Submission No 1

INQUIRY INTO UNFAIR TERMS IN CONSUMER CONTRACTS

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Please find attached my submission in respect of the Inquiry into Unfair terms in consumer contracts.

The attached files include a five page summary of the major arguments in the article titled "The Irrational Consumer and why we need National Legislation governing unfair contract terms"

I hope you find them of some use.

Please contact me if you would like me to elaborate on any points.

Submission to the New South Wales Parliamentary Inquiry

Standing Committee on Law and Justice

Unfair Terms in Consumer Contracts

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Summary

[1]. Thank you for the opportunity to contribute to this vitally important issue. It is one that I consider to be of critical importance for Australia. My ideas are more fully expressed in the attached article which was first published in the *Competition and Consumer Law Journal* (2005) (13) CCLJ 51-72. Another recent Australian reference which may assist the Committee is F. Zumbo, 'Dealing with unfair terms in consumer contracts: The search for a new regulatory model' (2005) 13 *TPLJ* 194. Both these articles contain references to other sources.

[2]. The competitive market based economy has led to significant competition on price, but relatively little competition on other contractual terms. For example, the contracts between different mortgage providers exhibit largely a uniform approach to regulation. Whilst this is understandable given the competitive nature of the credit industry and the dictates of legislation such as the *Consumer Credit Code*, the result has been that the industry has been able to self-regulate the mandating of punitive terms in these agreements. As consumers shop mainly on price, any attempt by a credit provider to ameliorate the effect of this largely goes unnoticed. Accordingly, what occurs is that the more harsh terms drive out the better terms (the same situation can be seen in the market for used cars – hence the need for 'lemon laws'). Many of these largely standard form contracts contain provisions which permit unilateral alteration (e.g. changes in fees, interest rates in mortgage contracts), or which penalise the consumer, but not the

supplier when in breach (e.g. failed transaction fees in the banking sector, by contrast, consumer may well have to approach the Banking Industry Ombudsman when they have a complaint with their financial provider). Because of this absence of competition within contractual terms, and the inability to have supply side remedies (i.e. many of these standard form contracts exist in highly competitive industries) – there is a need for demand side reform.

[3]. Standard form contracts have no doubt brought significant economic benefits (in lower transaction costs), but which have come at the expense of genuine bargaining between two parties. This has been highlighted with the increasing prevalence of on-line transactions (click-wrap agreements), and the requirement of the consumer to indicate compliance with the terms and conditions. The consumer in doing this is known as 'boundedly rational' in that it does not make economic or behavioural sense to obtain legal advice of the meaning of these terms. This can lead to surprises post-purchase (e.g. the jurisdiction for the resolution of disputes with Amazon.com is Seattle, Washington). Intuitively one suspects that most on-line purchases would be bought without active consideration of the terms and conditions. The reason for this is that the low cost of the transaction will, in many instances, serve as a disincentive to undertake a rigorous checking of the contractual provisions. Furthermore, if the transaction is a one-off, and there is no continuing relationship between the parties, the need for an understanding by the consumer of all provisions is small. By contrast, the supplier, given the number of transactions that they have with millions of consumers (e.g. credit card issuing company and its relationship with its card holders) has a financial incentive to understand and appreciate the individual nuances of the contractual relationship that they have with consumers. What this means is that in those situations where the consumer has received what that person considers to be a bad bargain, the question becomes one of causality. What was the reason for the bad bargain? Did the consumer not receive appropriate disclosure at time of contracting, was there a surprise post-purchase, or was the consent of the consumer somehow impaired (e.g. duress, undue influence). The

common law provided a range of responses to this problem – such as remedies for unconscionability and innocent misrepresentation. This, however, was not enough, legislative reform was necessary (Part V of the *Trade Practices Act* 1974, and allied State based reform). The largely restrictive interpretation of these provisions (e.g. s51AA-51AC *Trade Practices Act* 1974 (unconscionability)) has not led to the necessary structural changes, with the need for unfair contract legislation of the ilk established in Victoria.

[4]. In making any consumer change, it is critical that the policy makers determine the basis for reform. This could be because of economic efficiency (disclosure laws); paternalism (gun control legislation), or distributive welfare (price control legislation). With unfair contract laws, all three bases could be invoked, but it is submitted that theoretically, wider political support can be garnered if economic efficiency is seen as the guiding principle. To this effect, economic efficiency is enhanced with unfair contract legislation by less disputation, greater consumer confidence with this feeding into a higher level of consumer activity. In essence, there will be less bad bargains.

[5]. Another reason for legislation of this nature is that in some instances, consumption will be the superior way to evaluate the suitability of the item – this mandates that a contract be formed before the consumer is able to accurately judge the worth of the product (e.g. gym memberships/holidays).

[6]. Furthermore, consumer behaviour is not homogenous – some will be more susceptible to advertising pressure than others, and consumers will display a range of biases that affect their decision making (see OECD, Directorate of Science, Technology and Industry – Committee for Consumer Policy, 'Roundtable on Demand Side Economics for Consumer Policy: Summary report for a list of consumer biases, available at www.oecd.org). Given the difficulty of identifying which consumers need assistance, structural reform (in the sense of applying to all consumers) is necessary.

[7]. Given that consumers have few incentives to fully understand the contractual terms, and in many cases the small size of the transaction presents as a disincentive to seeking ex

post relief (i.e. who would travel to Seattle to dispute a transaction in respect of a book purchase from Amazon), unfair contract legislation is required to assist consumers.

[8]. Common law remedies are largely inadequate and presently represent a piecemeal response to consumer problems. Statutory incursions such as unconscionability have been interpreted narrowly (see *ACCC v CG Berbatis Holdings Pty Ltd* (2003) 197 ALR 153) and have failed to make a significant cultural change to contractual practice. The unconscionability doctrine appears inescapably tied to find a particular aspect of disadvantage – such as age, relationship, or language. General unfairness or a lack of good faith has failed to find a common law foundation for intervention (see B. Dixon, 'Common law contracts of good faith in Australian commercial contracts – a relational recipe', (2005) 33 *ABLR* 87). Given this failure of the common law, the role of Parliament is mandated.

[9]. New South Wales legislation such as the *Contracts Review Act* 1980 has largely seen a focus on procedural rather than substantive unfairness (T. Carlin, 'The Contract Review Act 1980 (NSW)' (2001) 23 *Sydney Law Review* 125).

[10]. Part 2B of the Victorian *Fair Trading Act* 1999 represents a cultural change from merely examining procedural unfairness to also encompassing substantive unfairness. Significantly it allows for the Director of Consumer Affairs to apply to the Victorian Civil and Administrative Tribunal for an advisory opinion as to whether a term is unfair. If adequately resourced (and this is a critical point, and demonstrates the need to consider the role of institutions in change), this option will allow for certain terms in contracts to be quickly examined, and if necessary changed. Whilst this would not remove standard form contracts from the market place (an undesirable aspect in any event as consumers don't have the resources to individually bargain), it will see the making of contracts that more fairly represent the balance between the interests of consumer and supplier. For example, the equivalent United Kingdom legislation has seen some 1541 terms altered or amended in the two year period of 2003-2004.

[11]. Any legislative change should direct the Courts to consider the normative issue of the unfairness of the term, rather than the unfairness of that term in the context of the relationship between the individual warring parties. This will overcome the House of Lords decision in *Director General of Fair Trading v First National Bank* [2001] UKHL 52; contrast Court of Appeal [2000] 2 All ER 759.

[12]. What the reform should encompass:

- Economic efficiency (the cost to the suppliers of change must not see increased costs passed onto the consumer);
- The recognition that all people are consumers (and for this reason, and recognising that the terms of reference allow for consideration of any other matters, thought may be given to abandoning the notion of consumer contracts and make all contracts subject to any reform legislation. The personal, domestic, household criteria are urban-centric by nature, (e.g. see the decision of *Jillawarra Grazing Co v John Shearer Ltd* (1984) ATPR 40-441, airseeder not of personal or domestic use, even though it could be argued that in rural properties, they are very common); may have some arbitrary financial limitation and was probably only included as a compromise to see the introduction of the *Trade Practices Act* 1974. It could now be removed;
- Resourcing is necessary for the Consumer Affairs department to allow monitoring and empirical evidence obtained of industries where there are systemic problems with unfair terms;
- Preferably legislation would be introduced nationally, but if this is not feasible, a uniform approach between the States may force the Commonwealth hand; and
- Finally, unfair contract reform legislation of the type established in Victoria should be introduced into New South Wales, with this hopefully leading to change across all jurisdictions.