Contract Disputes – How to prevent them; How to deal with them

Presentation by Geoff Browne, Victorian Small Business Commissioner to the Victorian Waste Management Association

27 May 2014

Thank you for the opportunity to speak to you this morning. My presentation will:

- Provide a quick overview of the role of my Office;
- Summarise key changes to my legislation which came into effect on 1 May 2014;
- Review the types of contract disputes my Office deals with, including those in your industry;
- Provide an update on the Commonwealth review of business-to-business contracts; and
- Leave you with a challenge/ opportunity to do something about contract disputes in your industry.

Role of the Victorian Small Business Commissioner (VSBC)

The VSBC is an independent statutory role established under its own Act by the State Government in 2003. While the VSBC has a number of functions under that Act, today our predominant function is to provide a quick, low cost dispute resolution service for businesses with a commercial dispute with other businesses.

I also have dispute resolution roles under other specific legislation – Retail Leases Act 2003; Owner Drivers and Forestry Contractors Act 2005; Farm Debt Mediation Act 2011; and from 1 July 2014, the new Taxi Reform legislation.

The policy rationale for our dispute resolution role is to enable businesses to resolve disputes without having to go through litigation, and get back to business – and that is equally applicable to the business complaining and the business against whom the complaint is made. Litigation takes a long time, is costly and time consuming, and is a major distraction to your business. It can often result in parties to litigation incurring costs which far exceed the amount in dispute. And it can have adverse effects on business performance, work related stress and the general health and wellbeing of the business owner – particularly smaller businesses.[1]

[1] Research conducted by the VSBC surveyed businesses involved in commercial litigation with another business in VCAT in 2012. The survey obtained data on direct expenditures and time spent on the litigation, as well as qualitative impacts of the litigation on work related stress and general health and wellbeing of the business owner. A summary of the survey results are provided in 'Avoid the Costs of Litigation', an Information Sheet available at www.vsbc.vic.gov.au

Some commercial disputes must by law be referred to my Office for attempted resolution before they can progress to litigation. These are commercial disputes relating to landlords and tenants in retail leases, owner drivers and their hirers, and farmers in default of a farm debt.

Other commercial disputes can be brought to my Office, but there is no statutory requirement to do so. These include general commercial disputes relating to supply contracts; licencing agreements; franchises; distribution agreements; non-retail leases; and so on.

Our services

Our main form of dispute resolution is mediation. I appoint an independent expert mediator to sit down with the parties under tight confidentiality, and work with the parties to try to identify a resolution of the dispute they are both happy with. My Office is not part of the civil justice system, so mediation through my Office (unlike disputes lodged with VCAT or the Courts) is not on the public record.

The role of the mediator is not to determine who is right or wrong, or make a determination. The role of the mediator is to facilitate effective communication between the parties and try to find a pragmatic resolution of the dispute. The settlement is not necessarily defined by legal obligations or precedent, and can be quite creative. Avoiding subsequent litigation provides a strong incentive for most parties to try to resolve the dispute through mediation.

Another key benefit of mediation is that it is far more likely to enable the parties to continue to conduct business together. The outcome is quick, pragmatic, and acceptable to both parties. Once involved in a litigation process, it is very difficult to continue a business relationship. Research[2] conducted by my Office in 2007 found that one of the key elements of building and maintaining successful business relationships is identifying and resolving disputes early and quickly, and avoiding litigation.

For most mediations, we charge each party $195 for a half-day mediation. This is a highly subsidised fee for the mediator. While most mediations are conducted in our Offices in Melbourne, last year 20% were held in regional Victoria. We send the mediator to the regional location, hire the venue, and cover the travel costs of the mediator. All the parties pay us is $195 each.

If the parties wish to bring along representation, they can, obviously at their cost.

Over our 11 years, we have conducted more than 6,000 mediations, with a settlement rate averaging 80%. Satisfaction of those using the service is consistently around 93%. And not

[2] Report is available at www.vsbc.vic.gov.au

all disputes we receive progress to mediation. This financial year, about 30% of disputes have been resolved by my staff through shuttle engagement with the parties – at no cost to either party.

While our predominant activity relates to business-to-business disputes, we also deal with business-to State or Local government disputes, although this has traditionally been only 2% of our total volume.

Unfortunately, a number of parties to a dispute refuse to engage with my Office. I have no powers to compel participation although for certain disputes I can issue a certificate certifying mediation has been refused, which can have costs consequences for the refusing party if the matter subsequently progresses to litigation. This has the effect of reducing the refusal to mediate rate for those types of disputes.

Refusal to engage is regrettable, as in many cases these disputes will escalate to litigation, with costs and other impacts on both parties. $195 for a half day mediation, within a few weeks of the dispute being lodged, and the likelihood of a continuing business relationship, must be a better outcome on any measure.

Amendments to the Small Business Commissioner Act 2003

However, Amendments to my Act, commencing on 1 May this year, will I believe encourage more 'general commercial' disputes to be brought to my Office, and increase the willingness of respondent parties to engage with us.

The key change is that I now have the power to issue certificates to parties relating to general commercial dispute lodged with my Office. Certificates can be issued to state:

- that alternative dispute resolution (ADR) has been attempted, but been unsuccessful;
- that ADR is unlikely to resolve the dispute; or, importantly,
- that a party has *unreasonably refused* to participate in dispute resolution with the Office.

Provision of a certificate that mediation has been attempted, unsuccessfully, can be useful to the parties as evidence to a Court that they have sought to resolve the matter through ADR, thereby satisfying requirements of the Civil Procedures Act.

However, if I issue a certificate that a party has unreasonably refused to participate in ADR, I may also publish the name of that refusing party in my Annual Report, tabled in Parliament. I expect this will provide greater incentive for Respondent parties in general commercial disputes to engage with my Office, and significantly reduce the relatively high refusal rate experienced in in the past decade for these types of disputes.

I have developed guidelines on what 'unreasonable refusal' means, and these are on our website, although every case will need to be considered on its merits.

So my first 'take away' for you today is, if you find yourself in a commercial dispute with another business, whether as the complainant or the other party, be prepared to use our services and try to resolve the dispute quickly and pragmatically. Importantly, I have no constraining definition of 'small business', so will take disputes involving most businesses.

Common causes of contract disputes

I'd now like to turn to some of the common characteristics of 'general commercial' disputes lodged with us, and in particular some of the terms and conditions in these contracts which are often the basis of the dispute.

Let me give you some examples. Ask yourself whether you as a consumer would sign a contract – say a contract for mobile phone services or personal training services – with these terms:

> "The Contract may be varied by Supplier at its sole discretion with effect from publication by Supplier of the varied Contract"
>
> "At any time during the term, Supplier may vary the fees upon giving notice to the customer"
>
> "The Customer acknowledges that the Fees are subject to change without notice"
>
> "Time is <u>not</u> of the essence in relation to the performance of the Services" (emphasis added)
>
> "This agreement is for a three year period and unless either party advises the other party in writing no more than 60 days and no less than 30 days prior to the end of the period that it wants to terminate the agreement, the agreement is automatically renewed for a successive period of the same duration, and at the Suppliers discretion, on these terms and conditions or the terms and conditions applying at the time of renewal." (And no right of Customer to terminate otherwise without significant cost.)
>
> "In the event of an early termination of this agreement by either party (except as a result of a breach by Supplier) the customer agrees to pay damages equating to the service fees relating to the remaining period of the agreement"
>
> "Supplier may refuse to provide the services in its absolute discretion"
>
> "If the customer receives an offer to provide the services from a third party (at the end of the contract term), the Customer grants to the Supplier last right of refusal for the further provision of the Services by Supplier at the same price until one year after expiry

or termination of this Agreement. This clause survives termination or expiry of this Agreement".

"The Supplier may terminate the agreement at any time during the term by giving the customer 30 days notice." [The customer can't terminate during the term without incurring a $300 administration fee and paying the Supplier the amount payable for the balance of the term as 'agreed liquidated damages'.]

"If your dispute results in a chargeback your account will be sent to collections and you will incur a penalty fee. If you have a dispute and contact a government department you will incur an hourly fee for the time needed to resolve it." [regardless of the validity of the dispute]

"Early cancellation fee is 20% of the invoiced amount. Collection fee is 15% of the outstanding amount. Administration fee is $100. Penalty fee is $100. Hourly fee is $100. "

"We accept no liability for any loss whatsoever"

Under the Australian Consumer Law (ACL), such terms would be, or would likely be, deemed 'unfair terms' and thereby void in standard form consumer contracts. These are contracts between a business and a consumer where there is no negotiation over the terms and conditions – a 'take it or leave it' contract.

The ACL considers terms 'unfair' in a standard form consumer contract where the term satisfies three requirements:

- It causes a significant imbalance in the parties' rights and obligations under the contract;
- It is not reasonably necessary to protect the legitimate interest of a party to the contract (and the party who would be advantaged has the onus of proof that the term is reasonably necessary); and
- It causes detriment to a party to the contract if applied.

Most of the terms presented above have been found by a Tribunal or Court (whether under the ACL, or the Victorian Fair Trading Act prior to the ACL, which included unfair contract terms provisions) to be unfair terms and therefore void in consumer contracts[3].

[3] FCA 2013: ACCC v.Bytecard PL Consent Orders, cited by DLA Piper Australia in online article 'Australia: ACCC obtains its first unfair contract terms declaration: ACCC v Bytecard Pty Limited', 4 August 2013; ; VCAT 2009: Director of Consumer Affairs v. backloads.com ; VCAT 2008: Director of Consumer Affairs v. Trainstation Health Clubs; VCAT 2006: Director of Consumer Affairs v AAPT

The general type of terms considered unfair are:

- Unilateral variation, without right of customer to terminate to avoid changes without penalty
- Indemnity in any circumstances for the supplier
- Supplier right to terminate contracts at any time without cause while the customer's right to terminate are subject to conditions
- Unreasonable limitation of liability for supplier
- Imposing an unreasonable indemnity burden on customer, including legal cost on customer / limiting customer's rights to sue.
- Penalising the customer – costs on customer of termination significantly more than the cost arising on supplier of termination [such an amount is, or is likely to be significantly more than the Supplier's reasonable costs reasonably incurred because of the early termination]
- Supplier unilaterally to determine the consequences of a breach of the agreement
- Supplier right to terminate service provision where trivial or inconsequential breach.

However, such terms in contracts between businesses are not currently captured under the ACL. While in my view such terms remain unfair terms, they are not void or illegal (unless they extend to unconscionability or misrepresentation).

Some terms in business-to-business disputes may be considered onerous and therefore unenforceable. In Bonola v. Elite Oriental Products [2012] VCAT 431, the member commented that

> *"The words 'This agreement will be automatically renewed for extra 3 years unless the Clients give written cancellation notice to Supplier at least 3 months before the end of the term' are arguably unenforceable, as they constitute an onerous clause which has not been sufficiently brought to the Applicant's attention".*

As the member said further:

> *"The common law of contract places an onus on the party seeking to enforce an onerous clause. … I consider (this clause) to be onerous, because there is no justification for the contract rolling over for a three year term. …. As the Respondent does not go out and buy new equipment or hire new staff in reliance on a new three year term, there is no commercial justification for the renewed term being so long."*

As the VCAT member further comments, the onerous nature of terms in contracts are particularly problematic where a customer has not had the opportunity to read the contract before entering into it. Where both parties sign a contract the Courts have generally taken the view that both parties have read and understood the terms of that contract. Nonetheless, bringing potentially onerous clauses to a customer's attention, prior to signing, is better business practice than trying to hide such clauses, notwithstanding the clause itself may not be considered as consistent with building and maintaining successful business relationships.

The Bonola case also considered the question of damages arising to the Supplier from cancellation of the contract by the customer. The terms of the contract required the customer to pay the Supplier the amount payable under the contract for the (rolled) three year term if cancelled during the term.

The VCAT member noted:

> *"Of course, such clauses are unenforceable if they operate as a penalty. To be enforceable, such a clause must provide for the payment of a genuine pre-estimate of damage."*

In this case, the VCAT member interpreted the 'damages' clause as requiring a payment on cancellation of the full three years' fees, rather than the balance of the fees for the three year period, and found the clause on this interpretation a penalty and therefore not enforceable. Nonetheless, even if the clause was clearly for payment of fees for the balance of the term (as the examples provided above tend to be), the question remains whether requiring payment of the balance of the fees for the term is a 'genuine pre-estimate of the damage' suffered by the Supplier, notwithstanding a term of the contract stating this is the case. Clearly the amount envisaged is gross revenue, so I find it difficult to accept that such amount could constitute a 'genuine pre-estimate' of damage or loss to the Supplier when the product or service is not being supplied.

VCAT decisions are specific to the case and do not bind the Courts. Nonetheless, this case raises questions about the enforceability of rolling contracts, the justification for the term to 'roll over' for such a lengthy period, and the associated 'damages' clauses based on gross revenues forgone as an estimate of loss.

My Office has received a number of disputes relating to such contract terms in a number of industries. One of the most prominent is your industry, the waste management sector. All of the examples given above are from the fine print in waste management services terms and conditions, from a number of suppliers, large and small. Other industry sectors also feature: online and onsite advertising; online search optimisation; serviced offices; and leased equipment. The Bonola case was about the security monitoring sector.

While many of these terms may currently not be illegal in business-to-business contracts, in my view they are clearly unfair. Arguably, they are designed to bind the customer into onerous provisions, which cannot be consistent with building ongoing successful business relationships.

Unfair Contract Terms in Business Contracts – Commonwealth review

The Commonwealth Government made an election commitment to extend consumer protections against unfair contract terms to small business. A consultation paper on this issue is expected to be released by the Commonwealth very soon.

The recent Federal budget allocated $1.4m over four years to support this election commitment. It is going to happen.

While I suspect a lot of the submissions to the consultation paper will focus on defining 'small business', in my view that misses the point. These terms are unfair. I see no reason why any standard form business to business contract should contain such terms, regardless of the size of the client business. Can you imagine the situation where a Supplier has both 'small' businesses and 'medium' businesses as clients, and has two forms of standard form business contracts – one with fair terms and the other with unfair terms. In my view a ridiculous situation.

An Opportunity and a Challenge

The use of contract terms I've previously mentioned appears widespread in your industry. I suspect it's evolved as new small businesses take on board the terms the larger players have been using, perpetuating the spread of such terms.

My final 'take away' message is that you have an opportunity to address these unfair terms before the outcomes of the Commonwealth review are known, and legislation changes, which may be some time.

This could be progressed by the industry association taking a lead, and developing guidelines as to what terms it considers should not be included in contracts. Alternatively, some businesses may see the opportunity to pursue a competitive advantage by removing unfair terms from its contracts and promoting its 'good business' terms to current and prospective customers.

Or you could do nothing until forced to by changes to Commonwealth law. If this is your preference, I ask you to reflect on how these terms assist you in maintaining business relationships, and what customer complaints you have to deal with arising from these terms.

Proactive or reactive? The choice is yours.

Thank you for the opportunity to speak with you today.