

## CRITIQUE AND COMMENT

### **THE AUSTRALIAN UNFAIR CONTRACT TERMS LAW: THE RISE OF SUBSTANTIVE UNFAIRNESS AS A GROUND FOR REVIEW OF STANDARD FORM CONSUMER CONTRACTS**

JEANNIE PATERSON\*

*[In 2010, the Commonwealth Parliament passed legislation implementing a national consumer law, the Australian Consumer Law ('ACL'). These reforms include a regime regulating unfair terms in standard form consumer contracts, the unfair contract terms law ('UCTL'). This piece outlines the important aspects of the UCTL, including the test for determining whether a term is unfair, the examples provided in the legislation of the kinds of terms that may be unfair, and the matters which the court must take into account in determining whether a term is unfair. The UCTL, along with similar provisions in the United Kingdom and Victoria, is then examined in light of both classical contract theory and behavioural economics, with attention given to how these regimes deal with both substantive and procedural fairness. Drawing on behavioural economics, this piece argues that, as consumers' ability to make rational decisions when presented with complex problems is significantly limited, measures designed to ensure procedural fairness, for example through requirements of transparency and clarity in contract terms, are not sufficient to protect consumers entering into standard form contracts. It is argued that regulation of the substantive fairness of contract terms, as envisaged under the UCTL, is necessary for an effective consumer protection regime in Australia.]*

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\* BA (Hons), LLB (Hons) (ANU), PhD (Monash); Senior Lecturer, Melbourne Law School, The University of Melbourne. The author wishes to thank Natalia Antolak-Saper and Joel Gory for their research assistance and the anonymous referees for their insightful comments. Any errors are the author's own.

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## I INTRODUCTION

In the first part of 2010, the Commonwealth Parliament passed a package of reforms implementing a comprehensive national consumer law, the *Australian Consumer Law* ('ACL').<sup>1</sup> The *ACL* will be contained in sch 2 of the *Trade Practices Act 1974* (Cth) ('*TPA*'), itself to be renamed the *Competition and Consumer Act 2010* (Cth) ('*CCA*').<sup>2</sup> The states and territories have agreed to introduce and enact mirror legislation applying the *ACL* as part of their respective laws.<sup>3</sup> Part 2-3 of the *ACL* regulates unfair terms in standard form consumer contracts.<sup>4</sup> The unfair contract terms law ('UCTL') is based on recommendations of the Productivity Commission in its 2007 *Review of Australia's Consumer Policy Framework*.<sup>5</sup> The Productivity Commission recognised that some prices for contracting parties could rise in the short term as a result of regulating unfair contract terms but considered that the benefits of a fairer market outweighed these costs.<sup>6</sup> Similar regimes have already been in force in the United Kingdom and in Victoria. In the United Kingdom, the *Unfair Terms in Consumer Contracts Regulations 1999* (UK) ('*UTCCR*') implemented the *European Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts*<sup>7</sup> to regulate the use of unfair terms in consumer contracts.<sup>8</sup>

<sup>1</sup> See generally Standing Committee of Officials of Consumer Affairs, Parliament of Australia, *An Australian Consumer Law: Fair Markets — Confident Consumers* (2009) <<http://www.treasury.gov.au/contentitem.asp?ContentID=1484&NavID=037>> ('*Australian Consumer Law Report*'). The first stage of the reforms was contained in the *Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010* (Cth), which came into force on 1 July 2010. The second stage of reforms is contained in the *Trade Practices Amendment (Australian Consumer Law) Act (No 2) 2010* (Cth), which comes into force 1 January 2011.

<sup>2</sup> *Trade Practices Amendment (Australian Consumer Law) Act (No 2) 2010* (Cth) sch 5 items 1–2. References in this piece will be to the *ACL* as it appears in the *CCA* (in force 1 January 2011).

<sup>3</sup> Council of Australian Governments, *Intergovernmental Agreement for the Australian Consumer Law* (2009) cl 3.2.

<sup>4</sup> See generally Treasury, Australian Government, *The Australian Consumer Law: Consultation on Draft Provisions on Unfair Contract Terms* (2009) 24–9.

<sup>5</sup> Productivity Commission, *Review of Australia's Consumer Policy Framework*, Inquiry Report No 45 (2008) <<http://www.pc.gov.au/projects/inquiry/consumer/docs/finalreport>>.

<sup>6</sup> *Ibid* vol 1, 34–5, vol 2, 155–6, 433–8, cited in *Australian Consumer Law Report*, above n 1, 29–30.

<sup>7</sup> *Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts* [1993] OJ L 95/29.

<sup>8</sup> See generally Susan Bright, 'Winning the Battle against Unfair Contract Terms' (2000) 20 *Legal Studies* 331, 332–3; Hugh Collins, 'Good Faith in European Contract Law' (1994) 14 *Oxford Journal of Legal Studies* 229; Elizabeth Macdonald, 'The Emperor's Old Clauses: Unincorporated Clauses, Misleading Terms and the *Unfair Terms in Consumer Contracts Regulations*' (1999) 58 *Cambridge Law Journal* 413.

In Victoria, unfair terms in consumer contracts were regulated under part 2B of the *Fair Trading Act 1999* (Vic) ('FTA'), now amended to mirror the UCTL.<sup>9</sup>

Under the UCTL, a term in a standard form consumer contract will be void if the term is unfair.<sup>10</sup> A term of a consumer contract will be unfair if 'it would cause a significant imbalance in the parties' rights and obligations arising under the contract', 'it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term', and 'it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.'<sup>11</sup> In determining whether a term of a consumer contract is unfair, a court 'may take into account such matters as it thinks relevant' and must take into account 'the extent to which the term is transparent' and 'the contract as a whole.'<sup>12</sup> The UCTL provisions regulating unfair contract terms do not affect terms that define 'the main subject matter of the contract', set 'the upfront price payable under the contract' or are 'required, or expressly permitted, by a law of the Commonwealth, a State or a Territory'.<sup>13</sup> Although the *ACL* unfair contract term regime does not apply to contracts that are financial products or contracts for the supply or possible supply of services that are financial services,<sup>14</sup> equivalent provisions regulating unfair terms in these contracts have been introduced into the *Australian Securities and Investments Commission Act 2001* (Cth).<sup>15</sup>

The test for unfairness under the UCTL focuses on the substance of the terms (substantive unfairness) rather than flaws in the process through which the contract was made (procedural unfairness).<sup>16</sup> However, the interaction between substantive and procedural concerns under the UCTL is not entirely clear. In particular, a question remains as to whether terms may be insulated from a claim of substantive unfairness by procedural measures aimed at ensuring that consumers have notice of the terms of standard form contracts and that those terms are transparent. An approach influenced by classical contract theory might suggest that such measures should preclude any need to inquire into the substantive fairness of the terms of a contract. This piece argues that the UCTL should be used to prompt a more nuanced understanding in consumer law in particular, and contract law in general, of the behaviour of contracting parties than that inherent in classical contract theory. Insights from behavioural

<sup>9</sup> *Fair Trading Amendment (Unfair Contract Terms) Act 2010* (Vic). On the regime in Victoria, see generally Consumer Affairs Victoria, *Preventing Unfair Terms in Consumer Contracts: Guidelines on Unfair Terms in Consumer Contracts* (2007); Jeannie Paterson, 'The Elements of a Prohibition on Unfair Terms in Consumer Contracts' (2009) 37 *Australian Business Law Review* 184, 185, 187–8.

<sup>10</sup> *ACL* s 23(1).

<sup>11</sup> *ACL* s 24(1).

<sup>12</sup> *ACL* s 24(2).

<sup>13</sup> *ACL* s 26(1).

<sup>14</sup> *CCA* s 131(2).

<sup>15</sup> *Australian Securities and Investments Commission Act 2001* (Cth) pt 2 div 2 sub-div BA, inserted by *Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010* (Cth) sch 3 item 7.

<sup>16</sup> On the distinction between procedural and substantive unfairness, see *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, 620 (McHugh JA).

economics suggest that consumers typically base their contracting decisions on a small range of salient features and are limited in their ability accurately to assess the risks inherent in a transaction. An understanding of these limitations on the decision-making processes of consumers suggests that measures focused on procedural fairness, such as requirements for transparency in and notice of the terms of standard form consumer contracts, are not sufficient to ensure that those terms are fair.

This piece has three substantive parts. Part II outlines the influence of classical contract theory on the modern law of contract and its approach to issues of substantive fairness. Part III discusses the scope of the UCTL. Part IV discusses the relationship between the test of unfair terms in the UCTL and the role of transparency, notice and other measures aimed at providing information to consumers about the terms of their contracts. In discussing the UCTL, the party against whom a term in a standard form contract is alleged to operate unfairly is referred to as the 'consumer' and the party who is advantaged by the term is referred to as the 'trader'.

## II CLASSICAL CONTRACT LAW AND PROCEDURAL AND SUBSTANTIVE FAIRNESS

The threshold test for an unfair term in a standard form consumer contract under the UCTL focuses on the substantive fairness of the term. The test is concerned with the effect of the term — whether it is imbalanced, is reasonably necessary to protect the legitimate interests of the trader and would cause detriment to the consumer<sup>17</sup> — not the process through which the contract has been made. In addressing the substantive fairness of the terms of standard form consumer contracts, the UCTL presents a significant departure from the approach taken by the common law of contract. Courts do not traditionally invalidate contract terms purely on the ground that they are unfair.<sup>18</sup> Thus, in *Biotechnology Australia Pty Ltd v Pace*, Kirby P explained that:

the law of contract which underpins the economy, does not, even today, operate uniformly upon a principle of fairness. It is the essence of entrepreneurship that parties will sometimes act with selfishness. That motivation may or may not produce fairness to the other party. The law may legitimately insist upon honesty of dealings. However, I doubt that, statute or special cases apart, it does or should enforce a regime of fairness upon the multitude of economic transactions governed by the law of contract.<sup>19</sup>

This refusal by the common law courts to acknowledge substantive unfairness as a ground for intervention in otherwise validly formed contracts reflects the influence on modern contract law of the classical theory of contract of the 19<sup>th</sup> century. Classical contract theory emphasises the importance of the principle

<sup>17</sup> *ACL* s 24(1).

<sup>18</sup> See Elizabeth V Lanyon, 'Equity and the Doctrine of Penalties' (1996) 9 *Journal of Contract Law* 234, 250.

<sup>19</sup> (1988) 15 NSWLR 130, 132–3. See also *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189, 193–4 (Kirby P); *Baltic Shipping Co v Dillon* (1991) 22 NSWLR 1, 20 (Kirby P) ('*Baltic Shipping*').

of 'freedom of contract'.<sup>20</sup> Under this approach, freedom of contract promotes individual autonomy by allowing contracting parties to make their own choices about the types of contract they will enter into and the terms on which they will contract. This freedom is fundamental to the individualistic ideals of liberal political theory<sup>21</sup> and free-market economic theory<sup>22</sup> that influenced classical contract theory.

The emphasis placed on the principle of freedom of contract by classical contract theory requires that contractual obligations be voluntarily assumed by contracting parties.<sup>23</sup> The concept of voluntariness, in turn, requires certain preconditions be met before parties can consent to the obligations they assume in entering into a contract. For a party's decision to enter into a contract to be voluntary, the party must not have made his or her decision under conditions of pressure and must have been informed about the consequences of the decision.<sup>24</sup> As Michael Trebilcock has shown, a pure concept of free and informed consent is probably unattainable: 'Most exchanges are entered into under constraints as to either available trading partners or, even more commonly, the terms of trade.'<sup>25</sup> Thus, the contractual view of voluntariness is a qualified standard. As described by Andrew Robertson, the standard probably requires that 'the decision to assume the obligation ... be substantially unconstrained ... and the obligation itself ... be substantially understood.'<sup>26</sup>

Under classical contract theory, one of the functions of the law of contract is to preserve the integrity of the bargaining process and the conditions for substantially unconstrained and informed decisions by contracting parties.<sup>27</sup> This objective is promoted by the various doctrines that may vitiate an otherwise validly formed contract: misrepresentation; unconscionable dealing; duress; undue influence; and their legislative equivalents, such as the prohibitions on misleading and deceptive conduct and unconscionable conduct. The content of the contract is then within the purview of the parties.<sup>28</sup> If the conditions for

<sup>20</sup> See generally Patrick Atiyah, *The Rise and Fall of Freedom of Contract* (1979) chs 10–15. See also Andrew Robertson, 'The Limits of Voluntariness in Contract' (2005) 29 *Melbourne University Law Review* 179, 180–1.

<sup>21</sup> See generally Rick Bigwood, *Exploitative Contracts* (2003) ch 3; John N Adams and Roger Brownsword, 'The Ideologies of Contract' (1987) 7 *Legal Studies* 205, 206–10.

<sup>22</sup> See Hugh Collins, *The Law of Contract* (4<sup>th</sup> ed, 2003) 6–7; Jay M Feinman, 'The Significance of Contract Theory' (1990) 58 *University of Cincinnati Law Review* 1283, 1296; Iain Ramsay, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets* (2<sup>nd</sup> ed, 2007) 61, citing Iain Ramsay, *Rationales for Intervention in the Consumer Marketplace* (1984) [3.25]–[3.27].

<sup>23</sup> See Robertson, above n 20, 180–1.

<sup>24</sup> Ibid 184, citing Aristotle, *Nicomachean Ethics* (Sir David Ross trans, 1925 ed) Book III [trans of: *Ethica Nicomachea*].

<sup>25</sup> Michael J Trebilcock, *The Limits of Freedom of Contract* (1993) 79. See also Friedrich Kessler, 'Contracts of Adhesion — Some Thoughts about Freedom of Contract' (1943) 43 *Columbia Law Review* 629, 632; Douglas G Baird, 'The Boilerplate Puzzle' (2006) 104 *Michigan Law Review* 933, 935–6.

<sup>26</sup> Robertson, above n 20, 185. See also Trebilcock, *The Limits of Freedom of Contract*, above n 25, 79.

<sup>27</sup> Stephen A Smith, *Contract Theory* (2004) 354.

<sup>28</sup> See Geraint Howells, 'The Potential and Limits of Consumer Empowerment by Information' (2005) 32 *Journal of Law and Society* 349, 350.

substantially voluntary decisions on the part of contracting parties are met, then, under the classical approach, it follows that the terms agreed between those contracting parties cannot be unfair. Judicial or regulatory intervention to invalidate those terms on grounds of unfairness may be criticised as a paternalistic intrusion on individual autonomy and an unjustified interference with the operation of the market.<sup>29</sup>

It seems likely that the suspicion shown by classical contract theory to intervention on grounds of substantive fairness has influenced the courts' approach to statutory prohibitions on unconscionable conduct under the *TPA*.<sup>30</sup> Although the range of factors that courts may consider in assessing whether a conduct is unconscionable may, in principle, extend to issues of substantive fairness, in practice, the judicial approach to these prohibitions on unconscionable conduct has generally been cautious.<sup>31</sup> Sections 51AB and 51AC of the *TPA* have been applied primarily to regulate concerns about the exploitation of vulnerable consumers in the process of contract formation.<sup>32</sup> A similar approach has been taken under s 7(1) of the *Contracts Review Act 1980* (NSW) and s 70(1) of the uniform *Consumer Credit Code*,<sup>33</sup> both of which allow courts to give relief in respect of an 'unjust' contract. Although the jurisdiction potentially extends to matters of substantive unfairness, as with unconscionable conduct, courts tend to look for procedural injustice before granting relief.<sup>34</sup> A similar tension between concerns of substantive and procedural fairness may well arise under the UCTL.

### III THE SCOPE OF THE UCTL

#### A *Standard Form Consumer Contracts*

The appropriate regulatory response to standard form consumer contracts has long been the subject of debate among courts and commentators.<sup>35</sup> Standard form contracts may benefit contracting parties by reducing the transaction costs

<sup>29</sup> See, eg, Anthony T Kronman, 'Paternalism and the Law of Contracts' (1983) 92 *Yale Law Journal* 763, 763–4.

<sup>30</sup> These provisions are now found in the *ACL* pt 2-2.

<sup>31</sup> Liam Brown, 'The Impact of Section 51AC of the *Trade Practices Act 1974* (Cth) on Commercial Certainty' (2004) 28 *Melbourne University Law Review* 589, 612–17; Nicola Howell, 'Catching Up with Consumer Realities: The Need for Legislation Prohibiting Unfair Terms in Consumer Contracts' (2006) 34 *Australian Business Law Review* 447, 450–3.

<sup>32</sup> See, eg, *Hurley v McDonald's Australia Ltd* (2000) ATPR ¶41-741, 40 584–6 (Heerey, Drummond and Emmett JJ); *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 (Unreported, Spigelman CJ, Giles JA and Gzell J, 25 May 2006) [67]–[80] (Spigelman CJ). See also Howell, above n 31, 457–8. For a case raising issues of substantive unconscionability, see *Kowalczyk v Accom Finance Pty Ltd* (2008) 252 ALR 55.

<sup>33</sup> *Consumer Credit (Queensland) Act 1994* (Qld) appendix ('*Consumer Credit Code*').

<sup>34</sup> See Tyrone M Carlin, 'The *Contracts Review Act 1980* (NSW) — 20 Years On' (2001) 23 *Sydney Law Review* 125, 136–7; Ben Zipser, 'Unjust Contracts and the *Contracts Review Act 1980* (NSW)' (2001) 17 *Journal of Contract Law* 76, 79–85.

<sup>35</sup> See, eg, W David Slawson, 'Standard Form Contracts and Democratic Control of Lawmaking Power' (1971) 84 *Harvard Law Review* 529; Robert A Hillman and Jeffrey J Rachlinski, 'Standard-Form Contracting in the Electronic Age' (2002) 77 *New York University Law Review* 429, 440–1; Todd D Rakoff, 'Contracts of Adhesion: An Essay in Reconstruction' (1983) 96 *Harvard Law Review* 1173.

associated with negotiating and drafting individualised contracts.<sup>36</sup> However, there is likely to be an inequality of bargaining power between the parties to standard form consumer contracts due to the disparities in resources, information and experience that typically exist between traders and consumers.<sup>37</sup> In this context, standard form contracts appear to offer little potential for genuine consent on the part of the consumers to whom such contracts are presented. The whole point of standard form contracts is that there will be no negotiation over, or variation of, the terms of the contract. They are presented on a '[t]ake it or leave it' basis.<sup>38</sup> The opportunities for consumers to read, comprehend or take advice on the terms of the contracts are typically limited.<sup>39</sup>

Standard form contracts are subject to generic consumer protection provisions, such as those prohibiting misleading and deceptive conduct and unconscionable conduct.<sup>40</sup> Unlike these other measures, the UCTL applies only to standard form consumer contracts.<sup>41</sup> In this approach, the UCTL follows the *UTCCR*<sup>42</sup> rather than the *FTA*, the latter of which applied to all consumer contracts.<sup>43</sup> Under the UCTL, a consumer contract is defined by reference to the use of the goods. Thus, a consumer contract is a contract for:

- (a) a supply of goods or services; or
- (b) a sale or grant of an interest in land;

to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.<sup>44</sup>

Standard form contracts are not defined. The UCTL creates a rebuttable presumption that a contract is a standard form contract in circumstances where it is alleged that the contract is of such a kind.<sup>45</sup> The UCTL also provides a broad list of factors that the court may take into account in determining whether a contract is a standard form contract:

<sup>36</sup> Michael J Trebilcock, 'Rethinking Consumer Protection Policy' in Charles E F Rickett and Thomas G W Telfer (eds), *International Perspectives on Consumers' Access to Justice* (2003) 68, 93.

<sup>37</sup> *A Schroeder Music Publishing Co Ltd v Macaulay* [1974] 3 All ER 616, 624 (Lord Diplock) ('*Schroeder Music Publishing*'); *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] QB 284, 302 (Lord Denning MR) ('*George Mitchell*'). See also Hugh Collins, *Regulating Contracts* (1999) 47.

<sup>38</sup> *George Mitchell* [1983] QB 284, 297 (Lord Denning MR); *Schroeder Music Publishing* [1974] 3 All ER 616, 624 (Lord Diplock).

<sup>39</sup> Robertson, above n 20, 188; Hillman and Rachlinski, above n 35, 432–3; Melvin Aron Eisenberg, 'The Limits of Cognition and the Limits of Contract' (1995) 47 *Stanford Law Review* 211, 242.

<sup>40</sup> *ACL* pts 2-1, 2-2.

<sup>41</sup> *ACL* s 23(1)(b).

<sup>42</sup> See *UTCCR* reg 5(1), which provides that the regulations apply only to contract terms that have not been individually negotiated.

<sup>43</sup> See *FTA* s 32X, later amended by *Fair Trading Amendment (Unfair Contract Terms) Act 2010* (Vic) s 7, which provided that whether the contract had been individually negotiated was a factor to be considered in assessing whether a term was unfair.

<sup>44</sup> *ACL* s 23(3). Compare the different definition of consumer in *ACL* s 3.

<sup>45</sup> *ACL* s 27(1).

- (a) whether one of the parties has all or most of the bargaining power relating to the transaction;
- (b) whether the contract was prepared by one party before any discussion relating to the transaction occurred between the parties;
- (c) whether another party was, in effect, required either to accept or reject the terms of the contract ... in the form in which they were presented;
- (d) whether another party was given an effective opportunity to negotiate the terms of the contract ...;
- (e) whether the terms of the contract ... take into account the specific characteristics of another party or the particular transaction;
- (f) any other matter prescribed by the regulations.<sup>46</sup>

### B Excluded Terms

The UCTL does not apply to a term that:

- (a) defines the main subject matter of the contract; or
- (b) sets the upfront price payable under the contract; or
- (c) is a term required, or expressly permitted, by a law of the Commonwealth, a State or Territory.<sup>47</sup>

The *upfront price* payable under a standard form contract is defined as the consideration that:

- (a) is provided, or is to be provided, for the supply, sale or grant under the contract; and
- (b) is disclosed at or before the time the contract is entered into;

but does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.<sup>48</sup>

The *UTCCR* similarly excludes from review a term relating to the 'definition of the main subject matter of the contract'<sup>49</sup> and 'the adequacy of the price or remuneration, as against the goods or services supplied in exchange.'<sup>50</sup> Significantly, however, the UCTL, unlike the *UTCCR*, specifically provides that consideration that is in some way contingent does not form part of the 'price', which is excluded from review as an unfair term.<sup>51</sup> United Kingdom case law suggests that the categories of excluded terms should be interpreted narrowly. In

<sup>46</sup> *ACL* s 27(2).

<sup>47</sup> *ACL* s 26(1). In addition, the UCTL does not apply to 'a contract of marine salvage or towage', 'a charterparty of a ship', 'a contract for the carriage of goods by ship', or 'a contract that is the constitution ... of a company, managed investment scheme or other kind of body': s 28.

<sup>48</sup> *ACL* s 26(2).

<sup>49</sup> *UTCCR* reg 6(2)(a).

<sup>50</sup> *UTCCR* reg 6(2)(b).

<sup>51</sup> Thus, the decision in *Office of Fair Trading v Abbey National plc* [2010]1 All ER 667 that bank charges were excluded from review under the *UTCCR*, may not be followed in Australia. For a critical response to this decision, see Mindy Chen-Wishart, 'Transparency and Fairness in Bank Charges' (2010) 126 *Law Quarterly Review* 157. See also Elizabeth Macdonald, 'Scope and Fairness of the Unfair Terms in Consumer Contracts Regulations: Director General of Fair Trading v First National Bank' (2002) 65 *Modern Law Review* 763, 765–8.

the leading decision on the *UTCCR*, *Director General of Fair Trading v First National Bank plc* ('*First National Bank*'), Lord Bingham explained that:

The object of the [*UTCCR*] is to protect consumers against the inclusion of unfair and prejudicial terms in standard-form contracts into which they enter, and that object would plainly be frustrated if [the exemption provisions] were so broadly interpreted as to cover any terms other than those falling squarely within it.<sup>52</sup>

The main subject matter of the contract and upfront price payable under the contract are excluded from review under the UCTL on the ground that these are issues that consumers may be expected to understand easily and take into account when deciding whether to enter into a particular contract.<sup>53</sup> Interestingly, in light of this rationale, there is no requirement in the UCTL that the main subject matter and upfront price of the contract be clearly expressed. By contrast, the *UTCCR* excludes terms relating to price and subject matter from review only to the extent that those terms are expressed in plain and intelligible language.<sup>54</sup>

#### *C Determining whether a Term in a Standard Form Contract Is Unfair*

Under the UCTL, a term in a standard form contract will be unfair if:

- (a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
- (b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- (c) it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.<sup>55</sup>

The UCTL provides that the onus is on the party who would be advantaged by the term to prove that it is reasonably necessary in order to protect the legitimate interests of that party (typically the trader).<sup>56</sup>

The test of unfairness under the *UTCCR* also considers whether there is a significant imbalance in the rights and obligations of the parties to the detriment of the consumer. The major difference between the tests is that reg 5(1) of the *UTCCR* directs courts to consider whether an imbalanced term is 'contrary to the requirement of good faith' rather than whether the term is 'reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term' as under the UCTL.<sup>57</sup> A similar reference to 'legitimate interests' is included in the considerations relevant to determining unconscionable conduct

<sup>52</sup> [2002] 1 AC 481, 491; see also at 499–500 (Lord Steyn). See also *Office of Fair Trading v Abbey National plc* [2010] 1 All ER 667, 671–2 (Lord Walker J).

<sup>53</sup> *Australian Consumer Law Report*, above n 1, 34; Treasury, above n 4, 15.

<sup>54</sup> *UTCCR* reg 6(2). See also *Office of Fair Trading v Abbey National plc* [2008] 2 All ER (Comm) 625, [83]–[122] (Andrew Smith J).

<sup>55</sup> *ACL* s 24(1). See also Paterson, 'The Elements of a Prohibition on Unfair Terms in Consumer Contracts', above n 9, 190–3.

<sup>56</sup> *ACL* s 24(4).

<sup>57</sup> *ACL* s 24(1)(b).

under s 51AC(3)(b) of the *TPA*, now s 22(2)(b) of the *ACL*. The concept has also been used by Australian courts in defining the limits of a general duty of good faith in contract performance.<sup>58</sup>

The good faith element of the test for an unfair term in the *UTCCR* was not included in the *UCTL*, largely due to continuing uncertainty over the function and meaning of the duty of good faith under both this regime<sup>59</sup> and contract law generally.<sup>60</sup> In *First National Bank*, Lord Bingham equated good faith under the *UTCCR* to ‘good standards of commercial morality and practice’,<sup>61</sup> a description which does not take the inquiry very far. He stated that good faith embodied a principle of ‘fair and open dealing’<sup>62</sup> and that

[o]penness requires that the terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps. Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a trader should not, whether deliberately or unconsciously, take advantage of the consumer’s necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or any other factor listed in or analogous to those listed in [the *UTCCR*].<sup>63</sup>

The concept of ‘fair and open dealing’ proposed by Lord Bingham appears to express a concern with ensuring voluntary consent by consumers entering into standard form contracts. These concerns may be more directly addressed through doctrines regulating the process of contract formation, such as unconscionable dealing and undue influence, and through measures regulating the information provided to consumers on entering into a contract.

#### 1 *Does the Term Cause a Significant Imbalance in the Parties’ Rights and Obligations under the Contract?*

Under the *UCTL*, review of the fairness of a term in a standard form consumer contract is triggered by there being ‘a significant imbalance in the parties’ rights and obligations arising under the contract’.<sup>64</sup> Some of the examples of potentially unfair terms given in the provisions suggest that the issue is whether a right given to a trader is balanced by a similar right given to the consumer.<sup>65</sup> However,

<sup>58</sup> See, eg, *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) ATPR ¶41-703, 43 104 (Finkelstein J). See also Jeannie Marie Paterson, ‘Implied Fetters on the Exercise of Discretionary Contractual Powers’ (2009) 35 *Monash University Law Review* 45, 62–5. See also *Schroeder Music Publishing* [1974] 3 All ER 616, 623, for the test of fairness referred to by Lord Diplock.

<sup>59</sup> In relation to the *UTCCR*, see Bright, above n 8, 347–50; Hugh Beale, ‘Legislative Control of Fairness: The Directive on Unfair Terms in Consumer Contracts’ in Jack Beatson and Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* (1995) 231, 242–6. A reference to good faith in the test for an unfair term was deleted from *FTA* s 32W in 2009 by *Fair Trading and Other Acts Amendment Act 2009* (Vic) s 5.

<sup>60</sup> Treasury, above n 4, 3. See also Jeannie Paterson, Andrew Robertson and Arlen Duke, *Principles of Contract Law* (3<sup>rd</sup> ed, 2009) 582–3.

<sup>61</sup> [2002] 1 AC 481, 494.

<sup>62</sup> *Ibid.*

<sup>63</sup> *Ibid.*

<sup>64</sup> *ACL* s 24(1)(a).

<sup>65</sup> See *ACL* s 25(1).

many transactions are such that it would not be appropriate to expect perfect symmetry between the parties' rights and obligations. The issue should be whether there are burdens placed on the consumer that are not balanced by concessions elsewhere in the transaction.

In many cases, whether a term in a standard form contract causes a significant imbalance in the parties' rights and obligations under the contract may be assessed by considering the extent to which the term detracts from the rights held by the consumer under the common law.<sup>66</sup> The common law of contract provides a range of 'default' rules governing the rights and obligations of the parties to a contract. This allocation of rights and obligations, having evolved over a long period of time under constant judicial scrutiny, may be presumed to present a relatively fair balance between the interests of contracting parties. Thus, a contractual term that attempts to realign these rights may be treated with suspicion.

Price may also be a relevant consideration in assessing whether there is a significant imbalance in the parties' rights and obligations under the contract. In an ideal market, the allocation of a particular risk to consumers should be balanced by a reduction in the price paid by consumers to the trader of the goods or services in question. If it can be shown that the effect of an otherwise onerous term has been offset by a tangible reduction of the contract price, the term will not be imbalanced and hence not unfair.<sup>67</sup> A direct and significant correlation between the price of a product and particular contract terms will not exist in all cases. The effect of the term on the price may only be marginal. Moreover, traders themselves may not be aware of all of the boilerplate terms in their standard form contracts and thus may not have factored the effect of those terms into their pricing decisions.<sup>68</sup>

## 2 *Is the Term Reasonably Necessary in Order to Protect the Legitimate Interests of the Party Who Would Be Advantaged by the Term?*

The second element of the test for an unfair term in a standard form consumer contract under the UCTL qualifies the issue of imbalance. Courts must consider whether an imbalanced term is 'reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term',<sup>69</sup> typically the trader.

There would seem to be two stages to this inquiry. First, it must be shown that the term protects a legitimate interest of the trader. This requirement might be satisfied by showing that the term protects the trader from risks inherent in the transaction. Secondly, the term must be *reasonably necessary* to protect the trader's legitimate interests. It seems likely that a relevant consideration will be

<sup>66</sup> Chris Willett, *Fairness in Consumer Contracts: The Case of Unfair Terms* (2007) 47.

<sup>67</sup> *Director General of Fair Trading v First National Bank plc* [2000] QB 672, 687 (Peter Gibson LJ); *Jetstar Airways Pty Ltd v Free* [2008] VSC 539 (Unreported, Cavanough J, 3 December 2009) [129] ('*Jetstar*').

<sup>68</sup> Hillman and Rachlinski, above n 35, 444.

<sup>69</sup> *ACL* s 24(1)(b).

the proportionality of the term.<sup>70</sup> Typically, it is suggested that a term will be reasonably necessary to protect the legitimate interests of the trader only where the term represents a proportionate response to the risk it addresses.<sup>71</sup> This inquiry may require courts to consider other possible ways of protecting the trader's interests that would be less burdensome to the consumer. Parties may be expected to bring evidence of this issue. Market practice may also be relevant.<sup>72</sup>

3 *Would the Term Cause Detriment (whether Financial or Otherwise) to a Party if It Were to Be Applied or Relied on*

The Productivity Commission recommended that a challenge to unfair contract terms should be available only where there is 'material detriment' to consumers.<sup>73</sup> The UCTL requires only that an unfair term cause detriment (whether financial or otherwise) to a party *if it were to be applied or relied on*.<sup>74</sup> It is not necessary to show that the term was actually relied upon by the trader or to quantify the detriment as 'material' or even 'substantial'.<sup>75</sup> This approach recognises that it may be difficult to show consumers have actually been affected by an unfair term.<sup>76</sup> In particular, harsh or imbalanced terms in a standard form contract favouring the interests of a trader may have a 'chilling effect' on the conduct of consumers. The mere existence of the term may dissuade consumers from acting contrary to that term without the need for enforcement by the trader.

The *UTCCR* require that the imbalance in the rights and obligations of the parties under the contract be to the detriment of the consumer,<sup>77</sup> whereas the UCTL uses a more general reference to 'detriment ... to a party'.<sup>78</sup> In *First National Bank*, Lord Steyn stated that the element of detriment under the *UTCCR* did not 'add much' to the formulation for identifying an unfair term but instead 'serve[d] to make clear that the *Directive* is aimed at significant imbalance against the consumer, rather than the seller or trader'.<sup>79</sup> It remains to be seen whether Australian courts will adopt a similarly minimalist approach in respect to the requirement of detriment under the UCTL.

<sup>70</sup> See *Director of Consumer Affairs Victoria v AAPT Ltd* [2006] VCAT 1493 (Unreported, Morris P, 2 August 2006) [50]; *Director of Consumer Affairs Victoria v Trainstation Health Clubs Pty Ltd* [2008] VCAT 2092 (Unreported, Harbison V-P, 24 October 2004) [175] ('*Trainstation Health Clubs*'); *Director of Consumer Affairs Victoria v Backloads.com Pty Ltd* [2009] VCAT 754 (Unreported, Harbison V-P, 11 May 2009) [248]–[250].

<sup>71</sup> See Paterson, 'The Elements of a Prohibition on Unfair Terms in Consumer Contracts', above n 9, 193–8.

<sup>72</sup> See, eg, *Jetstar* [2008] VSC 539 (Unreported, Cavanough J, 3 December 2009) [119].

<sup>73</sup> Productivity Commission, above n 5, vol 1, 69.

<sup>74</sup> *ACL* s 24(1)(c).

<sup>75</sup> Compare the earlier version of the *ACL* in Treasury, above n 4, 11.

<sup>76</sup> *Ibid.*

<sup>77</sup> *UTCCR* reg 5(1).

<sup>78</sup> *ACL* s 24(1)(c) (emphasis added).

<sup>79</sup> [2002] 1 AC 481, 499.

#### D Examples of Unfair Terms in Standard Form Contracts

The UCTL sets out a list of examples of the kind of terms in standard form consumer contracts that may be unfair.<sup>80</sup> Paragraph (a) of this list identifies ‘a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract’.<sup>81</sup> Many terms within this category will already be void as purporting to exclude or limit liability for the breach of terms implied under consumer protection legislation.<sup>82</sup>

Paragraph (b), refers to terms that permit ‘one party (but not another party) to terminate the contract’.<sup>83</sup> Termination clauses perform an important role for many traders in managing risks in ongoing contractual relationships and as a self-help response to breaches by consumers or other adverse events affecting the viability of the transaction.<sup>84</sup> However, it should be possible for such clauses to be drafted in a way that termination is not authorised for disproportionately trivial events.<sup>85</sup>

Paragraph (c) refers to ‘a term that penalises, or has the effect of penalising, one party (but not another party) for a breach or termination of the contract’.<sup>86</sup> Standard form consumer contracts frequently contain an agreed damages clause, that is, a clause specifying the amount payable by consumers to the trader in the event of a breach of the contract by consumers. An agreed damages clause is valid under the law of contract provided it does not amount to a penalty. A clause stipulating a sum payable on breach will be a penalty where the sum is ‘extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach’<sup>87</sup> rather than ‘a genuine pre-estimate of the damage likely to be caused by the breach.’<sup>88</sup> A clause that allows a trader to claim loss of bargain damages on termination following breach by a consumer, discounted to account for any benefits accruing to the trader as a result of early termination, will not be a penalty at common

<sup>80</sup> *ACL* s 25(1). This list is based on both *UTCCR* sch 2 (which provides ‘an indicative and non-exhaustive list of the terms which may be regarded as unfair’: reg 5(5)) and *FTA* s 32X (which provides a list of factors that a court or tribunal may take into account in determining whether a term is unfair). See generally Paterson, ‘The Elements of a Prohibition on Unfair Terms in Consumer Contracts’, above n 9, 193–8.

<sup>81</sup> *ACL* s 25(1)(a); see also ss 25(1)(i), (k), which reflect concerns relating to limitations of liability.

<sup>82</sup> For concerns expressed over this type of clause, see *Australian Consumer Law Report*, above n 1, 36. See also *Trainstation Health Clubs* [2008] VCAT 2092 (Unreported, Harbison V-P, 24 October 2004) [223]; *Director of Consumer Affairs Victoria v Craig Langley Pty Ltd* [2008] VCAT 482 (Unreported, Harbison V-P, 17 March 2008) [71]–[75] (‘*Craig Langley*’).

<sup>83</sup> *ACL* s 25(1)(b).

<sup>84</sup> Jeannie Marie Paterson, ‘Limits on a Lender’s Right to Repayment on Demand: Construction, Implication and Good Faith?’ (1998) 26 *Australian Business Law Review* 258, 262–3.

<sup>85</sup> Cf *Director of Consumer Affairs Victoria v AAPT Ltd* [2006] VCAT 1493 (Unreported, Morris P, 2 August 2006) [53].

<sup>86</sup> *ACL* s 25(1)(c).

<sup>87</sup> *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79, 87 (Lord Dunedin), quoted in *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656, 662 (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ).

<sup>88</sup> *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656, 662 (Gleeson CJ, Gummow, Kirby, Hayne, Callinan and Heydon JJ). See also *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79, 86 (Lord Dunedin).

law.<sup>89</sup> Such a clause may also not be unfair. The reference in para (c) to a clause that ‘penalises’ one party for a breach of the contract suggests a concern with penalty provisions, not agreed damages clauses. Under an agreed damages clause, a trader may be claiming only what would be recoverable in an action for damages.

Some types of fixed term consumer contracts, such as credit, mobile phone and internet service contracts, expressly allow consumers a right to early termination of the contract. Such provisions commonly also impose an ‘early termination fee’ payable by consumers to the trader, effectively as compensation for terminating prior to the expiry of the term of the contract. The common law rules relating to penalties are unlikely to apply to early termination fees because the fee is not payable in the event of a *breach* by consumers.<sup>90</sup> Paragraph (c) indicates that these types of term may be subject to review for unfairness. Early termination fees will not be excluded from review on the ground that they relate to a term that ‘sets the upfront price payable under the contract’<sup>91</sup> because they are not payable ‘upfront’ and, moreover, they are ‘contingent on the occurrence or non-occurrence of a particular event.’<sup>92</sup> The use in para (c) of the word ‘penalise’ might suggest that the concern will be with whether the early termination fee is used in a similar way to a penalty clause, that is, to recover an amount that is ‘extravagant’ in comparison to the greatest loss that might be suffered by the trader on event of early termination. Fees that allow a trader to recover more than a reasonable pre-estimate of the losses associated with early termination are, by definition, unnecessary to protect the legitimate interests of the trader.<sup>93</sup> An analogy with agreed damages clauses would suggest that ‘fair’ early termination fees might legitimately cover loss of profit, provided they are discounted by any other benefits accruing to the trader on termination, and reasonable administrative costs associated with the event.<sup>94</sup>

Paragraph (d) refers to ‘a term that permits, or has the effect of permitting, one party (but not another party) to vary the terms of the contract’.<sup>95</sup> Similarly, paras (f) and (g) list unilateral variation rights in respect to the price and subject matter of the contract. The purpose of terms allowing the trader a unilateral right to vary some aspect of the contract is usually to allow traders to respond to changes affecting their ability to continue to perform the contract. For example, terms authorising unilateral variation of the contract by the trader are often found in contracts for mobile phone and credit card services. These contracts

<sup>89</sup> See, eg, *Esanda Finance Corp v Plessnig* (1989) 166 CLR 131.

<sup>90</sup> *Re Apex Supply Co Ltd* [1942] Ch 108, 119 (Simonds J); *Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd* (2008) 257 ALR 292, 321 (Allsop P). Giles and Ipp JJA agreed: at 335.

<sup>91</sup> *ACL* s 26(1)(b).

<sup>92</sup> *ACL* s 26. See also Treasury, above n 4, 15–17.

<sup>93</sup> *Australian Consumer Law Report*, above n 1, 39. See, eg, *Trainstation Health Clubs* [2008] VCAT 2092 (Unreported, Harbison V-P, 24 October 2004) [240]; *Craig Langley* [2008] VCAT 482 (Unreported, Harbison V-P, 17 March 2008) [95].

<sup>94</sup> On the review for fairness of bank charges in the United Kingdom, see above n 51 and accompanying text.

<sup>95</sup> *ACL* s 25(1)(d).

commonly extend over a considerable period of time and are subject to relatively volatile market conditions and significant levels of government regulation. Thus, traders of these types of contracts may have good commercial reasons for seeking to retain discretion to vary aspects of the contract. There may nonetheless be concerns over a lack of proportionality in terms authorising unilateral variation of standard form consumer contracts by the trader.<sup>96</sup> In most cases it should be possible for a trader to preserve flexibility while still respecting the interests of consumers. Thus, for example, terms allowing the trader a unilateral right to vary some aspect of the contract might specify the circumstances under which the terms may be varied, qualify the types of variations that may be made or provide realistic opportunities for consumers to become aware of the variations and exit the contract if they object to them.<sup>97</sup>

Paragraph (l) refers to ‘a term that limits, or has the effect of limiting, the evidence one party can adduce in proceedings relating to the contract’.<sup>98</sup> A term in this category might be an ‘entire agreement’ clause.<sup>99</sup> Entire agreement clauses attempt to limit the types of statements on which a consumer may rely in its contractual dealings with the trader by providing that the written terms of the contract represent the entire agreement of the parties. In deciding whether to enter into a particular contract for goods or services, consumers often rely on what was said by the trader as much as, if not more than, the written terms of the contract. Under the common law of contract, an oral representation made with promissory intent by a trader in the process leading up to contract formation may form part of the contract where the contract was partly oral and partly in writing (so as to overcome the limitations of the parole evidence rule).<sup>100</sup> Entire agreement clauses may accordingly be seen as an unfair attempt by traders to detract from the common law rights of consumers by denying contractual status to statements made by the trader prior to making the contract.

#### *E Matters the Court Must Take into Account in Determining whether a Term Is Unfair*

The UCTL provides that in determining whether a term of a standard form contract is unfair a court may take into account ‘such matters as it thinks relevant’.<sup>101</sup> The UCTL also provides that a court must take into account the following matters:

<sup>96</sup> See, eg, *UTCCR* sch 2 para 1(j); *FTA* s 32X(g); *Director of Consumer Affairs Victoria v AAPT Ltd* [2006] VCAT 1493 (Unreported, Morris P, 2 August 2006) [50]; *Trainstation Health Clubs* [2008] VCAT 2092 (Unreported, Harbison V-P, 24 October 2004) [126]–[149].

<sup>97</sup> Office of Fair Trading (UK), *Unfair Contract Terms Guidance: Guidance for the Unfair Terms in Consumer Contracts Regulations* (2008) 52–3.

<sup>98</sup> *ACL* s 25(1)(l).

<sup>99</sup> See *Australian Consumer Law Report*, above n 1, 35–6; *UTCCR* sch 2 para 1(q). See also *Trainstation Health Clubs* [2008] VCAT 2092 (Unreported, Harbison V-P, 24 October 2004) [156]–[163]; Macdonald, ‘The Emperor’s Old Clauses’, above n 8, 428–31.

<sup>100</sup> See *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 61 (Gibbs CJ), 89–90 (Mason J), 120 (Deane J).

<sup>101</sup> *ACL* s 24(2).

- (a) the extent to which the term is transparent;
- (b) the contract as a whole.<sup>102</sup>

### 1 *The Contract as a Whole*

The UCTL directs courts to consider the contract as a whole in determining whether a particular term in a standard form contract is unfair.<sup>103</sup> The reason for this direction is presumably to ensure that the court takes into account features of the contract which may counteract an otherwise unfair term.

### 2 *Transparency*

There is generally considered to be an information asymmetry between parties to standard form consumer contracts.<sup>104</sup> Traders who prepare the contracts have every opportunity to be well informed about the meaning and effect of the terms of those contracts. Consumers are less well placed. Experience and empirical studies suggest that they commonly do not read the terms of standard form contracts.<sup>105</sup> Moreover, the terms of standard form contracts are commonly expressed in obscure and/or legalistic language that makes it difficult for consumers to understand.<sup>106</sup> The terms of a standard form contract may not even be available to consumers at the time the contract is made.<sup>107</sup>

Under the UCTL, courts are directed to consider the transparency of a term in assessing whether that term is unfair. A term is transparent if it is:

- (a) expressed in reasonably plain language; and
- (b) legible; and
- (c) presented clearly; and
- (d) readily available to any party affected by the term.<sup>108</sup>

The *UTCCR* and the *FTA* also contain provisions relating to transparency. However, in contrast to the UCTL, these provisions are independent requirements. Regulation 7(1) of the *UTCCR* provides that any written term of a contract is to be 'expressed in plain, intelligible language.' Under s 163(3) of the *FTA*, consumer contracts are to be 'easily legible', 'clearly expressed' and, if printed or typed, be in a 'minimum 10 point Times New Roman font, or a

<sup>102</sup> *ACL* s 24(2).

<sup>103</sup> *ACL* s 24(2)(b).

<sup>104</sup> See, eg, Productivity Commission, above n 5, vol 2, 30–2; Hillman and Rachlinski, above n 35, 443.

<sup>105</sup> *Baltic Shipping* (1991) 22 NSWLR 1, 25 (Kirby P). See also *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] AC 361, 406 (Lord Reid); Robertson, above n 20, 188–90; Hillman and Rachlinski, above n 35, 431–3; Eisenberg, above n 39, 242–3.

<sup>106</sup> Cf *Baltic Shipping* (1991) 22 NSWLR 1, 17, 50 (Kirby P); Eisenberg, above n 39, 241; Hillman and Rachlinski, above n 35, 446.

<sup>107</sup> See, eg, *Oceanic Sun Line Special Shipping Co Inc v Fay* (1988) 165 CLR 197, 204 (Wilson and Toohey JJ).

<sup>108</sup> *ACL* s 24(3). The definition of 'transparent' in the *ACL* is based on a similar definition proposed in Law Commission and Scottish Law Commission, *Unfair Terms in Contracts: A Joint Consultation Paper*, Law Commission Consultation Paper No 166, Scottish Law Commission Discussion Paper No 119 (2002) 97 ('*Joint Consultation Paper*').

minimum font of an equivalent size'. Given that the opportunities for consumers to understand the terms of standard form contracts are considerably reduced if the terms are not clear, it would have been desirable for there to be an independent requirement of transparency under the UCTL. In the absence of such a requirement, it is suggested that transparency should be considered necessary in establishing that a term in a standard form consumer contract is fair.

### 3 *Such Matters as the Court May Consider Relevant*

Under the UCTL, in determining whether a term in a standard form contract is unfair, a court may take into account such matters as it considers relevant.<sup>109</sup> Conceivably, such matters might include measures complementing the requirement of transparency and aimed at improving the information available to consumers about the terms of a standard form contract. Relevant factors might include the notice given to consumers about the terms (and, in particular, any unusual terms), the way in which the contract was explained to consumers, whether consumers had a reasonable opportunity to consider the information before entering into the contract and whether consumers should or could have sought professional advice.<sup>110</sup>

If such an approach is adopted, then the distinction between signed and unsigned contracts under the common law of contract may be much reduced in respect to standard form consumer contracts. Under the common law,<sup>111</sup> courts will consider whether a party who enters into an unsigned standard form contract has been given notice of the terms of that contract. Courts have suggested that, where the terms to be incorporated into the contract are unusual, special notice — such as will fairly and reasonably bring the terms to the attention of the party to be bound — must be given.<sup>112</sup> This approach essentially embodies a principle of 'unfair surprise', whereby terms that would not reasonably be expected by contracting parties must be specifically disclosed.<sup>113</sup> By contrast, a party who signs a contractual document is presumed to have appreciated the legal significance of signing and, if he or she has not read the document, to have taken the risk of being bound by onerous terms.<sup>114</sup> The UCTL may provide an

<sup>109</sup> *ACL* s 24(2).

<sup>110</sup> *Joint Consultation Paper*, above n 108, 95–6.

<sup>111</sup> For discussion on the way in which classical contract theory has favoured businesses, see Hugh Collins, *Regulating Contracts*, above n 37, 47.

<sup>112</sup> *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163, 169 (Lord Denning MR), 172–4 (Megaw LJ); *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433, 445 (Bingham LJ); *Baltic Shipping* (1991) 22 NSWLR 1, 8, 24–5 (Kirby P) (appealed to the High Court on other issues: *Baltic Shipping Co v Dillon* (1993) 176 CLR 344); *Livingstone v Roskilly* [1992] 3 NZLR 230, 237 (Thomas J). See also *Maxitherm Boilers Pty Ltd v Pacific Dunlop Ltd* [1998] 4 VR 559, 569 (Buchanan JA).

<sup>113</sup> M J Trebilcock, 'The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords' (1976) 26 *University of Toronto Law Journal* 359, 370–1.

<sup>114</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165, 180–1 (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ); *L'Estrange v F Graucob Ltd* [1934] 2 KB 394, 403 (Scrutton LJ) (quoting *Parker v South Eastern Railway Co* (1877) 2 CPD 416, 421 (Mellish LJ)); *Oceanic Sun Line Special Shipping Co Inc v Fay* (1988) 165 CLR 197, 228 (Brennan J); *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 (Unreported, Spigelman CJ, Giles JA and Gzell J,

opportunity for courts to consider whether consumers have been given notice of at least unusual terms, regardless of whether the contract is signed or unsigned.

#### IV THE RELATIONSHIP BETWEEN SUBSTANTIVE UNFAIRNESS, TRANSPARENCY AND NOTICE

Given the traditional unwillingness of courts to review the substantive fairness of the terms of a contract, the respective roles of substantive and procedural fairness under the UCTL may be the subject of some debate. In particular, there may be uncertainty about the proper relationship between the substantive test of an unfair term and measures designed to ensure procedural fairness. Under the UCTL, the procedural measures of primary relevance will relate to the transparency of the terms. They might also include notice of unusual terms and other opportunities to obtain and reflect on information about the terms of the contract.<sup>115</sup> The issue that may arise is whether a trader can establish that an otherwise imbalanced and disproportionate term is fair by showing that the term was highly transparent or that other steps were taken to inform consumers about the term.

The inclusion of good faith in the test for unfairness under the *UTCCR* might suggest that this regime is primarily concerned with matters of procedural fairness. Certainly, the statement of Lord Bingham quoted above, equating good faith with ‘fair and open dealing’, appears directed at procedural concerns.<sup>116</sup> However, the predominant view of courts and commentators in both jurisdictions is that the *UTCCR* extends to regulate terms that are unfair in substance.<sup>117</sup> In *First National Bank*, Lord Steyn stated that ‘[a]ny purely procedural or even predominantly procedural interpretation of the requirement of good faith must be rejected.’<sup>118</sup> In *Jetstar Airways Pty Ltd v Free*, Cavanough J said that the *FTA* regime regulating unfair contract terms (which at that time referred to good faith)<sup>119</sup> ‘proceeds on the assumption that some terms in consumer contracts, especially in standard form consumer contracts, may be inherently unfair’, ‘regardless of how comprehensively they might be drawn to the consumer’s attention’.<sup>120</sup>

It is suggested that a similar approach should be taken to the UCTL on the ground that the threshold test of unfairness focuses on issues of substantive fairness. Others might argue that procedural fairness should be the determinative

25 May 2006) [75]–[76] (Spigelman CJ), quoting *Burt v Australian & New Zealand Banking Group Ltd* (1994) ATPR (Digest) ¶46-123, 53 597–8 (Bryson J).

<sup>115</sup> See above n 110 and accompanying text.

<sup>116</sup> See above n 63 and accompanying text.

<sup>117</sup> See, eg, Beale, above n 59, 245; Paolisa Nebbia, ‘Reforming the UK Law on Unfair Terms: The Draft Unfair Contract Terms Bill’ (2007) 23 *Journal of Contract Law* 228, 236–8. See also Willett, above n 66, 37–9.

<sup>118</sup> [2002] 1 AC 481, 500.

<sup>119</sup> *FTA* s 32W, later amended by *Fair Trading and Other Acts Amendment Act 2009* (Vic) s 5.

<sup>120</sup> [2008] VSC 539 (Unreported, Cavanough J, 3 December 2009) [115]. See also *Director of Consumer Affairs Victoria v AAPT Ltd* [2006] VCAT 1493 (Unreported, Morris P, 2 August 2006) [48].

consideration and support this argument by noting that courts are specifically directed to consider the transparency of a term in assessing whether the term is unfair. Such an approach would be supported by classical contract theory. An approach informed by classical contract theory would suggest that in a case where the terms of a standard form consumer contract are transparent, or where the trader has provided consumers with notice or other information about the terms of the contract, the conditions for relatively informed consent by the consumer have been met. In these circumstances, the principle of freedom of contract would suggest that the decision of a consumer to enter into the contract must be respected even if, ex post facto, the contract proves to be less beneficial than the consumer expected. This suspicion of substantive fairness as a ground for review of the terms of standard form contracts is based on the particular model of contracting parties adopted by classical contract theory. It is suggested here that a different, more nuanced model of consumer contracting would support making the substantive fairness of the terms in a standard form contract the primary focus of the UCTL.

In emphasising the value of freedom of contract, classical contract theory is based on a model of highly competent and rational contracting parties.<sup>121</sup> Under this model, contracting parties are vigorously dedicated to pursuing their own interests in the contracting process. They are ‘reasonably well-informed and reasonably observant and circumspect.’<sup>122</sup> They have a well-developed ability to assess price or risk trade-offs presented to them. They are articulate in expressing their own preferences.

This model of highly competent and rational contracting parties makes it possible to portray the failure of consumers to read or consider the terms of standard form contracts as a rational choice, consistent with the principle of freedom of contract. Under this approach, where consumers make an assessment that the risks likely to be allocated to them by standard form contracts will be relatively low, they may be making a rational decision not to invest time in reading and assessing the terms presented in those contracts.<sup>123</sup> In such cases, the benefits of information about the terms of the contract may be outweighed by the costs of finding and processing such information.<sup>124</sup> The model of contracting parties presumed by classical contract theory also makes it possible to argue that, where consumers recognise that the terms of a standard form contract are likely

<sup>121</sup> See Paula Baron, ‘Shells of Steel and Bodies of Pulp: Commercial Man, Commercial Morality’ (1993) 11 *Law in Context* 3, 5–6; Brown, above n 31, 592–3; Eisenberg, above n 39, 212; Feinman, above n 22, 1286. See generally Adams and Brownsword, above n 21, 206–10.

<sup>122</sup> This standard is based on the jurisprudence of the European Court of Justice: see, eg, *Gut Springenheide GmbH v Oberkreisdirektor des Kreises Steinfurt — Amt für Lebensmittelüberwachung* (C-210/96) [1998] ECR I-4657, I-4691, discussed in Ramsay, *Consumer Law and Policy*, above n 22, 286.

<sup>123</sup> For a similar argument, see Randy E Barnett, ‘Consenting to Form Contracts’ (2002) 71 *Fordham Law Review* 627, 634–43. For criticism of this approach, see Robertson, above n 20, 190–3.

<sup>124</sup> Trebilcock, *The Limits of Freedom of Contract*, above n 25, 103; Eisenberg, above n 39, 243.

to be weighted against their interests, they will seek to compensate for these risks by discounting in the price paid under the contract.<sup>125</sup>

Many commentators have suggested that the classical model of contracting parties does not accurately reflect the decision-making process of consumers entering into standard form contracts and maybe even of parties to commercial contracts generally. They argue that a different model of contracting behaviour is required.<sup>126</sup> Support for such a model comes from behavioural economics, which attempts to model decision-making behaviour using more accurate assumptions about human behaviour than classical contract theory.<sup>127</sup> Behavioural economics presents a number of key insights about decision-making which suggest that consumers ‘act in ways that systematically and predictably diverge from the “rational choice” model of traditional economic analysis’<sup>128</sup> and therefore also from classical contract theory.

One key finding of behavioural economics is that individuals become less adept at decision-making the more factors there are to consider.<sup>129</sup> In making decisions, individuals cannot process large amounts of information and consequentially tend to focus on a few key factors.<sup>130</sup> In the process of contracting, consumers will typically focus on a few key ‘salient’<sup>131</sup> or visible terms,<sup>132</sup> such as price, quantity or warranties,<sup>133</sup> and pay little attention to the remainder of the contract. This inability of consumers to focus on more than a few key factors is exaggerated if there are other distractions accompanying the decision-making process, for example, prominent advertising.<sup>134</sup>

A second key finding of behavioural studies is that, even to the extent that a particular factor is incorporated into the decision-making process, individuals are poor statisticians and poor at assessing the risks associated with a particular contract term. There are a number of factors that impact on the inability of individuals to assess risk accurately. Individuals ‘use heuristics (shortcuts) to assess risk.’<sup>135</sup> One such available heuristic is that individuals estimate the

<sup>125</sup> See Trebilcock, ‘The Doctrine of Inequality of Bargaining Power’, above n 113, 376.

<sup>126</sup> See, eg, Stewart Macaulay, ‘An Empirical View of Contract’ [1985] *Wisconsin Law Review* 465, 467–8; Feinman, above n 22, 1305–6.

<sup>127</sup> See Ramsay, *Consumer Law and Policy*, above n 22, 71–2, quoting Roberto Weber and Robyn Dawes, ‘Behavioral Economics’ in Neil J Smelser and Richard Swedberg (eds), *The Handbook of Economic Sociology* (2<sup>nd</sup> ed, 2005) 90, 91.

<sup>128</sup> Jason J Kilborn, ‘Behavioral Economics, Overindebtedness and Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions’ (2005) 22 *Emory Bankruptcy Developments Journal* 13, 17. See also Shmuel I Becher, ‘Behavioral Science and Consumer Standard Form Contracts’ (2007) 68 *Louisiana Law Review* 117, 123.

<sup>129</sup> Russell Korobkin, ‘Bounded Rationality, Standard Form Contracts, and Unconscionability’ (2003) 70 *University of Chicago Law Review* 1203, 1229; Ramsay, *Consumer Law and Policy*, above n 22, 75.

<sup>130</sup> Korobkin, above n 129, 1226–9.

<sup>131</sup> *Ibid* 1229–30; Ramsay, *Consumer Law and Policy*, above n 22, 162.

<sup>132</sup> Rakoff, above n 35, 1251.

<sup>133</sup> Hillman and Rachlinski, above n 35, 452. See also Ramsay, *Consumer Law and Policy*, above n 22, 162; Eisenberg, above n 39, 241.

<sup>134</sup> See Eldar Shafir, ‘A Behavioural Perspective on Consumer Protection’ (2008) 15 *Competition and Consumer Law Journal* 302, 309–10; Ramsay, *Consumer Law and Policy*, above n 22, 75.

<sup>135</sup> Ramsay, *Consumer Law and Policy*, above n 22, 74.

probability of risk by reference to their experience or knowledge of the risk.<sup>136</sup> Thus, individuals ‘judg[e] risk to be high when the type of harm is familiar or easily imagined and low when it is not.’<sup>137</sup> Moreover, they tend to be overly optimistic about their abilities to avoid risk.<sup>138</sup> A related phenomenon is hyperbolic discounting, whereby ‘individuals systematically overvalue immediate benefits and costs and undervalue delayed benefits and costs.’<sup>139</sup>

The insights of behavioural economics suggest a very different model of contracting parties to that assumed by classical contract theory. Rather than contracting parties being highly competent and rational decision-makers, a more descriptively accurate model would recognise that ‘human rationality is normally bounded by limited information and limited information processing.’<sup>140</sup> These insights do not render redundant measures aimed at ensuring that consumers are better informed about the terms of standard form contracts. Measures designed to provide information to consumers about the terms of their standard form contracts may result in some terms moving from an incidental factor in the decision-making processes of consumers to a salient one. Measures designed to improve the information available to consumers about the terms of their contracts may also prove an important safeguard for consumers at a later stage in the contractual relationship should disputes between the parties eventuate. Consumers faced with a dispute are more likely to be able to assess and assert their rights where the terms of their contracts are readily available and clearly expressed.<sup>141</sup> Thus, it is suggested that, under the UCTL, courts should consider the transparency of a term and other steps taken to inform consumers about the terms of their contract in assessing whether a term is unfair. Indeed, it is suggested that the absence of such measures may be a ground for finding that a term in a standard form contract is unfair.<sup>142</sup>

It is also argued that transparency and other measures designed to provide information to consumers about the terms of a contract should not be sufficient to insulate a term from being found unfair. It is suggested that the emphasis under classical contract theory on ensuring that the preconditions for voluntary (in the sense of substantially unconstrained and informed) decisions to enter into a contract are met does not adequately address the issue of the fairness of the incidental or non-salient terms of standard form consumer contracts. Instead, the insights of behavioural economics suggest that measures designed better to

<sup>136</sup> Ibid.

<sup>137</sup> Korobkin, above n 129, 1233. See also Eisenberg, above n 39, 213, 218–19; Jon D Hanson and Douglas A Kysar, ‘Taking Behavioralism Seriously: The Problem of Market Manipulation’ (1999) 74 *New York University Law Review* 630, 662–4.

<sup>138</sup> Hillman and Rachlinski, above n 35, 453–4; Eisenberg, above n 39, 217–18; Howells, above n 28, 360; Cass R Sunstein, ‘Behavioral Analysis of Law’ (1997) 64 *University of Chicago Law Review* 1175, 1188–9; Ramsay, *Consumer Law and Policy*, above n 22, 73.

<sup>139</sup> Kilborn, above n 128, 21. See also Hanson and Kysar, above n 137, 678–80; Sunstein, above n 138, 1193–4.

<sup>140</sup> Eisenberg, above n 39, 214.

<sup>141</sup> See Howells, above n 28, 355. See also Baird, above n 25, 938.

<sup>142</sup> See *Joint Consultation Paper*, above n 108, 97. See also Macdonald, ‘The Emperor’s Old Clauses’, above n 8, 424.

inform consumers about the incidental terms of standard form contracts may have little effect on most consumers' decisions to enter into those contracts.<sup>143</sup>

Consumers entering into standard form contracts are not merely unlikely to read the terms of those contracts. Behavioural economics shows that consumers 'will often process imperfectly even the information they do acquire.'<sup>144</sup> While consumers may be reasonably competent at choosing between the salient features of different goods and services available to them, they may not be able to bring these skills to the incidental or boilerplate terms of the standard form contracts for such goods and services.<sup>145</sup>

Consider again some of the types of clauses vulnerable to challenge as unfair under the UCTL, including terms allowing the trader a unilateral right to terminate or vary some aspect of the contract, entire agreement clauses and terms imposing various fees for termination. These types of terms are likely to be found towards the end of a contract document and may be expressed in technical legal language. These factors reduce the likelihood of consumers being aware of the existence or impact of the terms. However, even if such terms are relatively transparent in the sense of being displayed in a prominent position and expressed in clear language, they may not influence consumers' decisions to enter into the contract. Consumers may instead be focusing on issues of price and quantity and are unlikely to base their decisions on an assessment of the potential impact of the boilerplate or incidental terms.

Even to the extent that consumers do consider the impact of incidental terms, their assessment of the risk imposed by these terms may be inaccurate. To assess the risks involved in agreeing to an entire agreement clause, consumers must have an understanding of the legal position that would apply in the absence of such clauses. Most consumers will not have such understanding. Accordingly, consumers may dismiss as remote the risk allocated in an entire agreement clause. This assessment may occur notwithstanding the fact that consumers may have been influenced to enter into the contract by oral statements made by the trader about the desirable features of the goods or services being offered, which are precisely the sort of statements an entire agreement clause attempts to exclude from having effect.

In respect to variation and termination clauses, consumers may be able to understand the legal effect of the clauses. Termination and variation are relatively straightforward concepts. Consumers may nonetheless fail to assess adequately the risk allocated by these clauses. For example, consumers may be overly optimistic about their ability to perform the contract without breach, they may underestimate the risk of opportunistic behaviour by traders in exercising

<sup>143</sup> Cf Karen Gross, 'Financial Literacy Education: Panacea, Palliative, or Something Worse?' (2005) 24 *Saint Louis University Public Law Review* 307, 309–10, arguing that financial literacy is not sufficient to address social problems underlying unfair consumer credit contracts.

<sup>144</sup> Eisenberg, above n 39, 214.

<sup>145</sup> Rakoff, above n 35, 1231.

their rights under the clause or they may not consider the impact of changing market conditions on performance of the contract.<sup>146</sup>

## V CONCLUSION

The UCTL expressly provides for review of the substantive fairness of the terms in standard form consumer contracts. A term will, prima facie, be unfair if it causes an imbalance in the rights and obligations of the parties under the contract and the term is not reasonably necessary to protect the legitimate interests of the party who would benefit from it (usually the trader). An issue likely to arise in the interpretation of the UCTL is the relationship between the test of substantive unfairness and issues relevant to procedural fairness. In particular, there may be some dispute about whether measures aimed at addressing the information asymmetry between traders and consumers, for example transparency in the terms of the contract or notice of unusual terms, should be sufficient to ensure that a term is fair.

This piece has argued that, while measures designed better to inform consumers about the terms of their contracts are important, they do not resolve concerns about the substantive fairness of those terms. Consumers do not fit the model of the competent and rational contracting party presumed by classical contract theory. Decisions to accept onerous or unbalanced contract terms are not necessarily a calculated risk assumed by consumers in return for a concession in price. Rather, the insights of behavioural economics suggest that there are significant limitations on the decision-making processes of consumers relating to 'rational, social, and cognitive factors', which are not necessarily improved by consumers being provided with more information about the incidental terms of their contracts.<sup>147</sup> Such measures may not ensure that these terms become part of the decision by consumers to enter into a standard form contract in any meaningful sense. To the contrary, it is suggested that under the UCTL consumers may be better able to choose between the various goods and services offered to them precisely because they can 'leave the detail of standard form contracting to be regulated by the law.'<sup>148</sup>

<sup>146</sup> For a discussion of boilerplate terms in credit card contracts, see Ronald J Mann, "'Contracting' for Credit" in Omri Ben-Shahar (ed), *Boilerplate: The Foundation of Market Contracts* (2007) 106, 109–10.

<sup>147</sup> Hillman and Rachlinski, above n 35, 455. See also Robert A Hillman, 'Online Boilerplate: Would Mandatory Web Site Disclosure of e-Standard Terms Backfire?' in Omri Ben-Shahar (ed), *Boilerplate: The Foundation of Market Contracts* (2007) 83, 85.

<sup>148</sup> Howells, above n 28, 364.