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Unfair contract terms update for financial services providers

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Agenda

- Overview of unfair contract terms (**UCT**) regime
- A close look at what makes a UCT
- Summary of the key changes coming in
- Types of clauses to focus on when reviewing for UCTs
- Excluding UCTs from your contracts



Financial services

*Australian
Securities and
Investments
Commission Act
2001 (Cth) (ASIC
Act)*

Regulated by ASIC

**Rest of the
economy**

*Australian
Consumer Law
(ACL)*

Regulated by the
ACCC



How the 2 laws could apply to you



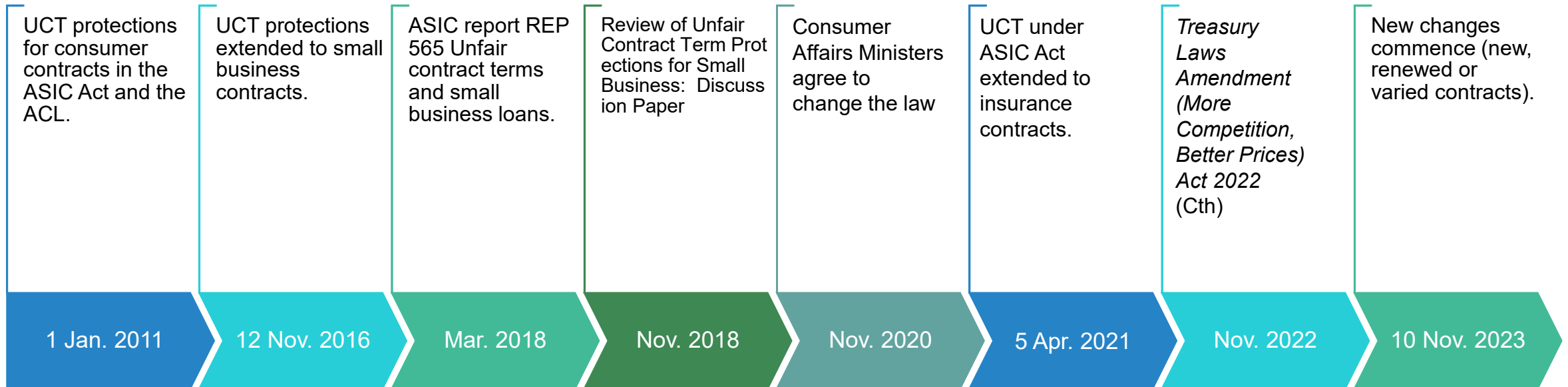


The story so far ...





UCT regime history





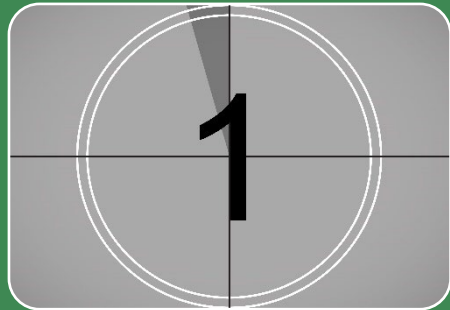
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When does UCT apply?



Contract must meet 2 conditions



Standard form contract



Consumer contract or a small business contract



What is a standard form contract?

- Not defined in the legislation.
- **Presumption:** If a party to a proceeding alleges that a contract is a standard form contract, it is presumed to be a standard form contract unless another party to the proceeding proves otherwise.
- **Factors to be taken into account:** In determining whether a contract is a standard form contract, a court may take into account such matters as it thinks relevant, but must take into account the following:
 - whether one of the parties has all or most of the bargaining power relating to the transaction;
 - whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties;
 - whether another party was, in effect, required either to accept or reject the terms of the contract in the form in which they were presented;
 - whether another party was given an effective opportunity to negotiate the terms of the contract;
 - whether the terms of the contract take into account the specific characteristics of another party or the particular transaction;
 - any other matter prescribed by the regulations.



What is a consumer contract?

- One of the parties is an individual
- Acquires what is supplied under the contract wholly or predominantly for personal, domestic or household use or consumption



What is a small business contract?

Current law	New law
<ul style="list-style-type: none">• One party to the contract is a business that employs fewer than 20 persons, and• The upfront price payable under the contract does not exceed \$300,000 (or does not exceed \$1,000,000 if the contract has a duration of more than 12 months)	<p>ACL</p> <p>One party to the contract is a business that:</p> <ul style="list-style-type: none">• employs fewer than 100 persons; or• has a turnover for the last income year of less than \$10,000,000. <p>ASIC Act</p> <ul style="list-style-type: none">• One party to the contract<ul style="list-style-type: none">• employs fewer than 100 persons; or• has a turnover for the last income year of less than \$10,000,000; <u>AND</u>• the upfront price payable does not exceed \$5,000,000 (same as AFCA limit) <p>Part time employees are to be counted as an appropriate fraction of a full-time equivalent employee.</p>

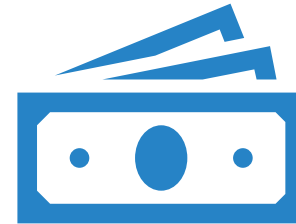


Calculating the \$5m “upfront price” limit for a credit product



Includes:

principal (credit limit)
establishment fees



Does not include:

interest payable
loan default fees



Banking Code complications – small business

ACL	ASIC Act	Banking Code of Practice (BCOP)	Customer Owned Banking Code of Practice (COBCOP)
one party to the contract is a business that employs fewer than 100 persons or has a turnover for the last income year of less than \$10,000,000.	<ul style="list-style-type: none">the upfront price payable does not exceed \$5,000,000, andone party to the contract employs fewer than 100 persons or has a turnover for the last income year of less than \$10,000,000.	<p>“small business”:</p> <ul style="list-style-type: none">it had an annual turnover of less than \$10 million in the previous financial year*; andit has fewer than 100 full-time equivalent employees*; andit has less than \$3 million total debt to all credit providers — including: i. any undrawn amounts under existing loans; ii. any loan being applied for; and iii. the debt of all its related entities that are businesses.	<p>“Small Business” – A business or group having fewer than 100 full-time (or equivalent) employees.</p> <p>“Small Business loan” – A loan to a Small Business with total debt to all credit providers (including any undrawn credit under an existing loan plus the loan applied for) of less than \$5 million.</p>

BCOP and COBCOP are narrower than UCT



Your loan amount	Other indebtedness	Total indebtedness	UCT applies	BCOP applies	COBCOP applies
\$3m	\$3m	\$6m	No	No	No
\$5m	\$0	\$5m	Yes	No	Yes
\$5m	\$25m	\$30m	Yes	No	No
\$2m	\$1m	\$3m	Yes	Yes	Yes



Example

- COBCOP paragraph 87:
87. If we give you notice of a breach of your Small Business loan, we will not require you to repay the full amount of the loan, or take proceedings to enforce the loan, unless you fail to remedy the breach during the notice period.
- If you include a clause like this in your loan contract, you could:
 - apply it to all UCT “small business contracts” (individual loan amount up to \$5m); or
 - limit it to COBCOP “Small Business loans” (total of all debts is less than \$5m); or
 - apply it to all borrowers.



UCT and security documents

- Are mortgages and guarantees subject to the UCT regime?
- Yes, because:
 - ASIC Act UCT regime applies to a **financial product**
 - A **credit facility** is a financial product
 - A **mortgage** or a **guarantee** is a credit facility



What is an unfair contract term?

UCT definition is a 3-legged stool



- A term of a standard form contract will be “unfair” if:
 1. It would cause a **significant imbalance** in the parties’ rights and obligations under the contract.
 2. It is not reasonably necessary for the protection of the **legitimate interests** of the party advantaged by the term.
 3. It would cause financial or other **detriment** to a party if it were relied on.
- All 3 conditions are necessary for a term to be unfair – if any are not met, the term is by definition *not* unfair.



Presumption

A term of a contract is **presumed** not to be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, unless that party proves otherwise.



Factors to be taken into account for deciding a UCT

- A court may take into account such matters as it thinks relevant, but must take into account the following:
 - the extent to which the term is **transparent**;
 - the **contract as a whole**.
- A term is transparent if the term is:
 - expressed in reasonably plain language; and
 - legible; and
 - presented clearly; and
 - readily available to any party affected by the term.



Terms that **MAY** be unfair (grey list)

- a term that permits only one party to:
 - avoid or limit performance of the contract;
 - to terminate the contract;
 - vary the terms of the contract;
 - renew or not renew the contract;
 - vary the upfront price payable under the contract without the right of another party to terminate the contract;
- a term that permits one party unilaterally to:
 - vary financial services to be supplied under the contract;
 - determine whether the contract has been breached or to interpret its meaning;
 - assign the contract to the detriment of another party without that other party's consent;
- a term that penalises only one party for a breach or termination of the contract;
- a term that limits:
 - one party's vicarious liability for its agents;
 - one party's right to sue another party;
 - the evidence one party can adduce in proceedings relating to the contract;
- a term that imposes the evidential burden on one party in proceedings relating to the contract;
- a term prescribed by the regulations.



Key terms are not defined in legislation

- “Significant imbalance”
- “Legitimate interests”
- “Detriment”
- What do the courts say?



Leg 1 - Significant imbalance

- *Australian Competition and Consumer Commission v CLA Trading Pty Ltd* [2016] FCA 377 at [54]:

“the “significant imbalance” requirement is met if a term is so weighted in favour of the supplier as to tilt the parties’ rights and obligations under the contract significantly in its favour – this may be by the granting to the supplier of a beneficial option or discretion or power, or by the imposing on the consumer of a disadvantageous burden or risk or duty: *Director-General of Fair Trading v First National Bank* at 494 [17] per Lord Bingham, applied in *ACCC v CAN 117 372 915 Pty Ltd (in liq) (formerly Advanced Medical Institute Pty Ltd)* [2015] FCA 368 at [950]...”
- One-sided benefits to the supplier, or one-sided burdens on the consumer/small business, create an imbalance – but it must be “significant”



Leg 2 - Legitimate interests

- *Australian Competition and Consumer Commission v Smart Corp Pty Ltd (No 3)* (2021) 153 ACSR 347, [67]:

“As for what is reasonably necessary to protect the legitimate interests of the supplier, it is not appropriate to attempt to define ‘legitimate interests’ as it will depend on the nature of the particular business of the relevant supplier, the particular circumstances of the business, and the context of the contract as a whole. A legitimate interest may not be purely monetary and may not be confined to reimbursement of expenses directly occasioned by the customer’s default. It may be intangible and unquantifiable.”

- May be non-monetary factors
- Context – can’t be viewed in isolation



Leg 2 – Legitimate interests

- Whether a term protects the legitimate interests of a party will depend upon the nature of the particular business of the relevant supplier and the context of the contract as a whole: *Australian Competition and Consumer Commission (ACCC) v Ashley & Martin Pty Ltd* [2019] FCA 1436.
- The legitimate interests of one provider may not be the same as those for another provider.



Leg 2 – Legitimate interests

- *Australian Competition and Consumer Commission v Ashley & Martin Pty Ltd* [2019] FCA 1436 at [48] - [49]:

“For example, a legitimate interest may not be purely monetary. A party's 'legitimate interests' are not confined to the reimbursement of expenses directly occasioned by the customer's default. A party may have interests in contractual performance which are intangible and unquantifiable: *Paciocco v Australia and New Zealand Banking Group Ltd* [2016] HCA 28; (2016) 258 CLR 525 at [26] (Kiefel J), [161] (Gageler J), [216], [266], [298] (Keane J). It may be of a business or financial nature: *Paciocco* (HCA) at [29] (Kiefel J).”
- As a financial services provider you may have a legitimate interest in ensuring that the customer complies with the terms and conditions (even if it does not directly cause financial loss if they don't).



What is “unfair” may also depend on the customer

- A finding of unfairness turns on the unique facts and context of the relevant contract, parties and term.

“For a term to be ‘unfair’ requires consideration of the circumstances of the counterparties to each contract. Accordingly, while a particular form of words might be unfair in respect of one customer, it may not be in respect of another.” *Australian Competition and Consumer Commission v Employsure Pty Ltd* [2020] FCA 1409 [342].



Leg 3 - Detriment

- Harbison J in *Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd* [2008] VCAT 2092 (24 October 2008) at [36]:

“There does not seem to be much that can be said about the concept of the imbalance being to the detriment of the consumer. The only matter to be flagged about those words is that it is clearly an imbalance which is to the consumer’s detriment and not an imbalance to the detriment of the trader, which is important in considering this definition.”



Treat court decisions with caution

- Some of the key decisions on UCTs in relation to banks involved consent determinations:
 - *Australian Securities and Investments Commission v Bendigo and Adelaide Bank Limited* [2020] FCA 716;
 - *Australian Securities and Investments Commission v Bank of Queensland Limited* [2021] FCA 957
- “Great care should be taken in relying on consent determinations, especially where the applicant is a regulator and any agreement as to statutory contravention might well have been motivated by extraneous factors”: *Australian Securities and Investments Commission v National Australia Bank Limited* [2022] FCA 1324.



What's changing?



What's changing?

- **Small business contract** definition
- **Prohibition** –
 - A person must not propose, apply or rely on, or purport to apply or rely on, a UCT.
 - A pecuniary penalty may be imposed if a person proposes, applies, relies or purports to apply or rely on, an unfair contract term. (Penalties are different under ACL and ASIC Act).
 - This means –
 - You can no longer run the risk of a term being found unfair by a court.
 - You have to proactively review and ensure that all affected contract terms are not unfair.



What's changing?

- Factors for determining if a contract is a **standard form contract**.
- The amendments will provide that a contract may be determined to be a standard form contract despite there being an opportunity for:
 - a party to negotiate changes to contract terms that are minor or insubstantial in effect;
 - a party to select a term from a range of options determined by another party; or
 - a party to another contract or proposed contract to negotiate terms of the other contract or proposed contract.



What's changing

- **Powers of the court.**
 - Orders to void, vary or refuse to enforce the contract, if this is appropriate to prevent loss or damage that is likely to be caused.
 - The court does not have to consider whether they will redress actual loss or damage.
 - Orders, on the application of the regulator:
 - preventing a term that is the same or substantially similar in effect to a term that has been declared as unfair from being included by the respondent in any future standard form small business or consumer contracts.
 - to prevent or reduce loss or damage which is likely to be caused to any person by a term that is the same or substantially the same in effect to a term that has been declared unfair. These orders can be made in relation to any existing contract of the respondent, whether or not that contract is subject to the proceedings for which the court is making the order.



What's changing?

- **Excluded terms and excluded contracts**



Excluded terms

Current law	New law
<ul style="list-style-type: none">• A term that defines the main subject matter of the contract.• A term that sets the upfront price payable under the contract.• Contractual provisions that are required or expressly permitted by a law of the Commonwealth, or of a state or territory, are exempt.• For an insurance contract covered by the Insurance Contracts Act – if it is disclosed at or before the time the contract is entered into and it sets an amount of excess or deductible under the contract.	<ul style="list-style-type: none">• In addition to the current exemptions:<ul style="list-style-type: none">• contractual provisions that are taken to be included in a contract by operation of a Commonwealth, state or territory law• a clause of a contract that results in other contract terms being included in a contract because of the operation of another law of the Commonwealth or a state or territory



Excluded contracts

Current law	New law
<ul style="list-style-type: none">• A contract that is the constitution of a company, managed investment scheme or other kind of body.• A contract of insurance for medical indemnity cover under the <i>Medical Indemnity (Prudential Supervision and Product Standards) Act 2003</i> (Cth) for a medical practitioner or a registered health professional.	<p>Additional exclusions:</p> <ul style="list-style-type: none">• The operating rules of licensed financial markets such as ASX Limited.• The operating rules of licensed clearing and settlement facilities.• Real time gross settlement systems approved as payment and settlement systems by the RBA.• Certain life policies within the meaning of the <i>Life Insurance Act 1995</i> (Cth) entered into before 5 April 2021 which have been replaced, linked or unlinked.• A guaranteed renewable contract that constitutes a life insurance policy within the meaning of <i>the Life Insurance Act 1995</i> (Cth), which was made before 5 April 2021, or was entered into before 5 April 2021 and subsequently renewed on or after 5 April 2021.



Contract clauses of concern



Contract clauses of concern

- These were noted in ASIC REP 565
- **Default clauses**
 - Material adverse change
 - Specific non-monetary events of default
 - Financial covenants
- **Variation clauses**
- **Indemnities**
- **Entire agreement clauses**





Terms that **MAY** be unfair (grey list)

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- a term that limits:
 - one party's vicarious liability for its agents;
 - one party's right to sue another party;
 - the evidence one party can adduce in proceedings relating to the contract;
- a term that imposes the evidential burden on one party in proceedings relating to the contract;
- a term prescribed by the regulations.



Excluding unfair terms



Review your contracts

- Consider the “grey list” and ASIC REP 565 issues
- Look at the contract as a whole
- Consider a “reading down” clause



Severability and “reading down” clauses

Example 1 - General

If any provision of this Agreement is invalid or not enforceable in accordance with its terms in any jurisdiction, it is to be read down for the purposes of that jurisdiction, if possible, so as to be valid and enforceable and shall otherwise be capable of being severed to the extent of the invalidity or unenforceability without affecting the remaining provisions of this Agreement or affecting the validity or enforceability of that provision in any other jurisdiction.

Example 2 – National Credit Code

If:

- the National Credit Code (Code) would otherwise make a provision of this contract illegal, void or unenforceable; or
- a provision of this contract would otherwise contravene a requirement of that Code or impose an obligation or liability which is prohibited by that Code,

this contract is to be read as if that provision were varied to the extent necessary to comply with that Code or, if necessary, omitted.



Exclusion of unfair terms – sample clause

If any term of this contract is regulated by legislation relating to unfair contract terms and we are advantaged by that term, we may only exercise our rights under that term to the extent (if any) reasonably necessary to protect our legitimate interests. Words used in this clause have the same meanings as under the applicable legislation.



Legal sign-off on UCT

- Given the uncertainty as to whether a term is a UCT, a lawyer cannot reasonably be expected to give an opinion that there are no UCTs in a standard form contract.
- At most, an opinion could be given about the probability or level of risk of a term being unfair.
- An opinion would need to be qualified by the noting the uncertainty as to how the UCT regime will apply in particular cases.

Conclusion

Key takeaways	Action to take
<ul style="list-style-type: none">• What is a UCT has not changed, but the consequences of having UCTs has changed• A term can only be a UCT if it meets all 3 elements• The concepts underlying the UCT are unclear and will depend on the facts of particular cases	<ul style="list-style-type: none">• Identify standard form contracts that will be subject to UCT regime• Review (or re-review) contract terms for UCTs• Consider use of terms that qualify or limit all terms in a way that they cannot be UCTs





Thank you

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