency's standard credit contract provided that a home loan to indigenous people did not incorporate the 30 days default notice otherwise compulsory under the Uniform Consumer Credit Code.

- An insurance contract attached to a car hire agreement that excluded liability where the accident occurred whilst the car was being reversed.

- An insurance contract attached to a car hire agreement that excluded liability where the damage was incurred in either an accident with a tree or a kangaroo.

In addition, it is worthwhile to note the UK experience with unfair contract terms. In their Unfair Contract Terms Guidance (2001) publication the UK regulator has divided unfair contract terms into 13 categories which are set out below together with an example of each type of term : -

- Terms excluding or restricting liability for death or personal injury. (eg, "the company does not accept responsible for the failure of any fire protection equipment in the event of a fire".) (This was from a contract for the provision of fire protection equipment)

- Terms excluding or restricting liability for supplier's breaches of contract. (eg, "goods … which for any reason whatsoever are sold at less the manufacturer's recommended list price … shall be delivered to the purchaser in the condition as seen and approved by the purchaser and without any condition or warranty implied by statute, common law or otherwise.") (Caravan sale contract)

- Terms allowing retention of prepayments on consumer cancellation. (eg, "in the event of the purchaser cancelling the contract … or failing to accept delivery or failing to complete this contract the deposit shall be forfeited to the seller but such forfeiture shall not prejudice any other remedy which the seller may have for breach of any of the conditions.") (Retail contract)

- Terms imposing unjustified financial penalties. (eg, "if the purchaser shall fail … to perform any of the obligations … the purchaser shall become liable to the seller for the loss of profit upon this agreement, and such other losses as the seller may have suffered. A written statement of the amount of such damages prepared and signed by or on behalf of the seller shall be conclusive proof of such loss.") (Caravan sale contract)

- Terms allowing suppliers a right to cancel without refund. (eg, "in the event of failure to comply with these rules the management reserve the right to cancel the membership without refund.") (Social club contract)

- Terms requiring excessive notice periods for consumer cancellation (eg, "if a member does not wish to renew membership in any subsequent year then written notice of at least 4 weeks prior to the expiry of 12 months from the date of the membership certificate must be given. If such notice is given between 2 and 4 weeks expiry, then 75% of the renewal fee for the subsequent year will become payable and if less than 2 weeks of expiry then 100% of the renewal fee will become payable.") (Social club contract)

- Terms binding consumers to hidden terms (eg, "… this contract shall be subject to any conditions which the company may from time to time attach to the supply of the vehicle and accessories …") (Car sale)

- Terms allowing supplier's a right of final decision. (eg, "any dispute or difference which may arise in regard to the interpretation of the rules shall be determined by the management, whose decision shall be final.") (Social club contract)

- Terms limiting the contract to the formal agreement (eg, "no representations made by the company, or by its agents, shall be treated as having induced the customer to enter into the contract unless the same is included in this document".)

- Terms binding consumers where a supplier defaults. (eg, "a failure by the supplier to make an instalment delivery will not entitle the customer to repudiate the contract.") (Storage services)

- Terms allowing a supplier to assign without consent. (eg, "the company shall be entitled to assign this agreement in whole or in part. The customer shall not assign, re-sell, transfer or sub-lease the services or his/her rights under these terms and conditions.") (Internet services)

- Terms transferring inappropriate risks to consumers. (eg, "the client shall be liable for any loss or damage to the Hotel's property… or injury to persons including the Hotel's staff and shall indemnify the Hotel against any other loss or liability … arising from the function.") (Hotel contract)

- Unfair enforcement clauses. (eg, "if the monies due are not paid to the carrier within 14 days of their falling due the carrier … may sell the consignment and apply the proceeds of the sale towards the monies due and any reasonable expenses of sale.") (Courier services)

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

Modern contractual relations between suppliers and consumers are almost exclusively governed by standard form contracts.[1]

It is accepted that with the prevalence of standard form contracts has come greater efficiencies in the market including reducing costs associated with contracting (and hopefully, therefore price).

However, over time it has become recognised both in Australia and elsewhere, that standard form consumer contracts have also seen a significant shift in the rights and obligations between the parties to the unfair advantage of the supplier. The extent of this is exemplified in Part (a) above.

[1] As early as 1971, Slawson estimated that 99% of contracts were of a standard form variety: W Slawson 'Standard Form Contracts and the Democratic Control of Lawmaking Power', *(1971) 84 Harvard Law Review 529 at 529.* Lynden Griggs, in quoting these figures, suggests that the intuitive response is that there would be no significant difference today: L Griggs "The [ir]rational consumer and why we need national legislation governing unfair contract terms' *(2005) 13 CCLJ 51*

Information asymmetry and the inherent power imbalance that exists between the supplier (who have access and control over information to a contract) and the consumer (who does not) lies at the heart of the problem for consumers.

Standard form contracts are offered to consumers on a 'take it or leave it' basis. In this sense, despite the laudable principles of classic contract theory, the reality of consumer contracting is that consumers have absolutely no opportunity to bargain on the terms to an agreement. In many cases, consumers are not even provided with the time or opportunity to read the contract before signing.

As contracts are drafted by lawyers acting on behalf of suppliers, it is perhaps not surprising that they routinely contain clauses permitting the supplier (but not the consumer) to unilaterally vary the agreement, penalise the consumer (but not the supplier) for breach of the agreement and permit the supplier (but not the consumer) to unilaterally terminate the agreement. They are drafted by the supplier's lawyer with the supplier in mind.

It is also not surprising that as contracts drafted by commercial lawyers, they contain terminology and concepts that are foreign and unfamiliar to the average consumer. They can be printed in small font (as it no doubt reduces costs), with few or no headings. Despite legislative attempts to require the use of simple, plain English, comprehending the average contract can be beyond many consumers. Consumers do not have access to a similar level of professional advice as the supplier; nor, it is submitted that they should.

The existence of a competitive free market has not provided a solution to unfair terms in contracts because, apart from price, there is virtually no competition in the marketplace on contracting terms.[2]

Various reasons have been posited to explain this and consumer behaviour arguably provides some explanation. Quite simply consumers are either unwilling or unable to invest their time and resources in identifying the fairest contracts on which to contract. As one author says, 'the rational purchaser of today, voluntarily exercising their free will, does not seek to fully comprehend the complete contract'.[3] The behaviour of the modern consumer has been described as 'rationally bounded' in that 'her or she will limit the extent they will research or obtain information about the food or service they are seeking to purchase'.[4]

What then has evolved in standard form consumer contracting is a market either unwilling or unable to ameliorate the situation. Without unequivocal

[2] The lack of competition in the marketplace on contracting on fair terms was recognised as early on as 1976, when the Peden Report, the precursor to *Contracts Review Act 1980* (NSW) was prepared for the NRMA Attorney General.
[3] Griggs, op cit at 51

[4] Ibid

prohibition on such conduct and a mandate to the regulator to continuously monitor market behaviour, we believe that the problem will never be ultimately resolved fairly for consumers.

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

The prevailing laws in Australia do not adequately deal with the issue of substantive unfairness in terms in contract. The common law was not designed with standard form consumer contracting in mind. Equity has provided relief in limited circumstances of cases where it would be unconscionable for suppliers to enforce their strict legal rights. Beneficial legislation in NSW to date has failed in its attempt to mandate for fair terms in consumer trading.

Common law

The law of contract has not evolved in such a way as to provide adequate remedies to consumers who are faced with unfair terms in contracts. Based on underlying principles of laissez-faire economics, the common law developed in the 18th and 19th century to provide a set of firm legal principles to establish economic certainty in business dealings for parties who freely and willingly agreed to be bound to them.

Once privity of contract had been established, the Courts felt they had little scope to open up a bargain. Interestingly, and possibly somewhat ironically, it has been in the field of commercial dealings that the common law has provided some basis for relief for unfair trading. A body of case law has been developed around the principle of good faith in commercial contracting. The principle has at times been invoked as an implied term in commercial contracts. At other times, it has been invoked as a means of constructing commercial contracts. Cases such as *Renard Constructions (ME) Pty Ltd v Minister for Public Works, Burger King v Hungry Jack's* and *Vodafone Pacific Ltd v Mobile Innovations Ltd* have seen the Courts consider potential bases for intervention on grounds of good faith. *Vodafone Pacific Ltd v Mobile Innovations* Ltd, for example, the Court of Appeal was prepared to limit the effect of clause 41 which stated:

> *Where any provision of this Agreement allows the power to Vodafone to exercise any discretion, including where some act of Mobile is expressed to be conditional on Vodafone giving its consent or granting its approval, Vodafone may (unless that provision provides to the contrary) exercise that discretion in any manner it sees fit.*

It is interesting to speculate whether the Courts would have intervened if the subject provision had been in a consumer contract. The short answer is probably not. In one of the few cases to discuss the Victorian unfair terms consumer contract provisions, the President of the Victorian Civil and Administrative Tribunal observed that

> *It is not yet Victorian law, if it ever will be that consumer contracts are generally subject to an implied term of good faith'.* [5]

Why is it then that the Courts have been willing to construe principles of substantive unfairness in commercial contracts but not in consumer contracts? The answer may lie in the simple fact that Courts feel they have some role to play in overseeing commercial contracts given that such arrangements usually involve a negotiation process and an ongoing business relationship. Quite possibly, it is the very fact that there is no negotiation that makes opening up consumer contracts on good faith grounds almost impossible.

Equity

Recognising that the rigidity of the common law could at times produce unfair results, equity developed a set of principles for particular classes of people in discrete areas to avoid unconscionable results. Areas in which principles of equity has developed have included estoppel, undue influence, equitable fraud, fiduciary duties, mistake and confidentiality.

More recently, it has been recognized by Mason CJ in the landmark High Court decision of *Commonwealth Bank of Australia Ltd v Amadio*[6] that in one sense, these doctrines constitute 'species of unconscionable conduct' by the party who stands to receive a benefit under a transaction which, in the eye of equity, cannot be enforced because to do so would be inconsistent with equity and good conscience.

However, it must be remembered that equity has never had the power to intervene simply on grounds of unfairness or unconscionability. As Toohey J stated in *Louth v Diprose*:

> *Although the concept of unconscionability has been expressed in fairly wide terms, the courts are exercising an equitable jurisdiction according to recognised principles. They are not armed with a general power to set aside bargains simply because, in the eyes of judges, they appear to be unfair, harsh or unconscionable*[7]

Even accepting Mason CJ's sweeping statement in *Amadio* on the underlying principle of unconscionability, the Court only recognised its jurisdiction for intervening on the facts in *Amadio* where it was also able to be established that Mr and Mrs Amadio were suffering from a 'special disadvantage' as against the party seeking to enforce the agreement.

Consequently, equity would have no remedy to offer per se, without some further inequitable circumstance or conduct (that could enliven its jurisdiction), about terms of agreements that permitted a supplier to unilaterally vary the

[5] *Director of Consumer Affairs Victoria v AAPT* [2006] VCAT 1493
[6] *Commonwealth Bank of Australia Ltd v Amadio*, Mason CJ (1983) 151 CLR 447 at 461

[7] *Louth v Diprose*, (1992) 175 CLR 621 at 654

price or other characteristic of a good or service; that penalised a consumer but not the supplier when there is a breach of an agreement; that permitted a supplier to suspend services supplied under the contract whilst continuing to charge the consumer; or permitted the supplier but not the consumer to terminate the contract.

Further, it should be remembered that equity has further limitations. Equity is limited in the remedy it can provide where unconscionable conduct has been proven; namely, to provide the right to set aside the agreement or possibly confirmation by the court that agreement has been validly rescinded. It does not offer the opportunity to continue with the commercial relationship.

Statute

Variously attempts have been made to enact statute to address the issue of unfairness surrounding consumer contracting. Some beneficial legislation, such as the *Contracts Review Act* was specifically designed to remedy unfair in consumer contracts at a systemic level. All the beneficial legislation considered below, has made some attempt, albeit unsuccessfully, to consider remedying unfair terms in consumer contracts.

Contracts Review Act 1980 (NSW)

In 1976, Professor Peden produced a report (the 'Peden Report') into fair trading at the request of the NSW Attorney General. The Peden Report acknowledged the seriousness of the problems involved with unfair terms in consumer contracts and set them out as follows:

- The form of many contracts had become standardised so that there was often little actual freedom of choice or negotiation of terms;

- The Courts generally had no power to review the fairness of such standard form contracts nor treat them any differently from contracts resulting from free bargaining between parties of equal power and knowledge;

- The gap between the knowledge of a supplier and a customer in terms of the product had become wider with a correspondingly greater opportunity for abuse;

- The Courts had felt the need to develop a number of devices to do justice in individual cases. However, the result was not a frontal attack on the problem of unjust contracts but a multitude of individual decisions;

- The ability to grant relief in respect of harsh contracts conferred by other NSW legislation had been confined to specific areas and had

> generally proved to be largely ineffectual because of inadequate drafting and judicial reluctance.[8]

In response to the Peden Report, the NSW enacted 'revolutionary legislation'[9] known as the *Contracts Review Act 1980* (1980). It was said that its enactment may 'very likely' signal the 'end of much of classical contract theory'.[10]

The legislation gave Courts in NSW the power to reopen unjust contracts that were 'unconscionable, harsh or oppressive'[11] 'in the circumstances relating to the contract at the time it was made'.[12] In deciding whether the contract or a provision of it is ultimately unjust, the Court is required to consider the public interest and all the circumstances of the case including 'such consequences or results as those arising in the event of compliance'.[13]

The *Contracts Review Act* also enables the Minister or the Attorney-General to intervene (on application to the Supreme Court) where conduct or proposed conduct would offend the Act.[14]

Despite the laudable objects of the *Contracts Review Act,* it would be fair to say that it has not lived up to its objectives. The unfair consumer contracting that Professor Peden alluded to in 1976 are just as prevalent – possibly even more so - in 2006.

Why then has the *Contracts Review Act* failed in its attempt to alleviate unfair consumer contracting?

In a comprehensive review of the cases decided under the Act, Carlin[15] analysed all the cases decided under s 7 *Contracts Review Act 1980*. Carlin found a remarkable inconsistency in approach between the judges as to what would amount to unjust contract:

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[8] Peden J (1976) *Hash and Unconscionable Contracts* Report to the Minister for Consumer Affairs and Co-Operative Societies and the Attorney General for NSW, pp4-6 19-20 as cited in *Unfair Contract Terms- A Discussion Paper*, Standing Committee of Officials of Consume Affairs Unfair Contract Terms Working Party, January 2004.

[9] McHugh J in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 at 621

[10] McHugh J in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 at 621

[11] s 4(1) *Contracts Review Act 1980* (NSW)

[12] s 9(1) *Contracts Review Act 1980* (NSW)

[13] s 9(1) *Contracts Review Act 1980* (NSW)

[14] s 10 *Contracts Review Act 1980* (NSW)

[15] T Carlin, 'The Contracts Review Act 1980 (NSW) – 20 Years On' (2001) *Sydney Law Review* 125

> *At almost every turn, confusion and uncertainty protrude from the body of decided cases…On the one hand, it is suggested that 'fairness' is not an appropriate indicator of injustice for the purposes of determining the availability of relied under the Act, while on the other hand it is suggested that nothing much turns on the distinction between injustice and unfairness because the two are close fellows. And, of course, several cases incant quasi-religiously the table of the distinction between an unjust contract and an unjust transaction…'*[16]

Despite the fact that at least two provisions[17] within the *Contracts Review Act* specifically contemplate the Courts reopening unjust contract on the basis of the terms bargained for, recent research suggests that there has not been a single decision decided solely on the basis that the substantive term(s) of an agreement are unjust and there have only been two decisions where a contract involving procedural unfairness had been declared unjust.[18]

The fact that the Act requires a Court to consider unjustness 'in all the circumstances' arguably requires that there be an element of procedural unfairness before a Court will intervene. Certainly, these case results confirm the conclusion that, at least practically speaking, Courts consider that there should be a combination of procedural and substantive unfairness before they are prepared to intervene.

It is the view of the Commission that at least part of the problem with the existing legislation may also lie with the discretions afforded to the Courts. That is, a test which requires courts to consider unjustness, in the context of the public interest and 'in all the circumstances', may simply be too all-encompassing. It is no doubt understandably difficult for Courts to abandon 200 years of classic contract theory (including the notion that parties freely enter into bargains) without clearer guidance as to the inherent unfairness of standard form consumer contracting.

It is not surprising, therefore, that Courts have felt far more comfortable intervening where there has been procedural unfairness rather than substantive unfairness. It may well be this is because procedural unfairness is in the familiar territory of common law unconscionable conduct.

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[16] Ibid at 137

[17] *Contracts Review Act 1980* (NSW) – Section 9(2) subsection (d) and (g) substantive unfairness factors:

> (d) whether or not any provisions of the contract impose conditions which are unreasonably difficult to comply with or not reasonably necessary for the protection of the legitimate interests of any party to the contract – considers ability of consumer to afford to pay terms
>
> (g) where the contract is wholly or partly in writing, the physical form of the contract and the intelligibility of the language in which it is expressed

[18] B Zipser 'Unjust Contracts and the Contracts Review Act 1980 (NSW)' (2001 17 *Journal of Contract Law* 76

However, the Courts cannot be solely held responsible for the failure of the *Contracts Review Act* to deal with unfair terms in contracts. The Act provided clear power under s 10 for the Executive to also intervene in unfair contracts. The power has almost never been exercised in the Courts. As will be seen in Part 9 (d) below, it is the very strength of the regulator, well-resourced, committed and active that has provided the greatest change in business practice in the UK.

- *s 51 AB Trade Practices Act 1975* (Cth)

Section 51 AB of the *Trade Practices Act 1975* (Cth) prohibits 'conduct'[19] that is 'unconscionable'. Whilst equity is confined to procedural unconscionability, the statute is broader in its scope and permits the Court to have reference to the terms of a contract. The section provides a non-exhaustive list of factors that the Court can consider when applying the section, some of which look to the bargaining process (procedural unconscionability) and others which look to the terms of the agreement (substantive unfairness)[20].

In theory, at least, the statute provides scope for a Court to determine a matter solely on the grounds of substantive unfairness factors. Indeed, Parliament acknowledged as much in its Second Reading Speech when it was said the section was designed to catch conduct that is 'clearly unfair or unreasonable'.[21] However, to date, the Courts have been most reluctant to use substantive unfairness factors to identify unconscionability under the Act. As one author observes:

While the terms of s 51AB(2)(b) and (e) appear to contemplate that the substantive outcome achieved may, of itself, constitute a basis for a claim under s 51AB, a number of courts have required that some form of special disability or disadvantage be suffered by the party claiming relief: Guardian Mortgages Pty Ltd v Miller [2004] NSWSC 1236, Wood CJ at [108], [113] The imposition of this requirement has, in some cases, had the effect of bringing the standard of conduct required by s51AB closer to that required by the equitable doctrine of unconscionability and under s 51AA. On the reasoning adopted in these cases, it is necessary to show circumstances other than the mere terms of the contract which render reliance on the terms of the contract

[19] As distinct from other beneficial legislation such as *Contracts Review Act 1980* (NSW) which relates to 'contracts'.

[20] *Trade Practices Act 1975* (Cth) – Section 51AB subsection (2) (b) and (e) substantive unfairness factors:

> (b) whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation;
>
> (e) the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services from a person other than the corporation

[21] Second Reading Speech, Trade Practices Revision Bill (1986), Commonwealth, House of Representatives Parliamentary Debates, 19 March 1986, p.1627.

unconscionable: Australian Competition and Consumer Commission v Lux Pty Ltd [2004] FCA 926 Nicholson J at [94] citing Hurley v McDonald's Australia Ltd [1999] FCA 1728[22].

Consumer Credit Code

The Consumer Credit Code is uniform State and territory legislation that applies to consumer credit transactions. Relief is available against credit contracts and mortgages which is 'in all the circumstances…unjust'.[23] The Code provides that 'unjust' is defined as 'unconscionable, hash or oppressive'.[24] The Code then lists a series of factors that relate to procedural unfairness and substantive unfairness[25] that may assist in determining whether a contract is unjust.

The Act is drafted in similar terms to the *Contracts Review Act* and was possibly modelled on its provisions.[26] It is also suggested that the case law relevant to the construction of the *Contracts Review Act* is directly relevant to the constructions of the *Consumer Credit Code.*[27] As such, the arguments raised above in respect of the limitations of *Contracts Review Act* to deal with issues of substantive unfairness apply equally to the Consumer Credit Code. This includes the fact that Courts have been most reluctant to find unjust contract without some element of both procedural and substantive unfairness.

It is important to note that, as illustrated in Part (a) above, despite the existence of the Consumer Credit Code, it is the Commission's experience that unfair terms in consumer credit contracts is also as prevalent today as when this legislation was enacted. The Commission submits that, the Code has not done enough to remedy unfair terms at a systemic level.

Consumer Claims Act 1998 (NSW)

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[22] P Vout (Editor), Unconscionable Conduct: The Laws of Australia, LawBook Company 2006

[23] ss 70-71 *Consumer Credit Code*

[24] s 70(7) *Consumer Credit Code*

[25] *Consumer Credit Code* s 70 substantive unfairness factors include:

> (a) the consequences of compliance or non-compliance , with all or any of the provisions of the contract, mortgage or guarantee;
>
> (e) whether or not any of the provisions of the contract…impose conditions that are unreasonably difficult to comply with, or not reasonably necessary for the protection of the legitimate interests of a party to the contract…
>
> (n) the terms of other comparable transactions involving other credit providers and, if the injustice is alleged to result from excessive interest charges, the annual percentage rates payable in comparable cases

[26] P Vout (Editor), Unconscionable Conduct: The Laws of Australia, LawBook Company 2006 at p,528

[27] Ibid

The *Consumer Claims Act* (NSW) 1998 is State based legislation that gives jurisdiction to the NSW Consumer Trader and Tenancy Tribunal to intervene in consumer matters in circumstances where it would be 'fair and equitable to all the parties to the claim'.[28] Interestingly, unlike most other beneficial legislation, the test does not require the Tribunal to consider 'all the circumstances'. However, in determining what is just and equitable, the Tribunal can have regard to a list of matters that relate to procedural unfairness.[29]

Despite the existence of this legislation, it could not be said that unfair terms in consumer contracts have become any less prevalent. It should also be noted that unlike s 10 *Contracts Review* Act, there is no scope for intervention by the regulator for systemic breaches of the Act.

Summary of current law

In short, there is much that can be learnt from the common law and statutory context for any proposed unfair terms in contract legislation.

Despite various attempts to introduce beneficial legislation that will, *amongst other things*, seek to root out substantive unfairness, the experience of legislation such as s51AB *Trade Practices Act* and *Contracts Review Act* has been to date that it has failed to do so in consumer contracts.

The reason for this failure may be explained variously as set out below :

(a) 'in all the circumstances' tests require that the subjective circumstances of *this* consumer be considered before relief can be granted - but the reality is all standard form contracts are inherently unfair because they are always drafted by the supplier with the supplier's interests in mind

(b) 'in all the circumstances' tests lead courts to consider that despite the existence of substantiveness unfairness in consumer contracts, they should also have some evidence on procedural unfairness before they will intervene, possibly a hangover from 200 years of classic contract theory. To address this would need a clear mandate on objective standards of reasonable conduct.

(c) Public interest components also provide a discretionary basis for judges to impart their own conditioned[30] sense of what is fair which again allows for resort to the classic contract theory.

[28] s 13(1) *Consumer Claims Act 1998* (NSW)

[29] s 13(2) *Consumer Claims Act 1998* (NSW)

[30] That is, by 200 years of classic contract theory.

(d) Ambiguous terminology – for example the difference between unjust and unfair contracts, common law and statutory unconscionability. Parliament must provide clear guidance to the reach and the limits of new laws.

(e) Lack of regulator intervention. Apart from s 10 of the *Contracts Review Act*, there is no general power of the regulator to intervene and where that power does exist there have not been the resources or the will for intervention to occur.

What may be concluded from these observations is that the lack of effectiveness to date of beneficial legislation in rooting out substantive unfairness in consumer contracts has been hampered by a failure to devise a clear, principled approach specific to the issue of substantive unfairness.

A useful way of conceptualising beneficial legislation and common law may be to recognise, as one author[31] does, that common law and statute address (possibly without being totally conscious of it) different tiers of illegitimate behaviour: These are ranked below by that author in terms of the inappropriateness of the behaviour from most serious (and therefore least likely to be found) to least serious (and therefore most likely to be found):

(1) unconscionability at common law;

(2) breach of obligations of good faith;

(3) Breach of section 51AB of the Trade Practices Act;

(4) Unreasonableness (in an objective sense).[32]

Developing clear principles that bridge differing tiers of illegitimate conduct is no doubt the biggest hurdle that Parliament and the Courts face with any attempt to remedy illegitimate conduct. When attempts have been made to do this, say in the area of unconscionability, Courts and commentators have come under some criticism.[33] Quite possibly, it is the very fact that these beneficial laws seek to remedy differing tiers of illegitimate conduct that has led to difficulties and criticism of such laws as being 'unprincipled'.

Unfair terms in contract legislation should be squarely aimed at redressing only the issue of objectively unreasonable or unfair conduct. The failing of existing beneficial legislation is quite possibly that it seeks to incorporate different tiers of inappropriate behaviour from the dishonest to the unreasonable. Requirements of procedural and substantive unfairness should

[31] E Peden "When Common Law Trumps Equity: the Rise of Good Faith and Reasonableness and the Demise of Unconscionability' (2005) 21 *Journal of Contract Law* 226

[32] Ibid

[33] See for example E Peden 'When Common Law Trumps Equity: the Rise of Good Faith and Reasonableness and the Demise of Unconscionability', (2005) 21 *Journal of Contract Law* 226

not be necessary for legislation designed simply to prohibit unfair terms in standard form contracts.

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

To date, specific purpose legislation enacted in the UK and more recently in Victoria[34] has had a significant practical success across various industries in alleviating unfair terms in contracts. In the UK, for example, on average approximately 1500 terms are abandoned following discussions between suppliers and the Office of Fair Trading.[35] The resounding success of the UK experience has largely been the result of a robust, enthusiastic, committed and well-resourced regulator.

In terms of the application of the provisions in case law, it is our submission that the Courts may have considerable difficulty in consistently interpreting and applying the beneficial legislation.

In the UK, a term is unfair if 'contrary to the requirement of good faith' it causes 'a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer'[36]. In assessing whether the term is unfair, regard is to be had to, amongst other things, all the circumstances surrounding the conclusion of the contracts.

In Victoria, under s 32W of the *Fair Trading Act 1999* (Vic) 'a term is regarded to be unfair if, contrary to the requirements of good faith and in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment to the consumer'.[37] The Act then provides a non-exhaustive list under s 32X of issues that may assist in assessing whether a term is unfair including the four factors set out in (a) (i) to (iv) of these Terms of Reference.

The Victorian provisions were considered in the recent VCAT decision of the *Director of Consumer Affairs v AAPT Ltd*. [38] In considering s 32W, the President had considerable difficulty in applying the definition provided of unfair terms suggesting that the definition was circular. He stated:

> *It is apparent that a term in a consumer contract is to be regarded as unfair if it causes a significant imbalance in the parties' rights and obligations arising under the contract. It is apparent that the significant*

[34] The *Amended Victorian Fair Trading Act* 1999 (Vic) Part 2B came into force on 9 October 2003.

[35] Office of Fair Trading Annual Reports, 2001-2004

[36] Regulation 5(1) *Unfair Contract Terms in Consumer Contracts Regulations*

[37] S 32W *Fair Trading Act 1999* (Vic)

[38] *Director of Consumer Affairs Victoria v AAPT* [2006] VCAT 1493

imbalance must be to the detriment of the consumer. And it is apparent that in determining whether a term causes a significant imbalance in the parties' rights and obligations one must have regard to all the circumstances. What is less apparent is: what is meant by a "significant" imbalance? And what is the role to be given to the words "contrary to the requirements of good faith"?

The word "significant" simply means "important" or "of consequence". It does not mean "substantial". It is not a word of fixed connotation and besides being elastic is somewhat indefinite. [Footnote: In Merri Creek Quarry Pty Ltd v Foletta (1951) 82 CLR 347, at 353, Dixon J made the same comment about the word "works". It is common for a word used in a statute to have a grammatical or semantic meaning that does not readily reveal the legal meaning. See Aharon Barak, Purposive Interpretation in Law, Princeton University Press, 2005 and F A R Bennion, Statutory Interpretation, 3rd Edition, 1997.] However, in its context, it is designed to identify an imbalance, to the detriment of the consumer, which should be regarded as unfair. In this sense the definition is circular. But it is impossible to avoid the notion of fairness in determining whether a term causes a significant imbalance, even though this exercise is designed to ascertain whether a term is unfair.[39]

The President also noted that it his opinion, s32W required both the significant imbalance and a lack of good faith in all the circumstances before unfairness could be established. In this sense, he accepted that the test had a requirement for both procedural and substantive unfairness.

As identified in Part (c) above, it is the view of the Commission that the effectiveness of beneficial legislation in rooting out unfairness in consumer contracts has been hampered by a failure to devise a clear, principled approach to substantive unfairness.

New test for unfairness

It is suggested that a better test for unfair terms would be to focus simply on the normative aspect of substantive unfairness (in an objective sense). That is, what lies at the heart of the unfairness of standard form contracts isn't confined to the particular circumstances of a consumer, but the wording of the standard form agreement itself. The Courts should feel confident and encouraged to intervene where clear evidence exists of illegitimate business conduct. But to make them confident, precise language and clear principle must be developed.

The common law has a strong history of being able to provide certainty of principle in contract law. Several authors have suggested that in the context of creating greater certainty in principles such as unconscionability, equity can learn from the common law.[40] It is suggested that in the context of beneficial

[39] *Director of Consumer Affairs Victoria v AAPT* [2006] VCAT 1493 at [33] - [34].

legislation, similar benefits may apply in borrowing from the common law. Clough says that

> *In each of the areas of economic duress, restitution and unconscionability, the Courts are attempting to resolve the essential issue of what constitutes illegitimate conduct as opposed to reasonable commercial conduct.*

It is proposed that the test for unfair contracts should be as follows:

> A term in a consumer contract is to be regarded as unfair where it is either not reasonably necessary to protect the legitimate interests of the supplier or it imposes condition(s) which are unreasonably difficult to comply with.

In short, the test seeks to catch illegitimate conduct in two types of situations:

- where terms are unfair on their face;
- where terms are unfair in their effect.

To assist in determining when such circumstances will arise, other jurisdictions have proposed a series of factual indicia. In Victoria, for example, s 32X of the *Fair Trading Act*, provides a list of matters in s 32X (a) to (m) that a Court may have regard to in determining whether a term of a consumer contract is unfair (noting of course that the Terms of Reference[41] for the current inquiry nominate some of the factors listed in s 32X (a) to (m)). We support the inclusion of factual indicia such as those of Victoria.

However, it is the Commission view that those indicia may be better at identifying terms which are unfair on their face. Terms that are unfair in their effect will, no doubt, be more difficult to identify and root out. It is beyond the scope of this submission to provide a list of indicia that may assist in identifying terms that are unfair in their effect. However, it may be that concepts such as whether a consumer could have acquired an identical or equivalent good or service from another supplier may be one example of this type of situation.[42]

To illustrate just how difficult it may be to identify terms which are unfair in their effect, it is worth considering the UK decision of Director *General of Fair Trading v First National Bank* [43]. In that case, the trial Judge and the House of

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[40] See Daniel Clough, *Trends in the Law of Unconscionability* (1999) 18 Australian Bar Review 34

[41] Paragraphs (a) (i) to (iv) Terms of Reference, Inquiry into Unfair Terms in Consumer Contracts, Standing Committee on Law and Justice.

[42] This terminology is borrowed from s 51AB (2)(e) *Trade Practice Act* and . The section presumably borrows from the law of tort and loss of opportunity cases there.

[43] Trial Judge [2000] 1 ALL ER 240; [2000] 1 WLR 98; Court of Appeal [2000] QB 672; House of Lords [2002] 1 AC 481

Lords came up with a differing understanding from the Court of Appeal in determining how the reasonable expectations of the parties were to be determined in a credit card case that involved terms that were unfair in their effect. The Court of Appeal's focus in determining there was unfairness not so much on the experience of the debtor or that of the reasonable debtor but with 'normative issues of substantive fairness of the term (and its consequences for the unwary consumer)'. The House of Lords rejected this approach, deciding that unfairness needed to be determined against a background of what the parties could reasonably expect in this contract.

Quite clearly, this case illustrates that more work needs to done to develop a list of indicia that will assist in the assessment of terms of consumer contracts that are unfair in their effect.

Other key aspects of proposed unfair terms legislation

Proposed legislation should contain a number of other key features

- National legislation or uniform state based legislation[44]
- Broad range of civil remedies[45] be available to consumers and the regulator including the capacity to declare the term void
- Well-resourced, committed regulator who can put into effect the objects of the proposed legislation
- They should apply to consumer credit contracts[46]
- Civil penalty provisions should apply
- Criminal sanctions available for use of prohibited terms in certain circumstances
- That a specialist jurisdiction be established to deal with the litigation; perhaps connected to an existing tribunal such as NSW Consumer Trader and Tenancy Tribunal (CTTT)

[44] As set out previously, there are long term economic benefits to business in having uniform legislation in place in Australia.

[45] These would include the following, as set out in the *Fair Trading Act (Vic)* in s32Y (unfair term void but contract can continue), s 32ZA (injunctions by Director of Fair Trading), s s32ZB (request for information by Director of Fair Trading), s 32ZC (declarations on unfair terms or prescribed unfair terms), s32ZD (referral by Director of Fair Trading for an advisory opinions).

[46] The Victorian unfair contracts provisions do not apply to consumer credit contracts, s 32V *Fair Trading Act*. For the reasons set out in this paper in Part (c) in relation to the continued existence of unfair terms in consumer contracts, we support the need for proposed legislation to apply to all consumer contracts.

- That litigation be a secondary resort and that the favoured tool of the regulator be consultation leading to, if appropriate, enforceable undertakings by the supplier including seeking an advisory opinion

- That there also be standing for designated consumer representatives to apply for terms to be declared unfair

Conclusion

Whilst the legislation will be revolutionary in its design, a strong and clear mandate by Parliament is necessary to rectify a widespread and serious problem that faces consumers in modern markets. It must be remembered that whilst the legislation will be novel in NSW, industry will be asked to do nothing more than contract on fair terms. The fact that industry has apparently been able to comply with the regulator in both the UK and Victoria is testament to the fact that such reform is workable and a proportionate response to the issue.

The Commission thanks the Standing Committee on Law and Justice for the opportunity to comment and the extension granted to provide them. If you have any questions, please do not hesitate to contact David McMillan on 92195814 or via email on david.mcmillan@legalaid.nsw.gov.au.