



**Submission by CHOICE
to the Inquiry into unfair terms in consumer
contracts**

13 October 2006



CHOICE is a not-for-profit, non-government, non-party-political organisation established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and campaign for change when markets or regulation fails consumers.

CHOICE is fiercely independent: we do not receive ongoing funding or advertising revenue from any commercial, government or other organisation. With over 200,000 subscribers to our information products, we are the largest consumer organisation in Australia. We earn the money to buy all the products we test and support our campaigns through the sale of our own products and services.

Our policy voice is widely recognised. We campaign without fear or favour on key consumer issues based on research into consumers' experiences and opinions and the benefit or detriment they face. Our current campaigns cover food, health, financial services, product safety, communications and consumer protection law.

CHOICE conducts research, publishes policy reports and online information, gives presentations and keeps the media informed of our policy views. We provide representatives for many industry and government committees and independent bodies considering matters of concern to consumers.

To find out more about ACA's campaign work visit www.choice.com.au/campaigns and subscribe to CHOICE Campaigns Update at www.choice.com.au/ccu.



Introduction

CHOICE welcomes the decision of the NSW Legislative Council to establish the current inquiry into unfair terms in consumer contracts and the opportunity to provide a submission to the Inquiry.

Unfair terms in consumer contracts are prevalent. The pervasiveness of unfair terms is all the more evident in the modern digital age, with the increasing reliance of e-commerce and standard form agreements to enter into contracts.

Commerce works most effectively when consumers have confidence that they are treated fairly. The risk of unfairness is highlighted in the age of rising reliance on e-commerce and the use of online technology to contract for goods and services.

However, the market cannot, and will not fix many of the problems caused by unfair terms in contracts.

In this submission, CHOICE argues that in the absence of effective remedies, adequate regulation and market indifference to consumer detriment it is in consumers' interests that dedicated unfair terms regulation accompanied by appropriately resourced enforcement and proactive administrative guidance powers be introduced nationally. In the absence of a national regulatory framework, we would welcome the introduction of unfair terms legislation in NSW.

This submission has been prepared in a relatively short time. The submission identifies the nature and scope of unfair contract terms in selected industries. It is not an attempt to systematically identify all unfair terms. Attempting to identify all the unfair terms in the many thousands of consumer contracts that are currently in use in Australia would be a daunting prospect. The very fact that it is near impossible to know the size and scope of the problem faced by consumers is one of the most powerful arguments in favour of the need for a regulatory response.

The scope of the problem demonstrates that current regulation of unfair and unjust contracts is not operating as effectively as it could. The need for a regulatory response is all the more critical because of the increasing use of e-commerce in consumer transactions. The emergence of this model of contract making was not envisaged when existing regulation was developed.

Remedies available under the common law and statute have failed to protect consumers from detriment caused by unfair terms. They have only afforded consumers protection from unfairness or injustice that accompanies the conduct of parties making a contract, rather than the substantive unfairness of the terms themselves. Common law remedies have failed give consumers redress for unfair terms demonstrated by the reluctance of the courts to find unfairness in contracts terms. In particular, it will be argued the absence of effective statutory oversight means that the opportunity to more systematically address consumer detriment and poor industry practice has been lost. This cumulative lack of protection means that consumers effectively have no protection from harm caused by unfair terms in contracts.

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It will be argued that some unfair contract terms may be sorted out by the market. It is true that in some circumstances the relative fairness of a particular contract will be transparent to a reasonable percentage of consumers and provide alternative products an advantage such that astute consumers at least will have the choice of taking a similar product or service on fair terms.

But there are a wide range of circumstances where the market provides no incentive to avoid unfair contract terms. These include:

- where a supplier has a monopoly or is part of an oligopoly
- where the unfair term is not relevant to consumers' purchasing decisions and thus where there can be no competitive advantage in having a more fair term (for example terms that relate to default fees or the right to unilaterally change contract terms)
- where consumers are faced with a 'confusopoly' – that is where it is in supplier's interest to confuse consumers (typically where there are many suppliers with many products available over a period of time such as in telecommunications services, financial services, insurance)¹.

The incidence and detrimental impact of unfair terms in contracts on consumers is high. This submission will respond to each of the terms of reference by providing to the Inquiry examples of unfair terms and case studies that illustrate unfairness. Although the incidence of unfair terms is high and spread across many industries, we have limited our discussion to a variety of classes of unfair terms in particular industries, with a focus on consumer contracts in the telecommunications and consumer credit industry.

Recommendations

1. Legislation prohibiting unfair terms in consumer contracts should be introduced in NSW.
2. Unfair terms legislation should apply to all consumer contracts, including consumer credit contracts.
3. Any unfair terms legislation should be supported by a process whereby businesses and traders can be given advice from the Regulator as to whether terms in their contracts with consumers are fair or otherwise.
4. Individual consumers should have a right to bring an action in an appropriate tribunal or court to challenge unfair terms.
5. Unfair terms legislation should include mechanisms to designate qualified consumer bodies as empowered to make "super-complaints". Super-complaints would be made by designated consumer bodies when they have evidence that a

¹ A confusopoly was first applied to a group of companies with similar products who intentionally confuse customers instead of competing on price. It can now be used even where there is no evidence of deliberate confusions. See discussion of energy contracts below J Gans.

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- contract term, or class of such contracts, is unfair and is likely to cause significant harm to the interest of consumers.
6. Where a super-complaint is made, the Commissioner would be required to consider the complaint and the extent, if any, of the alleged problems. The Commissioner would be required to publish a response within 90 days setting out what action, if any, he or she proposes to take in response to the complaint.
 7. Any unfair contracts terms legislation should be accompanied by adequately resourced prosecution and enforcement mechanisms to enable the regulator to take action where there is non-compliance.
 8. An appropriate regulator should be adequately resourced to allow it to undertake continuous review/audit of unfair terms including reporting on the findings of any such review/audit.
 9. The regulator should provide and publish guidelines and provide other guidance to industry, for example, to review and provide guidance on individual trader's contracts.
 10. The regulator should be supported by adequate resources and infrastructure to enable it to undertake the responsibilities expressed and implied above.
 11. Consideration should be given to enable industry and companies to develop standard terms with guidance from the Commissioner and/or a specified Tribunal be empowered to declare particular terms acceptable or not acceptable with the principles in unfair terms legislation.

Consumer markets and the need for regulation

While a competitive market may deliver the best price and quality for consumers, competition does not guarantee fair contracts. In order for markets to work optimally, including finding the appropriate balance between suppliers and consumers' rights under a contract, consumers need to be able to rely on all contract terms (not just essential terms such as price and quality) to be fair.

Research on consumer behaviour also points to the misguided assumption held by many consumers that contracts are fair, and that in the context of effective market competition and consumer protection law, governments and regulators have some oversight of contracts, and would ensure that terms are fair and reasonable. It is also a misguided assumption that consumers have the time or expertise to assess, query or negotiate contract terms. Legislation and regulation needs to be based on what consumers really do, not what we think they should do².

² N Howell, An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts (Centre for Consumer and Credit Law, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 6.

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Unfair contract terms legislation is necessary to facilitate commerce in an electronic and digital age. It is not realistic to expect consumers to review anything other than the most essential contract terms (price and nature of service or goods) on for example, a mobile phone, or through interactive television, given the format, time or cost implications that they would face. For consumers to trust such transactions, and thus enable these forms of commerce to grow, they must have confidence that contract terms are fair. That fairness can be assured through a combination of unfair contracts legislation and the development of standard terms is described elsewhere in this submission.

While consumer advocates have welcomed the emergence of unfair terms in contracts regulation, industry and business response has been less enthusiastic. Opposition to regulating contracts is based on the theory that parties should be free to contract on their own terms, and that market competition and consumer choice adequately takes care of consumers, ensuring that businesses and traders do not include unfair terms in consumer contracts. Industry also argues that there is already sufficient regulation, that unfair terms regulation would impose further costs on businesses - which would be passed directly onto consumers, and that there is no evidence that the existing regulation is not working³.

In practice, however, consumers rarely read lengthy fine-print contracts - contemporary online 'click-wrap' contracts where consumers simply click "I agree" to form a contract militate against reading the terms and conditions. And in a market where, from the consumer perspective at least, competition is generally fought out on price rather than other terms and conditions, it is unlikely that negotiation on unfair terms is going favour consumers, if such terms ever come to consumers' attention at all⁴.

This submission will address the above industry reservations to unfair terms legislation by arguing that the existing regulation is not working and does not protect consumers, and that the costs of industry of unfair terms legislation will not impose costs on industry.

Incidence and impact of unfair contract terms

This section of the submission responds to the Inquiry's terms of reference. Parts (i) to (iv) discusses the incidence and impact of some kinds of contract by reference to (a) (i)-(iv) of the Inquiry's terms of reference. Part (v) gives examples of other classes of unfair terms. We also refer to the extensive research undertaken by the Communications Law Centre in unfair terms in telecommunications contracts, set out in their submission to this Inquiry.

(i) terms which allow the supplier to unilaterally vary terms

Some contracts have terms which allow providers, but not consumers to cancel contracts, limit the performance of contracts, or change terms or goods or services supplied under contracts.

³ There are some of the themes emerging from industry submissions to the 2004 Standing Committee of Officials of Consumer Affairs (SCOCA) discussion paper on unfair terms regulation.

⁴ N Howell, An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts (Centre for Consumer and Credit Law, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 6, referring to studies on behavioural economics and consumer decision-making, suggesting that consumers are likely to trade off the benefits of extra information for costs.



See, for example, the following term in a mortgage contract:

we can change the Credit Limit at any time...

...we may reduce the Credit Limit at any time, whether or not you have breached this Contract. If we do so and you are not in breach of the Contract, we will tell you in writing

And the following from clause from a major bank for their Term Deposit accounts.

2.3 In addition to the other changes [bank] may make to these terms and conditions which are detailed in these terms and conditions, [bank] may change any other terms and conditions (including by imposing new fees or charges, changing the amount, type, or method of calculation of fees and charges payable) [bank] will make any changes in accordance with any applicable legislation and industry codes.

Many mobile phone contracts allow the supplier to vary the rates and charges (for calls and SMS) at any time and regularly without notice to the consumer.

(ii) penalising the consumer

Terms that penalise consumers for late payment or early termination of contracts are common.

A late payment fee is usually taken to mean a charge for default, including a failure to pay on the due date. Sometimes referred to as “administration fees”, these fees may include both a fee plus an additional interest charge. Excessive and unreasonable fees contribute to a spiralling of debt for vulnerable and disadvantaged consumers.

Some contracts require consumers to pay a fee for early termination, on top of paying out the fees that remain for the term of their contract.

At common law, a term that requires a party to pay an amount of money upon their breach of an agreement that is not a genuine pre-estimation of the damages that the party who is not in breach will suffer is a penalty clause and is not enforceable.

Traders regularly attempt to contract out of this by using terms such as:

You agree to pay us interest on all outstanding charges at a rate of 9% per annum. You agree that such interest is genuine pre-estimate of our damages.

The legality or otherwise of penalties, however, sits uncomfortably with the reality that in many cases it would not be practical to challenge the enforcement of any penalty.

Some contracts provide for the supplier to recover damages on terms attempt to override the above common law prohibition. See for example, the contract term below which entitles the supplier, on the consumer’s payment default

(a) ...to recover liquidated damages on the overdue amount which you agree is a genuine pre-estimate of the actual loss that we will suffer as a result of you being late in any payment to us.

(b) for each failure to make a payment in full and on time, the amount of liquidated damages payable will be the greater of \$25 or 0.05% per day on the overdue amount until paid in full.

Other terms may deem a consumer in default of a contract where the consumer becomes bankrupt. This is arguably unfair, especially for a consumer who while bankrupt may well be able and willing to continue making payments under that contract.

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The clause below found in a vendor mortgage was recently litigated in the NSW CTTT, and found to be unjust under the *Uniform Consumer Credit Code* (the Code). Vendor terms, known as “wrapping” have been promoted to consumers struggling to buy a home.

The purchaser shall forfeit to the vendor and the vendor shall keep the deposit and all instalments paid under this contract, as liquidated damages for non – performance of the contract without necessity for the vendor to give notice or to do any other thing.

When the purchasers fell into arrears, and in reliance on the above clause, the vendor retained the purchaser’s payments of \$58,000. The CTTT re-opened the contract transaction pursuant to s70 of the Code, finding that the vendors had failed to inquire into the purchaser’s ability make the payments according to the contract’s terms. Ultimately, the CTTT found the contract unjust and by way of making compensation ordered the vendor remit \$28,000 to the purchasers. This was upheld on appeal in the Supreme Court.

It is likely that unfair terms legislation would have obviated the need for litigation in this matter.

A reverse mortgage that allows a lender the right to ask for immediate repayment of a loan for a minor issue which is then regarded as a default, allowing the lender to charge a penalty interest rate 2-3% higher than the normal rate until repayment is made.

Bank penalty fees

There is a strong case that the high fees imposed on consumers by banks and other lenders - such as direct debit fees and inward cheque dishonour fees – are an amount greater than the loss the lender suffers. Unfair terms legislation could address the imbalance in the rights and obligations of consumers and lenders that cause detriment to consumers arising under these kinds of terms.

Switching costs

Any unfair terms legislation should be sufficiently broad to protect consumers from excessive switching costs. The UK unfair terms legislation require that contract terms should be expressed fully, clearly, legibly and contain no concealed pitfalls or traps. Switching can be potentially unfair for consumers where a contract term creates excessive notice periods for cancellation or which require a consumer who terminates a contract early to pay high sums in compensation. It is likely that a term allowing high switching fees, that is, a fee that requires a consumer who fails to fill an obligation to pay a disproportionately high sum in compensation, would offend the UK legislation⁵.

(iii) supplier suspends services while continuing to charge the consumer

Some contracts contain terms that result in charges continuing in the event of a failure of provider to supply the goods or services contracted for.

Some supplier’s agreements give the supplier the right to suspend the service, for reasons including maintenance, security or where there is a direction or notice issued by a regulator body or court. This may be detrimental and unfair to the consumer if suspension lasts for an extended period, and the customer is still required to pay ongoing charges.

⁵ See Unfair Terms in Consumer Contracts Regulations 1999, Schedule 1, Cl 1(e)

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Some contracts may cause detriment to the consumer by failing to make reference to a consumer's right for a refund for services not yet provided, or any reduction in price for inconvenience caused by a failure or suspension of supply. Research undertaken by Communications Law Centre in 2003 into mobile phone contracts found that the consumer's right to a refund was not outlined in the majority of these contracts⁶.

Some contracts contain "unclaimed monies" clauses, which typically state:

In the event that your account is terminated and monies are owed to you by us, we will notify you of these amounts. In the event you do not claim those monies within three months of being notified we will retain the money and you agree that you will have no further claim in relation to those monies.

(iv) supplier but not the consumer permitted to terminate the contract

Some contract terms don't allow consumers to terminate the contract – or if they do, the penalty fees are so high, the consumer is better off staying with an unwanted contract. See the following two examples.

Ms A enrolled in a fashion school, agreeing to pay almost \$24,000 in monthly instalments over 3 years. After attending the course for the first semester, Ms P had to urgently move interstate to care for her ill parents. The contract included a "declaration" that

I acknowledge that by signing the [school] enrolment agreement I undertake to pay the prescribed fees by the specified dates as set out in the table of fees...whether I finish the course or not.

I understand that no deferrals are possible and that no refunds will be made for any reason whatsoever.

The school agreed to defer her course temporarily and to study by correspondence, but it would not allow her to cancel the contract. Ms P is being pursued by debt collectors for almost \$20,000.

Ms B signed a 12-month contract with a fitness centre. After 4 months Ms B moved house, and work pressures meant she was no longer able to attend the gym. She asked to cancel the contract, but the fitness centre refused, relying on a term in the contract that required her to pay the full amount of fees remaining for the 12-month term of the contract.

(v) other unfair terms

The following section outlines classes of terms, other than those identified above, which may be regarded as unfair. This list is drawn from various sources including classes of unfair terms set out in the Victorian and UK unfair terms legislation or schedules thereto, as well as examples of terms gathered in the ordinary course of CHOICE's research/work, and consultations with consumer advocates. Examples of these unfair terms and case studies are provided to illustrate unfairness – they are not intended to be an exhaustive list of the incidences of unfair terms, but exemplify the scope of unfair terms.

⁶ CLC *Fair Terms and Telecommunications Consumer Contracts* 2003 at <http://www.comslaw.org.au/currentprojects/CLCFairTermsReport.pdf>.

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Terms that exclude all liability, even though liability would arise at law in some circumstances

In the case of some suppliers, such as internet providers, this may involve excluding the supplier's liability for damage caused on installation of internet equipment, or even defective equipment. See, for example, the following clause obliges the consumer to continue to pay for goods:

... no matter what happens, even if the Equipment is lost, stolen, damaged or destroyed, if it is defective or if you can no longer use it...

Other terms are phrased in a way which may be interpreted by consumers to exclude all liability, often in terms that misrepresents consumers' legal rights. For example, the following example:

Subject to the Trade Practices Act and other laws [supplier] is not liable for any costs, loss, liability or damage, whether direct or consequential arising out of [supplier's] supply, delay or failure to supply service.

Other terms may be uncertain, and interpretation of these terms arguably misrepresents a supplier's liability under law – for example under trade practices or negligence law.

See also (iii) above, in relation to unfair unclaimed monies clauses.

Terms that limit consumers' rights and/or remedies

Some contracts seek to exclude liability and limit jurisdiction and thus available remedies. Exclusionary clauses may operate to:

- exclude rights or remedies otherwise available under common law or statute,
- restrict rights, for example, by imposing a limit on damages, or
- qualify rights, for example, imposing mandatory alternative conflict resolution processes.

The use of unfair exclusionary terms in some industries' standard form of agreements is pervasive. Where each industry supplier uses similarly offensive terms and conditions, the capacity for consumers to exercise choice and move to a business competitor is more apparent than real. In this environment of markets operating to the detriment of consumers, effective regulation is required. It appears that Victoria and UK experience of unfair terms legislation has led to better contracts working to the advantage of consumers, and a market advantage to suppliers using fairer contracts.

Riders such as "other than those implied by law" or "to the extent permitted by law" are common in contract terms which try to impose limits on consumers' rights of redress. These clauses are confusing, misleading or meaningless to consumers. The effect of these contradictory clauses may prevent consumers from pursuing, enforcing or defending their rights under a contract.

An example of a contract using one of the above riders while limiting the liability of the supplier to pay damages is illustrated by the following example:

...We limit our liability to the extent permitted by the Trade Practices Act. Our maximum liability under the Agreement (except for breach of a term implied by the Trade Practices

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Act) is limited to the total Charges paid by You during the 1 month period prior to Your claim.

Compulsory arbitration clauses may limit a consumer's rights to a limited set of laws thus excluding remedies that may be otherwise available in other jurisdictions. This may cause particular consumer detriment in inter-state services, for example freight services. See for example,

The Agreement is governed by the laws of New South Wales. Each of us agree to submit (and may not subsequently change our mind about doing so) to the exclusive jurisdiction of the courts of New South Wales.

Terms that permit a supplier to assign their rights to another supplier without notice or consent of consumer, or without permitting consumer to terminate

Examples of these kinds of terms which create unequal obligations, to the detriment of consumers include the following:

You acknowledge that we may, without giving you notice, sell, assign or otherwise dispose of or deal with our interest in the [goods] or [agreement].

You may not transfer any rights and obligations under this Agreement without us first agreeing in writing.

You may not transfer your rights or obligations under these terms without [supplier's] prior written consent.

Terms that permit the supplier to cancel or suspend the service for a breach by the consumer of another contract

A typical example of this class of unfair terms includes:

Related Accounts. If [supplier] terminates an Account, [supplier] may terminate any other Accounts that share the same member name, phone number, email address, postal address, Internet Protocol address, or credit card number with the terminated Account.

Acceptable use policies (AUPs)

AUPs are prevalent in internet service provider contracts, which often contractually oblige consumers to abide by the terms of an AUP as part of their contract. AUPs are often external to the contract making terms within them hidden from the consumer. Typically, standard form agreement will include a term stating:

You must comply with the [supplier's] Acceptable Use Policy

A breach of a term of the AUP may result in a consumer incurring additional usage charges or having services suspended or limited or their contract terminated. Some contracts make a breach of an AUP a breach of the contract, and may effectively deem *any* breach of an AUP to be serious breach, entitling the supplier to terminate a contract. See, for example:

You will be in serious breach of [the contract] if you breach the [AUP].

Terms which allow supplier to cancel or suspend for minor breaches

CHOICE's investigation into reverse mortgages has found default clauses which trigger default action for minor issues, like overlooking paperwork⁷. Terms which unreasonably

⁷ Uta Mihm 'Signing your home away?' *Money & Rights* CHOICE No 13 April/May 2006 pp 8-15.

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lead to action disproportionate with the breach should be considered unfair. Many lenders' 'No Negative Equity Guarantee' terms mean that the lender will not honour the guarantee if the borrower is in default at the time of the sale of the property, while one lender will not cover a loan shortfall if the borrower has been in default at *any time* during the loan term.

Another example is a reverse mortgage contract which contains many clauses similar to a home loan contract and includes many provisions that a borrower "must" do – for example, keep their password secure for an online or phone facility, and punctually pay all rates and taxes in connection with the mortgaged property. This contract states that the borrower will be in default if they "breach any other provision of [the] loan contract." Reverse mortgages are targeted at elderly people. It is unfair that these borrowers may risk serious consequences of default for mere failure to pay a council rate bill.

On-line contracts

Contracts formed on-line contracts are not conducive to negotiation. Various referred to as 'clickwrap' or 'click-on' agreements, the process of agreeing to contract terms generally involves scrolling through lengthy terms and conditions, and forming the contract by clicking "I agree". The risk to consumers in e-commerce transactions is that consumers will agree to terms that they have not had an opportunity to negotiate and that may be substantively unfair, or even agree to purchase goods that may be substantially different to those displayed on screen. For example, one online retailer's fine print contained the term "the actual products are often not the same as the images".

Some online traders bury essential terms and conditions on their websites – the consumer is simply directed to refer to the terms and conditions elsewhere on the site, or is informed that these terms are available "on request". These hidden terms and conditions often contain key obligations.

E-commerce now commonly makes consumers' use of suppliers' websites subject to unfair terms and conditions. See, for example:

It is a condition of use of this Site that you accept and agree to the following terms and conditions of The Company... The Company may vary these terms from time to time and the revised terms will be deemed to apply at the relevant time in respect of your application. By proceeding to enter the Site you agree to be bound by the following:

The Company reserves the right to alter or delete material from the Site at any time and may, at any time, revise these terms by updating this posting. You are bound by any such revision and should therefore periodically visit this page to review the then current terms.

While the Company uses reasonable efforts to include accurate and up to date information in the Site, the Company makes no warranties or representations as to its accuracy. The Company assumes no liability for any errors or omissions in the content of the Site.

Other examples or types or classes of unfair terms

- Irrevocable powers of attorney which apply beyond that which is necessary and reasonable.

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- Choice of law clauses, for example those that apply to interstate freight contracts, and don't allow consumer choice of applicable laws under which to lodge or resolve disputes
- Non revocable direct debit clauses, where a direct debit is set up with a finance institution to pay moneys to a third supplier – and where contract with third supplier terminates or is suspended and direct debit continues.

Prevalence of unfair terms in standard form agreements

Standard form contracts or agreements (SFOA) are used widely. SFOA drawn up by a supplier provide no or little opportunity for a consumer to negotiate or amend terms. These are prevalent in the form of on-line or “click-wrap” contracts referred to earlier. There is evidence that consumers’ problems with and complaints about contracts are heightened by the use of SFOAs, in particular in consumer telecommunications contracts, which consumers had no opportunity to review or change⁸. Indeed, according to Consumer Affairs Victoria, it was the emergence of standard form contracts that limit consumers’ ability to exercise real choice that was instrumental in introducing the unfair contracts legislation in Victoria⁹.

This part of the submission will look only briefly at the use of standard form agreements in particular the effect of SFOAs on industry practice.

The submission then considers the option for the establishment of a mechanism to enable industry and companies to develop standard terms with guidance from the Commissioner and/or a specified Tribunal.

Standard form agreements

The *Fair Trading Act 1999* (Vic) (FTA) defines a standard form contract as a “consumer contract that has been drawn up for general use in a particular industry, whether or not the contract differs from other contracts used in that industry”¹⁰. The onus is on the consumer, or on the regulator (under s 32Z) to show that the contract is a standard form contract¹¹.

⁸ Communications Law Centre *Unfair Practices and Telecommunications Consumers* 2001.

⁹ Communications with Consumer Affairs Victoria (CAV) October 2006, see also *CAV Annual Report 2005-2006* p 92.

¹⁰ section 32 U *Fair Trading Act 1999* (Vic)

¹¹ The definition of an unfair term in the UK includes the “a contractual term which has not been individually negotiated” and a test of “drafted in advance” and may be broader in application to the concept of standard form contract. See SCOCA Working Party Discussion Paper p 62.

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The FTA provides that the Commissioner can prescribe a term as unfair. Where a term is prescribed as unfair under the Act, once it has been shown that it is a standard form contract, the term is unfair 'per se'¹².

According to industry, SFOAs are a practical necessity in most consumer markets, for the following reasons:

- 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.

Industry says that in the face of an unfair contract term, consumers are free to turn to an alternative trader with better contract terms. However, in practice most consumers have little time, expertise or other incentive to compare contracts' terms – and suppliers have no incentive to provide fairer terms than their competitors. The presumption that in the face of poor market practices, consumers will exercise choice and move to a business competitor is more apparent than real. As noted above, in the age of e-commerce, click-wrap agreements, and contracts that not uncommonly extend to over 100 pages of fine print, the use of SFOAs in many cases causes detriment to consumers who have no real opportunity to review, negotiate or change their terms.

In fact, in many ways it is more rational consumer behaviour to *not* read a contract, where reading terms or navigating services under a contract brings no benefit.

On this latter point, my own experience with choosing gas and electricity plans stands in sharp contrast. In preparing for a presentation at an ACCC conference last year, I decided to see how much competition amongst energy retailers had got us. I rang up all the main incumbents (including my own provider) and tried to compare the plans. The task was incredibly difficult. Some plans were based on monthly consumption, others bi-monthly. Some had the prices stated ex. GST and others including GST. And there was more. I put it into a spreadsheet and what did I find? They were all exactly the same! Hours of work for nothing. They were all the same and at their regulated cap¹³

SFOAs and industry practice

While the terms in some contracts may be technically compliant and within the letter of the law, their similarity to alternative suppliers' contracts and their complexity and length may have the effect that consumers are discouraged or hindered from seeking out or enforcing their rights. Consumers will simply not bother to navigate the complexity of the terms and find themselves committed to unwanted contracts, or contracts with onerous terms which may have detrimental consequences.

There is evidence that similar standard form contracts containing similar unfair terms are being used by product suppliers otherwise engaging in fierce pricing battles between their competitors (illustrated by the mobile phone market). There is evidence that this is particularly the case in some telecommunications contracts.

¹² Standing Committee of Officials of Consumer Affairs *Unfair Contract Terms: A Discussion Paper* (January 2004) p 62.

¹³ J Gans '[Confusion as a screening device](http://www.economics.com.au/?p=100)' <http://www.economics.com.au/?p=100>

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The incidence of unfair terms in standard form contracts in some industries is such that consumers' capacity to exercise market choice and choose an alternative supplier with better contract terms is limited. By agreeing to some contracts which include unfair terms, consumers sometimes unwittingly lock themselves into contracts they don't want or need, and may cause detriment.

developing standard terms and guidance for industry

Consumers engaged in pre-paid contract formation where there is limited practical ability to review contract terms need confidence that contract terms are fair. With some adaptation, the standard terms regime of the Insurance Contracts Act (ICA) offers a model for commerce in a digital age. The ICA provides for regulation to establish standard minimum contract terms, which insurers can amend but only by effectively bringing those variations to consumers' attention prior to contract formation.

Having standard terms in regulation for a wide range of consumer industries would not be practical. A system where industries or companies are free to develop standard terms that comply with the principles set out in unfair contracts legislation combined with guidance issued by the Commissioner and the ability for the Commissioner and/or a specified Tribunal to declare particular terms not acceptable would lead to a similar result in a more efficient and practicable way. The advantage for business, consumers and overall economic efficiency is that business would compete for consumer's spending based on the virtues of their product and its pricing rather than the ingenuity of their lawyers and marketers.

Remedies for unfair contracts

A common argument against the introduction of unfair contract terms regulation is that there are a range of legislative and common law provisions that deal adequately with the concerns about consumer detriment. However, in all jurisdictions other than Victoria, consumers can effectively only challenge unfair processes in contract formation: that is, the procedures and conduct of parties accompanying the making of a contract – but not the substantive terms of the contract itself. Those protections that may have protected consumers from substantive unfairness have, in practice, not operated to consumers' benefit.

Recent consumer protection initiatives including as the *Financial Services Reform Act* and the *Consumer Credit Code* have focused on laws promoting competition between businesses and disclosure of information to consumers. However, these measures have failed to curb the detrimental impact of unfairness at a fine print level in consumer contracts.

Remedies (other than Part 2B of the Victorian unfair terms legislation discussed later in this submission) that may be available to consumers for unfair contracts include:

- Equitable remedies, including unconscionability, special disability, undue influence etc,
- *Trade Practices Act 1974 (Cth)*, *Australian Securities and Investment Commission Act 2001 (Cth)* and State and Territory fair trading legislation prohibiting misrepresentation and deceptive conduct and unconscionability etc,

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- Uniform Consumer Credit Code protections against unjust transactions, and
- In NSW, the *Contracts Review Act 1980* (NSW) prohibiting unjust contracts.

There was historically some promise that s 70 of the Consumer Credit Code could provide a remedy for procedural and substantive injustice, based on factors similar s 9(2) of the *Contracts Review Act*¹⁴. However, an analysis of the case law shows that that without demonstrated procedural injustice at the time of the making of the contract, it will provide no relief for the consumer. It also appears that the courts have been reluctant to find unfairness solely on substantive grounds¹⁵.

Problems with pursuing current remedies

Apart from the obvious problem outlined above – that to get effective redress, consumers must demonstrate procedural unfairness in the making of the contract rather than substantive unfairness in contract – other problems with the current framework include:

At an individual level:

Challenging unfairness in consumer contracts commonly takes place in courts rather than lower cost tribunals. The problems for consumers litigating unfairness in contract in the courts are well-known and include:

- litigation is expensive, time consuming and often distressing,
- there are clear inequalities in litigants' resources and bargaining positions,
- case law on unconscionability, undue influence and special disability varies widely, making outcomes unpredictable,
- the rules of evidence can be intimidating for consumers,
- litigation relies heavily on evidence of facts and credibility which makes outcomes difficult to predict and costly to pursue,
- the variety of common law and statutory remedies means consumers often plead a number of alternative cases – thus prolonging already complex litigation,
- the above unpredictability, cost and complexity cumulatively act as disincentives for individuals to pursue their rights.

At an aggregate level:

- Under the current regimes unfairness is decided on a case-by-case basis giving no scope for systemic change. This means the opportunity to systemically improve industry practice is lost.

¹⁴ see Centre for Credit and Consumer Law, Griffith University *Submission to the Standing Committee of Officials of Consumer Affairs Unfair Contract Terms Working Party* citing *Unfair Contract Terms - A Discussion Paper* SCOCA Unfair Contract Terms Working Party January 2004.

¹⁵ *Unfair Contract Terms-A Discussion Paper*, SCOCA Unfair Contract Terms Working Party January 2004 p 39.

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- Removing unfair terms is competition enhancing, bringing overall societal benefits. Consumers, industry and government all lose when consumers abandon faith in industry and government to protect them from unfair or unjust practices¹⁶.

Effectiveness of Victorian and UK unfair terms legislation

In general, evidence from other jurisdictions strongly suggests that substantive unfairness caused by unfair terms can only be effectively addressed by dedicated legislation and well-resourced, proactive administrative guidance¹⁷.

This section of the submission looks briefly at the effectiveness of the Victorian and UK unfair terms in consumer contracts legislation, and supports these jurisdictions' approach of combining an expanded regulatory and enforcement jurisdiction with clear administrative guidance.

Fair Trading Act Victoria, Part 2B (FTA)

Part 2B of the FTA makes a term in a consumer contract 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.

This submission does not comment on the appropriateness or otherwise of the definition of an unfair term in a consumer contract, nor does it comment on how this definition was considered in the recent the Victorian Civil and Administrative Tribunal case¹⁸. Further consideration of an appropriate definition of an unfair term may well be required, and CHOICE would welcome the opportunity to contribute to any discussion in that regard¹⁹.

Where Part 2B is applied:

- unfair terms in consumer contracts are void,
- certain terms can be prescribed as unfair,
- it will be an offence to use a prescribed unfair term,
- the Director of Consumer Affairs Victoria (CAV) can apply to the Victorian Civil and Administrative Tribunal (VCAT) for a declaration that a term is unfair, and for injunctions to prevent the continued use of unfair terms, and
- individual consumers can also take civil action to void an unfair term.

¹⁶ C Britton 'The simple life – in a "low trust" society' *Consuming Interest* No 101 Spring 2004 p 10 cited in N Howell *An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts* (Centre for Consumer and Credit Law Research Paper, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 8.

¹⁷ For an analysis of how other overseas jurisdictions have addressed substantive unfairness, see J Davidson *Unfair Contract Terms and the Consumer: Regulating Substantive Unfairness* Centre for Credit and Consumer Law, Griffith University (September 2006).

¹⁸ *Director of Consumer Affairs Victoria v AAPT (Ltd) Civil Claims* [2006] VCAT 1943

¹⁹ Consideration of the SCOCA Working Party Discussion Paper will also be useful in this regard.

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One of the positive aspects of the operation of the new FTA unfair terms legislation is the regulator's proactive approach to engage industry and negotiate fair terms without the need for it, or consumers, to litigate unfair terms. CAV employs a compliance strategy based in the first instance on industry education and consultation, whereby individual companies' consumer contracts are reviewed and cooperation is sought by those companies to modify or remove unfair terms²⁰. CAV is also providing information and advice on the legislation, including advice to lawyers. CAV reports that in most cases, these negotiations result in amended contracts²¹.

There is some evidence that unfair contract terms in the Victorian FTA has led to an improvement, albeit incremental, in some consumer contracts to the benefit of consumers²². To date, the CAV has obtained undertakings from businesses to alter unfair contract terms related to loyalty cards, vouchers and gift cards and has secured revisions to terms in consumer contracts in the hire car, gymnasium, pay television and mobile phone industries, to the benefit of consumers. CAV has also successfully brought an action in the VCAT against unfair terms used by telecommunications company AAPT²³. In this case, the VCAT found that terms dealing with unilateral variation, suspension of service and immediate termination of the agreement were unfair.

While the introduction of unfair terms regulation within the FTA is welcomed, the effectiveness of the FTA could, however, be improved²⁴.

Firstly, the FTA legislation currently exempts consumer contracts to which the Victorian consumer credit legislation applies²⁵, unless consumer credit contracts are in a 'prescribed class of contract'²⁶. To date, no classes of contracts have been prescribed²⁷. The recent review of consumer credit in Victoria²⁸ has set out the option of extending the unfair contract terms provisions in Part 2B of the FTA to consumer credit contracts, and the Victorian government has supported this option²⁹. The UK Regulations also apply to consumer credit contracts. Evidence of a high proportion of unfair terms in credit contracts amended as a result of UK Office of Fair Trading oversight adds further support for their inclusion in any regulatory regimes.

²⁰ Consumer Affairs Victoria *Annual Report 2005-2006* p 92.

²¹ Consumer Affairs Victoria *Annual Report 2005-2006* p 93.

²² See Submission to this Inquiry by Communications Law Centre.

²³ *Director of Consumer Affairs Victoria v AAPT (Ltd) Civil Claims* [2006] VCAT 1943.

²⁴ Chris Field, *Fair's Fair*, CHOICE

[http://www.choice.com.au/viewArticle.aspx?id=104284&catId=100387&tid=100008&p=1&title=Fair's+fair+\(archived\)](http://www.choice.com.au/viewArticle.aspx?id=104284&catId=100387&tid=100008&p=1&title=Fair's+fair+(archived))

²⁵ Sections 32V and 163(2) FTA excludes the *Consumer Credit (Victoria) Act 1995*.

²⁶ See amendments to the FTA, s 3 *Fair Trading (Consumer Contracts) Act 2004*, amending s 32V(a) of the FTA. It appears that the exception was introduced to deal with concerns over the possible exploitation of the first homebuyer's grant and vendor terms in contracts by rogue financiers, rather than a general provision to override the credit contract exemption – see N Howell *An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts* (Centre for Consumer and Credit Law, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 10.

²⁷ Communications with Consumer Affairs Victoria, October 2006.

²⁸ Merlino J *The Report of the Consumer Credit Review* Consumer Affairs Victoria (2006).

²⁹ see *Government Response to the Report of the Consumer Credit Review* Option 5.3 pp 12-13

[http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/\\$file/Credit%20Review%20-%20Government%20response%20\(web\).pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/$file/Credit%20Review%20-%20Government%20response%20(web).pdf)

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Secondly, unfair contracts legislation should explicitly include “penalty clauses” (that is, a term which allows for fees that are not a genuine pre-estimate of the loss that a business incurs as a result of a breach by a consumer). As noted above penalty clauses have potential to cause significant harm to consumers. Of note is the recent Victorian government response to the consumer credit review that gave in-principle support to making fees and charges reviewable on the grounds of unreasonableness³⁰. As noted below, in the UK one of the classes of terms most commonly found to be unfair are those applying unreasonably high penalties.

Thirdly, the remedies available under the FTA include rendering unfair terms void and unenforceable³¹, imposing injunctions to prevent the continued use of unfair terms³² and declarations³³ and advisory opinions.³⁴ The power to impose penalties for use of unfair terms are restricted to incidences where “prescribed” unfair terms are used, or where a person attempts to enforce such terms.³⁵ A “prescribed unfair term” is one which is prescribed by the regulations (by the Governor-in-Council) to be unfair or one of like effect. As noted above, no unfair terms, or classes of contracts containing unfair terms have been prescribed to date. It is also arguable that the civil penalty imposed on suppliers who continue to use a prescribed unfair term may be too low, and will not act as a sufficiently strong disincentive.

Fourthly, on its own, the legislation will not necessarily have the optimum benefit to consumers, as it may not affect the contracting practices of national industries or corporations. Ideally, a national, uniform approach is required.

To achieve optimum benefits of unfair terms legislation, any regulator must be empowered to take a proactive approach to monitoring, compliance and enforcement. This could include the introduction of a “super-complaints” jurisdiction, as is the case in the UK. This is discussed in the next section. It must also be appropriately resourced to enable it to provide valuable guidance to industry to systemically improve contracting practices.

Additionally, the UK unfair contract terms regulations annex a non-exhaustive ‘grey-list’ of terms, providing guidance on what *may* be considered unfair. The inclusion of such a list could also be considered in Australian unfair contracts legislation, or could be provided to industry as guidance by the appropriate regulator. CHOICE refers the Inquiry to such a list compiled by consumer advocates at

http://tpareview.treasury.gov.au/content/subs/105_Attachment2_ACA.rtf.

Unfair Terms in Consumer Contracts Regulation 1999 (UK)

³⁰ see *Government Response to the Report of the Consumer Credit Review* Option 5.3 pp 7-8 at [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/\\$file/Credit%20Review%20-%20Government%20response%20\(web\).pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/$file/Credit%20Review%20-%20Government%20response%20(web).pdf)

³¹ Section 32Y

³² Section 32ZA

³³ Section 32ZC

³⁴ Section 32ZD

³⁵ Section 32Z

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The United Kingdom *Unfair Terms in Consumer Contracts Regulation 1999* was developed to implement a 1993 *European Union Directive on Unfair Terms in Consumer Contracts*.

The UK legislation uses the following definition:

A contractual term which has not been individually negotiated shall be regarded as 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 consumer³⁶.

The effect an unfair term is that the consumer is not bound by the term.

The regulations enable the UK Office of Fair Trading (OFT) to take action to stop the use of unfair terms by applying for an injunction to prevent their use. However, the OFT has most commonly used its jurisdiction to enter into discussions with traders, and obtain undertakings from these to stop using unfair terms. As a result of OFT intervention, between 1000 and 1,500 unfair terms each year are revised or abandoned³⁷.

Over the last three years, the most commonly successfully challenged unfair terms under the legislation are those relating to:

- Exclusion or limitation of liability for breaches of contract, particularly liability for poor services, work or materials,
- Terms requiring consumers to pay financial penalties,
- Terms imposing unfair financial burdens, consumer declarations and unreasonable ancillary obligations and restrictions, and
- Failure to use plain and intelligible language³⁸.

The OFT has also been proactive in promoting the legislation by issuing regular bulletins on the changes that have been made to consumer contracts as a result of its negotiations with traders, and has issued guidelines on unfair terms in contracts for holiday caravans, package holidays, home improvements, health and fitness, and tenancy, among others³⁹. The OFT also regularly publishes updates on undertakings, detailing the company, the nature of the unfair term changed and the reasons why the term were considered unfair.

The UK unfair terms regulations attach a non-exhaustive list of unfair terms as a schedule to the regulations that may be regarded as unfair. The OFT publishes extensive guidance on the OFT's view of kinds of unfair terms on its website, by reference to the "grey list" schedule of unfair terms and also on terms commonly used by particular industry sectors. The OFT also publishes details of industry undertakings outlining why the term was considered unfair to consumers.

The OFT shares enforcement powers with other "qualifying bodies" which include fair trading bodies, and Which? an independent consumer organisation. The OFT does not have the power to take up consumers' individual cases, but protects consumers by seeking to prevent the continued use of unfair terms. The OFT, however, has a duty to

³⁶ Section 5(1) *Unfair Terms in Consumer Contracts Regulation 1999* (UK).

³⁷ See UK Office of Fair Trading Annual Reports (1000 in 2006).

³⁸ UK Office of Fair Trading, Annual Reports 2003-4, 2004-5, 2005-06.

³⁹ See, for example, guidelines at <http://www.offt.gov.uk/Business/Legal/UTCC/guidance.htm>

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consider any complaint made to it, unless one of the other qualifying bodies notifies the OFT that it will do so.

The OFT has a duty to consider any complaint made to it that a contract term drawn up for general use is unfair⁴⁰, unless one of the ‘qualifying bodies’ given jurisdiction with the OFT to enforce the regulations notifies the OFT that it will do so.

The OFT also has a “super-complaints” jurisdiction⁴¹, which allows designated consumer bodies to represent consumers to make complaints about a feature, or a combination of features of a market that is, or appears to be significantly harming the interests of consumers.

One notable distinction between the UK and Victorian unfair terms legislation is that the UK regulations apply to all consumer contracts including finance contracts. As noted above, terms within credit contracts feature amongst the highest proportion of terms found to be unfair by the OFT.

Other matters

Industry improvement

The Communications Law Centre (CLC) has undertaken extensive research in the area of telecommunications. Unfair terms has been a priority issue for CLC, and it has completed numerous reports on the area, including compliance reports for Consumer Affairs Victoria on unfair terms⁴². CLC notes in its Submission to the Inquiry there has been an appreciable improvement in consumer contracts used by industry. CLC’s view is that the reduction in unfair terms and conditions has been brought about as a consequence of the inclusion of unfair contracts terms provisions in the Victorian *Fair Trading Act 1999*⁴³.

Perhaps the most positive consequences of unfair terms regulatory regime is the capacity for the regulator to directly negotiate with industry to revise their contracts. While there have been no terms prescribed as unfair, and to date only one case prosecuted by CAV (AAPT), the regulator has already negotiated with companies in industries including telecommunications, car hire firms, fitness centres, pay television providers and has recently targeted store loyalty cards to revise hundreds of unfair contract terms.

Not only is this a positive step in encouraging better industry practice, this preventative approach to consumer protection translates into avoided costs to government which won’t have the bear the flow-on costs of supporting consumers who suffer detriment when unfair terms lead to harm and spiralling debt.

There are also benefits to industry by embracing good practice. A consumer detriment survey conducted by Consumer Affairs Victoria in 2005-6 found that in response to dissatisfaction with goods/service, the behaviour most commonly reported was telling

⁴⁰ Except those that are frivolous or vexatious: s10 *The Unfair Terms in Consumer Contracts Regulation 1999* (UK).

⁴¹ See <http://www.ofc.gov.uk/Business/Super-complaints/default.htm>.

⁴² set out in the Communications Law Centre’s submission to this Inquiry.

⁴³ CLC also attributes this industry improvement, although to a lesser extent, to the introduction of the Communications Industry Forum Consumer Contracts Code.

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others not to do business with the offending party (61%)⁴⁴. Dissatisfied customers also report doing less business themselves with offending traders (43%) or doing no future business with them at all (56%). Six per cent (6%) of those surveyed were involved in or contemplating formal action against traders.

Cost saving to industry

There is some argument that prescriptive regulatory reform creates added compliance costs – and a better regime is to have little regulation and assist consumers make informed choices about products.

Unfair contracts legislation, however, is not accompanied by increased or prescriptive disclosure obligations often blamed for increased industry costs. The costs to industry of excising unfair terms from contracts are not likely to cause substantial costs to industry.

The benefits of increased certainty in contracts outweigh any costs. Giving the regulator jurisdiction to determine whether contracts are unfair, and an additional advisory role in overseeing contract terms will lead to better and fairer contracts subject to less scrutiny or challenge. Measures that establish or build up consumers' faith in suppliers, and the terms under which they purchase their goods or services are likely to have widespread benefits for both industry and consumers.

Prescriptive regulation and contract terms

The benefits that flow from a regulatory approach to consumer protection in unfair contracts terms include:

- the capacity to influence industry behaviour, and contribute towards “responsibilising”⁴⁵ industry practice
- economic benefits/avoided costs:
 - consumers who don't have to suffer detriment before seeking redress
 - courts and tribunals will not have to hear matters where a contract terms is voided and dispute resolution costs avoided
 - businesses won't be bogged down complying with the minutiae of otherwise prescriptive legislative provisions
- protection from unfair contract terms legislation can be achieved prospectively, rather than retrospectively (after consumer detriment has occurred)⁴⁶.
- a properly empowered and resourced regulator can seek undertakings from businesses to remove or revise unfair terms, negating the need for individual consumers to engage in complex and time-consuming disputes with better-resourced service providers on matters of interpretation.

⁴⁴ See CAV Consumer Detriment Survey at [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Annual_Report_2006/\\$file/cav_annualreport_2006_cons_detr_survey.pdf#xml=http://search.justice.vic.gov.au/isysquery/irlcfc/1/hilite](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Annual_Report_2006/$file/cav_annualreport_2006_cons_detr_survey.pdf#xml=http://search.justice.vic.gov.au/isysquery/irlcfc/1/hilite)

⁴⁵ I Ramsay ‘Consumer Law, Regulatory Capitalism and the “New Learning” in Regulation’ (2006) 28 *Sydney Law Review* 12.

⁴⁶ E Lanyon *Consumer Credit Law: the End of an Enclave?* unpublished paper (2006).



- obviates the problems associated with pursuing common law remedies outlined above.

If you would like to discuss the matters raised in this submission please contact Gordon Renouf or Dr Nick Coates on 02 9577 3399.