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Briefing note July 2015

Changing times: developments in the regulation of dealings between large and small businesses under the Competition and Consumer Act

Key issues

- The Australian Government is proposing to extend the unfair contract terms regime under the Competition and Consumer Act so that it applies to business to small business contracts.
- The necessary legislation is likely to pass in the spring Federal Parliamentary sittings. A six month transition period is proposed. The transition period is to allow businesses to prepare for the implementation of the new regime.
- The ACCC is also focussing on using its existing powers to regulate unconscionable conduct by big business against small business, as highlighted by the recent Coles litigation.
- The Government is also considering its response to the Harper Report which has recommended changes to the misuse of market power provisions, partly to address small business concerns. The ACCC noted in its Small Business Half Yearly Report that misuse of market power is the competition related issue that receives the most competition law complaints (being 367 complaints in the 2014-2015 financial year).
- In the circumstances, we recommend that businesses conduct an internal due diligence on their business processes with small business and the use of standard form contracts to assess which processes and types of contracts may need to be changed to ensure compliance.

Background

The proposed extension of the unfair contract terms regime in the *Competition and Consumer Act 2010* (Cth) ("**CCA**") to small businesses, means it is an opportune time to review compliance issues for larger corporations dealing with small businesses.

This extension needs to be considered in light of previous unconscionable conduct proceedings commenced by the Australian Competition and Consumer Commission ("**ACCC**") against the supermarket chain Coles concerning its dealings with smaller suppliers and the Government's focus on possible changes to misuse of market power provisions to deal with complaints raised by the small business sector.

Unfair Contract Terms

The Proposed Changes

The Commonwealth Government recently introduced the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015 (Cth) ("**Bill**") in order to amend the *Australian Securities and Investments Commission Act 2001* (Cth) ("**ASIC Act**") and the CCA (through the Australian Consumer Law, Schedule 2 of the CCA ("**ACL**")).

Currently, the ASIC Act and the ACL render void and unenforceable unfair terms in standard form contracts between business and consumers. The unfair contract term provisions apply to contracts for the supply or acquisition of goods and services and for the sale or grant of an interest in land. The Bill proposes to extend these provisions to dealings with small businesses who employ less than 20 people.

If passed by Parliament, the changes will likely come into effect in early 2016, as there is a six month transition period between Royal Assent and the commencement of the amendments. Any contract that is entered into or renewed with a small business after the commencement date will be covered by the proposed extension of the unfair contract terms regime. Further, any terms varied after the commencement date must comply with the proposed regime.

Rationale for the amendments

The Government considers small businesses to be vulnerable to unfair terms in standard form contracts because it considers that, like consumers, small businesses often lack the time and resources to adequately understand contract terms and do not have the bargaining power to negotiate to protect their own interests.

While there is an appreciation of the commercial efficiency of standard form contracts in the context of high volume, low value transactions, the Government is concerned with contracts being offered on a "*take it or leave it*" basis which contain one sided terms which are unfair to the small business. The Government took to the previous election a commitment, as part of its Policy for Small Business, to provide additional protection to small business.

What contracts are to be regulated?

The proposed regime will apply to standard form contracts where one party is a small business and where the price payable is less than the prescribed threshold being $100,000 (for contracts less than 12 months in duration) or less than $250,000 (for contracts more than 12 months in duration). The number of employees is calculated on the basis of the number of full-time, part-time and casual employees who work on a regular or systemic basis. The proposed regime will also apply to contracts entered into between two small businesses.

What is a standard form contract?

As noted above, the provisions will only apply to standard form contracts. The Bill contains a rebuttable presumption that if a party alleges a contract to be a standard form contract it is presumed to be a standard form contract unless it is proved otherwise. In determining whether the contract is a standard form contract, the Bill sets out six matters the court must take into account. These include whether one of the parties has all or most of the bargaining power, whether the contract was prepared by one party prior to any discussion between the parties, whether the contract was offered on a take it or leave it basis and whether there was any effective opportunity for negotiation.

What constitutes an unfair term?

A term in a regulated contract will be unfair if:

(a) it provides for a significant imbalance in the parties' rights and obligations under the contract;

(b) it would cause detriment (financial or otherwise) if relied upon; or

(c) it is not reasonably necessary for the protection of the interests of the party advantaged by the term (the Bill includes a presumption that a term is not reasonably necessary unless proved otherwise).

Courts will have regard to the contract as a whole and consider whether the term in dispute is transparent. A term is transparent if it is expressed in reasonably plain language, legible, presented clearly and readily available to any party affected by the term.

Both the ACL and the ASIC Act list a number of examples of terms which may be unfair. These include any term which:

- allows one party to unilaterally vary, renew or terminate the contract;
- allows one party to unilaterally determine whether the contract has been breached or interpret its meaning;
- penalises one party but not another for breach or termination of the contract;

- allows one party but not another to avoid or limit performance of the contract; or
- limits one party's rights in respect of any proceedings related to the contract.

However, it is important to note that the regime will not apply to a term to the extent that it (i) sets the upfront price payable; (ii) is required by law; or (iii) defines the main subject matter of that contract.

Remedies

Although an unfair term may be declared void and unenforceable upon application to a court by the small business or the ACCC, the remainder of the contract will still be binding on the parties.

Breach of the proposed regime will not give rise to pecuniary penalties as apply in the case of misuse of market power or unconscionable conduct. However, a court may also declare that the term is void in all of the defendant's standard form contracts, not just the contract in dispute. This may obviously have significant consequences for a business.

What this may mean for your business

If the Bill is passed and you use standard form contracts in your dealings with small businesses, you will need to review these contracts to ensure they do not contain any unfair terms. You will also need to put in place processes to review standard form contracts already entered into at the time the changes take effect if these are to be varied or renewed. At the time of renewal or variation such contracts will need to comply with the new regime.

Proposed Changes To The Misuse Of Market Power Provisions

Section 46 and protection of small business interest

The final report of the Commonwealth Government's Competition Policy Review led by Professor Ian Harper ("**Harper Review**") has drawn headlines as a result of its proposal to change the misuse of market power provision in section 46 of the CCA. These recommendations were made in part in response to criticism that the section is not working effectively in regulating the behaviour of larger businesses and not adequately protecting small businesses.

However, section 46 of the CCA was not designed to be a vehicle to protect small business interests, but rather to protect the competitive process. In the Melway case the High Court observed that "[s]*ection 46 aims to promote competition, not the private interests of particular persons or corporations".*[1]

Nonetheless, small businesses have consistently sought to use section 46 as a vehicle to protect their interests. The 2007 amendment of section 46 to introduce protection relating to predatory pricing (the so called "Birdsville amendment") was expressly designed to protect small business interests. In the second reading speech for the Birdsville amendment, Senator Barnaby Joyce (as he then was) remarked:

We have to look after small business...the scale has tipped too much in favour of big business. That needed to be addressed. In this legislation we are addressing this.[2]

Background to section 46

At its core, section 46 is a prohibition on a corporation that has a substantial degree of power in a market from taking advantage of that power for the purpose of:

(a) eliminating or damaging a competitor;

(b) preventing the entry of a person into that or any other market; or

(c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

The ACCC has had a poor track record in winning section 46 cases. The recent Pfizer case[4] was another high profile loss for the ACCC (although the decision is currently the subject of an appeal to the Full Federal Court). These losses have fuelled the ACCC's criticism of section 46.

The small business lobby has consistently advocated for amendments to section 46. The Minister for Small Business, Mr Bruce Bilson has expressed concern that section 46 provides inadequate protection for small businesses. Mr Bilson has responsibility for competition policy within his portfolio.

Harper Report proposed changes to section 46 and Treasury Consultation

The Harper Review's final report proposed that section 46 should prohibit a corporation with substantial market power from engaging in conduct which has the "*purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market".* This would remove the "*take advantage*" element in the section and the requirement to demonstrate a

purpose in subsections 46(1)(a) to (c). Further, it is said to bring section 46 it in line with the substantial lessening of competition test used in sections 45, 47 and 50 of the CCA.

To prevent the revised section 46 capturing pro-competitive conduct, the Harper Review final report recommended the introduction of a requirement for the court to have regard to whether the conduct has the purpose, effect or likely effect of enhancing efficiency, price competitiveness and product qualities and whether it has the purpose, effect or likely effect of deterring existing competition or hindering new competition. The utility of such guidance is questionable, given these are factors which courts may already consider when determining considering whether there has been a substantial lessening of competition.

What this means for your business

The Harper Review's final report is now with Treasury. A consultation process is being undertaken prior to the Government responding to the report, which is likely to occur in late 2015. The first round of proposed legislative changes is likely to be passed in 2016. However it is by no means assured that the Government will accept the recommendation to amend section 46 or that any such amendments will be passed by the Senate either before or after the next election in 2016.

Nonetheless, if the changes to section 46 are implemented large businesses, particularly in concentrated industries, will need to carefully consider the effect of conduct which is likely to have a substantial effect on the competitive dynamics of a market. If the proposed conduct is likely to bring about a substantial lessening of competition, notwithstanding it is unilateral conduct which does not have any anticompetitive purpose, the conduct may contravene an amended section 46. A finding of a breach of an amended section 46 brings with it pecuniary penalties, follow on damages and associated reputational damage.

While the focus of the recommended amendments is on the effect on the market rather than individual competitors (such as small businesses), large businesses would need to be particularly mindful of the competitive impact of their conduct on small businesses. As highlighted in the recently issued ACCC Small Business Half Yearly Report, misuse of market power is the competition related issue for which the ACCC receives the most complaints (being 367 complaints in the 2014-2015 financial year).[5] These complaints could be expected to increase if section 46 is amended.

Unconscionability

Unconscionability in dealings with small business

Unconscionable conduct as between businesses is prohibited by sections 21 and 22 of the ACL, as well as sections 12CA, 12CB and 12CC of the ASIC Act and the general law. The ACCC has used the ACL provisions to regulate the behaviour of large businesses in their dealings with small businesses.

The recent litigation by the ACCC against the supermarket chain Coles concerning its treatment of certain of its suppliers is a particularly high profile example of the increased use by the ACCC of the unconscionable conduct provisions of the ACL. This case also demonstrates the unfavourable publicity which can follow from an allegation of unconscionable conduct by the ACCC. That matter resulted in Coles paying an agreed penalty of $10 million as well as refunding $12 million to its suppliers (following an independent arbitration process between Coles and the affected suppliers).

The ACCC also recently succeeded in proceedings against a cleaning franchisor in respect of its dealings with its franchisees.[6] In addition there are reports of the ACCC conducting an investigation into the supermarket chain Woolworths in respect of its dealings with its suppliers.[7]

Unconscionable conduct is not defined in the ACL, though section 22 of the ACL provides a non-exhaustive list of 12 statutory indicators of unconscionability. These include the relative bargaining positions of the parties, whether a customer/supplier was required to comply with conditions that were not reasonably necessary to protect the legitimate interests of the supplier/acquirer, whether any undue influence or pressure was exerted or any unfair tactics used and whether there has been any unreasonable failure to disclose to the customer/supplier any intended conduct of the supplier/acquirer or risks to the customer/suppler. The ACL also provides that the definition of this term is not to be limited to conduct falling within general law concepts of unconscionable conduct.

The ACCC's proceedings against Coles suggests the ACCC will look to what is in its view a deliberate course of conduct and processes that are in place rather than 'one off' events.

What this means for your business

In order to avoid any allegation of unconscionable conduct, large businesses should seek to ensure no undue influence or pressure or unfair tactics are used in any dealings with small business counterparties and processes are put in place to provide checks and balances for its conduct. Further consideration should be given to seek to ensure that small businesses have sufficient time to review and seek advice on any agreements which may be entered into and are provided with sufficient information to properly consider any proposed agreement.

Further, any agreements with a small business should not contain terms that may be considered to be harsh or oppressive, with particular care to be taken to avoid terms which operate unilaterally for the benefit of large businesses and terms which go beyond what is reasonably necessary to protect its legitimate interest.

Conclusion

Engaging with small business carries with it certain challenges and requires a degree of vigilance on compliance issues. The ACCC has shown particular interest in the area. Ensuring your business has a good compliance regime is important. Those dealing with small business should adopt a common sense approach– does the proposed conduct pass a reasonable person's objective view of fairness?

Given the likely changes to the regulatory environment in this area in the next 6-12 months, we recommend an internal due diligence and "health check" and an update of contracts and contract renewal processes.

If you need any assistance in reviewing your contracts with small business or advice on any aspect of your dealings with your small business partners, please contact one of our Clifford Chance team.

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[1] Melway Publishing Pty Ltd v Robert Hicks Pty Ltd t/as Auto Fashions Australia (2001) 178 ALR 253, [17] (Gleeson CJ, Gummow, Hayne and Callinan JJ)

[2.] Second Reading Speech, Trade Practices Legislation Amendment Bill (No. 1) 2007 (Cth) dated 11 September 2007.

[3.] *Boral Besser Masonry Ltd v Australian Competition and Consumer Commission* (2003) 215 CLR 374.

[4.] *Australian Competition and Consumer Commission v Pfizer Australia Pty Ltd* [2015] FCA 113.

[5.] ACCC, *Small Business in Focus: Small Business franchising and industry codes*, Half Year Report No. 10, January-June 2015.

[6.] *Australian Competition and Consumer Commission v South East Melbourne Cleaning Pty Ltd (in liq)* [2015] FCA 25.

[7.] See e.g. Mark Hawthorne, "Woolworths' Christmas threat to suppliers", *Sydney Morning Herald* (online) 19 December 2014 (http://www.smh.com.au/business/retail/woolworths-christmas-threat-to-suppliers-20141219-12a16o.html).

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Contacts

Sydney

Dave Poddar
Partner
T: +61 2 8922 8033
E: dave.poddar@cliffordchance.com

Mark Grime
Associate
T: +61 2 8922 8072
E: mark.grime@cliffordchance.com

Gemma Stooke
Associate
T: +61 2 8922 8025
E: gemma.stooke@cliffordchance.com

Mark Pistilli
Partner
T: +61 2 8922 8001
E: mark.pistilli@cliffordchance.com

Danny Simmons
Partner
T: +61 2 8922 8007
E: danny simmons@cliffordchance.com

Paul Vinci
Partner
T: +61 8 9262 5504
E: paul.vinci@cliffordchance.com

Paul Lingard
Partner
T: +61 8 9262 5575
E: paul.lingard@cliffordchance.com

Justin Harris
Partner
T: +61 8 9262 5503
E: justin.harris@cliffordchance.com