Consumer Law Reform Additional Paper – September 2010

Unfair Contract Terms

This paper provides further analysis of the proposition that the Fair Trading Act 1986 could be amended to include unfair contract terms provisions. In June 2010, the Ministry of Consumer Affairs released the discussion paper "Consumer Law Reform".[1] The discussion paper included a section on unfair contract terms which raised the possibility of including provisions regulating unfair contract terms in the Fair Trading Act along the lines of the Australian Consumer Law (refer pages 30 – 34).

Submissions from consumer-oriented groups and some businesses supported including provisions in the Fair Trading Act that would provide a remedy for consumers against unfair contract terms, but generally the submissions from business groups have criticised the discussion paper for not establishing clearly enough that there is a problem with unfair terms in standard form contracts, and therefore not providing sufficient justification for any regulatory intervention. In particular, several submissions commented that harmonising consumer and business law with Australia as part of the promotion of the Single Economic Market is an insufficient reason in itself for making a change to New Zealand law.

What is an Unfair Contract Term?

An unfair contract term is a term that causes a party to a contract (usually a consumer) to be at a disadvantage while the term is not reasonably necessary for the protection of the interests of the other party (usually a business). Typically, an unfair term is a pre-written term in a standard form contract.

A standard form contract is a contract created by the business in advance of an agreement being made, and it is not negotiated separately with each consumer. In comparison, a negotiated term is agreed on by the business and each individual consumer. The types of consumer contracts which are typically standard form contracts include rental car agreements, electricity and gas agreements, telephone line agreements, gym memberships and retirement home contracts.

Unfair contract terms have been identified in other jurisdictions as causing a significant imbalance in the parties' rights and obligations under contracts (especially standard form contracts), to the detriment of consumers. A term that states that a business may change or alter other terms in a contract without consulting the consumer may be an example of an unfair contract term.

Is Regulatory Intervention on Unfair Contract Terms Justifiable?

Regulating unfair contact terms would be in accord with international consumer law practice, including in the Australia and the United Kingdom. Prohibitions related to unfair contract

[1] www.consumeraffairs.govt.nz/legislation-policy/policy-development/consumer-law-reform

terms have been in place for some time in the United Kingdom and Victoria, Australia.[2] There is also the European Union directive 93/13/EEC 1993 on Unfair Terms in Consumer Contracts.

This legislation was considered by the Australian Productivity Commission in its Review of Australia's Consumer Policy Framework.[3] The Australian Productivity Commission recommended that provisions addressing unfair contract terms along the lines of the provisions of the Victorian Fair Trading Act should be incorporated in the new national Australian Consumer Law. The Australian Consumer Law passed in April 2010 includes new unfair contract terms provisions which came into effect on 1 July 2010, and these are generally consistent with the recommendations in the Australian Productivity Commission Review.[4]

Regulatory intervention can only be justified if there is an identifiable problem that the intervention would address. The following generalisations regarding standard form contracts suggest unfair contract terms do cause a problem for consumers:

- Standard form contracts are prevalent in New Zealand, just like every other modern economy
- Standard form contracts strain the concept of offer and acceptance to the point that conventional concepts of contract law and the freedom of contract become artificial. Consumers do not have a real opportunity to read, understand, or negotiate the terms of the standard form contracts they enter into
- Standard form contracts are an efficient and effective way for businesses to undertake transactions with consumers and among themselves, and it would be inefficient (and probably futile) to inhibit their use
- There are myriad examples of terms found in standard form contracts which seem to be unfair in how they allocate risk to consumers rather than suppliers, and limit customers' rights in ways which are unbalanced
- The legal remedies and protections available to consumers against terms in contracts they are deemed to have agreed to are very limited – generally contract terms are enforceable, even if they might be regarded as being unfair
- Competition has not limited the ability of suppliers to take advantage of unfair contract terms.

We are making an assumption that virtually all contracts entered into by consumers in New Zealand are standard form contracts, and that consumers are entering into more contracts as the marketplaces for goods and services become more complex. This is consistent with international experience, although there is no specific research on the prevalence or content of standard form contracts in New Zealand.

Regulators and legislators in Australia have accepted that standard form contracts are prevalent, and that unfair contract terms which reflect the imbalance in power in favour of the suppliers which prepare the contracts are common. There is no reason to believe that the position in New Zealand would be materially different from that in Australia, because the

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[2] Unfair Terms in Consumer Contracts Regulations 1999, United Kingdom, and the Fair Trading Act 1999, Victoria.
[3] Review of Australia's Consumer Policy Framework, Productivity Commission Inquiry Report, No. 45, 30 April 2008 – http://www.pc.gov.au/projects/inquiry/consumer/docs/finalreport.
[4] The Australian Securities and Investments Commission Act 2001 also includes identical unfair contract terms provisions. New Zealand's Fair Trading Act applies to credit and other financial sector contracts and thus any consideration of unfair contract terms provisions will need to consider their applicability to financial services and products.

goods and services acquired by consumers are similar in each country, and many suppliers are the same or similar companies.

Generally the provisions in New Zealand statute and case law which might protect consumers from an unfair contract are also found in Australian State or Commonwealth law, and they have not been found to provide effective protection for consumers in Australia (e.g. duress, unconscionability, oppression provisions in the Credit Contracts and Consumer Finance Act 2003, unfair practices under the Fair Trading Act). The Australians have more relevant legislation than New Zealand (e.g. unconscionability under the Trade Practices Act 1974, and the Contracts Review Act 1980 (NSW)), but they have still decided that additional protection is necessary for consumers.

The Australian Productivity Commission decided there were *ethical* and *economic* justifications for providing consumers with a remedy to protect themselves from unfair contract terms. The ethical reason is that the concept of fairness has an inherent value in its own right. The economic reason is that shifting risk on to consumers through unfair contract terms is not economically efficient, either between competing suppliers or between suppliers and consumers. Theoretically, consumers would price the risk they assume under the terms of their contracts, and goods and services would be cheaper because their price would reflect the risk (and cost) consumers assume. However the idea that consumers would price their risk is artificial when they are generally unaware of the content and implications of unfair contract terms in standard form contracts. The one-sided nature of standard form contracts and the lack of transparent evidence – or even consideration – of the allocation of risk and cost between suppliers and consumers suggest that unfair contract terms are most likely to be inefficient, as well as being detrimental to consumers.

Research Base

The research information which supports the proposition that there is a problem with unfair contract terms comes largely from Australia and includes,

(1) *Unfair Contract Terms Working Party Discussion Paper*, Standing Committee of Officials of Consumer Affairs (SCOCA) (January 2004)
(2) *Unfair Terms in Consumer Contracts*, Standing Committee on Law and Justice, NSW Legislative Council, Report 32 (November 2006)
(3) *Unfair contract terms in Victoria: Research into their extent, nature, cost and implications*, Consumer Affairs Australia, Research Paper No. 12 (October 2007)
(4) *Review of Australia's Consumer Policy Framework*, Australian Productivity Commission (30 April 2008)
(5) *An Australian Consumer Law Fair Markets – Confident Consumers*, SCOCA (February 2009)

The relevant information from these papers includes,

1. Unfair Contract Terms Working Party Discussion Paper, Standing Committee of Officials of Consumer Affairs (SCOCA) (January 2004)

The SCOCA Discussion Paper discusses the nature and incidence of unfair contract terms, the regulatory response to date (including in New Zealand), and regulatory options (including doing nothing, self-regulation and three different regulatory options).

The use of standard form contracts evolved out of conventional commercial law, and the efficiency justification for suppliers using standard form contracts is compelling. The SCOCA Discussion Paper goes on to say (at pages 16-17),

> However, standard form contracts do pose problems. These types of contract will usually have been drafted by professionals on behalf of the supplier. Generally, the purchaser has no time or opportunity to read the contract before signing, let alone obtain the same standard of advice as the supplier. If there is time to read it, it is doubtful whether the purchaser will understand the meaning and impact of each term in light of the whole contract. Even if the putative purchaser did read and understand the contract, the supplier may not be prepared to change clauses at their request. This 'take it or leave it' attitude places purchasers in a difficult position: agree the terms or forgo the product or service. Although, at law, there may not be a circumstance of duress, for example, or unconscionable conduct on the part of the supplier prior to or at the time the contract is made, the particular purchaser may have no option but to agree if he or she wants the product.
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> It has become increasingly clear that many such standard form contracts contain clauses which are unfair or unnecessarily one-sided to the detriment of the purchaser. One reason that these have become so prevalent is that there is little, if any, competition in this regard. Purchasers do not normally "shop around" on the basis of the best contract terms: it would be too impractical an exercise for the vast majority of people to decide, for example, which car-hire company to use based on the best contract terms. Purchasers predominantly focus on price and the quality or characteristics of the product. They may not appreciate that a "good" price has been achieved through the imposition of onerous terms. As a result, terms may well be standard across an industry and even if the purchaser went elsewhere, they would be faced with a similar situation.

The SCOCA Discussion Paper refers to examples of unfair contract terms in mobile phone contracts (allowing telecommunications companies to change services or charges without notice, arbitrary and difficult to understand penalties for exceeding pre-set call limits, contracts in small print), car rental contracts (complex and poorly laid out contracts with key provisions in small print, including vehicle damage and insurance provisions, and containing other unreasonably harsh provisions), and banking terms and conditions (allowing banks to unilaterally change "any other term or condition").

The regulatory responses at the time of the SCOCA Discussion Paper in Australia include the unconscionability remedy available under the Trade Practices Act 1974, the Contracts Review Act 1980 in New South Wales, the Uniform Consumer Credit Code 1994 and the Victorian Fair Trading Act 1999 amendments dealing with unfair contract terms.

Unconscionability had not been effective in dealing with unfair contract terms because the courts in Australia have been reluctant to extend the scope of the concept beyond its case law foundation (i.e. the courts continue to focus on procedural unfairness, rather than substantive unfairness). There are also access to justice and cost barriers for consumers taking unconscionability claims under the Trade Practices Act.

The New South Wales Contracts Review Act empowers the courts to provide remedies where contracts and provisions of contracts are found to be "unjust in the circumstances at the time it was made." This Act has been generally ineffectual because it relies on consumers making civil claims in the courts, and the reference to the circumstances at the time the contract was made has directed the courts to focus on procedural rather then substantive justice issues. The definition of unjust being "unconscionable, harsh or oppressive" seems to have set the bar too high for most consumer cases, and most of the cases taken have involved mortgages.

The Uniform Consumer Credit Code has not been used extensively by consumers enforcing their rights in Australia. It includes provisions to reopen "unjust" credit contracts, which are defined as including "unconscionable, harsh or oppressive" terms. In New South Wales, actions tend to be taken under the Contracts Review Act rather than the Uniform Consumer Credit Code.

The Victorian legislation only came into force in October 2003, so it was too early (in January 2004) for the SCOCA Working Party to comment on its impact.

The Unfair Contract Terms Act 1977 in the United Kingdom prohibits various limitation of liability clauses and indemnity clauses in consumer contracts, and subjects other clauses to a "reasonableness" test. Few cases have been brought, and the Act does not provide for unfair contract terms to be dealt with systemically.

The United Kingdom Unfair Terms in Consumer Contracts Regulations 1999 provide greater protection for consumers against unfair contract terms. The approach is similar to that subsequently adopted in Victoria; consumers are not bound by contract terms which are unfair, and unfairness is defined in terms of being contrary to good faith, and causing a significant imbalance in the parties' rights and obligations, to the detriment of the consumer. The United Kingdom courts have interpreted the good faith requirement as requiring "fair and open dealing," and have not limited it to suppliers being deceitful. Individual consumers can challenge unfair contract terms in the courts, but the United Kingdom Office of Fair Trading can also take a more systemic approach in the interests of consumers and competitors generally.

Information from the Office of Fair Trading and the UK Law Commission shows that the systemic approach where the Office of Fair Trading can prevent traders from using particular unfair contract terms generally is more effective in changing market behaviour than consumers' exercising their right to take individual cases.[5]

In terms of regulatory options, SCOCA concluded that a decision not to take any action would leave the inequity of consumers bearing additional costs and risks unaddressed. There would be no cost or disadvantage to businesses in retaining the status quo, but consumers would have no practical redress for substantive unfair contract issues.

The SCOCA Discussion Paper includes the following preliminary cost-benefit analysis of adopting the United Kingdom (and Victorian) model for regulating unfair contract terms (at page 11),

Option 3 – UK model and variants

Government	Business	Consumer
Cost involved in regulation may be significant. However, it could be argued that this can be used as a co-regulatory option, as in practice in the UK, court costs have been avoided by negotiating with business. By following the Victorian provisions which allow for some clauses to be prescribed, more certainty would be created for business and there will be less need to negotiate on all terms. Higher levels of consumer confidence across the marketplace as consumer detriment capable of being addressed in a systemic	One-off cost of re-drafting contracts and staff training. Once contracts are acceptable, there would be no further compliance work required. A reduction in consumer complaints could be expected and therefore dispute resolution costs; consumers should better understand their rights and obligations, and therefore make more informed choices. Higher levels of consumer confidence across the marketplace. All business would be subject to the same requirements	The ability to have unfair terms addressed systemically, either by government negotiation or action in relation to a business or industry or by prescribing certain terms as unfair would reduce the costs to individual consumers in addressing the matter. The detriment to consumers would also be addressed more swiftly and across the marketplace. There may be increased costs to consumers where business has kept prices low by the use of unfair terms. However, this may be balanced out by the

[5] *Unfair Terms in Contracts* (2002) The Law Commission of England and Wales (Consultation Paper 166)

manner.	therefore no inequity between businesses or industry.	extra costs and risks consumers would otherwise have borne as a result of the unfair terms.

This is obviously not a quantitative cost benefit analysis, but the qualitative points seem likely to be valid. Note that the Australian Consumer Law as passed did not follow the Victorian (or UK) approach of providing for particular clauses to be prescribed generally as unfair contract terms. This had the effect of reducing the costs *and* benefits of the option finally adopted in Australia.

2. *Unfair Terms in Consumer Contracts, Standing Committee on Law and Justice, NSW Legislative Council, Report 32 (November 2006)*

The Standing Committee on Law and Justice of the New South Wales Legislative Council conducted an inquiry and published a 92 page report on unfair terms in consumer contracts in 2006.

The report recommended that the New South Wales Government should amend its Fair Trading Act to deal specifically with unfair contract terms along the lines of the provisions in Victoria. The New South Wales proposal was overtaken by the Commonwealth Australian Consumer Law, but the needs analysis in the Standing Committee report is relevant for New Zealand.

Chapter 2 of the Report considers the incidence and impact of unfair terms in consumer contracts. The Standing Committee's terms of reference identify four types of contract terms which are generally considered to be unfair, and the committee's Report examines each type. They were,

(1) *Terms which allow the supplier to unilaterally vary the goods or services.* The case studies provided in the Report were a car-hire agreement where the hire company can change the car if the car type originally booked is unavailable, and a pay TV contract where the television company unilaterally switched a sports channel for a comedy channel.

Evidence was submitted that in some cases, unilateral variation clauses are fair and necessary. For example, a home loan agreement may be for 25 or 30 years, and circumstances will change over that time. A home loan with a variable interest rate is inherently, and quite fairly, variable.

Other unilateral variations are clearly unfair and detrimental to consumers. An example was provided where a bank introduced a new low-rate credit card, and customers used the card to repay other credit cards with higher interest rates. The bank responded by relying on a unilateral change clause to charge a new $160 fee if the new card was not used for making new purchases.

The NSW Commissioner for Fair Trading submitted that unilateral change clauses should not be prohibited outright, but they should be redrafted so there is a balance between parties' rights and obligations. Unilateral variation clauses should be narrowly and clearly drafted, and set out the specific circumstances where a variation may occur. Consumers should also have the opportunity to cancel a contract without penalty if the change does not suit the consumer.

(2) *Penalties against the consumer but not the supplier for breach of contract.* The case study was a mobile phone customer who missed a payment and the phone company demanded the whole balance owing under the contract.

Evidence was submitted that contracts drafted by suppliers never provide for any penalty against the supplier for a breach of contract by the supplier, but they often include significant penalty fees and charges for breaches by consumers.

(3) *Terms allowing the supplier to suspend services but continue to charge.* The case study provided was a gym membership contract where the member could not cancel the contract without paying for the 12 month minimum period, and where the contract automatically rolled over for another year.

The NSW Energy and Water Ombudsman also provided examples where electricity suppliers could terminate supply for defaults which include refusing access to authorised persons.

(4) *Terms which permit the supplier but not the consumer to terminate the contract.* The case study provided was a website which hosted an online journal under a one year contract which was unilaterally cancelled by the service provider.

The Standing Committee received evidence that this type of clause is prevalent and particularly detrimental to consumers in the telecommunications industry.

Standard form contracts are the vehicle for unfair contract terms. There are obvious efficiency benefits from standard form contracts, especially where banks, for example, have millions of customers with multiple transactions. The scale is different in New Zealand, but the point is essentially the same. The committee noted in its report that it did not have any criticism of the use of standard form contracts per se, but the problem identified in the inquiry was that standard form contracts facilitate the incorporation of unfair contract terms.

Problems identified included the non-negotiability of standard terms, and the fact that unfair contract terms are unavoidable for consumers because suppliers all use similar contracts. The Standing Committee also discussed contracts which incorporate additional information by reference which may not be readily accessible to consumers, excessively long contracts, internet “click” acceptance contacts which consumers hardly ever read, and a lack of plain English.

There is market failure in this area because consumers do not make product or service selections on the basis of the contract terms, and in some industries the contract terms are uniformly bad for consumers. Often unfair contract terms go beyond what is necessary to protect the business interests of suppliers in shifting risks on to consumers.

The Standing Committee sought quantitative evidence of the extent of the problem with unfair contract terms, but the evidence was not available. The NSW Commissioner for Fair Trading advised that anecdotal evidence suggests that the incidence of unfair contract terms is increasing and that this is due to the growing use of standard form contracts:

> … the incidence has probably increased since 1980. The use of contracts for the normal, run-of-the-mill person has significantly increased because of the changes in the market. For example, since 1980 some of the worst unfair contract clauses have appeared in contracts for goods and services that did not exist before then; for example, mobile phones, pay TV and health and fitness centres. There are many more people, including young people, signing up for complicated contracts day after day. In some cases they sign up over the Internet, where they

click an "I agree" button to obtain services. There is a general view that the incidence is increasing because a number of contracts did not exist before."[6]

The Standing Committee concluded on the incidence and impact of unfair contract terms as follows (page 24),

2.82 The above discussion illustrates the kind of unfair terms that create a significant imbalance between the rights and obligations of the consumer and the supplier, to the detriment of the consumer. Submissions received by the Committee revealed a wide-range of unfair contract terms across a number of industries providing goods and services to consumers.

2.83 The evidence presented by Inquiry participants shows that the growing use of standard form contracts in the past few decades has increased the prevalence of unfair terms in consumer contracts. While standard form contracts provide a convenient and economic way for a consumer to engage a service provider, they also leave the consumer open to unfair terms, particularly if contracts are very lengthy, are not written in plain English, and refer to additional material that is not provided with the original contract.

2.84 In trying to determine the extent of the problem, the Committee sought data from regulatory bodies such as the NSW Office of Fair Trading and Consumer Affairs Victoria. The Committee was informed, however, that accurate data collection in relation to unfair contractual terms as a particular consumer issue was not available.

2.85 Nonetheless, the anecdotal evidence presented by witnesses and submission makers working in the area of consumer complaints, the law and various industries clearly indicates that this is a very real and significant ongoing problem for a large number of consumers in NSW as it is elsewhere. Inquiry participants identified the following services as the most problematic in relation to unfair terms:

- mobile phones
- cable television
- internet service provision
- gym membership
- banking services
- hire cars

2.86 The Committee is concerned that the prevalence of these terms has, and will continue to, caused a significant injustice to consumers. It is also clear that the contract terms discussed above may be particularly detrimental to vulnerable consumers.

The Standing Committee recommended as a consequence of its inquiry that the NSW Government should amend the NSW Fair Trading Act to establish a scheme for the protection of consumers in relation to unfair contract terms, and that the scheme should be modelled on the Victorian legislation.

3. Unfair contract terms in Victoria: Research into their extent, nature, cost and implications, Consumer Affairs Australia, Research Paper No. 12 (October 2007)

The Fair Trading Act in Victoria contains a part focussing on the substantive fairness of consumer contract terms, and making unfair consumer contract terms void. Consumer Affairs Victoria conducted empirical research in 2007 into the experience of Victorian

[6] *Unfair Terms in Consumer Contracts,* Standing Committee on Law and Justice, NSW Legislative Council, Report 32 (November 2006), citing evidence from the NSW Commissioner of Fair Trading, at p.22

consumers who enter into written contracts, and the results were published in a Research Paper published in October 2007.

The quantitative aspect of the research included surveying a total of 1,690 consumers aged 16 years and above. The survey measured the incidence of Victorian consumers entering into contracts containing terms or conditions that had been assessed as unfair.

Twenty in-depth interviews were also conducted to provide a qualitative aspect of the research.

The interesting findings from the research include:

- When they were unprompted, the respondents had very low recall of any contracts they had entered into. Once prompted, respondents were able to recall a range of contracts. This indicates that consumers do not necessarily make the link between signing up for a product or service and consciously entering into a contract (page 5).

- 30% of respondents reported entering into contracts they thought contained unfair terms or conditions. Further filtering showed 17% of respondents were aware of terms and conditions that may have been unfair in terms of the unfair contract term provisions in the Victorian Fair Trading Act. Respondents generally believed they had no power to challenge unfair contract terms because the contract was legally binding, and being "caught out" was a "bit of bad luck" (pages 7-8).

- The industries primarily identified as having unfair contract terms for consumers were mobile and landline phones, internet service providers, banks and finance providers, utilities, recreation/leisure services and insurance (page 9).

- The common complaints were about contracts with unclear service fees or additional fees, changes to contract terms, excessive penalties or changes to the goods or services provided (page 12).

- The (more detailed) qualitative research showed consumers believed contracts were legally binding, and that they were compelled to abide by the terms and conditions, regardless of whether they were fair or reasonable (page 13).

- Consumers saw contracts as a necessary evil, which are designed to protect services providers, but which are unavoidable. Legal jargon and fine print deterred consumers from reading contracts. Consumers had a casual attitude towards storing contracts, and often discard them or forget where they put them (page 13).

- More consumers read their contracts than was expected. 72% of consumers who reported encountering unfair contract terms (i.e. 72% of 30%) reported reading all or part of the contract before entering into it. 85% of consumers who reported unfair contract terms in banking, credit or finance contracts reported reading all or part of the contract (pages 15-16)

- Of the consumers who identified unfair contract terms, 70% complained. Of those who complained, 37% were able to cancel the contract, agree a refund or vary the terms. 63% conceded that they were bound by the unfair contract term (pages 17-18).

- The detriments reported by consumers were emotional (feeling annoyed, disappointed, frustrated), economic (feeling ripped off and cheated), and social (losing confidence in suppliers and their own judgement) (pages 23-24).

The conclusions from the Research Paper were (page 25),

> Consumer Affairs Victoria's research paints a clear picture. Many consumers do not read contracts, which are often long and complicated, before they sign on the dotted line. Even those consumers who read contracts carefully are likely to misunderstand them or overlook important terms and conditions. This means that consumers do not have the skills to make educated choices about suppliers. It also means that they may find themselves bound by enforceable contractual changes that may have negative consequences. As a result, competition in the market is impaired.
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> Not all forms of unfairness met by consumers can be or are resolved by typical Fair Trading Act protections that deal with misleading and deceptive conduct or implied warranties. This paper shows that consumers are liable to be deterred from pursuing complaints once suppliers refer them to contract terms or conditions that appear to be legally binding.
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> The evidence contained in this paper suggests that the number of complaints about unfair contract terms lodged with Consumer Affairs Victoria is the tip of an iceberg. It reveals that many consumers do not complain or, if they do, they lodge a complaint with the supplier rather than Consumer Affairs Victoria. The research shows that this may be because consumers do not know legislation to protect them from unfair contract terms exists. This is evidenced by the fact that in the main, consumers who complain report the substance of the complaint (i.e. a change to type of goods or services or two extra direct debits), rather than the relevant contract term (i.e. unilateral variation permitting change to unlimited calls or requirement to cancel in specified way and time).
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> This paper reveals that consumers are incurring both financial and emotional costs after encountering unfair contract terms. In addition, there is evidence of a flow-on-effect – consumers who come across unfair terms become suspicious of written contracts or drop out of the market.

There is no law in New Zealand under which consumers can complain to a regulator (in practice, the Commerce Commission) about contract terms they regard as being unfair. This means New Zealand consumers are more likely to be deterred from complaining than Victorian consumers. Nevertheless, the research on the prevalence and costs of unfair contract terms in Victoria is likely to be applicable to New Zealand.

4. Review of Australia's Consumer Policy Framework, Australian Productivity Commission (30 April 2008)

The Australian Productivity Commission published its Review of Australia's Consumer Policy Framework on 30 April 2008, and it underpinned the Australian Consumer Law passed by the Commonwealth Government in 2010.

The Australian Productivity Commission was asked to report on (page 9),

- ways to improve the policy framework to assist and empower consumers, including disadvantaged and vulnerable consumers;
- options for promoting harmonisation and coordination of consumer policy across jurisdictions;
- any areas of consumer regulation that are unlikely to provide net benefits and that could be revised or repealed;
- the scope for more effective use of self-regulatory, co-regulatory, and consumer education and information approaches and principles-based regulation; and
- changes to the consumer policy framework to facilitate greater economic integration between Australia and New Zealand.

Harmonisation between States with disparate consumer laws was therefore one of the objectives of the Review, but it also included evaluating the effectiveness and net benefits of the different elements of the consumer law framework across Australia.

This is the context in which the Productivity Commission recommended that a new national consumer law should include provisions addressing unfair contract terms.

Several submissions on the Consumer Law Reform Discussion Paper from industry groups argue that the Ministry of Consumer Affairs is placing too much reliance on the Australian Productivity Commission Review, particularly in relation to the unfair contract terms proposal. The argument is that no need to regulate unfair contract terms has been identified for New Zealand, and a separate review should be undertaken, specifically for New Zealand before any decision should be taken on the proposal.

The Productivity Commission Review document includes a 20 page summary discussion on unfair contract terms, leading to the Commission's recommendation that unfair contract term provisions should be included in the Australian Consumer Law (pager 149 – 169). The Review also includes a 38 page appendix providing a more detailed discussion as Appendix D (pages 403 – 441).

The issue on which we have been challenged is whether this analysis is relevant or persuasive for New Zealand.

The "Key points" in the Productivity Commission Report in this context are summarised as follows (page 139),

- Existing consumer laws deal adequately with most instances of unfair practices and conduct.
- However there is a gap in provisions relating to unfair contract terms.
  - There are sound economic and ethical rationales for proscribing unfair contract terms that cause consumer detriment.
  - The existing unconscionability provision of the generic consumer law prohibits the abuse of unfair terms only in constrained circumstances, is very costly and slow to use, and lacks clarity about its application in this area.
- Despite sound in-principle arguments for intervention, the cost-benefit trade-off for a new national provision against unfair contract terms is difficult to judge.
  - The aggregate benefits of a law against unfair contract terms are hard to assess. This is because, whilst there is persuasive evidence of the prevalence of unfair terms, there is limited information on the extent of the detriment associated with them and because of the nature of the problem can make it difficult to collect data;
  - On the other hand, there is little evidence in Victoria or in the other countries that have enacted laws against unfair contract terms, of significant business compliance or other burdens. Indeed, some businesses in Australia have supported such regulation and many are used to complying with provisions against unfairness in industry codes.
  - The absence of a provisions dealing with unfair contract terms in the Trade Practices Act has already led to one state enacting its own law and others may introduce different laws. A uniformly adopted provision would aid in the development of a nationally consistent generic consumer law.
- The Commission considers that, on balance, a law that addresses unfair terms is warranted. The regulatory risks entailed by such a new law could be reduced by:
  - taking account of the full circumstances of the contract, including any beneficial or adverse effects of changes to unfair terms for consumers generally; and
  - excluding upfront price terms and negotiated contracts from its scope.
- Any law would need to incorporate the capacity for a class of affected consumers or a regulator to take representative actions to achieve redress since, by their nature, unfair terms can affect large groups of individuals.
- The main remaining policy issue is whether unfair terms should be addressed ex ante on the basis of their likely detriment for consumers, or ex post after establishing detriment. While the two approaches are less different than is often supposed, the key trade-off is between greater pre-emption of unfair terms on the one hand, and an additional reduction in the risk of regulatory overreach on the other. For the interim at least, the Commission favours the ex post approach.

The efficiency argument about different States having different or uniform laws is not directly relevant to New Zealand, although the New Zealand Government's single economic market policy is premised on the assumption that there is a benefit in New Zealand businesses being encouraged to operate across the Tasman by having consistent laws.

In terms of the need for a change in the law to deal with unfair contract terms, the Productivity Commission Report includes the following more specific propositions that are relevant for present purposes,

- Many consumer groups, State and Territory Governments, and some businesses have said they are concerned about unfair contract terms (page 149);

- The biggest concerns arise for standard-form contracts – typically used in the supply of a broad range of services including air travel, telecommunications, energy, consumer credit, car hire, holiday packages, home improvements and software sales (page 149);

- Previous attempts to devise national uniform legislation along the lines of the Victorian model have so far stalled, with the regulatory impact statement not meeting the required standard. In particular, the submitted regulatory impact statement only provided anecdotal evidence of the detriment from the use of unfair terms (page 149);

- The Commission accepts that there is a rationale for addressing unfair contract terms. The strongest argument for doing so is ethically based – and it is merely the extension of existing ethical principles about fairness in contracts, to cover substantive terms that appear to be manifestly unfair in most circumstances (page 151);

- There is a conventional economic rationale too, but it is more complicated and depends on the nature of the risk appraisal by consumers and the difficulties that "good" firms have in signalling that they will act in good faith with their customers compared with "bad" firms (page 151);

- What appear to be one-sided contracts may sometimes better protect the bulk of customers from the behaviour of the few, than balanced contracts. In that case, they may not be so one-sided (page 151);

- Measures against unfair contract terms have to steer a middle course, by seeking to stem acts of bad faith or otherwise inappropriate behaviour by either party to a contract (page 151);

- There is persuasive evidence that notionally unfair terms are commonplace in Australian contracts not covered by the Victorian legislation. However, the rationale for action principally rests on the unreasonable *use* of unfair terms, not their *existence*. This is because, perceptions of their inherent unfairness aside, dormant unfair terms often do not cause detriment to consumers (page 153);

- The evidence about the use of unfair terms is of variable quality. Much of the cited evidence is anecdotal. Nevertheless, there is quantitative evidence from Victoria and from various other countries that suggests that somewhere between 5 and 15% of consumers might be detrimentally affected by unfair terms. The wide range of these estimates underlines the uncertainty about how many consumers are adversely affected (page 152);

- The evidence about the overall extent of detriment suffered by consumers is also limited

(page 153);

- Given these difficulties, an equally relevant question is whether the incidence of detriment is low *enough* not to be relevant for policy (page 154);

- Barring unfair contract terms is likely to have some adverse knock-on impacts for consumers through higher prices (or lower quality goods and services). The implication is that the net benefits to consumers from action are not as high as might be thought by looking at the direct benefits (page 155);

- The question of net benefit appears to hinge on whether remedies for the residual misuse of terms and the gains from a consistent national approach are worth the costs (page 156);

- One option would be to do nothing now on the grounds of uncertainty, and to collect more evidence. However, it is not clear, given the nature of the issues, that this approach would unearth much beyond the evidence that the Commission has already gathered from its Australian and international consultations and from various existing studies (page 156).

The Productivity Commission's response to the uncertainty around quantifying the need (or potential benefit) from intervening was to consider a range of proposals to minimise the cost of intervening. These proposals included building an implicit "public benefit" element in the test for unfair contract terms by requiring the court (or regulator) to have regard to "all the circumstances of the contract" in determining the unfairness of a contract term. The proposal was also to exclude negotiated contracts, and the prices of goods and services, from the scope of potential unfair contract term remedies.

There would also be greater scope for regulatory over-reach if the regulator was empowered to regulate *ex ante* (i.e. in advance) contract terms, rather than evaluating actual contract terms *ex post*. The Commission therefore recommends regulating unfair contract terms *ex post*, on the basis that it would involve less compliance costs.

It is significant that the Productivity Commission Review was accepted as the regulatory impact statement, setting out the analysis of the costs and benefits and justification for intervening in relation to the unfair contract term provisions in the Australian Consumer Law.

5. An Australian Consumer Law Fair Markets – Confident Consumers, SCOCA (February 2009)

The Fair Markets – Confident Consumers report responded to the Productivity Commission Report on, among other things, unfair contract terms. The Standing Committee of Officials on Consumer Affairs (SCOCA) accepted the Productivity Commission's findings that unfair contract terms appear to be widespread in contracts, particularly standard form contracts, and the consumer detriment flowing from them is likely to be non-trivial.

The costs associated with regulating unfair contract terms include (page 30),

- Standard form contracts can provide significant cost savings and, if altered in response to unfair terms regulation, some prices for consumers could rise in the short term.

- Renegotiation of certain terms where it is reasonable for a supplier to vary regularly (for example, mortgage interest rates) would be more costly than unilateral variation.

- The law may weaken the capacity of businesses to deal with a small number of consumers acting in bad faith, limiting in turn their capacity to deal fairly, cheaply and efficiently with the bulk of consumers.

The model adopted in Australia is designed to minimise these costs. The elements of the model include,

- A term is "unfair" when it causes a significant imbalance in the parties' rights and obligations arising under the contract, and it is not reasonably necessary to protect the legitimate interests of the supplier.

  This avoids the problem of defining "good faith" as part of the definition of "unfair" proposed by the Productivity Commission. The reference to "not reasonably necessary to protect the legitimate interests of the supplier" permits suppliers to use terms in standard form contracts which are justifiable.

- Remedies will be available only where the claimant (an individual or a class) shows detriment to the consumer, or a substantial likelihood of detriment, not limited to financial detriment.

  The requirement to establish actual detriment, or a substantial likelihood of detriment, limits the risk of "regulatory over-reach" from contract terms being challenged on the ground that they are theoretically unfair.

- The provision will relate only to standard form, non-negotiated contracts. Should a supplier allege that the contract at issue is not a standard form contract, then the onus will be on the supplier to prove that it is not.

SCOCA agrees with the Productivity Commission's view was that the risks would exceed the likely benefits if the law was applied to negotiated terms.

- The provision will exclude the upfront price of the good or service.

  This follows the UK approach, and is based on the expectation that consumers will have been aware of and expressly accepted the price, even in a standard form contract. Exposing businesses to claims that their prices are unfair would significantly increase the uncertainty for businesses.

- The provision will require all the circumstances of the contract to be considered, taking into account the broader interests of consumers, as well as the particular consumers affected.

  This means that the context of the contract will be considered, and a term which might be unfair on its face may nevertheless be fair in the overall context of the contract.

The Fair Markets – Confident Consumers report also discusses the types of unfair contract terms which might be banned outright under the new law. This would have had the effect of *ex ante* or preventative regulation, rather than establishing that an existing contract term is unfair *ex post*. The UK and Victorian legislation provides for a "black list" of certain terms which are banned, but in the end this was not included in the Australian Consumer Law.

The decision not to enact a black list mechanism limits the regulatory reach of the unfair contract terms provisions in the Australian Consumer Law, but it also reduces the potential compliance costs for suppliers.

The Fair Markets – Confident Consumers report also assumes that the unfair contract terms provisions would apply to small businesses, on the ground that many small businesses are required to accept standard form contracts in the same way as individual consumers, and their interests are essentially the same as individual consumers in respect of unfair contract terms. The unfair contract term provisions in the Australian Consumer Law do not apply to contracts entered into by small businesses.

Enforcement

One of the principles of the Consumer Law Reform project is that consumer laws should be effective and enforceable.

Under the Australian Consumer Law, unfair terms in consumer contracts are void on the declaration of a Court, and an application may be made to the Court by a party to the contract or the regulator (section 250). Apart from the unfair contract term being void, there is no other penalty or consequence from a Court deciding that a contract term is unfair.

This means unfair contract terms can only be dealt with on a case by case basis under the Australian Consumer Law. The cost of this could be minimised in New Zealand if the Disputes Tribunal is given jurisdiction to declare contract terms to be unfair (and therefore void), but there would still be no ability to deal with unfair contract terms systemically.

This contrasts with the Victorian Fair Trading Act provision, and the United Kingdom Unfair Terms in Consumer Contracts Regulations. In addition to the Courts issuing injunctions on a case by case basis, the Victorian Fair Trading Act allows for specified unfair contract terms to be banned outright through a "black-list" prescribed in regulations. This means that, if a contract term in a contract between a particular consumer and a supplier is found to be unfair, that term can be rendered void in all of the supplier's contracts by a regulation applying across the board.

No regulations actually banning particular clauses have been made in Victoria, but Consumer Affairs Victoria has stated in various submissions that the fact that the power exists has been used to effectively negotiate contract amendments with suppliers.

The United Kingdom approach is to provide for the Office of Fair Trade to apply to the Court for an injunction banning suppliers from using particular unfair contract terms in all their contracts. These injunctions can apply to particular suppliers, or to entire industry sectors. Regulation 12 of the Unfair Terms in Consumer Contracts Regulations 1999 (UK) says,

> (4) An injunction [*against using an unfair term in a standard form consumer contract*] may relate not only to use of a particular contract term drawn up for general use but to any similar term, or a term having like effect, used or recommended for use by any person.

It is interesting that, although the United Kingdom Office of Fair Trade has issued copious guidelines on unfair contract terms, and negotiated amendments to 2,000 unfair contract terms between 2000 and 2005,[7] there has been very little litigation under the regulations since the initial version of the regulations came into force in 1994. The cases which have been taken have been test cases that have gone to the higher Courts in the United Kingdom, but they have not covered the scope of the injunction power under regulation 12.[8] Therefore

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[7] Evidence from the UK Office of Fair Trading cited in the *Unfair Terms in Consumer Contracts,* Standing Committee on Law and Justice, NSW Legislative Council, Report 32 (November 2006), at page 62.

[8] The three leading cases are *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52 (which set out the legal test for "good faith" in relation to unfair contract terms), *London Borough of Newham v Khatun* [2004] EWCA Civ 55 (which held that the regulations apply to the terms of

the breadth of the injunction powers that might apply to “any person” under the United Kingdom regulations, even if they were not a party to the case, do not seem to have been tested in the Courts.

Several of the research reports referred to in this paper discuss the importance of regulators being able to take a systemic approach to unfair contract terms, rather than relying on individual cases being taken in the Courts.[9] In various submissions, the regulators from Victoria and the United Kingdom emphasised that the ability to deal with unfair contract terms systemically was critical to minimising the effect of unfair contract terms generally.

SCOCA and the Standing Committee on Law and Justice of the New South Wales Legislative Council accepted that providing a broader remedy than that available for individual cases was important, and the Victorian black-list approach was originally included in the draft of the Australian Consumer Law.

However the Australian Productivity Commission had been ambivalent on the issue, and it generally favoured *ex post* rather then *ex ante* regulation as a way of reducing compliance costs. The black-list is a mixture of *ex ante* and *ex post* regulation. Another argument against the black-list approach is that a term of a contract which is unfair in one circumstance might be fair in another, so a black-list might be simplistic.

In the end, the Victorian black-list provisions were removed from the Australian Consumer Law as it was passed, and there is no parallel in the Australian Consumer Law to the UK Office of Fair Trading mandate to apply for injunctions from the Courts to deal with unfair contract terms across the range of contracts used by particular suppliers or industry sectors.

The enforcement power under section 250 of the Australian Consumer Law is limited to the Court declaring a particular term is an unfair contract term, on the application of a consumer or the regulator. It remains to be seen whether the lack of more systemic powers for the regulator in relation to unfair contract terms in the Australian Consumer Law will limit the potential costs for businesses using standard form contracts with potentially unfair terms. There is a risk that the lack of the Victorian power to regulate a black-list of prescribed terms, or the United Kingdom power to obtain broad-based injunctions, may limit the potential for the Australian Consumer Law to promote changes in more general market behaviour.

In New Zealand, we ought to consider the option of providing the Commerce Commission with the power to apply for broadly-based injunctions which might apply to unfair contract terms in all the consumer contracts used by particular suppliers or industry sectors, along the lines of the powers of regulation 12 of the UK Unfair Terms in Consumer Contracts Regulations.

Conclusion

This paper has been prepared following consideration of the submissions received on the Consumer Law Reform discussion paper. In particular, it addresses the criticism that the discussion paper did not make a strong case for regulating unfair contract terms, and that the

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residential tenancies), and *Office of Fair Trading v Abby National plc* [2009] UKSC 6 (which held that bank fees were a ‘core term’ of a banking contract, and therefore not subject to the regulations).

[9] e.g. *Unfair Contract Terms Working Party Discussion Paper*, Standing Committee of Officials of Consumer Affairs (SCOCA) (January 2004), *Unfair Terms in Consumer Contracts,* Standing Committee on Law and Justice, NSW Legislative Council, Report 32 (November 2006), *An Australian Consumer Law Fair Markets – Confident Consumers, SCOCA (February 2009).*

discussion paper placed too much emphasis on the alignment of consumer and business law with Australia without sufficient justification.

The argument that New Zealand should have similar laws to Australia for the sake of the Single Economic Market (and the opportunities that presents for New Zealand businesses) is relevant, but not conclusive. The more compelling argument is that Australia and New Zealand consumers purchase a similar range of goods and services from similar (and, in many cases, the same) suppliers. The policy development process undertaken in Australia has been extensive over the last 6 years, and it is obviously efficient for the New Zealand Government to take advantage of the Australian analysis. The evidence is strong that Australian suppliers have been taking advantage of unfair contract terms at the expense of consumers and economic efficiency generally, even if the evidence is largely anecdotal.

There is no evidence that consumers in New Zealand are less likely to enter into standard form contracts than consumers in Australia, or that those standard form contracts will not contain similar unfair terms to those found in Australia (or the United Kingdom). In the absence of any evidence that New Zealand consumers are in a different position to consumers in similar countries, it is reasonable and efficient to rely on the Australian analysis. None of the business groups which made submissions on the discussion paper argued that their standard form contracts do not contain clauses which are potentially unfair, although many argued that clauses in their contracts which are potentially unfair are nevertheless justifiable.

The Australian Productivity Commission Report, and the subsequent policy decisions now given effect to in the Australian Consumer Law, were careful to balance the interests between consumers and suppliers, and to ensure that reasonably justifiable terms will remain valid and enforceable.

The enforcement provisions in relation to unfair contract terms in the Australian Consumer Law seem to be deliberately narrow, and that may limit the effectiveness of the law as compared to the laws in Victoria and the United Kingdom. Providing the Disputes Tribunal with jurisdiction to declare that contract terms are unfair would be useful from an access to justice perspective, but it may also be appropriate to ensure the Commerce Commission has broad and systemic enforcement rights in relation to unfair contract terms, similar to the UK Office of Fair Trade.

Recommendations

We conclude that the analysis above supports recommendations that:

- Unfair contract term provisions are added to the Fair Trading Act;
- The Disputes Tribunal has jurisdiction to declare that contract terms in standard form consumer contracts are unfair in appropriate cases;
- The Commerce Commission has similar powers to the UK Office of Fair Trading to apply to the Court for an injunction banning the use of specified unfair contract terms by particular suppliers or industry sectors

We are continuing to work on the detail necessary to design unfair contract term provisions to be added to the Fair Trading Act. One of the implementation issues that will need to be resolved is whether the right to challenge unfair contract terms in standard form contracts should be available for small businesses as well as consumers. We are consulting with the Small Business Advisory Group on this issue. In the meantime, we would welcome additional feedback on this paper, and are available to meet with interested parties who

would like to discuss the issues further. Please contact us on 04 462 4273 or at consumerlawreform@mca.govt.nz or Ministry of Consumer Affairs, PO Box 1473, Wellington.