

CONSUMER ACTION LAW CENTRE

Supplementary Submission

Unfair Contract Terms^{*}

Costs and Benefits of Intervention in Relation to Unfair Contract Terms

Competitive markets, free from regulatory intervention will perform efficiently and this will benefit not only producers but also consumers – the market will supply the products that consumers most value at prices that reflect the value of the resources used to produce them and producers will be responsive to changes in demand and supply conditions. In such markets buyers and sellers are free to enter into contracts relating to the supply of goods and services and they will do so where such arrangements are mutually beneficial and so those contracts will be efficient. Contract provisions are legally enforceable by either party and this is important to ensure efficient outcomes.

Thus, Vickers observes:

*'...with symmetric information between a buyer and a seller...freedom of contract should lead to an efficient outcome – the gains from trade should be maximised. Sellers would have every incentive to offer terms that deliver value for money to consumers as efficiently as possible. If a sales contract contained a term that benefited the consumer less than it cost the seller – or harmed the consumer more than it benefited the seller – then the term would be inefficient and would go. Without the inefficient term the seller would be able to offer a deal that would be better both for the seller and the consumer. Likewise there would be every incentive to include efficient terms. In short, deals would be tailored efficiently by unfettered market participants.'*¹

As noted in the original submission by the Consumer Action Law Centre to the Productivity Commission, standard form contracts, as a process, are efficient and may benefit consumers because in competitive markets reduced transaction costs will be reflected in lower prices or other improvements in sales terms. Thus,

'Standard form contracts can have advantages to both supplier and purchaser provided that a fair chance is achieved between both parties to the contract. They reduce transaction costs for the supplier which would otherwise be passed on to the purchaser. They allow for lengthy and detailed contracts to be finalised with the

^{*} This paper was prepared by Rhonda Smith, Economics Department, University of Melbourne at the request of , and with participation from, the Consumer Action Law Centre. It forms part of a broader research task which examines Part V of the Trade Practices Act and considers whether it has kept pace with developments around the world and within other Australian jurisdictions.

¹ John Vickers (2003), Economics for consumer policy, p.8, available at www.ofc.gov.uk/shared_ofc/speeches/spe0503.pdf. See also Russell Korobin (2002), Bounded Rationality, Standard Form Contracts, and Unconscionability, *University of Chicago Law Review*, Vol 70, pp1203- 1295 for a discussion of how market structure and willingness of purchasers to acquire information influences the presence of unfair contract terms.

*minimum of time and by lay persons who only need to negotiate the specifics such as price, description of goods and services and delivery times. Over a period of time, people become familiar with the contracts because they are standard and may encourage a general understanding of trading practice.*²

Arguably, those who desire and are willing to pay the extra costs of non standard contracts, are free to do so and it might be assumed that under competitive conditions firms would respond to such requests. Frequently, it seems that, for various reasons, the reality is otherwise. It is not unusual for purchasers to enter into contracts into which they have had little or no input and frequently these contracts contain terms that are not necessarily fair and may not produce efficient outcomes.³ Although the discussion of unfair contract terms typically relates to standard form contracts, it may be more appropriate in the present context to consider more generally contracts that are not negotiated between the parties. This is because word processing enables suppliers to customise contracts for particular purchasers quickly and at very little cost but the purchaser still has no input in to the contract terms.

Although many contracts contain unfair terms whether as a consequence regulatory intervention of some sort is necessary or justified requires that the benefits from intervention exceed the cost that intervention imposes on various parties. This in turn raises a question of the welfare standard against which such an assessment is to be made.⁴ Having resolved this issue, if the cost of unfair contract terms is likely to exceed any benefits from non intervention, there are two other issues to be considered. The first is whether there are already adequate provisions in place to address the problem and, if not, what form should any intervention take, recognising that the costs and benefits associated with intervention are likely to be influenced by the particular policy instruments selected. This paper focuses on the costs and benefits of addressing unfair contract terms, and only briefly considers the form that such intervention might take.

The Costs Resulting From Addressing Unfair Contract Terms

Clearly there are costs associated with regulatory intervention in relation to contract terms. They include:

- i. an increase in transaction costs - standard form contracts are efficient as they reduce the transaction costs of buyers and sellers associated with negotiating

² Standing Committee of Officials of Consumer Affairs (2004), Unfair Contract Terms, A Discussion Paper, January, p.16. (hereafter SCOCA)

³ The Consumer Action Law Centre submission to the Productivity Commission.

⁴ In the context of an exemption from Part IV of the Trade Practices Act, the Australian Competition Tribunal canvassed the issue of the relevant welfare standard to apply in the Qantas-Air New Zealand matter. It concluded that the appropriate standard was a modified total welfare standard, a standard that could just as well have been described as a modified consumer welfare standard. In the present context the aim of the proposed intervention is to ensure consumer sovereignty and to avoid certain detriments to consumers. Therefore a consumer welfare standard would appear to be appropriate. However, this should be modified to recognise that the impact on consumer welfare of producer conduct may be indirect rather than direct (for example, efficiency increases free up resources for other uses and so benefits consumers even when there is no direct pass through of benefits in the form of lower prices or improved quality).

and drawing up a sales contract. In discussing unfair contract terms it seems that often the counterfactual is incorrectly assumed to be ceasing to use standard form contracts so that contracts must be individually negotiated. However, the issue is not standard form (or non negotiated) contracts, it is the terms that are inserted into them. If these contracts do not contain unfair terms, they may still be used;

- ii. adjustment costs, that is, the cost of amending and re-negotiating existing contracts. The extent of such costs depends on whether there are unfair terms in the contracts, the length of time before the contract expires and the time allowed for the removal of such terms. Word processing facilities mean that these contracts can be readily altered and at little cost so compliance costs and future transaction costs should not be as significant as they may have been in the past;
- iii. a one-off cost to amend contracts offered in future so that they will be compliant (see ii above), as well as the costs associated with monitoring the firm's own compliance in future;
- iv. the monitoring and enforcement costs of the regulator. The extent of the former depends in part on whether an existing body is charged with this responsibility as there are likely to be economies from shared overheads and even from better/fuller use of staff.

The costs associated with addressing unfair contract terms are affected by whether such regulation replaces some existing requirements (such as disclosure requirements). If so, the relevant cost is the cost of the new provisions net of the costs of existing, but now redundant, requirements. In addition, in determining the cost of new regulation, the cost savings of having a national regime for firms that operate nationally should be netted out. Further, to the extent that new regulation causes changes that avoid litigation under the existing, but perhaps not very satisfactory, provisions, the consequent saving of enforcement costs should be taken into account.

In his oral evidence to the Productivity Commission Inquiry, Professor Field discussed the costs associated with addressing unfair contract terms.⁵ In particular he argued that remedying the problem may deprive consumers of benefit, at least in part because it may reduce competition between rival suppliers. He stated:

*'...there's a potentially much more significant cost that's involved than compliance costs and its around the interference with what I would call the complex balance of the contractual bargain. Put simply, the deletion of one term as unfair may see another term which the consumer values affected adversely. What, of course, then seems on its face attractive, which is the protection of powerless consumers from the excessive power of business, may in fact upset the complex balance of the contractual bargain in a way that's harmful to consumers.'*⁶

⁵ Productivity Commission, Transcript

⁶ Productivity Commission, Transcript.

However, reference to the contractual bargain is hardly relevant in that essentially the issue of unfair contract terms arises where purchasers lack input into those terms and, as a consequence, the terms unduly favour the supplier. It is indeed the market power of the business with respect to those terms which is the problem.

Professor Field illustrates his comments with an example relating to contracts containing a term that creates a cost disincentive to discourage consumers from changing from one telecommunications supplier to another early in the contract. He states:

'The pricing offered to consumers to enter into those contracts is premised on the fact that consumers will stay in that contract for a period of time...If you take that clause out, they'll probably act rationally and that is, two months after they've entered that contract they may well find the next contract offered in the market at a cheaper price and they'll move to that.'

He concludes that this may lessen competition in the market.

There may be circumstances where removal of a particular term from a contract has implications for the commerciality of the contract. Nevertheless, the example provided is not appropriate on a number of levels and the conclusions drawn from it are not valid. Thus,

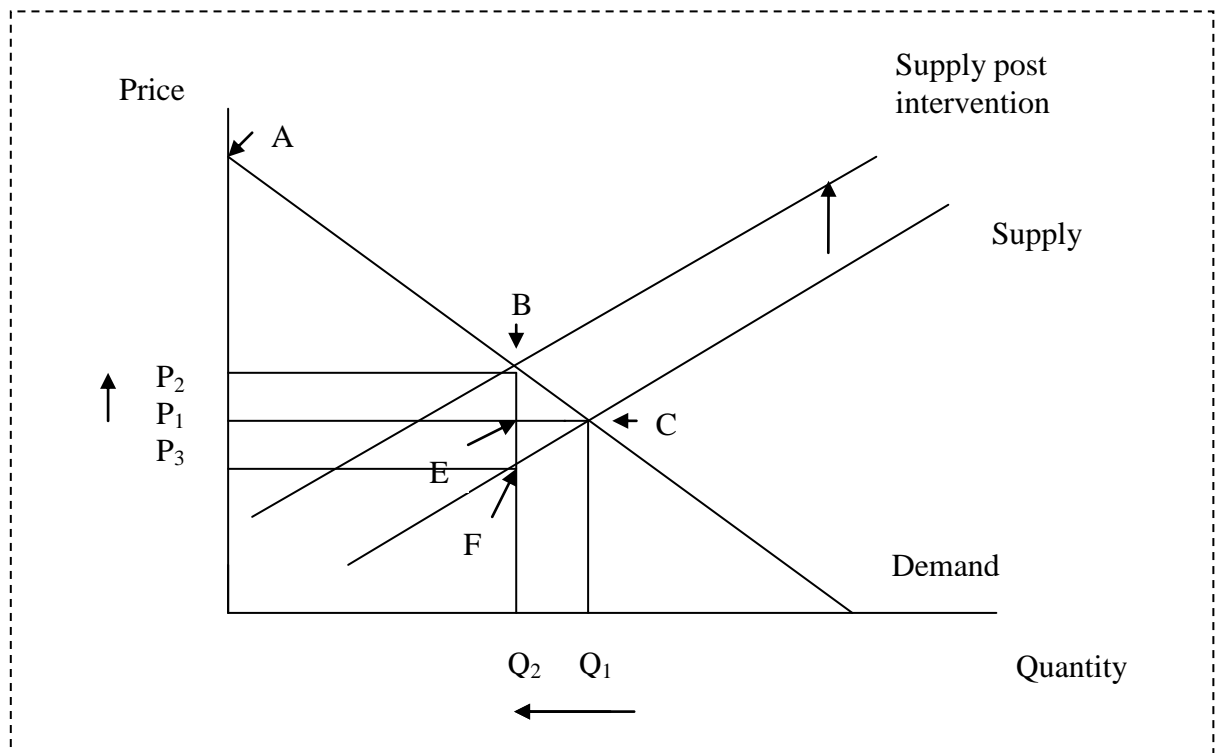
- i. a customer who signs up to a contract generally does so for a specified period and so is committed for this period without any need for penalty clauses. Indeed the suggested outcome can be avoided by offering the potential purchaser alternative contract periods with corresponding adjustments to the price;
- ii. ignoring (i) and accepting that customers could legally terminate contracts early,⁷ it is exactly that risk of losing customers that is the essence of what makes a competitive market work. That risk forces a firm to 'sharpen its pencil', to offer the best possible deals and to engage in innovation to achieve that outcome;
- iii. although the statement seems to accept that the penalty clause in the contract is unfair, it implies that if correcting it means additional changes then it should not be changed. One might think that at the very least the relative costs and benefits of the two scenarios would be relevant.

As a consequence of these costs Professor Field's line of reasoning leads to the conclusion that regulatory intervention in relation to the terms of standard form or non negotiated contracts will reduce the net efficiency with which markets operate, resulting in misallocation of resources (including the deadweight loss associated with responding to, complying with, and enforcing the regulation) and reducing the incentive to innovate and respond to changing market conditions due to any increase in uncertainty/risk and reduced profitability. However, regulation of unfair contract

⁷ Perhaps because there is a 'meet the competition' clause in the contract. This is unlikely in a 'take-it-or-leave-it' contract as it is in the interests of the purchaser rather than the supplier.

terms is unlikely to have such effects if contract terms are mutually beneficial and hence efficient rather than unfair.

The effect of regulatory intervention in relation to unfair contract terms is illustrated in Diagram 1.⁸ From the initial equilibrium C , the introduction of regulatory measures in respect of unfair contract terms increases the costs incurred by suppliers (implementation and compliance costs), represented by P_3FBP_2 , and this has the effect of shifting the supply curve to the left. The share of that cost passed through to consumers is P_1EBP_2 . The result is reduced supply and assuming that the demand curve is unchanged,⁹ increased prices for consumers and a reduction in consumer surplus (by P_2CBP_1) and in producer surplus (by P_3P_1CF). In addition, a deadweight loss of BCE is created. This represents an overall loss of P_1P_2BCF . The significance of these responses from a policy perspective depends largely on the extent of the increase in costs to suppliers, the impact of this on quantity and price (which depends on the relative elasticity of supply and demand) and the size of the deadweight loss. Further, it assumes that currently there is no exercise of market power in relation to the unfair contract terms (see below). If this is not the case, then account must be taken of the reduction or elimination of monopoly rents through regulatory intervention, and the net impact of intervention on the size of the dead weight loss. In addition to the changes represented on the diagram, there may be adverse effects on the incentive to invest (dynamic efficiency), as well as increased costs for government of implementing the regulatory provisions and enforcing them.



⁸ An issue is whether the cost associated with regulatory intervention is an additional variable cost or an additional fixed cost. The diagram and discussion could be taken to assume that it is a variable cost. Nevertheless, in the long run (the relevant time period) if the market is competitive the additional cost may result in some smaller firms (or firms with more favourable alternatives) exiting the industry, thereby restoring normal profits but causing the supply curve to shift to the left (as in Diagram 1).

⁹ This assumption is relaxed below.

Diagram 1

Whether the above scenario is realistic depends on whether certain conditions are satisfied. The first of these is that:

*'...the parties are able to negotiate on an equal footing, have equal bargaining power, are equally able to look after their own interests and have a full understanding of the consequences of their actions and the terms of the contract. In reality, this is not always the case.'*¹⁰

In order to assess the implications of regulating unfair contract terms, the relevant 'price' is not simply the 'ticket price' but the price that takes into account all of the terms and conditions associated with supply, including any that may come into effect in the future. The second condition is that efficient outcomes are conditional on the absence of significant market failures. Yet, in reality, this is rarely if ever the case and so, even when markets are highly competitive, competition may not result in a market that operates efficiently. In relation to unfair terms in contracts, neither of these conditions may be satisfied.

Unfair Trading Terms and Consumer Sovereignty

Ensuring consumer sovereignty is an accepted justification for consumer protection policy.¹¹ Informed consumer choice is the distinguishing feature of consumer sovereignty, and it is a necessary condition for markets to function effectively.¹² Consumer sovereignty requires that the market offers a range of options to consumers, and that consumers are able to formulate preferences and choose effectively between the options available.¹³ For various reasons (see below), consumers often fail to account fully for non core contract terms¹⁴ when making purchase decisions. Consequently, even if initially suppliers offer different terms, lack of competition on non core terms, is likely to mean that the non core terms of contracts within an industry become standardised to the least favourable terms for consumers – this is analogous to bad products driving out good products as explained by Akerlof.¹⁵ Thus, this has the effect of reducing consumer options and it means that there is little incentive for innovation in respect of the risk resulting from the contingencies to which these terms relate. Unfair contract terms may impair consumer sovereignty.

¹⁰ SCOCA, p.16

¹¹ For a discussion of this issue see Rhonda L. Smith and Stephen King (2007), 'Does Competition Law Adequately Protect Consumers?' *European Competition Law Review*, Vol 28, No 7, July, pp 412-424, at pp 413-414.

¹² Michael Waterson, "The Role of Consumers in Competition and Competition Policy", *Warwick Economic Research Papers*, No. 607, Dept of Economics, University of Warwick, 2001, p.2.

¹³ Averitt, Neil W. and Robert H. Lande, "Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law", *Antitrust Law Journal*, Vol 65, 1997, p 713-756, at pp. 713.

¹⁴ Core terms are price and quality attributes; non core terms are all other contract terms such as the terms and conditions of cancellation, quality guarantees, provision for refunds and the like.

¹⁵ George A. Akerlof (1970), 'The Market For Lemons: Quality Uncertainty and the Market Mechanism', *Quarterly Journal of Economics*, Vol 84, pp488-500. This may hurt the producers of good products as well.

Although in many situations consumers face a price which they do not negotiate, in imperfectly competitive markets consumers generally are able to choose between suppliers who may offer different price/quality bundles. In many cases these are products that are purchased repeatedly, if not regularly. Consequently, if the consumer is not satisfied with a particular purchase, subsequent purchases may be made from a different supplier. However, in the case of unfair contract terms, even if there is competition in relation to core terms (price/quality attributes), generally there is little or no competition with respect to non core terms, as noted above. Although there are alternative suppliers, this confers market power on suppliers (similar to the effect of a cartel on price) and so the allowance for risk associated with particular contingencies is not reflective of the likely cost associated with those events if they occur and this represents a misallocation of resources. Consumers have the choice of accepting contracts that contain unfair terms or not purchasing the particular good or service at all.

From the perspective of individual buyers, the cost associated with unfair contract terms is not, and indeed cannot, be accurately factored into the price of the product. While the probability of a particular event occurring is relevant for firms when determining their risk exposure and may be objectively available, it is not of much assistance to individuals in relation to consumption decisions – they are unlikely to be aware of the probability of such an event occurring, and even if they are, they cannot know the probability of it occurring in relation to themselves. The inherent problems of predicting and assigning a value to the risk of a particular contingency are illustrated by the use of unilateral variation clauses to fundamentally alter the nature of the supply conditions. For example, Telstra offered ‘unlimited’ download of its Big Pond product but later imposed a download limit on existing customers without providing consumers with an opportunity to exit the contract. Similarly, Citibank marketed a fee free credit card but subsequently introduced a one off fee of \$165 on existing customers (the fee could be avoided by spending money on the card). It was not until ASIC intervened that consumers were offered the option to exit the contract (though even this was imperfect given that the offer had enticed consumers to make balance transfers to the Citibank card from other cards, so they had to pay out the balances to achieve exit.

In circumstances where these probabilities and costs are unknown (and unknowable), individuals are likely to discount the likelihood that such an event will occur in relation to their own purchase, especially when it has a low probability of occurring, and so triggering a clause in a contract that may be detrimental to them.¹⁶ This can be illustrated with respect to the inclusion of penalty fees in banking products. Assume that there are 6 million bank accounts, and that each account holder incurs one penalty fee per annum of \$20 (this may be fairly conservative as fees can be as high as \$50 in the mainstream banking market and much higher in some fringe markets). This represents a cost of \$120 million to consumers per annum and is likely to hugely exceed the costs to the bank of the conduct that resulted in the penalty. If these types of terms are being ignored, the product price is underestimated and consequently consumers overbuy the product relative to the position if there were no unfair contract

¹⁶ See for example the discussion of hyperbolic discounting in the Consumer Action Law Centre’s Submission to the Productivity Commission Inquiry.

terms. The significance of the failure to take non core contract terms into account is shown in Diagram 2.

Before considering Diagram 2 (and 3), certain qualifications in relation to the diagrammatic representation should be made explicit. First, the implications of regulatory intervention for price and quantity, for the deadweight loss and so on, depend in part on the absolute shifts of the supply and demand curves. Second, while the implications of these changes for quantity are unambiguous, this is not the case for price, and the new equilibrium values post intervention will be influenced by the relative price elasticity of demand and supply. Notwithstanding these qualifications, the general result that intervention to address unfair contract terms is likely to lessen inefficiency is justified. The appropriate comparisons are the pre-intervention equilibrium and the post intervention equilibrium that reflects the actual price rather than the ticket price.

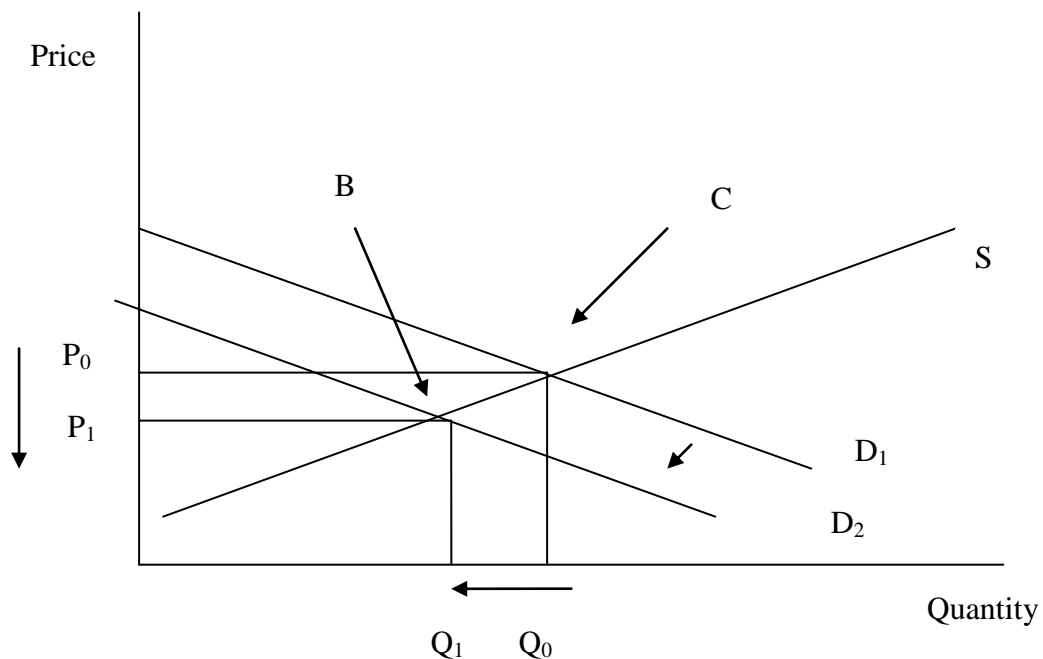


Diagram 2

If consumers fail to account fully for the cost to them of unfair contract terms, then the demand curve in Diagram 1 while representing actual willingness to buy based on the 'ticket price', overstates what that willingness would be if consumers took account of those costs, that is, it misrepresents consumer preferences. As shown in Diagram 2, the true demand curve consistent with consumer preferences is D_2 rather than D_1 . As a consequence with demand represented by D_1 , the product price is lower than it would otherwise be (it fails to take account of the non core terms) and the equilibrium quantity traded is greater. The efficient equilibrium is B rather than C with Q_1 rather than Q_0 and P_1 rather than P_0 .

Given this correction, Diagram 3 re-introduces regulatory intervention to address unfair contract terms, thereby shifting the supply curve to the right (S_1). As a result of reducing or eliminating unfair contract terms, the 'correct' demand curve D_3 will be to the right of D_2 but to the left of D_1 , its exact position depending on the cost to consumers of fairly addressing the relevant contingencies. The new equilibrium would be C (the intersection of D_3 and S_1 , although if consumers still fail to take account of these costs the actual equilibrium will be the intersection of S_1 and D_1 , that is, at B. Nevertheless, this is an outcome that is more efficient than if the unfair contract terms were not regulated in some way. At B, quantity exceeds the efficient level by Q_1Q_2 whereas without intervention quantity exceeds the efficient level by Q_0Q_2 . The effect on price is uncertain as the supply response tends to increase price (reflecting increased costs) but the demand response puts downward pressure on price.

In addition, but not shown in the Diagram, regulatory intervention may make buyers more aware of non core contract terms and this may stimulate competition in respect of those terms which will further increase efficiency.

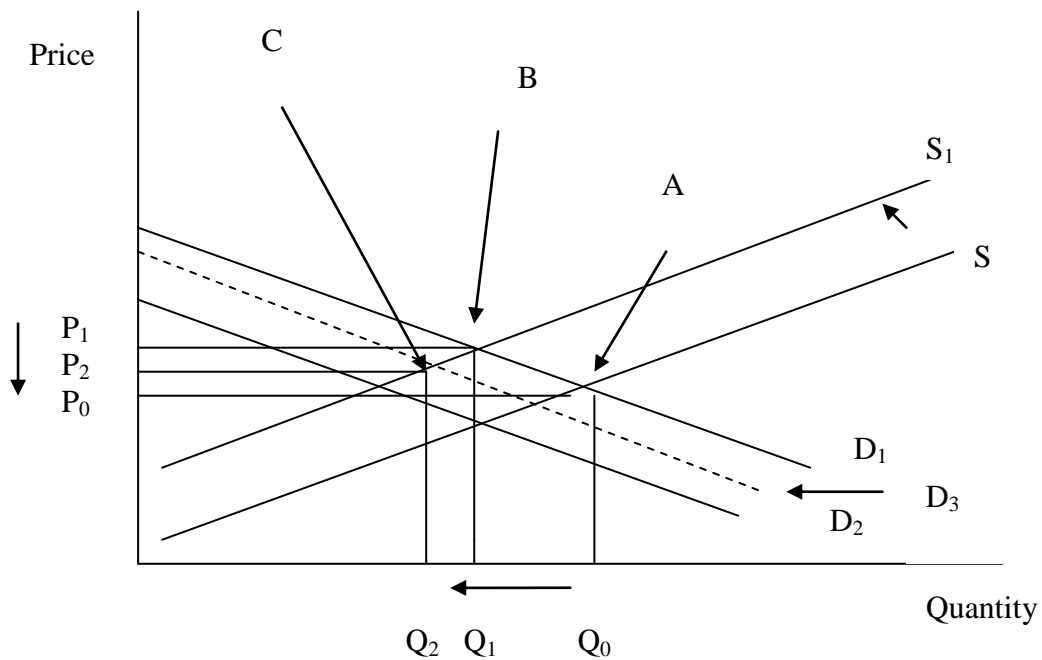


Diagram 3

Some additional considerations

First, publicity may alert consumers to the existence of problems resulting from unfair terms in contracts in particular industries (such as in relation to mobile phone contracts), although they may be only vaguely aware of the specific nature of the problem. In relation to that market at least a proportion of consumers will be more wary than they otherwise would be and may over-invest in seeking information about

the nature of the contract in that specific market. The effect will be to move the demand curve to the left of D_1 . To the extent that the concern is unwarranted or overstated, the relevant demand curve will be to the left of D_2 , resulting in under-consumption compared to a situation where no such uncertainty exists.

However, the adverse effects of unfair contract terms may not be confined to the market in which the contracts exist. Concern about contracts in one market, such as mobile phones, may spillover into other markets, such as those for the supply of electricity or gas. This may mean over-investment in seeking information in these markets as well and/or failure to respond to welfare-enhancing offers available from alternative suppliers. Further, the consequence may be to dampen competition in these markets not just in relation to the non core terms of the contract, but also in relation to core terms. This is because uncertainty makes consumers reluctant to switch suppliers even when an alternative supplier actually offers a better deal.¹⁷

Second, if businesses are able to reduce their costs by the use of unfair contract terms, they may be able to offer a lower price for a given product quality than can competitors that operate with fairer contracts.¹⁸ As a consequence consumers may find themselves locked into a supplier for a considerable period because to switch to another supplier will trigger those terms and significantly increase the effective purchase price post purchase.¹⁹ Examples of such terms include penalties for early repayment of a loan, and terms stating that there will be no refunds in relation to cancellation of pre-booked holiday packages. Consumers often fail to realise that post purchase the contract terms convert the bargain into a rip-off. Awareness of such an outcome may cause at least some consumers to accept a somewhat higher price in exchange for greater flexibility in responding to changes in the market. As noted above, supplier conduct of this type tends either to result in all suppliers offering unfair terms or to drive out those offering fair terms. While the former reduces competition in relation to non core terms, the latter reduces competition in relation to core terms. Thus, removal of unfair contract terms protects competition and more efficient outcomes may result.

Equity benefits from intervention

Although competitive markets can be expected to operate efficiently, absent market failure, there is no reason to expect that they will produce equitable outcomes. Economists are prone to respond to concerns about equity by arguing first that competition should be unimpeded by concerns about equity because other policies such as taxation and welfare are superior instruments to address distribution issues. Second, they may suggest that if markets are efficient they will result in a higher level of economic activity and so everyone will be better off and there will be more wealth to redistribute.

Irrespective of whether these arguments are valid in competitive markets, the counterfactual to intervention to address unfair contract terms is not about interfering with such markets so that contracts contain unfair terms and markets are less

¹⁷ However, the adverse effects of unfair contract terms may not be confined to the market in which the contracts exist.

¹⁸ See for example, Centre for Credit and Consumer Law, submission to SCOCA March 2004, p.8.

¹⁹ See earlier discussion of Professor Field's evidence to the Productivity Commission.

competitive in relation to core terms and not competitive in relation to non core terms, so that they do not operate efficiently. Further, redistribution policies frequently focus on redistribution of income from high income to low income groups, although some policies such as education and health, attempt to address the cause of inequity. In relation to unfair contract terms exposure to such terms is not determined by income level, but rather by the desire to purchase a particular product, that is, by being a purchaser.²⁰ If intervention is justified in these circumstances, it should be preventative and pro-active rather than reactive.²¹

Lack of consumer response to unfair contract terms

In the face of unfair contract terms, consumers typically continue to base their purchase decisions primarily on core terms and fail to take account of non core terms, although as noted above purchase decisions may be affected when there is awareness of the potential for unfair terms; and do not utilise existing means of redress. These responses (or the lack of them) could be taken to indicate that consumers do not consider unfair contract terms as significant enough to cause them to respond. However, the actual position seems to be otherwise. In order to understand the lack of consumer response it is important to consider why these unfair terms exist (this is also important for determining the nature of any regulatory intervention) and to understand the likely cost of remedial action.

Just as consumer protection problems were, and still are, often attributed to a lack bargaining power on the part of consumers, so too is the presence of unfair contract terms. Consequently, this is a problem that is assumed to arise in markets characterised by limited competition. In such markets consumers have little or no choice of supplier and so have limited bargaining power. The solution is therefore aggressive competition policy.²²

In perfectly competitive markets consumers are protected because they have plenty of choice of supplier and are they fully informed. This same choice constrains suppliers, depriving them of market power. Thus, perfect competition prevents an imbalance of bargaining power between buyers and sellers, and so competition is perceived by many as the best form of consumer protection, including protection from unfair contract terms. However,

- i. although markets may be competitive, few are perfectly competitive, and in such markets competitive pressure may result in consumer exposure to risk, including in relation to unfair contract terms (see discussion of switching costs);
- ii. nor are consumers fully informed. Information deficiencies, including asymmetry of information, confer power on the party possessing information, and lack of access to relevant information or the cost of

²⁰ All purchasers of the product are exposed to risk and it may be that those who are time poor, but income rich, can afford to engage in less search and so are more likely to realise the consequences of unfair contract terms.

²¹ See, for example, Frank Zumbo (2007), 'Promoting fairer consumer contracts: Lessons from the United Kingdom and Victoria, *Trade Practices Law Journal* , vol 15, pp 84-95, at p.88.

²² For a discussion of this see Smith and King, *supra* note 10, pp 418-420.

obtaining it, may prevent consumers responding so as to avoid or reduce the impact of unfair contract terms. Consumers may make inappropriate choices because the costs of acquiring information and/or using it are too great relative to the expected benefits likely to result.²³

- iii. The findings of behavioural economics indicate that quite frequently consumers fail to acquire and/or to use fully relevant information about transactions. Apparently irrational consumer behaviour may result from inertia, incapacity to process the complex information required to make the decision to switch or, faced with choice, the fear of making the wrong choice.²⁴ Thus, even when consumers are aware of the potential for consumer detriment as a result of unfair contract terms, frequently they do not respond to that risk but this does not mean that the cost is insignificant. In such circumstances, addressing information deficiencies is not likely to overcome consumer problems of this sort.

Addressing consumer detriment from unfair contract terms

It may be argued that if individual consumers are aggrieved in relation to contract terms, they already have avenues of redress and so specific regulation directed at unfair terms simply duplicates regulatory costs. However, to the extent that there may be avenues that individual consumers can currently pursue, the cost incurred by an individual as a consequence of the terms is unlikely to justify the legal costs of seeking redress. In the context of consumer protection policy generally and as applied to the US but equally applicable to unfair contracts terms:

‘...for consumer transaction going to court is usually not economically feasible. When disputes involve small losses to consumers, private lawsuits will not work. Nor have class actions evolved to provide adequate enforcement. Further, small claims courts do not sufficiently reduce the costs of litigation. Thus, government consumer protection agencies have become part of the process to enforce the basic rules as well as to provide modification and amplification.’²⁵

Yet collectively, the cost to consumers of unfair contract terms may be very large (or to put it slightly differently, the benefit derived by business from such terms may be very substantial). Regulation against such terms provides the basis for collective action that may improve the position of consumers affected by the terms and may reduce the incentive to impose such terms by necessitating that the costs associated

²³ Smith and King, *supra* note 10, pp 415-416.

²⁴ Eldar Shafir (2006), A behavioural perspective on consumer protection, paper presented to OECD Roundtable On Demand-side Economics For Consumer Policy: Summary Report, 2006, available at www.oecd.org/dataoecd/31/46/36581073.pdf. Griggs points out that ‘Increasingly the good or service being purchased encompasses the contract as an essential feature of the product or service.’²⁴ For example, the firm supplying Pay TV supplies the installation services, and associated equipment under a single service contract. Consequently, ‘...the rational consumer does not and cannot be expected to fully appreciate the embedded contractual complexity...’ (Lynden Griggs (2005), ‘The [ir]rational consumer and why we need national legislation governing unfair contract terms, CCLJ, Vol 13, pp 51-72, at p.52.)

²⁵ Timothy J. Muris (1991), ‘Economics And Consumer Protection’, *Antitrust Law Journal*, vol 60, no 1, pp 103-121, at p.105.

with such actions (after factoring in the probability of being caught) be taken into account by firms when determining a course of action.

Unlike the labour market where there are concerns about unfair employment terms in contracts, there is little potential for effective collective action in relation to consumer acquisitions (and possibly not even in relation to businesses purchasing inputs). Other potential remedies also appear flawed or incomplete²⁶ – for example, it seems that the Australian courts are not prepared to interpret unfair terms in contract as unconscionable conduct; while Victoria’s prohibition on certain unfair contract terms has limited cover (it excludes the financial sector) and, of course, is confined to Victoria.

A Proposal to Address Unfair Contract Terms

It is apparent that the actual costs and benefits resulting from addressing unfair contract terms depend in part on the nature of the process to be employed. Victoria introduced regulation in respect of these terms in 1999 and through the SCOCA process other states are involved, at least to some extent, in consideration of the issue. An outcome likely to result in more significant compliance and administrative costs is for each state to introduce slightly different provisions. A more cost effective outcome is a national approach. This might involve inclusion in the Trade Practices Act of a new provision (for examples 51AAA) which prohibits unfair contract terms and it would apply not only to business dealings with consumers but also with large business dealings with small businesses. This might identify certain types of terms as unfair, while providing a basis for assessing whether other terms are unfair. Assessment of whether a particular term is unfair could be undertaken by the ACCC (or some other body) either at its own instigation or in response to complaints by purchasers. Alternatively, a company could request an administrative decision from the regulator in respect of a particular clause/s or for an entire contract, in a process akin to notification. An appeal process in relation to these administrative decisions should be available (as for authorisation and notification decisions). On legal issues this would be to the Federal Court but otherwise to a tribunal.²⁷ The remedy for unfair contract terms would be to void those terms in the contract, but not the entire contract. Only where the supplier failed to comply with this requirement would a pecuniary penalty be imposed.

²⁶ This issue has been explored in detail in numerous submissions to the Productivity Commission and in oral presentations and so is not elaborated here.

²⁷ Although this role could be filled by the Australian Competition Tribunal, it would need to be differently constituted when considering cases relating to unfair contract terms, that is, its membership should include a consumer representative.