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SUPERANNUATION & FINANCIAL SERVICES

UNFAIR CONTRACT TERMS: ARE YOU READY?

New civil penalties and deemed significant breaches for AFSL holders

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Index

KEY "TAKEAWAYS"

From 9 November 2023 new penalties apply for including an "unfair term" in a standard form contract.

For holders of Australian financial services licences (AFSLs), the mere inclusion of an unfair contract term, or reliance on such a term, may give rise to a deemed "significant breach" reportable to ASIC.

This is potentially relevant to superannuation trustees, IDPS operators, managed fund operators, financial advisers and other financial services businesses.

It may be timely to review and possibly amend standard form contracts in use in your business, both contracts used with clients and contracts with sub-contractors and service providers.

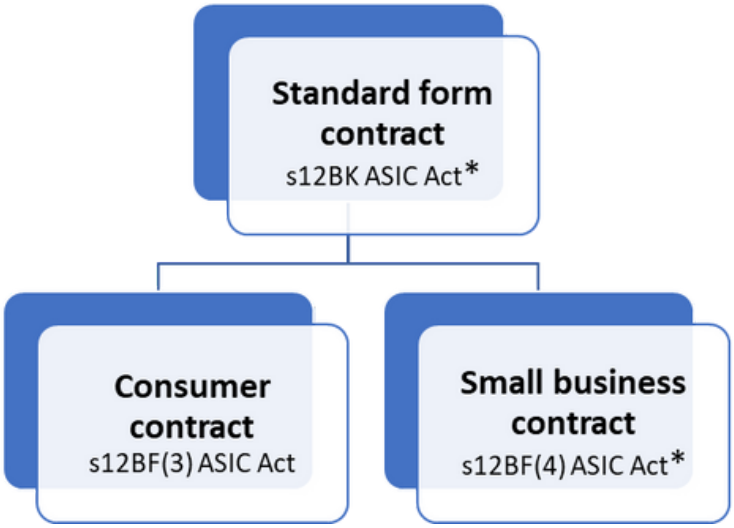
ASIC has named unfair contracts as one of its 2023 enforcement priorities.[1]

OVERVIEW OF THE CHANGES

There is existing law in relation to unfair contracts but to date it has had minimal overt impact on the financial services industry. The existing law empowers a court to declare unfair terms in certain kinds of contracts to be void, and grant consequential civil remedies, for example rescission of the contract, injunctions and compensation, but with no civil penalty risk.

From 9 November 2023 important legislative changes take effect in relation to "standard form contracts" that are also "consumer contracts" or "small business contracts".[2]

[1] ASIC media release 22-302 *ASIC announces Enforcement Priorities for 2023*, published 3 November 2022.
[2] Pursuant to the *Treasury Laws Amendment (More Competition, Better Prices) Act 2022* (Cth). It passed Parliament and received Royal Assent on 9 November 2022, but the relevant provisions that are the subject of this article (in Schedule 2) take effect 12 months after Royal Assent, hence the 9 November 2023 commencement date.



**These sections are being affected by the legislative changes*

Where such a contract constitutes a "financial product", or is for the supply of a "financial service", the relevant law is the *Australian Securities and Investment Commission Act 2001 (Cth)* (**ASIC Act**). For a standard form consumer contract or small business contract that is not a financial product or for the supply of a financial service, the relevant law is the Australian Consumer Law in the *Competition and Consumer Act 2010 (Cth)* (**ACL**). So it is a relatively complex regime. The ASIC Act and ACL provisions, and the impending amendments to them, are similar but not identical.

Generally, the changes:

- create **new civil penalties for merely including an unfair term in a relevant contract**, even if the term is not relied on or enforced;
- also create **separate penalties for applying or relying on an unfair term**;
- are additional to existing **civil remedies** in the ASIC Act and ACL for unfair contracts e.g. court orders invalidating part or all of contract; damages; and injunctions (but these existing remedies are also expanded by the changes);
- add to the criteria to be considered when determining whether a contract is a "standard form contract";
- expand the range of contracts that will be a "small business contract";
- for contract issuers who are AFSL licensees, have the consequential effect of creating **deemed "significant breaches"**, **reportable to ASIC**, for including an unfair term in a relevant contract, or applying or relying on an unfair term.

The comments below focus on the unfair contract terms provisions (**UCT provisions**) of the ASIC Act rather than the ACL, i.e. those provisions applying to standard form consumer or small business contracts that constitute a financial product or are for the supply of a financial service.

WHAT IS A STANDARD FORM CONTRACT?

The UCT provisions do not precisely define "standard form contract" but include a non-exclusive list of matters that a court must take into account in deciding whether a contract is a standard form contract.[3] In addition to any other matters that a court considers relevant, the current provisions require a court to consider:

- the relative bargaining powers of the parties;
- if the contract was prepared by one party before any discussions occurred;
- if one party was required to either accept or reject the terms of the contract;
- if a party was given the opportunity to negotiate; and
- if the contract takes into account the relevant parties' specific characteristics.

The amendments will not materially change the above considerations but they:

- add another consideration, being whether a party has entered into the same or a similar contract before, and the number of times they have entered into this;[4] and
- provide that "minor" negotiated amendments or the selection of different options will not necessarily exclude a contract from being a standard form contract.[5]

[3] Section 12BK ASIC Act.
[4]See ASIC Act sub-section 12BK(2). Also, per 12BK(1), if a party to a legal proceeding alleges that a contract is a standard form contract then it is presumed to be unless the other party proves otherwise.
[5] See new ASIC Act sub-section 12BK(3).

WHAT KINDS OF FINANCIAL PRODUCTS AND CLIENT RELATIONSHIPS MIGHT BE COVERED?

In relation to the financial services industry, the businesses most likely to be affected are financial services licensees who deal with "retail clients" who are individuals or small business corporates, or with individuals meeting the relevant "sophisticated" or "high net-worth" criteria to be treated as wholesale clients.

This is because:

- the ASIC Act definition of "consumer contract" requires the contract to be with an "individual" (e.g. not a company) for an acquisition of something by the consumer wholly or predominantly for "*personal, domestic or household use or consumption*"[6] but there is no limit on the monetary value of the contract; and
- the amended ASIC Act definition of "small business contract" will require the upfront contract price to not exceed $5m and require that at least one party enters into the contract in the course of carrying on a business and is an employer of fewer than 100 persons and has a turnover for the last financial year of less than $10m.[7]

(The current "small business contract" definition has lower monetary and employee number thresholds and therefore the amendments will broaden the coverage of the existing UCT provisions).

[6] ASIC Act sub-section 12BF(3).
[7] ASIC Act sub-section 12BF(4).

In relation to the "consumer contract" definition, it is likely that a contract for the purposes of a person's personal investment needs, e.g. investing for their retirement, would be considered to be for "personal, domestic or household use or consumption".[8] However, a contract between a financial services provider (that is not itself a small business entity) and the corporate trustee of a self-managed superannuation fund (**SMSF**) is unlikely to be subject to the laws because the trustee will not be an "individual" and is unlikely to be carrying on a business.[9]

Examples of contracts that are likely to be subject to the ASIC Act UCT provisions are (assuming one of the counterparties is a "consumer" or "small business"):

- investor-directed portfolio (**IDPS**) contracts between an IDPS operator and an IDPS client;
- a contract between a financial adviser and a client for the provision of financial product advice;
- a contract for the provision of member discretionary account (**MDA**) services;
- sharetrading terms and conditions between a broker and client;
- general insurance and life policy contracts (subject to some grandfathering);
- annuity contracts;
- loan contracts for loans for personal use purposes (but this could include a loan to acquire an investment property or other investment e.g. margin-lending arrangements).

[8] See e.g. *Violet Homes Loans Pty Ltd v Schmidt & Anor* [2013] VSCA 56 and *Tonto Home Loans Australia Pty Ltd v Tavares* [2011] NSWCA 389.
[9] But the law does not actually prohibit an SMSF from carrying on a business, even if that is rare in practice.

ARE THE LAWS RELEVANT TO SUPERANNUATION?

A superannuation product will necessarily involve a trustee-beneficiary relationship between the superannuation fund trustee and fund member. Such relationships are usually governed entirely or predominantly by the governing rules of the fund, usually in the form of a trust deed, rather than by any contract. So there need not be any contract between trustee and member and, perhaps, there usually will be no contract.

However, a trust relationship and a contractual relationship are not mutually exclusive and they can co-exist. In the situation of an individual choosing their own fund (as opposed to an employee defaulted into an employer-chosen fund or continuing on in a stapled fund) the particular wording used by a trustee in its Product Disclosure Statement and application form might give rise to some contractual terms between the trustee and a member.

But even if the product application and issue process did not give rise to any contract, if a trustee offered ancillary product features or financial services on separate "terms & conditions" then these "T&Cs" might themselves be subject to the UCT provisions. Examples of such ancillary offers might be advice services or the use of "apps" or other online facilities that a member can use to give investment or switching instructions.

Since 1 January 2021 any person who "*operates a registrable superannuation entity as trustee of the entity*" will be providing a "superannuation trustee service" and a "financial service".[10] The concept of "operating" a superannuation entity is broad and this may increase the likelihood that T&Cs for ancillary services might be characterised as being for the supply of financial services and subject to the UCT provisions, provided the general law fundamentals for the creation of a contract are also satisfied.[11]

[10] See Corporations Act sections 766A and 766H.

[11] That is, an agreement between the parties (offer and acceptance); the mutual giving of consideration; capacity to contract; and an intention to be legally bound.

EXCLUSION FOR MANAGED INVESTMENT SCHEME CONSTITUTIONS AND OTHER EXCLUSIONS

ASIC Act sub-section 12BL(1) says that the UCT provisions do not apply to "*a contract that is the constitution of a company, managed investment scheme or other kind of body*".[12] So the constitution of a managed investment scheme (**MIS**) – i.e. a managed fund, whether registered or unregistered – will not be subject to the UCT provisions.[13] Also, the constitution of an unincorporated association or society will not be subject to the UCT provisions.[14]

There are also exclusions for:

- pre-5 April 2021 life policies and renewals or replacements of such life policies;[15]
- medical indemnity cover;[16]
- the rules of certain types of payment and settlement systems, and financial markets and facilities.[17]

[12] ASIC Act sub-section 12BL(1).
[13] In relation to other non-MIS trusts which might have a "constitution", it seems to us that those trusts would not be an "other kind of body". If so, the constitution of another type of trust is not automatically excluded from the scope of Subdivision BA. But of course that does not mean that a trust constitution is necessarily a contract. The circumstances need to be examined in each case (see, for example, the discussion under the heading above "Are the laws relevant to superannuation?").
[14] See the Corporations Act s9 definition of "body", which specifies a body corporate or unincorporated body, including a society or association.
[15] ASIC Act sections 12BLA and 12BLB.
[16] ASIC Act sub-section 12BL(1A).
[17] ASIC Act sub-section 12BL(4) and section 12BLC.

SUB-CONTRACTORS AND SERVICE PROVIDERS

The UCT provisions of the ASIC Act or the ACL might apply where a financial services provider contracts with a small business entity for that business to:

- supply financial services to clients on behalf of the provider;[18] or
- supply financial services to the provider; or
- do or supply things other than financial services.[19]

So the UCT provisions may apply to a contract that a superannuation fund trustee has with a small business (ie, where the contract price is less than $5m and the small business employs less than 100 people and has less than $10m turnover). However, such contracts are often "bespoke" or, even if based on a template that either party uses repeatedly, have substantial tailoring to the particular transaction. In such a case, the contract is unlikely to be a standard form contract and therefore unlikely to be subject to the UCT provisions. But the amendments make clear that a small degree of tailoring will not necessarily exclude a contract from being a standard form contract.

[18]The ASIC Act sub-section 12BF(4) definition of "small business contract" does not say expressly that the recipient of the financial service or financial product must be one of the parties to the contract; it is therefore at least arguable that the recipient could be a third party. In contrast, the ASIC Act definition of "consumer contract" does require that the acquirer of what is "supplied under the contract" is also a party to the contract.

[19] The amended "small business contract" definition in the ACL will omit any contract price threshold, thereby widening the coverage of the ACL provisions, but will otherwise be the same as that in the ASIC Act.

WHAT IS AN UNFAIR CONTRACT TERM?

Neither the current UCT provisions nor the amendments define "unfair" precisely; they only specify principles to apply in determining whether a contract term is unfair. These principles are that the term:

- would cause a significant imbalance in the rights and obligations of the parties;
- is not reasonably necessary to protect the legitimate interests of the advantaged party; and
- would cause detriment to the (disadvantaged) party if relied upon.[20]

The existing provisions also give "***examples*** *of the kinds of terms that* ***may*** *be unfair*".[21] The amendments do not change the examples. These include:

- one-sided termination rights and termination penalties;
- unilateral rights to vary the contract (not uncommon in financial services contracts);
- one-sided price variation rights where the party subject to the price variation (likely an increase) has no right to terminate as a consequence; and
- one-sided liability or liability exclusion terms.

A term of a kind in the examples is not necessarily unfair and the existence of such a term will not automatically constitute a contravention of the new penalty provisions. Whether the term is unfair will require a (potentially difficult) judgement that has regard to the nature of the contract and its commercial context, the reason for including the term, and how the term operates in conjunction with other terms of the contract.

[20] ASIC Act sub-section 12BG(1).
[21] Section 12BH ASIC Act.

EFFECT ON AFSL LICENSEE BREACH REPORTING

The current UCT provisions say that an unfair term is "void" and provide for consequential civil remedies against a person who proposed or attempted to rely on the term (and the amendments will continue and extend these civil remedies).

But the current provisions do not include civil penalties and, even if a contract term is unfair and void, such unfairness does not presently constitute a "contravention" of, or non-compliance with, any financial services law.[22]

The amendments will create civil penalty contraventions where a person proposes an unfair contract term that is included in a relevant contract; or a person applies, relies or purports to apply or rely on, an unfair contract term.[23]

For AFSL licensees, a contravention of the UCT civil penalty provisions will be a deemed significant breach and hence reportable to ASIC pursuant to Corporations Act sections 912D and 912DAA.[24] It might also be an "actual" significant breach according to the normal significance criteria in section 912D.

[22] But even under the current law, the attempted enforcement of an unfair term might indicate a contravention of some other obligation, for example a failure by an AFSL licensee to provide financial services efficiently, honestly and fairly as required by Corporations Act paragraph 912A(1)(a).
[23] New ASIC Act sub-sections 12BF(2A) and 12BF(2C) in conjunction with new paragraph 12GBA(6)(aa).
[24] This is because a contravention of new ASIC Act sub-section 12BF(2A) or 12BF(2C) will be a contravention of the Corporations Act paragraph 912A(1)(c) AFSL licensee obligation to comply with the "financial services laws"; per paragraph 912D(3)(b), compliance with 912A(1)(c) is a "core obligation" so far as it relates to (among other laws) the provisions of the ASIC Act specified in paragraph (c) of the Corporations Act section 761A definition of "financial services law", and paragraph (c) of that definition specifies a provision of Division 2 of Part 2 of the ASIC Act; sub-sections 12BF(2A) and 12BF(2C) are in Subdivision BA of Division 2 Part 2 of the ASIC Act and therefore compliance with those provisions is within the scope of a licensee's 912A(1)(c) "core obligation"; sub-sections 12BF(2A) and 12BF(2C) are also civil penalty provisions per new paragraph 12GBA(6)(aa); and, finally, per Corporations Act paragraph 912D(4)(b), a breach of the 912A(1)(c) core obligation to comply with the financial services laws that "is constituted by the contravention of a civil penalty provision under any law", which sub-sections 12BF(2A) and 12BF(2C) are, is "taken to be" a "significant" breach. Corporations Act paragraph 912D(4)(b) provides that regulations may exclude a civil penalty provision from giving rise to a deemed significant breach but the relevant regulation, Corporations Regulation 7.6.02, does not exclude any ASIC Act provisions.

It is not necessary for a court to declare a contravention before one will exist.

The strict legal consequence is that, from 9 November 2023, if a relevant type of contract merely includes an unfair term, an AFSL licensee who is the proponent of the unfair term (i.e. the author or "owner" of the standard form contract) will have an obligation to report a deemed significant breach to ASIC. Clearly, this is a material change to the law which needs to be considered very carefully in the lead up to 9 November 2023.

Given the relatively imprecise and therefore subjective meaning of "unfair", there may be reasonable differences of opinion about whether a term is unfair and a fully-informed judgement may require knowledge of all the relevant facts of the industry and commercial context and history of the contract. ASIC and a licensee may have different opinions in a particular case and therefore different opinions about whether a licensee has breached its significant breach reporting obligations. This may place licensees in a difficult position.

PENALTIES

The maximum penalty a court can order for contravening an ASIC Act UCT civil penalty provision will be:[25]

- For an individual, the greater of:
  - $1,565,000;[26] or
  - if the court can determine the amount of the benefit derived and detriment avoided because of the contravention, that amount multiplied by 3.

- For a body corporate, the greatest of:
  - $15.65m;
  - the amount of the benefit derived and detriment avoided because of the contravention multiplied by 3; or
  - either
    - 10% of the annual turnover of the body corporate for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene, the civil penalty provision, or
    - if 10% of the turnover is greater than an amount equal to $782.5m, then $782.5m.

These maximum penalties are applicable to each individual contravention. This means that if there are multiple unfair terms in a single contract, and/or uses of the same standard form for multiple clients, penalties can potentially apply to each instance of non-compliance. However, in practice, we expect that a court would only impose maximum penalties in the most serious cases and would usually look at the totality of the contravening conduct and impose a single penalty for each "batch" of similar contraventions.

Whilst it is hard to speculate on what penalties the courts could impose in practice once the reforms are in effect, penalties could be substantial in theory.

[25] ASIC Act section 12GBCA.

[26] The section provides for a maximum penalty of 5,000 Commonwealth penalty units and, from 1 July 2023, a penalty unit is $313. Other references to dollar penalties are also based on the number of penalty units specified in the legislation and the current penalty unit value of $313.

IMPACT ON EXISTING AND NEW STANDARD FORM CONTRACTS

The amendments will apply to new contracts made from 9 November 2023. They will not apply to pre-existing contracts unless such contracts are "renewed" or a term of the contract is "varied"; in the case of a variation the amendments will only apply to the terms that have been varied.

In applying these transitional rules, it is not the date that a standard form contract "template" was drafted or published that is relevant; it is the date of execution of each individual contract using that template. For example, if a financial services provider first published standard form consumer contract terms on its website in 2022 and each new client applies to open an account with the provider on those terms, and the terms do not change after 9 November 2023, then the amendments will *not* apply to the contract (incorporating the 2022 version of the website terms) between the provider and a client who opened an account before 9 November 2023 but the amendments *will* apply to the contract (incorporating the same 2022 terms) between the provider and a client who opens an account from 9 November 2023.

CONCLUSION

The introduction of the original UCT provisions in 2010 prompted many financial services businesses to review their standard form contracts at that time. But until recently there has been relatively little enforcement activity and litigation in relation to the UCT provisions and businesses may have subsequently relaxed their focus on unfair contract terms.

But the 9 November 2023 changes, particularly the introduction of civil penalties and deemed significant breaches, coupled with apparent increased ASIC focus in this area, mean that financial services providers (and other businesses) need to give priority to complying with these provisions.

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