

# Coversheet: Protecting business and consumers from unfair commercial practices

Advising agencies	Ministry of Business, Innovation and Employment (MBIE)
Decision sought	Expanding the protections for businesses and consumers against unfair commercial practices
Proposing Ministers	Minister of Commerce and Consumer Affairs Minister for Small Business

## Section A: Summary: Problem and Proposed Approach

### Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

These proposals seek to reduce the prevalence of unfair business-to-business and business-to-consumer conduct, and unfair business-to-business contract terms.

- **Unfair conduct** may include the use of pressure tactics to induce a party to enter into a contract, deceptive conduct, or enforcing a contract in a harsh manner.
- **Unfair contract terms** can include terms which shift risk from one party to another, make it difficult for a party to terminate a contract, allow one party to unilaterally vary the terms (including the price) of a contract, or are otherwise very one-sided.

Nearly half of businesses surveyed by MBIE in 2018 indicated that they had been offered what they considered to be unfair contract terms (UCTs), or otherwise treated in a way they considered to be unfair, in the last year (although the survey sample size was relatively low and aggrieved businesses may have been more likely to respond). We also have anecdotal information about unfair business-to-consumer conduct that may cause significant detriment.

Not all practices that businesses or consumers perceive as unfair are necessarily problematic from a policy perspective; some can be efficient and pro-competitive. To the extent that practices are problematic, businesses and consumers are already able to mitigate these to some degree (such as by not entering into a contract, or by asking for changes to unfair terms).

Nevertheless, due to factors such as imbalances in bargaining power, the lack of legal and commercial sophistication of some parties, and the presence of 'take-it-or-leave-it' standard-form contracts, without legislative intervention, unfair practices are likely to persist in a number of situations.

Unfair practices can have a number of negative economic impacts. They can:

- reduce consumers' and businesses' ability and willingness to transact and engage in markets with confidence;

- shift risk and liability to parties that are not well placed to manage them effectively;
- increase transaction costs, by requiring firms to spend more time doing ‘due diligence’ on contracts, or seek more legal advice;
- increase operating costs and finance costs, such as if a firm faces cash flow issues as a result of extended payment terms;
- increase costs for other parties, if the price of a contract is raised to compensate for unfair terms;
- negatively impact on firms’ ability to grow and innovate, if their limited resources are diverted into dealing with the above;
- lead to financial and emotional detriment for consumers and contractors who nominally function as businesses, but bear a number of similarities to employees; and
- lead to wasted time, inconvenience, and increased stress.

While some of these effects may be confined to individual businesses and consumers, many of them have the potential to have broader impacts, such as lower levels of competition, innovation, and productivity across the economy, with corresponding negative impacts for consumers.

While there are a number of protections in the Fair Trading Act, Commerce Act, and other legislation against unfair practices, there are significant gaps in the protections against UCTs and more modest gaps in the protections against unfair conduct. Given this, without future legislative intervention, unfair practices are likely to persist.

## Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

### Unfair conduct

In relation to unfair conduct, we considered:

- **Option 1A: Prohibit unconscionable conduct**, in line with Australia. Australian courts have ruled that unconscionable conduct is conduct that is ‘against conscience by reference to the norms of society’, with such norms including honesty and fairness.
- **Option 1B: Prohibit oppressive conduct**, in line with the definition in the Credit Contracts and Consumer Finance Act 2003. Conduct would be oppressive if it was judged to be harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice.

Both of these options would be targeted at similar types of conduct, such as egregious practices that involve exploiting another party’s vulnerabilities or lack of bargaining power, and conduct that goes well beyond what is commercially necessary or justifiable. Conduct would need to be more than simply ‘unfair’ to be judged as unconscionable or oppressive.

Ministers have indicated their intention to proceed with Option 1A, on the basis that this will support alignment with Australia and allow New Zealand to draw on Australian case law. In contrast, we have a slight preference for Option 1B. This is because there is existing New Zealand case law on the nature of oppressive conduct, which could reduce the uncertainty associated with the prohibition. In addition, there is a risk that the courts could interpret a statutory prohibition against unconscionable conduct too narrowly. Nevertheless, we think that either option would provide net benefits relative to the status quo.

## Unfair contract terms

In relation to UCTs, we considered extending the existing protections for consumers against UCTs (which are defined as terms in standard form contracts that are unbalanced, would cause detriment, and are not reasonably necessary) to also apply to:

- **Option 2A: Small business standard form contracts with a value below \$100,000.**
- **Option 2B: All standard form business contracts with a value below \$100,000.**
- **Option 2C: All standard form business contracts with a value below \$250,000.**

Ministers have indicated their preference to proceed with Option 2C, on the basis that this will provide protections against UCTs for a high proportion of business contracts. In contrast, we have a preference for Option 2B. This is because we think that there is a case for businesses to do their own due diligence and seek legal advice for contracts valued above \$100,000, and because the risks associated with intervention are likely to be greater if higher-value contracts are covered under the regime. We nevertheless think that all three options provide net benefits relative to the status quo.

## Section B: Summary Impacts: Benefits and costs

### Who are the main expected beneficiaries and what is the nature of the expected benefit?

There are a range of expected benefits associated with reform, including:

- Reduced detriment for consumers and contractors who nominally function as businesses, but bear a number of similarities to employees.
- Reduced transaction costs for businesses, by reducing the need to spend as much time doing 'due diligence' on contracts or to seek as much legal advice.
- Reduced operating costs or finance costs, such as if firms face fewer cash-flow issues as a result of being paid more promptly.
- Making it easier for businesses to grow and innovate, by diverting fewer of their limited resources into dealing with unfair conduct and UCTs.
- A better allocation of risk, cost, and liability to the firms that are best-placed to deal with it (rather than it being allocated on the basis of negotiating strength alone).
- Consumers and businesses transacting with increased confidence, in the knowledge that there will be fewer instances of unfair practices in markets.

The benefits are difficult to quantify. Some of these benefits are likely to be limited to individual businesses and consumers, but there is also a potential for broader economic benefits.

### Where do the costs fall?

Costs include:

- An estimated one-off cost for businesses of \$13 million to review their standard form contracts for compliance with the UCT provisions and amend them as necessary, as well as lower ongoing costs.
- General costs in terms of uncertainty (e.g. seeking legal advice, less organisational agility). However, many businesses are already familiar with the UCT regime, and most conduct will not be affected by an unconscionable conduct prohibition.
- Costs for the Commerce Commission associated with enforcing the new provisions.

**What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?**

In addition to the costs and benefits outlined above, there are the following potential impacts. These are outlined here because the net impact is unclear:

- There could be price increases if businesses feel that their negotiating ability is diminished, or have to increase their prices to account for not being able to shift risks onto another party. However, we think this risk is low, and there could also be net price reductions if suppliers reduce their prices as a result of facing fewer contractual risks.
- Some businesses could cease to supply some goods and services if they are no longer able to pass on risk and are not willing to absorb this risk. Again, we think this risk is low.
- There is also a risk that the proposed protections could shield inefficient businesses from competition but we think this risk is low in practice. Conversely, if a reduction in unfair conduct and contracts makes it easier for businesses to grow and innovate, then there is potential for these businesses to have greater capacity to effectively compete.

**Identify any significant incompatibility with the Government’s ‘Expectations for the design of regulatory systems’.**

None.

## Section C: Evidence certainty and quality assurance

**Agency rating of evidence certainty**

The evidence as to the nature of the problem is based on a survey of small businesses and anecdotal evidence provided through submissions and stakeholder meetings. We have also relied to a limited extent on MBIE’s 2016 National Consumer Survey. The survey of small businesses was opt-in, involved a subjective self-assessment as to experiences of unfair practices, and had a relatively low sample size. This means that, while there were attempts to frame the business survey neutrally, there may be some bias towards over-reporting of unfair practices, and in general the survey may not present a statistically robust picture of the prevalence of unfair practices across the New Zealand economy. Evidence of the problem was also limited by the unwillingness of some businesses to submit for fear of retribution. The evidence we do hold is, in any case, largely anecdotal. However, there is enough evidence to suggest that there are a range of business practices taking place that are at least potentially unfair.

There is some uncertainty as to the effects that the proposed prohibitions will have, and it is difficult to quantify the costs and benefits of the options considered as part of this RIS. However, the options draw on international approaches and existing legislative provisions, and we consider any risks to be manageable.

**Quality Assurance Reviewing Agency:**

MBIE

**Quality Assurance Assessment:**

MBIE’s Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement prepared by MBIE. The Panel considers that the information and analysis summarised in the Regulatory Impact Statement meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

# Impact Statement: Protecting business and consumers from unfair commercial practices

## Section 1: General information

### Purpose

The Ministry of Business, Innovation and Employment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

### Key Limitations or Constraints on Analysis

The content of this RIS has been informed by public consultation, including a formal discussion document, stakeholder meetings, and a survey of small businesses. We have also relied to a limited extent on MBIE's 2016 National Consumer Survey. The survey of small businesses was opt-in, involved a subjective self-assessment as to experiences of unfair practices, and had a relatively low sample size. This means that, while there were attempts to frame the business survey neutrally, there may be some bias towards over-reporting of unfair practices, and in general the survey may not present a statistically robust picture of the prevalence of unfair practices across the New Zealand economy. Evidence of the problem was also limited by the unwillingness of some businesses to submit for fear of retribution. The evidence we do hold is, in any case, largely anecdotal. However, there is enough evidence to suggest that there are a range of business practices taking place that are at least potentially unfair.

There are no significant limitations on the scope of the options considered in this RIS, although the options focus on high-level, economy-wide protections against unfair commercial practices, rather than sector- or conduct-specific regulation.

There is some uncertainty as to the effects that the proposed prohibitions will have, and it is difficult to quantify the costs and benefits of the options considered as part of this RIS. However, the options draw on international approaches and existing legislative provisions, and we consider any risks to be manageable.

### Responsible Manager

Authorised by:

Jennie Kerr  
Manager, Competition & Consumer Policy  
Ministry of Business, Innovation and Employment

20 June 2019

## Section 2: Problem definition and objectives

### 2.1 What is the context within which action is proposed?

#### Context

The New Zealand Government has a goal of building a more productive, sustainable and inclusive economy. Amongst other measures, this goal can be supported by ensuring that New Zealand's regulatory systems contribute to a business environment where businesses and consumers are confident participants in fair and thriving markets. A thriving business environment is not an end point in itself; rather, it serves to improve outcomes for all New Zealanders, in their capacity as consumers, employees, and investors.

Unfair commercial practices can undermine the economic and social outcomes sought by government. Because of this, legislation such as the Fair Trading Act 1986 (FTA) and the Commerce Act 1986 seeks to prohibit 'unfair' practices in both business-to-consumer and business-to-business transactions that ultimately harm outcomes for New Zealanders. Section 2.2 outlines the existing legislative protections against unfair conduct.

What is 'unfair' is highly subjective. However, it can broadly be grouped into two categories:

- unfair contracts; and
- unfair conduct.

Unfair contracts may include terms that:

- permit one party to unilaterally vary the terms of a contract;
- shift risk onto one party for events outside of their control;
- restrict the ability of a party to enforce its rights under a contract;
- limit one party's ability to terminate a contract (such as by imposing high cancellation fees);
- do not provide for a supplier to be paid until after an extended period of time (for example, terms that provide for payment up to 90 days after being invoiced); or
- are anti-competitive (such as price-fixing).

Unfair conduct, on the other hand, broadly involves matters other than the terms of a contract, such as:

- the way a party is induced into entering into a contract, such as through the use of harassment, coercion, or other pressure tactics (including making demands in relation to the upfront price of a good or service);
- enforcing a contract in a way that is within a business's legal rights, but goes well beyond what is commercially necessary or justifiable;
- making demands over and above the terms agreed in an existing contract;
- not complying with the terms of an existing contract (such as making late payments);
- misleading or deceptive conduct; or
- refusal to supply (or purchase) a good or a service.

As noted above, what is considered to be unfair is subjective – something regarded as unfair by one business may be regarded simply as robust commercial negotiation by another. Such negotiations form a key part of healthy competition and can lead to benefits for consumers. For example, a retailer that manages to secure reductions in wholesale prices from its suppliers can pass these savings on to consumers. Similarly, competitive conduct by a firm that leads to new or improved

goods and services is generally in the interests of consumers, even if it leads to the demise of its competitors.

Figure 1 below provides a visual representation of the relationship between practices that are 'unfair', practices that are harmful to consumers or the wider economy, and practices that are already prohibited.

Figure 1: Relationship between 'unfair', harmful, and already prohibited practices



In seeking to distinguish between practices that should be prohibited, and practices that should not, it is important to consider the effects of different practices on broader economic and social outcomes. This RIS assesses whether New Zealand currently has the balance right in terms of its protections against unfair commercial practices.

### What would happen if no action was taken?

If no action was taken, existing legislation (see section 2.2) would continue to protect against a range of unfair commercial practices. However, as outlined in section 2.3 below, there are gaps in the protections against unfair commercial practices that would continue to exist. This could have negative implications for individual firms and consumers, as well as the potential for broader negative economic impacts.

## 2.2 What regulatory system, or systems, are already in place?

### Existing protections against unfair commercial practices

As noted in section 2.1, what is 'unfair' is highly subjective. However, existing legislation<sup>1</sup> and common law provide a range of protections against practices that could be perceived as unfair. This section provides a brief overview of the extent of these protections in New Zealand. It also briefly outlines other current government reviews relevant to unfair commercial practices.

#### Fair Trading Act 1986

The FTA seeks to contribute to a trading environment in which the interests of consumers are protected, businesses compete effectively, and consumers and businesses participate confidently. To

<sup>1</sup> Existing legislation falls within the consumer and commercial, and competition, regulatory systems. For more information on these regulatory systems, see: <https://www.mbie.govt.nz/cross-government-functions/regulatory-stewardship/>.

this end, the FTA prohibits:

- misleading and deceptive conduct;
- false, misleading, or unsubstantiated representations;
- harassment and coercion;
- unfair contract terms (see below); and
- specific practices such as bait advertising and pyramid selling schemes.

Of particular relevance are the FTA's protections against unfair contract terms (UCTs). At present, the FTA prohibits UCTs in standard form consumer contracts. A UCT is defined as a term that:

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

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 any enactment, cannot be declared to be unfair.

A standard form contract is defined as a contract in which the terms have not been subject to effective negotiation between the parties, with reference to factors such as:

- whether one of the parties has all or most of the bargaining power relating to the transaction; and
- whether one or more of the parties was, in effect, required either to accept or reject the terms of the contract in the form in which they were presented.

For a contract term to be prohibited, the Commerce Commission must apply to a court for a declaration that a term is unfair. Private parties are not able to apply to have a term declared to be unfair – although they can make a complaint to the Commerce Commission requesting that the Commerce Commission make a court application.

If a court has declared that a term in a standard form consumer contract is a UCT, the business must not:

- include the UCT in a standard form contract; or
- apply, enforce, or rely on the UCT in a standard form contract.

The rest of the contract will continue to bind the parties to the extent that it is capable of operating without the unfair term.

Penalties and civil remedies do not apply in respect of UCTs, unless the term has previously been declared to be unfair.

The FTA includes a non-exhaustive list of contract terms that *may* be unfair. This is referred to as a 'grey list'. Terms are not automatically deemed to be unfair just because they are included in the grey list. The grey list includes terms that:

- permit one party (but not the other) to avoid or limit performance of the contract;
- permit one party (but not the other) to terminate the contract;
- penalise one party (but not the other) for a breach or termination of the contract;
- permit one party (but not the other) to renew or not renew the contract;
- permit one party to assign the contract to the detriment of another party without that other



party's consent;

- permit one party to vary the upfront price payable under the contract without the right of another party to terminate the contract;
- permit one party to unilaterally vary the characteristics of the goods or services to be supplied under the contract;
- permit one party to unilaterally determine whether a contract has been breached;
- limit one party's liability for its agents;
- limit one party's right to sue another party;
- permit one party (but not the other) to vary the terms of the contract;
- limit the evidence one party can offer in proceedings relating to the contract; and
- impose the evidential burden on one party in proceedings relating to the contract.

### Commerce Act 1986

The Commerce Act 1986 seeks to promote competition in markets for the benefit of consumers. It does so by prohibiting agreements (including cartels), and mergers that substantially lessen competition. It also prohibits anti-competitive unilateral conduct by firms with market power, and provides for the regulation of the price and quality of goods or services in markets where there is little or no competition.

The focus of the Commerce Act is on promoting competition, and the associated benefits it produces for consumers in terms of lower prices, higher quality, and innovation in goods and services. It is not designed to protect individual firms from their competitors. While protecting against unfair practices is not the primary goal of the Commerce Act, its provisions nevertheless protect against a range of practices which could be deemed to be unfair.

As will be outlined in section 2.3, many business concerns about unfair practices relate to practices by their suppliers or customers. While the Commerce Act does apply to practices by a firm towards its suppliers or customers, in practice such 'vertical' arrangements are less likely to be anti-competitive than 'horizontal' arrangements between competitors. As noted throughout this document, robust negotiations between a firm and its suppliers or business customers can often offer pro-competitive benefits (such as lower prices for consumers).

### Credit Contracts and Consumer Finance Act 2003

The Credit Contracts and Consumer Finance Act 2003 (CCCFA) protects against a range of practices which could be considered to be unfair in respect of credit contracts and related transactions. Of particular relevance are its provisions relating to oppressive contracts and conduct. Under the CCCFA, on application by the Commerce Commission, or any party to a contract, a court may 'reopen' a credit contract, a consumer lease, or a buy-back transaction if, in any proceedings, it considers that:

- the contract, lease, or transaction is oppressive;
- a party has exercised, or intends to exercise, a right or power conferred by the contract, lease, or transaction in an oppressive manner; or
- a party has induced another party to enter into the contract, lease, or transaction by oppressive means.

The CCCFA defines "oppressive" as "oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice".

If the court reopens a credit contract, consumer lease, or buy-back transaction, it may, among other things:

- cancel or change all or parts of the contract;
- order one party to pay the other party a sum of money; and/or
- order a lender to stop behaving in a particular way.

In deciding whether to reopen a credit contract, consumer lease, or buy-back transaction, the court must have regard to factors such as (but not limited to):

- the relative bargaining power of the parties;
- whether the borrower was reasonably able to protect their own interests, taking into account matters like their age, physical or mental condition;
- whether the lender used unfair pressure or tactics to encourage the borrower to enter into the contract;
- how the lender's contract compares with other lenders' contracts for similar finance products;
- the amount the borrower has to pay under the loan;
- whether the contract is in plain language; and
- whether the terms of the loan or guarantee are reasonably necessary to protect the lender's interests, and whether they allow the borrower a reasonable opportunity to comply with the loan.

#### Equitable doctrine of unconscionability

There is no statutory prohibition against 'unconscionable' conduct in New Zealand. However, the concept of unconscionability has developed within the courts over time. The Disputes Tribunal also has a power under the Disputes Tribunal Act 1988 to intervene if it finds contracts to be unconscionable.

Unconscionability does not have a precise legal definition, but it has been applied where New Zealand courts have considered it inequitable to allow a party to enforce its contractual rights against another party who is detrimentally affected by an agreement. Contracts which appear to be enforceable under normal legal principles will not be enforceable if a court decides they were made in an unconscionable manner.

There are three essential features of when New Zealand courts have intervened against unconscionable conduct:

- the weaker party has a qualifying disability (e.g. age, infirmity, difficulty understanding English);
- the stronger party has knowledge (actual or constructive) of this disability; and
- the stronger party took advantage of this disability to extract a benefit from a transaction.

There are, however, a number of limitations to the usefulness of unconscionability as a protection. For example:

- The doctrine of unconscionability only applies when it is invoked in court. It does not create a positive duty on parties to act in good conscience. It also means that the Commerce Commission cannot take a case and seek penalties against parties engaging in practices which are unconscionable.
- The cost of taking a case to court means that court cases usually only concern high-value transactions. This reduces the doctrine's applicability for many low-value consumer transactions. While the Disputes Tribunal has jurisdiction to consider unconscionability, parties who do not receive legal advice may not be aware of the existence of the doctrine of unconscionability and therefore may not take a case.
- There will generally only be a finding of unconscionability if it involves an element of unfair *conduct*. As such, the doctrine does not offer protections against the terms of a *contract*, even if

they are grossly unfair, unless there is also an element of victimisation.

- A finding of unconscionability will generally be limited to business-to-consumer transactions; the courts have tended to avoid a finding of unconscionability in respect of commercial transactions.

#### Other fairness-related provisions

Other legislation which potentially protects against some forms of unfairness includes:

- the Consumer Guarantees Act (CGA) 1993's statutory warranties in respect of the quality of consumer goods and the fitness-for-purpose of services, and associated rights of redress; and
- the Contract and Commercial Law Act 2017's provisions relating to contractual mistakes, misrepresentations, illegal contracts, and the sale and carriage of goods.

### Why is Government intervention necessary?

There are sound economic justifications for the existing protections against unfair commercial practices discussed above. For example, anti-competitive conduct by firms can harm consumers by increasing prices and restricting innovation. It can also harm other businesses which may be restricted from entering markets and competing. Misleading and deceptive conduct can prevent markets from functioning effectively by reducing consumer confidence and skewing the playing field in favour of businesses that act dishonestly.

In terms of the policy options considered as part of this RIS, we consider that there are good justifications for introducing further protections against unfair commercial practices. These are explored further in section 2.3 below, but include the potential to reduce business-to-business transaction, operating and finance costs; improve the operation of markets; and reduce detriment experienced by consumers.

## 2.3 What is the policy problem or opportunity?

### Introduction

This section outlines three potential issues associated with unfair commercial practices at present:

- Issue 1: Unfair business-to-business *contracts*;
- Issue 2: Unfair business-to-business *conduct*; and
- Issue 3: Unfair business-to-consumer *conduct*.

This section draws on a survey of (predominantly small) businesses conducted by MBIE in June and July of 2018<sup>2</sup>, as well as stakeholder submissions on a discussion paper which was consulted on between December 2018 and February 2019.

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<sup>2</sup> The survey was distributed via the government's business.govt.nz channels and through the Regional Business Partner network. The survey was started by 260 respondents, with a completion rate of around 77 per cent. 85 per cent of respondents had fewer than 20 employees. Businesses from all New Zealand regions and sectors (other than mining) were represented. As noted above, the survey was opt-in, involved a subjective self-assessment as to experiences of unfair practices, and had a relatively low sample size. This means that, while there were attempts to frame the survey neutrally, there may be some bias towards over-reporting of unfair practices, and in general the survey may not present a statistically robust picture of the prevalence of unfair practices across the New Zealand economy.

## 2.3 What is the policy problem or opportunity?

### Issue 1: Unfair business-to-business contracts

#### Prevalence and examples of unfair business-to-business contract terms

Overall, 45 per cent of businesses surveyed by MBIE indicated that they had been offered one or more contract terms that they considered to be unfair in the past year. Of the businesses that indicated that they had been offered UCTs:

- 59 per cent had been offered 'unfair' terms that limited the liability of their supplier or business customer and/or placed the risk on their business;
- 47 per cent had been offered 'unfair' terms that allowed their supplier or business customer to unilaterally vary the terms of the contract (including the price);
- 45 per cent had been offered an 'unfair' upfront price that their business had to pay or receive for goods or services;
- 41 per cent had been offered 'unfair' extended payment terms (e.g. not receiving payment until 90 days after supplying goods or services);
- 35 per cent had been offered 'unfair' terms that limited their ability to enforce their rights under the contract;
- 29 per cent had been offered 'unfair' terms that limited their ability to terminate a contract;
- 18 per cent had been offered terms that they considered to be anti-competitive; and
- 16 per cent had been offered 'unfair' terms that allowed their business customer or supplier to unilaterally determine when a contract has been breached.

19 per cent offered their own examples of what they deemed to be UCTs, including requiring high levels of liability insurance, extensive use of pro-forma invoicing, being required to pay the supplier's legal fees, the duration of the contract, and unrealistic timeframes for the delivery of services.

A number of small businesses, franchisees, and organisations representing small businesses highlighted similar concerns in their submissions on the discussion paper. Specific examples included:

- Franchise agreements that include a right for the franchisor to terminate a contract with 90 days' notice and with no reasons, and give franchisors unilateral rights to vary the terms of the contract on short notice.
- Contracts between collision repair businesses and insurance companies which set out the time allowed to carry out certain types of repairs, regardless of the actual damage to a vehicle and the actual work required.
- Contracts that state a franchisee must not withhold payment even if the franchisor does not perform its obligations.
- Contracts that give unilateral power to a firm to require the contractors to own or lease key capital items (such as vehicles, tools or specialist plant), which locks contractors into having to deal with certain suppliers that are preferred by the firm.
- Contracts that give a firm the right to dictate staff the contractor uses or an ability to give direction as to who is hired or not.

While the survey results and submissions on the discussion paper are not statistically representative (for example, the opt-in nature of the survey may overstate the prevalence of UCTs across the economy), they nevertheless indicate that a range of businesses are experiencing what they consider to be UCTs.

However, as noted above, not all contractual terms that businesses perceive as unfair are necessarily

problematic from a policy perspective. As one example, 'high' prices of goods and services tend to, by themselves, facilitate entry from competitors, and thus generally do not require government intervention. Similarly, a level of flexibility and uncertainty may be necessary in some types of contracts. For example, a business may legitimately use contract terms to pass on risk to a business customer for events that the customer is able to influence, therefore incentivising the customer to reduce the risk of this event occurring, and allowing the supplier to offer the good or service at a lower price.

The overall prevalence of UCTs is likely to be constrained, to an extent, by competitive forces. This is likely to be the case in situations where:

- a large number of businesses have a good understanding of the terms they are being offered;
- the power imbalance between suppliers and their business customers is low (such as if firms have potentially many other suppliers or customers to purchase from or sell to); or
- there is potential for a negative reputational impact if unfair terms are included.

Problems associated with UCTs are likely to be concentrated in contracts:

- which are standard form; and
- where one of the parties is small in either absolute terms, or relative to the other party.

### Standard form contracts

Standard form contracts are contracts typically offered on a 'take it or leave it' basis by a party with greater bargaining power. Generally, a contract is considered to be standard form if one of the parties has not had the opportunity to negotiate or change the terms of the contract when agreeing to it. The same standard form contract may be used widely by a firm with its customers or suppliers with little, if any, modification of the terms across different contracts.

Standard form contracts can provide a number of benefits. In particular, they save businesses time and resources, particularly for repeated transactions. Lower costs associated with using standard form contracts can enable businesses to offer more competitive pricing on goods and services than if individual terms were negotiated with each customer. It would be infeasible and inefficient to entirely prohibit the use of standard form contracts.

However, standard form contracts can also present disadvantages. Most significantly, they make it much easier to include UCTs in a contract, compared to a situation where both parties are involved in the preparation of a contract. This is because:

- the accepting party is likely to pay less attention to the detailed terms of the contract if they are not involved in drafting them, making it easier to 'hide' unfair terms; and
- the accepting party is less likely to challenge the terms of a contract if it knows that the contract is standardised.

In addition, some businesses may base standard form contracts on those currently being used by their competitors. This practice can result in poorly drafted and unfair terms being duplicated and multiplied across entire industries. One example of this that we are aware of in the business-to-consumer context is in the mobile trader ('truck shop') industry.<sup>3</sup>

MBIE's survey indicates that standard form contracts are widely used in New Zealand when businesses purchase and supply goods and services, with 79 per cent of respondents having entered in to at least one standard form contract in the past year.

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<sup>3</sup> Commerce Commission. (2015). *Mobile Trader 2014/15 project*. Retrieved from <http://www.comcom.govt.nz/the-commission/consumer-reports/mobile-trader-201415-project/>

### Businesses' vulnerability to unfair contract terms

The problems with UCTs are likely to be more pronounced for small businesses. Compared to larger businesses, small businesses are less likely to have:

- the resources to identify unfair terms, appreciate their significance, and determine whether they can manage the associated risks;
- the resources to engage in negotiations over the terms of a contract;
- the bargaining power to successfully negotiate the terms of a contract; and/or
- the resources and bargaining power to resist the enforcement of UCTs.

While these issues are likely to be most pronounced among small businesses, even medium and large businesses may lack bargaining power when dealing with (even) larger businesses.

Unfair contract terms can shift risks to the party that is less able to manage them effectively. Smaller businesses may be less likely to have robust risk management procedures and policies in place, and may be less able to absorb the detriment if an unfair term is enforced, than larger businesses. For example, a UCT may require a small business to bear the risk of a high-cost, low-probability event. While this may result in a lower contract price, the small business may be taking on risks that they are unable to effectively manage.

A business seeking to avoid signing a contract that includes unfair terms may incur substantial costs in gaining the necessary information to assess whether such terms are present. As small businesses often lack in-house legal expertise, gaining this information, even for a simple standard form contract, could feasibly cost several thousand dollars. For low-value contracts, this can be viewed as disproportionately high and, therefore, not worth undertaking.

Of the small businesses<sup>4</sup> we surveyed, 86 per cent agreed that they generally understood the terms and conditions contained in contracts they entered into, and less than half generally assumed that a contract they were offered contained no unfair terms. However, only 26 per cent felt that they were able to afford legal and financial advice regarding the terms and conditions of a contract, and only 39 per cent felt that they had the resources necessary to negotiate over the terms and conditions of contracts with their suppliers or customers.

### Businesses' response to unfair contract terms

Businesses that are offered a UCT have a number of options available to them, including declining the contract, seeking legal advice, and seeking to renegotiate the terms of the contract. For example, in response to the most 'unfair' contract that survey respondents had been offered, while 34 per cent reported entering into the contract in question, 45 per cent asked the business to alter or delete terms that were unfair, and 16 per cent did not enter into the contract. Of those businesses who asked their supplier or customer to alter or delete terms that were unfair, nearly half had all, or at least some, of their concerns addressed.

As shown above, despite the presence of one or more UCTs, in a number of situations, businesses may nevertheless enter into a contract. This may be because:

- They have no other viable alternative – there may be no other business customers or suppliers offering 'fair' terms. As such, accepting a contract may be the only avenue to a commercial opportunity that the business is seeking. Submitters who had experienced UCTs said they cannot effectively challenge the contract because they are often dependent on the more powerful business.
- They have 'fairer' alternatives, but consider that other features of the contract (such as the price

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<sup>4</sup> For this context, a small business is deemed to have less than 20 employees.

and quality of the good or service) outweigh their concerns about unfair terms.

- They believe that they will be able to mitigate the risk of the unfair terms ever needing to be invoked through, for example, a strong focus on relationship management.
- They may not be aware that the terms exist. According to our survey, of the businesses which suffered detriment as the result of an 'unfair' term being enforced, 44 per cent were not aware that the term existed at the time they signed the contract.

#### Business detriment and economic impacts as a result of unfair contract terms

36 per cent of businesses who had entered into a contract that contained an unfair term (16 per cent of all businesses) indicated that a term had been enforced in a way that had harmed their business. Examples of this detriment described by businesses included cash flow issues, increased costs, use of internal resources, reduced output and sales revenue, and reduced profitability. Submitters who claimed to have experienced unfair conduct reinforced these concerns.

More generally, we would expect that UCTs would:

- increase transaction costs, by requiring firms to spend more time doing 'due diligence' on contracts, or seek more legal advice;
- increase operating costs, such as if a firm is required to increase the amount of insurance it takes out as a result of a contract;
- increase finance costs, as a result of cash flow issues associated with extended payment terms;
- increase costs for other parties, if the price of a contract is raised to compensate for unfair terms; and
- negatively impact on a firm's ability to grow and innovate, if its limited resources are diverted into dealing with the above.

While some of these effects may be confined to individual businesses, many of them have the potential to have broader economic impacts (although this is difficult to measure). Nevertheless, at an economy-wide level, UCTs have the potential to ultimately result in lower levels of competition, innovation, and productivity across the economy, with corresponding negative impacts for consumers.

#### Are current protections sufficient to address unfairness in business-to-business contracts?

As outlined in the previous section, New Zealand's legal framework already provides a number of protections against unfair commercial practices. However, there are currently no legislative protections that specifically address UCTs in contractual dealings between businesses, other than terms which would breach the Commerce Act, or when businesses purchase 'consumer' goods (in which case they are covered by the consumer UCT protections).

In considering the role of government in intervening in business-to-business contract terms, MBIE's primary focus is on prohibiting practices that have an overall negative effect on New Zealand's economic performance. However, arguments can also be made that fairness, in and of itself, is important in business-to-business practices.

There are legitimate arguments that it is not the role of government to intervene in business-to-business contracts, and that the prevalence of unfair terms can already be mitigated to an extent by firms taking their own action. In addition, not all of the examples of unfair terms identified by businesses are necessarily detrimental to the economy. Some 'unfair' terms are likely to simply lead to transfers of wealth between parties, while other practices may be efficient and welfare-enhancing. Given this, we do not consider all 'unfair' terms to be problematic or to necessitate government intervention.

Nevertheless, there is both theory and evidence to suggest that businesses (particularly smaller ones) are vulnerable to UCTs in a range of circumstances and, as set out above, we think it is plausible that

UCTs can be having broader negative economic impacts. As such, we think there are good arguments that government intervention is justified to address the unfair and potentially economically inefficient terms that currently exist in some contracts.

## Issue 2: Unfair business-to-business conduct

### Prevalence and examples of unfair business-to-business conduct

In response to MBIE's survey, 47 per cent of businesses indicated that they had been treated unfairly by a supplier or business customer in the last year, other than in relation to the terms of a contract. Of the businesses that indicated that they had been subjected to unfair conduct:

- 34 per cent indicated that this involved suppliers or business customers not complying with the terms of an existing contract;
- 32 percent felt that they had been misled or deceived;
- 28 per cent indicated that they had faced demands over and above the terms agreed in an existing contract;
- 19 per cent dealt with firms that refused to supply a good or service, or refused to purchase a good or service; and
- 12 per cent considered that they had been harassed, coerced, or otherwise subject to pressure.

31 per cent of respondents offered other examples of what they deemed to be unfair conduct. These included poor levels of service, poor communication, price demands, late payments, and price changes without warning.

Submitters to the discussion paper provided specific examples of both historic and current conduct that they considered to be unfair, including:

- Supermarkets penalising suppliers for promotions run with other retailers by demanding compensation for perceived losses caused by other retailers' promotions and deducting it from payments to suppliers.
- Photographers being threatened, verbally abused, and 'blacklisted' after asking for payments that were due.
- Trucking and delivery contractors having the scope of their work increased unilaterally without consultation or compensation.
- A franchisor ordering a new fit-out of a franchisee's premises without consultation, and at the franchisee's expense. After approving the fit-out plans and allowing the fit-out to be completed, the franchisor 'changed its mind' and decided that further work was needed, affecting areas of the premises that had just been refurbished.
- A broker for an insurance company refusing to authorise payment to a vehicle componentry fitter unless the fitter shared information about its cost prices with the broker.

Like Issue 1, not all conduct that businesses perceive as unfair is necessarily problematic from a policy perspective (and the survey may also overestimate the prevalence of unfair conduct). For example, while many businesses are likely to appreciate the difference between reasonable negotiations and undue harassment or coercion, some may consider the former category to be 'unfair', despite the benefits that such negotiations can bring. For example, a retailer may be able to negotiate reduced margins from a manufacturer or wholesaler, leading to lower prices from consumers. Similarly, a manufacturer could insist on minimum standards for customer service levels from a retailer, which may also benefit consumers.

As with Issue 1, the overall prevalence of unfair conduct is likely to be constrained, to an extent, in cases where the power imbalance between suppliers and their business customers is low, or there is potential for a negative reputational impact from acting unfairly.



Much of the unfair conduct reported by businesses is already prohibited to some extent, or, in the case of breach of contract, subject to common law remedies. The prevalence of this conduct as reported by businesses therefore suggests that a combination of the below is likely:

- businesses are not complying with existing laws;
- some businesses feel aggrieved about conduct which is not problematic from a policy perspective; and
- there remains some gap in the protections against unfair conduct.

#### Businesses' vulnerability to unfair conduct

Like unfair contracts, small businesses are arguably more likely to be vulnerable to unfair conduct than large ones. In particular, small businesses are less likely to have the bargaining power or capability to negotiate in response to pressure tactics, or to deal with larger businesses who do not comply with the terms of a contract. Such tactics may result in most of the benefits of a contract being shifted to the larger party. However, some forms of unfair conduct are likely to impact on all businesses relatively equally. Widespread misleading or deceptive conduct in a market, for example, impacts on the ability of all businesses to operate efficiently.

#### Businesses' response to unfair conduct

As with UCTs, businesses have options in response to the unfair conduct that they face. In our survey, we asked businesses what they did in response to the most unfair conduct they had been subjected to in the past year. While 43 per cent were already in business with the other party and continued to be, 41 per cent asked the business to change their conduct, and 21 per cent ended their relationship with the relevant business. Of the businesses who asked the other party to change their conduct, 39 per cent had all or some of their concerns addressed.

#### Business detriment as a result of unfair conduct

59 per cent of businesses who had experienced unfair conduct (27 per cent of all businesses) indicated that the conduct had harmed their business in some way. Examples of this detriment offered by businesses included reputational damage, disrupted supply of goods and services, and wasted time, inconvenience, and increased stress. Businesses also reiterated many of the forms of harm that they identified in relation to UCTs, such as cash flow issues and reduced profitability.

As with UCTs, while some of these effects may be confined to individual businesses, many forms of unfair conduct can also have wider economic impacts. For example, unfair conduct could undermine competition and the efficient operation of markets if search costs increase as a result of widespread misleading or deceptive conduct. This could reduce the competitive pressure on businesses, and make it harder for businesses to effectively source or supply goods and services. Similarly, economic efficiency could be undermined if businesses are harassed or coerced into entering into, or altering, contracts that they ultimately do not want to enter into, straining the concept of freedom of contract.

#### Are current protections sufficient to address unfair business-to-business conduct?

In our view, the FTA, Commerce Act, and other legislation already protect against most forms of unfair conduct that justify government intervention (although the threshold at which conduct is prohibited is relatively high in many cases, such as under the FTA's provisions relating to harassment and coercion). Not all of the examples of unfair conduct provided by submitters – while undoubtedly seeming unfair to the affected parties – would (or should) necessarily be prohibited under any new conduct prohibition. Furthermore, the gap in protections that exists is likely to get smaller as a result of other policy work that is happening in parallel (see section 2.4).

Having said this, we think there is still a modest gap in the protections against unfair conduct that justifies intervention. This gap includes:

- Exploitative business practices that rely upon taking advantage of a smaller business's

vulnerabilities. This may be a function of a business's lack of legal or commercial sophistication.

- Businesses taking advantage of a smaller business's lack of bargaining power, such as where a business knows that the other party has no alternatives.
- Conduct that may be within a business's legal rights, but which goes well beyond what is commercially necessary or justifiable.

In addition to cases where there is a gap in legislation, there is also conduct which can potentially be captured under existing legislation, but only indirectly. This can make enforcement more difficult, and arguably reduces predictability for businesses and consumers about how the law will be interpreted.

### Issue 3: Unfair business-to-consumer conduct

#### Prevalence and examples of unfair business-to-consumer conduct

We do not have good data about the extent to which consumers have experienced unfair conduct. However, the Commerce Commission and Consumer New Zealand have provided some examples of unfair conduct that they have received complaints about. These are outlined below:

- A trader sold expensive skincare products in shopping malls. The trader employed young personable salespeople who employed aggressive sales tactics to sell the products. A number of the complainants were elderly or otherwise vulnerable. For example, two people with autism were charged \$10,000 for their purchases. The Commission considered that it was unable to take enforcement action under existing provisions.
- One New Zealand business operated mobile photo studios which approached young parents in shopping malls to take photos of their young children. When the customers returned to view the photos, they were offered packages costing up to \$4,777. In some circumstances customers were asked to sign contracts on electronic devices and copies of the contract were emailed to them after they had signed them. Some complainants indicated that, if they had been told upfront the likely price of the photos, they would have decided not to purchase them as the price was well beyond their means to pay. Some consumers said that, once they found out the price of the photos, they tried to cancel the contract but were then asked to pay significant cancellation fees. This conduct did not appear to clearly breach provisions of existing legislation.
- In one case, a mobile trader engaged in predatory lending practices by entering a mental health unit and signing up nearly all the clients to unreasonable contracts for phones and PlayStation consoles. While these lenders may have been breaching some existing legislative provisions, current prohibitions may not necessarily directly address the conduct in question.
- A third-tier lender repossessed and dumped the personal effects of borrowers which it knew to be of little or no value. The purpose of the repossessions was not to cover the borrower's unpaid debt, but rather, to send a message to the borrower to pay.
- A seller of educational software used a cynical sales strategy which 'attacked' vulnerable parents based on their concern for their children and sought to make them buy the software as a way to address their guilt of failing their children.
- The promoter of a 'rent to own' property scheme cynically and calculatedly exploited people through its marketing and contract terms in the process of leading consumers to believe that they were buying properties when in fact they were not.
- A family purchased two vouchers for a photo session. The vouchers cost \$39 each but were valued at \$450. After the session, the family was advised they needed to pay a minimum of \$880 for a photo package. The family felt 'duped' as they never would have purchased the vouchers if they had known the cost of the photos.
- A consumer was cold-called and offered a free set of coasters or chopping board if she agreed to a demonstration of a company's home purification system. She agreed and was subjected to a

vacuum cleaner and air filter sales pitch that lasted six hours. The consumer felt the only way to get the seller to leave was to sign up to buy the product.

### Consumers' response to unfair conduct

MBIE's National Consumer Survey 2016<sup>5</sup> provides some indications about how consumers respond to problems they experience with goods or services. While such problems are not necessarily synonymous with unfair conduct:

- 68 per cent of consumers who had problems took steps resolve the problem;
- 55 per cent of those who took action (37 per cent of those with problems) had their problem resolved to their satisfaction; and
- 35 per cent of those who took action (24 per cent of those with problems) were able to resolve the problem the first time they approached the business responsible.

These results indicate that consumers are having some – but not complete – success at resolving their consumer problems. However, it is likely that many consumers who were able to resolve their problems to their satisfaction were less likely to be vulnerable, and more likely to be dealing with 'reputable' traders who make reasonable efforts to act reasonably and comply with the law. We consider it likely that businesses that engage in conduct which is particularly unfair or egregious are less likely to adjust their behaviour or remedy the situation in response to action by consumers.

### Consumer detriment as a result of unfair conduct

It is difficult to identify the detriment that consumers experience as a result of unfair conduct. However, we would generally expect that it could:

- reduce consumers' ability to transact and engage in markets with confidence;
- lead to financial hardship; and
- lead to wasted time, inconvenience, and increased stress.

In addition to impacting on individual consumers, this conduct can also have broader economic impacts. For example, if unfair conduct harms consumer confidence, then this could negatively impact consumption expenditure and, in turn, economic output across the economy.

### Are current protections sufficient to address unfair business-to-consumer conduct?

As with Issue 2, a range of protections already exist against unfair business-to-consumer conduct, and other policy work is likely to increase the protections available to consumers. However, we think that there is nevertheless a modest gap in the protections available to consumers. This gap is similar to Issue 2, and includes:

- Exploitative business practices that rely upon taking advantage of a consumer's vulnerabilities. These vulnerabilities include those captured under the concept of unconscionable conduct that currently exists in the courts such as age, infirmity, or difficulty understanding English. But they can also include factors such as consumers lacking confidence, not understanding their legal rights, having poor financial capability, or general naivety.
- Businesses taking advantage of a consumer's lack of bargaining power, such as where a business knows that the consumer has no alternatives.
- Conduct that may be within a business's legal rights, but which goes well beyond what is commercially necessary or justifiable.

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<sup>5</sup> Ministry of Business, Innovation and Employment. (2017). *National Consumer Survey 2016: Summary Findings*. Retrieved from <https://www.consumerprotection.govt.nz/assets/PDFs/NCS-Final-Report-Summary-Findings.pdf>. The survey was conducted by Colmar Brunton and involves responses a nationally representative sample of 1,246 consumers.

Such conduct may not necessarily be misleading or reach the threshold of being coercive. However, by taking advantage of these vulnerabilities or lack of bargaining power, it can nevertheless lead to high levels of detriment in some instances.

We do not see it as the role of government to protect all consumers from all instances in which they may suffer harm, or from making any decision that they might ultimately regret. However, we think that consumers are generally less well-equipped to protect their own interests than businesses. As such, we think the case for protecting consumers from unfair practices is even stronger than the case for protecting businesses.

## 2.4 Are there any constraints on the scope for decision making?

### Scope

This RIS considers whether there is a need for additional generic protections against unfair commercial practices. In particular it considers whether additional protections are needed against:

- unfair business-to-business contracts;
- unfair business-to-business conduct; and
- unfair business-to-consumer conduct.

Unfair business-to-consumer contracts are not within the scope of this RIS, as there are already relevant provisions in the FTA which are being considered as part of a broader review of the FTA.

The focus of this RIS is on economy-wide, generic protections, as opposed to sector-specific regulation or regulation focussed on specific conduct. This aligns with the largely generic nature of New Zealand's existing competition and consumer legislation.

This RIS is not a broad review of existing competition, consumer, or other commercial law. It is also not a review of the effectiveness of individual provisions of legislation. Rather, it focuses on whether there are any high-level gaps in New Zealand's existing legal framework for regulating unfair commercial practices, and, if so, how these gaps could be addressed.

### Other current reviews

The Government is currently undertaking a number of other reviews relevant to unfair commercial practices. These include:

- **A broader review of the FTA.** In addition to this work on unfair commercial practices, MBIE is also conducting a broader review of the FTA. This includes considering changes to the enforcement regime for the current protections against UCTs.
- **Payment practices.** The government is considering how to improve business-to-business payment practices. While the policy options considered in this RIS could have some impact on payment practices, payment practice-specific legislation and other interventions are also being considered.
- **The CCCFA.** The Credit Contracts Legislation Amendment Bill was introduced to Parliament in April 2019. The Bill will strengthen protections for consumers against irresponsible and high-cost lending.
- **Insurance contract law and banking sector conduct.** Currently, some terms in insurance contracts are exempt from the FTA's consumer UCT protections. The government is considering whether these exemptions should be amended or removed. The government is also considering sector-specific options to regulate conduct in the insurance and banking sectors.
- **Section 36 of the Commerce Act.** Section 36 prohibits anti-competitive unilateral conduct by firms with market power. The Government is currently considering options for reforming section

36 on the basis that the current provision is costly and complex to enforce, and may not be sufficiently deterring anti-competitive conduct by powerful firms.

## 2.5 What do stakeholders think?

### Impacted stakeholders

The issues considered in this RIS have the potential to impact on all consumers and businesses in New Zealand. Depending on the options adopted, all consumers and businesses could benefit from additional protections against unfair practices, while all businesses could potentially face new obligations.

### Consultation

Public consultation on the issues and options considered in this RIS took place between December 2018 and February 2019. Forty-four submissions were received. In addition, a survey of (mostly small) businesses was conducted in June 2018, to understand the extent to which they considered that they had experienced unfair practices. Around 200 completed the survey.

### Stakeholder perspectives

Some examples of stakeholder perspectives are included in section 2.3 above. More broadly, stakeholders provided the following input on the potential problems outlined above.

Submitters who were opposed to additional protections against unfair commercial practices included business organisations, larger businesses and some law firms. These submitters made the following arguments:

- **No evidence of a problem:** Submitters said they were not aware of any UCTs or other unfair conduct occurring and that there is therefore no evidence of a problem to justify government intervention.
- **Existing regulation is sufficient:** Submitters said that existing laws provide sufficient consumer and business protections. They argued that the focus should be more enforcement of and more education about existing laws.
- **Businesses are not in need of the same protections as consumers:** Some submitters argued that, even if there is a gap in the legislative protections against unfair practices, this gap does not need to be filled, on the basis that there is less justification for protecting businesses than consumers. For example, submitters stated that businesses are less likely to use standard form contracts, there is less inequality in bargaining power, and they are more likely to have resources to negotiate. They also pointed to our 2018 survey, which found that some respondents who said they did not like the terms presented to them either negotiated further or refused to enter the contract, as indication that businesses were already effectively protecting their own interests.
- **Increased costs and uncertainty:** Businesses said there would be significant new costs for them to review and negotiate contracts if the options outlined below were introduced. They also submitted that having to change the terms of contracts to prevent them from being unfair could impact the viability of some business models, because such terms are necessary to conduct business. They also argued that a high-level prohibition against unfair conduct would be subjective, open to interpretation and create uncertainty, which would lead to costs for businesses, as they would need to seek more legal advice.

Submitters in favour of additional protections included a number of small businesses, franchisees, organisations representing small businesses, consumer advocates and the Commerce Commission. These submitters made the following arguments:

- **Businesses are engaging in unfair commercial practices:** Submitters provided examples of how

businesses and consumers are experiencing detriment at present from unfair practices, some of which are outlined above.

- **Proposals are used internationally:** Some submitters noted that the proposals being considered are relatively orthodox, with similar approaches having been implemented in Australia, the European Union, and other jurisdictions.
- **Costs will be offset by benefits:** Submitters thought that, even if there are costs associated with reform, these would be offset by benefits, such as businesses not needing to spend as much time reviewing or challenging UCTs. It was also noted that, if appropriately designed, new laws could potentially produce benefits including greater commercial certainty, enhanced competition and appropriate commercial standards.

## Section 3: Options identification

### 3.1 What options are available to address the problem?

#### Options

We have considered five options for addressing the problems outlined in this RIS.

#### Options focussed on addressing unfair conduct

- Option 1A: Prohibit unconscionable conduct
- Option 1B: Prohibit oppressive conduct

#### Options focussed on addressing unfair contract terms

- Option 2A: Extend UCT protections to small businesses, with a \$100,000 transaction value cap
- Option 2B: Extend UCT protections to all businesses, with a \$100,000 transaction value cap
- Option 2C: Extend UCT protections to all businesses, with a \$250,000 transaction value cap

Options 1A and 1B are alternatives to each other, as are Options 2A, 2B, and 2C. However, Option 1A or 1B are complementary to Option 2A, 2B, or 2C.

#### Option 1A: Prohibit unconscionable conduct

##### Description

This option would involve a statutory prohibition against unconscionable conduct. The intention would be to broaden the protections beyond those provided by the doctrine of unconscionability which, as set out in section 2.2, are limited. The statutory prohibition could be modelled in part on the provision in Australia's Competition and Consumer Act 2010 (CCA), which prohibits unconscionable conduct in relation to the supply and acquisition of goods or services that is, in all the circumstances, unconscionable. The prohibition would apply to conduct towards all consumers and businesses.

The prohibition would apply to:

- the circumstances surrounding the formation of a contract;
- the terms of a contract; and
- the way a contract is enforced.

It would also apply to a system of conduct or pattern of behaviour, regardless of whether a particular individual is identified as having been disadvantaged by the conduct or behaviour, and regardless of whether a particular contract was ultimately entered into.

The prohibition could also include a number of factors a court is required to consider when assessing whether conduct is unconscionable, including, but not limited to:

- the relative bargaining strength of the parties;
- whether any conditions were imposed on the weaker party that were not reasonably necessary to protect the legitimate interests of the stronger party;
- whether the weaker party could understand the documentation used;
- the use of undue influence, pressure or unfair tactics by the stronger party;
- the extent to which the stronger party's conduct with the weaker party is consistent with its conduct in similar transactions with other parties;
- the willingness of the stronger party to negotiate; and

- the extent to which the parties acted in good faith.

It would be an offence to engage in unconscionable conduct, with maximum penalties in line with the maximums in the FTA (currently \$200,000 for individuals, and \$600,000 for bodies corporate). The FTA's general regime in respect of civil proceedings and remedies (including providing for injunctions, refunds, damages, or having a contract altered or declared void) would apply. Consumers and businesses would also be able to seek remedies at the Disputes Tribunal.

### Discussion

'Unconscionable conduct' is not defined in the CCA. For some time, Australian courts commonly described statutory unconscionability as a concept which required 'a high level of moral obloquy'. This is a very high threshold. More recently, courts have essentially lowered the threshold at which conduct may be considered unconscionable, by clarifying that it must be 'against conscience by reference to the norms of society'. The courts are now more likely to consider social norms and questions of fairness and honesty rather than moral judgement when determining whether there has been a breach of the CCA.

Nevertheless, the threshold at which conduct is deemed to be unconscionable is still high. The Australian courts have been clear that unconscionability involves serious misconduct and that mere inequality in bargaining power that results in one party being disadvantaged is not, in itself, sufficient for a finding of unconscionability. We see this as appropriate given that the FTA already prohibits many forms of unfair conduct. In Australia, the courts have found a range of practices to be unconscionable, while avoiding interfering in everyday, reasonable, commercial transactions.

There is significant overlap between what is unconscionable under statute and in equity in Australia. However, the statutory prohibition is broader than the doctrine as it originated in equity. For example, unlike in equity, under the statutory prohibition, conduct can be found to be unconscionable even if there is no conscious targeting of a vulnerable party.

While we expect that this prohibition would generally be used in relation to unfair conduct, unfair contracts could still potentially be caught by this prohibition if they were particularly egregious.

The Australian provisions have recently been reviewed from both a competition policy and consumer policy perspective. In the context of business-to-business conduct, the Australian Competition Policy Review considered that the current provisions were working as intended. The Australian Consumer Law Review noted that there is some uncertainty as to how the provisions apply, and whether particular conduct is unconscionable according to the principles used by the courts. Some stakeholders suggested that this has affected the consistent application of the law across different courts and reduced the provision's deterrent effects and usefulness for consumers. However, overall, the Review considered that the law is continuing to develop in the direction intended by lawmakers.

Our overall impression is that the Australian prohibition appears to be relatively effective in addressing conduct which is particularly unfair and egregious. However, given the experience in Australia, there is a risk that New Zealand courts could interpret the provision too narrowly, in line with the equitable doctrine of unconscionability, rather than the broader concept that has eventually developed in Australia.

### Examples of conduct deemed unconscionable in Australia

The following examples of conduct have been found to be unconscionable in Australia:

- A sales representative from a vacuum cleaner company would call homeowners and offer a free maintenance check of their existing vacuum cleaner. If the offer was taken up, a representative would visit the householder, perform a very perfunctory check of the existing vacuum cleaner, and then attempt to sell to the householder a new vacuum cleaner. The sales strategy was premised on a 'deceptive ruse', which had the effect of taking advantage of elderly consumers living alone. The sales strategy manipulated the emotions and preferences of the consumers in order to create a subtle but real sense of obligation to buy. The vulnerability of the consumers arose from the difficulty in putting an end to the sales process once the salesperson was in their



home, especially after that person has spent time and undertaken persuasive effort in a sales pitch.

- The sale of diploma courses through door-to-door sales tactics which deliberately targeted vulnerable and disadvantaged communities, who in many cases were not aware that they were signing up to anything, and were misled into believing the course was free.
- The promotion and supply of medical services and medications to men suffering from sexual dysfunction. The companies involved engaged in conduct that took advantage of vulnerable consumers by exploiting the sensitive and personal nature of their condition. In particular, this conduct involved “frightening men by telling them of the dire adverse consequences of not agreeing to treatment”.
- The handling of complaints about quality issues with cars. The company involved told customers that their concerns were a result of their driving style and refused to provide refunds or replacements, despite knowing that there were quality issues with the vehicles in question.
- Conduct by a supermarket in relation to its suppliers, including failure to pay agreed prices to suppliers, making persistent demands for additional payments from suppliers, imposing penalties that were not previously negotiated, and threatening to remove products from shelves.
- An online business directory misled businesses into entering contracts, and refused to cancel contracts which customers did not want and did not intend to enter into. It used high pressure sales tactics and harassed staff by chasing debts that didn’t exist – one customer was called 993 times over a nine month period.
- A cleaning franchisor made false or misleading representations concerning the income that the two prospective franchisees would earn, and failed to pay the franchisees for the work they had completed, while continuing to demand payment for the initial franchising fee.

## Option 1B: Prohibit oppressive conduct

### Description

This option would involve introducing a prohibition against conduct that is ‘oppressive’. This would involve adopting the definition of oppressive from the CCCFA, which defines “oppressive” as “oppressive, harsh, unjustly burdensome, unconscionable, or in breach of reasonable standards of commercial practice”. The prohibition would apply to conduct towards all consumers and businesses. This option would share similarities to Option 1A in that it would apply to:

- the circumstances surrounding the formation of a contract;
- the terms of a contract;
- the way a contract is enforced; and
- a system of conduct or pattern of behaviour, regardless of whether a particular individual is identified as having been disadvantaged by the conduct or behaviour, and regardless of whether a particular contract was ultimately entered into.

This option could also involve giving a court the same factors to consider when assessing whether conduct is oppressive as under Option 1A. Like Option 1A, it would be an offence to engage in oppressive conduct, the FTA’s general regime in respect of civil proceedings and remedies would apply, and consumers and businesses would also be able to seek remedies at the Disputes Tribunal.

### Discussion

Under the CCCFA, the courts have decided that the “reasonable standards of commercial practice” element of the definition is the core test for determining whether something is oppressive. The courts have stated that in most cases, evidence will be required to establish what normal standards of commercial practice are. The courts have also left open the possibility that something may be oppressive even if the party is following a common industry practice, if that practice is a breach of

reasonable standards.

The courts have stated that the scope of oppression under the CCCFA is broader than the equitable doctrine of unconscionability (as distinct from the broader version outlined in Option 1A). On the other hand, the courts have also held that the standard of oppression is higher than simple unfairness, or whether a particular contract is advantageous or disadvantageous. As such, we think that a prohibition against oppressive conduct is likely to address similar conduct to that captured under Option 1A. Like Option 1A, it could also capture instances of unfair contracts, where such contracts were particularly egregious.

Despite existing case law, there would still likely be some uncertainty under this option about what is oppressive. We expect that this would be resolved over time as case law builds up. Another potential limitation of this option is if the requirement for parties to provide evidence about what normal standards of commercial practice are posed a barrier to upholding the prohibition. On balance, however, we think that a requirement to provide evidence adds a level of objectivity to the prohibition.

### Examples of conduct deemed oppressive under the CCCFA

While the CCCFA's provisions relating to oppression are limited to credit contracts and related transactions, examples of where contracts have been found to be oppressive include:

- A woman was induced to enter into an arrangement to prevent her husband being prosecuted for fraud. Under the arrangement, assets were transferred to the defendant and a mortgage was taken over the couple's home. This was held to be oppressive.
- A couple provided security by way of mortgage over their motel to assist their daughter to acquire a farm. The finance company told the couple that this was an interim measure and once the farm was acquired it would be substituted for the security over the motel. The mortgage fell into arrears. The finance company refused to substitute the security and demanded that the couple remedy the default. This conduct was held to amount to oppression because it was "unjustly burdensome", and the finance company had broken faith with the couple.
- An elderly woman got into financial difficulty and sold her property to a property company. On the same day, she entered into an agreement to buy her property back from them over a 25 year period. The terms of the buy-back agreement provided for termination if the woman fell into arrears, and allowed the company to recover damages for any breach of contract. The woman defaulted on her instalments early on, and the company took steps to terminate the buy-back agreement. The court found that termination of the agreement was oppressive on the basis that the company likely took advantage of the woman's age, lack of commercial experience and poor health.
- A lender took advantage of a borrower's gambling problem and other personal circumstances. She subjected the borrower to unfair pressure by representing that there would be severe consequences if the borrower did not meet the interest payments on a loan. The borrower could not meet the interest payments, resulting in the lender lending the borrower more and more funds. The court found these contracts to be oppressive and entered into by oppressive means.

## Option 2A: Extend the UCT protections to small businesses, with a \$100,000 transaction value cap

### Description

This option would involve extending the FTA's current protections relating to UCTs in consumer contracts to also protect small businesses. Small businesses would be defined as those with fewer than 20 employees. As with the FTA's existing protections against UCTs in consumer contracts, this would involve:

- limiting the prohibition to standard form contracts, which are contracts in which the terms have

not been subject to effective negotiation between the parties (as determined by factors such as whether one of the parties has all or most of the bargaining power relating to the transaction);

- the test that a term is unfair if it:
  - would cause a significant imbalance in the parties’ rights and obligations arising under the contract;
  - is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
  - would cause detriment (whether financial or otherwise) to a party if it were applied, enforced, or relied on; and
- the same exclusions from the UCT regime, namely 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 any enactment.

The protections would only apply to arrangements where the goods or services provided have a value below \$100,000 (or a value below \$100,000 *in a given year* in some cases where the arrangement spans more than one year). While some arrangements may be as simple as one contract between two parties, others may involve a series of closely-related contracts between two parties, or multiple contracts between one party and several related entities. The legislation will set out factors for determining what constitutes an arrangement, and when the transaction value cap has been reached. The overall principle will be that a court will have the discretion to consider the substance of the relationship between parties and look behind the specific legal form of contracts when determining whether the UCT protections apply.

The legislation would also define what ‘value’ is for the purpose of the transaction value cap. This could be the upfront price of a contract, or another measure, as appropriate. We also anticipate providing a regulation making power to allow for the clarification of the value of an arrangement or class of arrangements, in situations where the value might otherwise be unclear (such as, potentially, complex financial products).

The same enforcement regime as currently exists for consumer UCTs would apply. This means that it would not be an offence to include an unfair term, and civil remedies would not be available, unless the Commerce Commission had sought and received a court declaration that the term in question was unfair. Options for reforming the existing enforcement regime for consumer UCTs are currently being considered as part of a broader review of the FTA. It is likely that changes will be made to the enforcement provisions for both consumer and business UCTs through a subsequent Amendment Bill.

The ‘grey list’ that applies in respect of consumer contract terms would also apply in respect of business contract terms.

### Discussion

This option would affect business-to-business contracts across a wide range of sectors. However, as outlined above, the existing UCT provisions contain a number of tests designed to ensure that the protections do not over-reach and interfere with reasonable contracts that reflect the intentions of the parties to them. This includes restricting the protections to contracts which have not been subject to effective negotiation, and to terms which are not reasonably necessary.

In addition to the tests that are built in to the UCT regime, this option would limit the protections to small businesses. These firms are least likely to have the resources to undertake due diligence on contracts, and are likely to have less bargaining power than larger firms. By also including a relatively low transaction value cap, it would avoid interfering in larger, more strategically-important contracts, where there is arguably a stronger case for businesses to do their own due diligence, and where the

risks associated with intervention are higher. We also think that \$100,000 is around the value at which it is more reasonable to expect firms to incur the cost of seeking legal advice on contracts where necessary. 65 per cent of respondents to our 2018 survey indicated that they had not entered into *any* contract with a value above \$100,000 in the past year (and of the remaining 35 per cent, we expect that many of their contracts would fall under \$100,000).

While the UCT protections as they apply to consumer contracts are out of scope of this RIS, we are not aware of evidence to suggest that they are having unintended consequences, such as by significantly impeding pro-competitive or welfare-enhancing transactions. Similarly, the Australian cases outlined below do not, on the face of it, appear to be over-reaching by targeting terms that are fair or reasonably necessary.

A limitation of this option is that it would involve an arbitrary threshold between the businesses and transactions that are protected, and those that are not. In practice, even if the protections against UCTs only apply to small businesses, many businesses are not likely to have different standard form contracts for small and large businesses. As such, there might be some flow-over impact on larger businesses, as businesses remove unfair terms from all of their contracts. Nevertheless, to the extent that particular contracts *do* contain unfair terms, remedies would only exist for small businesses.

#### Examples of business-to-business contract terms that have been deemed unfair in Australia

In Australia, since the UCT protections were extended to businesses in 2016, the Australian Competition and Consumer Commission has taken action in a number of situations, including in relation to:

- A potato wholesaler which entered into exclusive supply contracts with potato farmers for a specified volume of fresh potatoes each season. These contracts were generally entered into at the time of planting, but the wholesaler did not determine the price it would pay until the potatoes were ready for harvest. The contracts allowed the wholesaler to unilaterally determine or vary the price it pays farmers for potatoes, allowed the declaration of potatoes as “wastage” without proper review, and prevented farmers from selling their own property unless the purchaser entered into an exclusive potato farming agreement with the supplier.
- Contracts for office space that were automatically renewed unless the customer had opted out, allowed the provider to unilaterally increase the contract price, permitted the provider to unilaterally terminate contracts, unreasonably limited the provider’s liability, and permitted the provider to keep a customer’s security deposit if a customer failed to request its return.
- An ATM provider whose contracts with small businesses included automatic renewal for six years, long minimum notice periods for cancellation, unilateral fee increases, and first right of refusal should businesses seek to change providers at the contract’s conclusion.
- A waste management company which included contract terms that allowed the company to unilaterally increase its prices, removed any liability for non-performance, allowed the company to charge customers for services not provided, and granted the company exclusive rights to remove waste from a customer’s premises.

### Option 2B: Extend the UCT protections to all businesses, with a \$100,000 transaction value cap

#### Description

This option is similar to Option 2A, except that it would involve extending the UCT protections to all businesses, to the extent that they were entering into arrangements with a value below \$100,000.

#### Discussion

The main advantage of this option is that, unlike Option 2A, it avoids the need for an arbitrary cut-off between businesses that receive the protections and those that do not. This places all businesses on the same footing, and reduces the risk that businesses are discouraged from, for example, taking on

a 20th employee to avoid losing the UCT protections.

However, this option would also have more of an impact on the ability of large, well-resourced businesses to contract freely between themselves. In practice, businesses would only benefit from the UCT protections to the extent that they are entering into standard form contracts. As we expect that many contracts between large businesses involve negotiation over the terms of the contract, or do not involve an imbalance in bargaining power (both are tests for whether a term is a standard form contract) the protections would not apply to large businesses in many cases. Given this, the difference between this option and Option 2A should not be overstated.

## Option 2C: Extend the UCT protections to all businesses, with a \$250,000 transaction value cap

### Description

This option is similar to Option 2B, except that it would apply to arrangements with a value below \$250,000 (rather than \$100,000).

### Discussion

Compared to Options 2A and 2B, this option would provide protections for a wider range of contracts. 77 per cent of respondents to our 2018 survey indicated that they had not entered into *any* contract with a value above \$250,000 in the past year (compared to 65 per cent for \$100,000).

However, by affecting higher value transactions, the costs and risks set out in sections 5.2 and 5.3 below would be higher for this option than for Options 2A or 2B. This option would also impact contracts where there is arguably a stronger case for businesses to conduct their own due diligence and/or seek legal advice. Having said this, as contracts increase in value, they are more likely to be subject to negotiation and as such less likely to be covered under the UCT protections in any case. Given this, the difference between this option and Options 2A and 2B is unlikely to be large.

## 3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The high level objective of this work is to ensure that New Zealand's regulatory systems contribute to a business environment where businesses and consumers are confident participants in fair and thriving markets.

The following criteria have been used to assess any potential changes to the regulatory framework governing unfair practices. These are:

- **Criterion 1:** Consumers are protected from high levels of detriment and practices which unduly impact on their ability to confidently participate in markets.
- **Criterion 2:** Businesses are protected from practices which unduly impact on their ability to confidently participate in markets.
- **Criterion 3:** Businesses are not unnecessarily prevented from competing effectively, negotiating firmly, and entering into contracts that reflect their wishes.
- **Criterion 4:** The law is predictable for businesses and compliance costs are reasonable.
- **Criterion 5:** Consumers and businesses have access to effective redress when things go wrong.

There are some potential trade-offs between Criteria 1, 2, and 5 on one hand, and Criteria 3 and 4 on the other. However, the options have been designed to minimise this trade-off. Criteria 1-3 are weighted more highly than Criteria 4 and 5, although all are important.

### 3.3 What other options have been ruled out of scope, or not considered, and why?

No options have been explicitly ruled out of scope. However, as noted above, the focus of this RIS is on high-level, economy wide protections against unfair commercial practices, rather than sector- or conduct-specific regulation.

There are, however, a number of sub-options that we have not fully considered as part of this RIS. These include:

- **A prohibition against ‘unfair practices’ based on the approach taken by the European Union.** This provides that a commercial practice is unfair if it is contrary to the requirements of professional diligence, and it materially distorts, or is likely to materially distort, the economic behaviour of the average consumer. We consulted on this option, however there was relatively little support for it. It is arguably the most complex, uncertain and far-reaching approach to addressing unfair conduct, as it would effectively introduce an obligation of ‘good faith’ across the economy.
- **Prohibiting unconscionable or oppressive conduct in relation to consumers or consumers and small businesses only.** Like for UCTs, there are arguments that consumers and small businesses are more vulnerable to unfair conduct than large businesses, and that any protections should therefore only apply to them. However, given the high threshold before either prohibition would apply, and the fact that a court would be likely to take into account the sophistication of a party in any case, we think that any prohibition should apply across the economy.
- **Restricting a prohibition against unconscionable or oppressive conduct from applying to the substance of a contract.** While the focus of either prohibition would be on conduct, some courts internationally have been willing to make a finding of unconscionability based solely on evidence of unfair *contracts*, regardless of the *conduct* itself. We consulted on whether a prohibition should allow for this to occur, or whether there must always be an element of unfair *conduct* for something to be deemed unconscionable or oppressive. We have concluded that the courts should not be restricted in when they can make a finding of unconscionability or oppression. In practice, we expect that there would likely be a very high threshold before a court would find a contract to be in breach of a prohibition, without there also being an element of unfair conduct.
- **Not including a transaction value cap for UCTs.** Some submitters argued that there should not be a transaction value cap if business-to-business UCT protections are introduced. This would mean that terms in standard form contracts of any value could be deemed to be unfair. While there are arguments that businesses are especially in need of protections for high-value transactions, we think that there is a strong case for businesses to do their own due diligence and seek legal advice on high-value, potentially strategically-important contracts.
- **Amending the enforcement regime for business UCTs in isolation of consumer UCTs.** As noted above, under the current consumer UCT regime, a term is not subject to a penalty or civil remedies unless the Commerce Commission has previously sought and received a court declaration that it is unfair. This imposes barriers to enforcement and reduces the incentive for businesses to remove unfair terms before they are approached by the Commission. Options for amending the enforcement regime are currently being considered as part of a broader review of the FTA. We had considered introducing an enforcement regime for business UCTs that departs from the current consumer UCT enforcement regime, ahead of this broader review being completed. However, we have concluded that it would be confusing and procedurally difficult to have two parallel enforcement regimes for consumer and business UCTs.
- **Applying the UCT protections to only the weaker party to a transaction.** It is possible that, in some situations, a standard form contract could be prepared by the ‘weaker’ party to the transaction. The stronger party could agree to the contract without seeking to negotiate the terms. If the weaker party included unfair terms as part of the contract, there is a question about whether the stronger party should benefit from the UCT protections. We considered limiting the

protections to only the weaker party. However, we ultimately concluded that, if the tests for a standard form contract and a UCT are met, then businesses should receive the protections, regardless of their theoretical level of bargaining power.

## Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

	No action	Conduct-focused options		Contract-focused options		
		Option 1A: Prohibit unconscionable conduct in relation to all consumers and businesses	Option 1B: Prohibit oppressive conduct in relation to all consumers and businesses	Option 2A: Extend UCT protections to small businesses, with \$100,000 transaction value cap	Option 2B: Extend UCT protections to all businesses, with \$100,000 transaction value cap	Option 2C: Extend UCT protections to all businesses, with \$250,000 transaction value cap
Consumers are protected from high levels of detriment and practices which unduly impact on their ability to confidently participate in markets	0	+	++	0	0	0
Businesses are protected from practices which unduly impact on their ability to confidently participate in markets	0	+	++	+	++	+++
Businesses are not unnecessarily prevented from competing effectively, negotiating firmly, and entering into contracts that reflect their wishes	0	0	0	0	0	-
The law is predictable for businesses and compliance costs are reasonable	0	--	-	--	-	--
Consumers and businesses have access to effective redress when things go wrong	0	+	+	0	0	0
<b>Overall assessment</b>	<b>0</b>	<b>+</b>	<b>++</b>	<b>+</b>	<b>++</b>	<b>+</b>

**Key:**

+++	much better than doing nothing/the status quo	++	better than doing nothing/the status quo	+	slightly better than doing nothing/the status quo
0	about the same as doing nothing/the status quo				
-	slightly worse than doing nothing/the status quo	--	worse than doing nothing/the status quo	---	much worse than doing nothing/the status quo



## Section 5: Conclusions

### 5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

#### Preferred options

Our preferred options are:

- Option 1B: Prohibit oppressive conduct
- Option 2B: Extend UCT protections to all businesses, with a \$100,000 transaction value cap

#### Option 1B: Prohibit oppressive conduct in relation to all consumers and businesses

As outlined earlier in this RIS, we think there is a case for introducing additional protections for both businesses and consumers against unfair conduct. Options 1A and 1B would both be targeted at similar conduct, and we think that either option would provide net benefits relative to the status quo.

We prefer Option 1B on the basis of Criterion 1: *Consumers are protected from high levels of detriment and practices which unduly impact on their ability to confidently participate in markets*, Criterion 2: *Businesses are protected from practices which unduly impact on their ability to confidently participate in markets*, and Criterion 4: *The law is predictable for businesses and compliance costs are reasonable*.

Both options are targeted at similar conduct, and both would involve an element of uncertainty as to the threshold before conduct would be in breach of the prohibition. However, we think the potential for uncertainty associated with Option 1A is higher than Option 1B. This is because there is an established body of case law (albeit restricted to credit contracts and related transactions) about the meaning of oppression, which appears to strike a suitable balance between prohibiting conduct that is grossly unfair, while not unnecessarily intervening in everyday, reasonable, commercial conduct. In contrast, because the case law related to unconscionability relates to the more narrow equitable doctrine, rather than that intended by a legislative prohibition, we think that there is a risk that prohibiting unconscionable conduct could lead to the courts interpreting the prohibition too narrowly.

We also think that the reference to factors such as ‘reasonable standards of commercial practice’ under an oppressive conduct prohibition offers more guidance to businesses than reference to factors such as ‘conscience’ and the ‘norms of society’ that could be referenced under an unconscionable conduct prohibition (if Australian case law is followed). This is strengthened by the fact that evidence as to what reasonable standards of commercial practice are is likely to influence a court’s findings as to whether conduct is oppressive.

#### Option 2B: Extend UCT protections to all businesses

We also think that the case has been made for extending the UCT regime to businesses, and we consider that Options 2A, 2B, and 2C would all provide net benefits relative to the status quo.

We prefer Option 2B to 2A on the basis of Criterion 2: *Businesses are protected from practices which unduly impact on their ability to confidently participate in markets*, and Criterion 4: *The law is predictable for businesses and compliance costs are reasonable*.

While the case for government intervention is partly a function of the fact that small businesses often lack the resources needed to understand and undertake due diligence on contracts, it is also a function of the power imbalance that exists in contractual relationships. A power imbalance is not limited to businesses which have fewer than 20 employees; even medium or large businesses can face a power imbalance when entering into contracts with larger entities.

Given this, limiting the UCT protections to only small businesses would arbitrarily restrict the benefits

of the protections to only some businesses, potentially distorting competition at the margins. It would also be difficult in some instances for businesses to determine whether the business they were contracting with had fewer than 20 employees, and therefore whether the protections applied.

We prefer Option 2B to 2C on the basis of Criterion 3: *Businesses are not unnecessarily prevented from competing effectively, negotiating firmly, and entering into contracts that reflect their wishes.*

While the UCT regime contains a number of safeguards to prevent it from interfering with contracts that are necessary, reasonable, or subject to effective negotiation, we nevertheless think that the risks associated with introducing the protections (see sections 5.2 and 5.3 below) are greater if they apply to higher-value contracts. In addition, as noted above, while any transaction value cap is arbitrary to an extent, we generally think the need for the protections for contracts above \$100,000 is less than for those below \$100,000. This is on the basis that it is more feasible to expect businesses to seek legal advice or conduct due diligence on contracts that exceed \$100,000, than those below it.

## Stakeholder views on the options

### Options 1A and 1B

Submitters in favour of increasing protections against unfair conduct had mixed views in terms of which form of prohibition they preferred, with some not specifying a preference. Some submitters favoured Option 1A (a prohibition against unconscionable conduct) on the basis that it aligned with Australia and the Australian case law could be relied upon. Other submitters – generally those opposed to reform – thought that the concept of unconscionable conduct would be highly subjective and might require a legal definition of the concept or a list of factors to be taken into account in determining whether conduct was unconscionable.

A few submitters favoured Option 1B (a prohibition against oppressive conduct) because they thought it would cover a broader range of conduct than Option 1A (although this is not necessarily the case), or because the test was potentially more objective. There was little support for (and the most opposition to) a prohibition against unfair practices (Option 1C in the discussion paper); as a result, this option has not been fully considered in this RIS.

### Options 2A, 2B, and 2C

Of those who supported extending the UCT protections to businesses, there were mixed opinions about which businesses should be protected. Several stakeholders were in favour of extending the protections to all businesses, noting that even large businesses can lack bargaining power in some situations. A few stakeholders supported limiting the protections to small businesses.

Some submitters in favour of extending the UCT protections to businesses thought that the protections should apply regardless of the value of the transaction. These submitters pointed out that some small businesses enter into high-value transactions but have low profit margins, which would mean that they would not have the benefit of the UCT protections if a low transaction value cap was introduced. Others supported the inclusion of a relatively low transaction value cap, as it would incentivise businesses to undertake due diligence on high-value transactions, rather than relying solely on the UCT protections.

Stakeholders opposed to any reforms expressed concern about the protections applying to small businesses only, on the basis that it was an unprincipled distinction, and that businesses would incur time and resources in determining which businesses the protections would apply to. Some submitters opposed to any kind of reform thought that if UCT protections were introduced for businesses, certain terms should be removed from the existing ‘grey list’ of unfair terms that apply to consumer contracts, because business-to-business contracts sometimes necessitated such terms. One submitter argued that businesses should be able to contract out of the UCT protections, where it is fair and reasonable to do so.

**5.2 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?**

Affected parties	Comment: nature of cost or benefit	Impact
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**Additional costs of proposed approach, compared to taking no action**

Regulated parties	Costs in terms of reviewing standard form contracts for compliance with UCT provisions and amending as necessary. General costs in terms of uncertainty (e.g. seeking legal advice, less organisational agility). However, many businesses are already familiar with the UCT regime, and most conduct will not be affected by a new conduct prohibition.	Estimated one off-cost of \$13m for reviewing standard form contracts. <sup>6</sup> Low ongoing costs as contracts are modified and updated. Low costs associated with uncertainty.
Regulators	Costs for the Commerce Commission associated with enforcing the new provisions.	Low-Medium
Wider government	N/A	N/A
Other parties	N/A	N/A
<b>Total Monetised Cost</b>		\$13 million
<b>Non-monetised costs</b>		Low-Medium

**Expected benefits of proposed approach, compared to taking no action**

Regulated parties	N/A, except in their capacity as other parties (see below)	N/A
Regulators	Easier for the Commission to take action in respect of certain conduct (rather than attempting to fit conduct within existing prohibitions).	Low
Wider government	N/A	N/A
Other parties	Reduced detriment for consumers and contractors who nominally function as businesses, but bear a number of similarities to employees. Reduced transaction costs for businesses, by reducing the need to spend as much time doing 'due diligence' on contracts or to seek as much legal advice. Reduced operating costs or finance costs,	Medium-High

<sup>6</sup> Based on Australian estimates scaled based on the number of businesses in New Zealand. See here: [https://static.treasury.gov.au/uploads/sites/1/2017/06/C2015-021\\_Extending\\_UCTs\\_RIS.pdf](https://static.treasury.gov.au/uploads/sites/1/2017/06/C2015-021_Extending_UCTs_RIS.pdf)

	<p>such as if firms face fewer cash-flow issues as a result of being paid more promptly.</p> <p>Easier for businesses to grow and innovate, by diverting fewer of their limited resources into dealing with unfair conduct and UCTs.</p> <p>A better allocation of risk, cost, and liability to the firms that are best-placed to deal with it (rather than it being allocated on the basis of negotiating strength alone).</p> <p>Consumers and businesses transacting with increased confidence, in the knowledge that there will be fewer instances of unfair practices in markets.</p>	
<b>Total Monetised Benefit</b>		N/A
<b>Non-monetised benefits</b>		Medium-High

### 5.3 What other impacts is this approach likely to have?

In addition to the costs and benefits outlined above, there are the following potential impacts. These are outlined here because the net impact is unclear:

#### Impact on prices of goods and services

A new unfair conduct prohibition could lead to price increases if business customers feel that they are able to negotiate less vigorously with their suppliers. We think this risk is fairly small. It is not the intent of any prohibition to prevent businesses from negotiating robustly with their suppliers, and we do not think it will have this effect. To the extent that a prohibition does impact on business-to-business negotiations, it is possible that there will be offsetting benefits. For example, several submitters argued that, when business customers insist on prices below 'sustainable' levels, it simply results in reduced levels of innovation and quality, exit of suppliers from the market, and negative impacts on the personal wellbeing of individual suppliers.

Similarly, there is a risk that extending the UCT protections could increase the prices of some goods or services, or result in some goods or services no longer being supplied in some instances. This could happen if, for example, suppliers are no longer able to pass certain risks on to their business customers. Suppliers could increase their prices to compensate for the need to absorb additional risks themselves, with flow-on impacts for consumers. If they are not able to increase their prices, then in some instances they may not be willing to absorb the increased risk, and may instead cease to offer their goods or services in some situations.

While we think these risks are legitimate, they should not be overstated. For example, we are not aware of any evidence to suggest that the existing UCT protections in New Zealand or Australia have led to an increase in inflation (although this would be difficult to observe, even if it was occurring). We are also not aware of examples of goods or services ceasing to be offered in either country as a result of the existing protections.

There are also counter-arguments that extending the UCT protections to businesses could *reduce* the price of some goods and services. For example, we have heard anecdotally that some small businesses increase their prices to account for contract terms that unfairly shift risk onto them. If a prohibition on business-to-business UCTs shifts risk back to the party that is more able to effectively manage risks, then the net impact could be reduced prices for consumers.

## Impact on competition

There is also a more general risk that the proposed protections have a negative impact on competition across the economy by shielding inefficient businesses from competition. As an example, we have heard concerns about contract terms which effectively allow a business customer to cancel what is nominally a long-term supply contract with minimal notice. If such a term were to be prohibited, it might make it harder for businesses to switch between suppliers to source from the most competitive provider.

Again, while this is a legitimate risk, it should not be over-emphasised. Such contract terms arguably undermine contractual certainty, and make it harder for businesses to invest to become more productive and competitive. In addition, even if such terms are deemed to be unfair, it should still be possible to achieve similar outcomes in different ways (such as by simply providing for shorter-term supply contracts).

It can also be argued that competition could improve as a result of these protections. For example, if a reduction in unfair conduct and contracts makes it easier for businesses to grow and innovate, then there is potential for these businesses to have greater capacity to effectively compete.

### **5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?**

Yes

## Section 6: Implementation and operation

### 6.1 How will the new arrangements be given effect?

Ministers have indicated their intention to proceed with Options 1A and 2C. This is on the basis that Option 1A will support alignment with Australia and allow New Zealand to draw on Australian case law, and that Option 2C will provide protections against UCTs for a high proportion of business contracts.

These proposals will be given effect through a Fair Trading Amendment Bill. It is expected that this Amendment Bill will be introduced in late 2019. It is anticipated that the changes will come into force 12 months after the legislation receives Royal Assent.

Public enforcement will be carried out by the Commerce Commission. Businesses and consumers will also be able to self-enforce the protections against unconscionable conduct, through courts or the Disputes Tribunal.

Stakeholders will be informed about the government's policy decisions and the progress of legislation via ministerial announcements, the MBIE website, and through direct contact with interested parties.

It is expected that the Commerce Commission and MBIE will undertake initiatives to raise awareness of businesses and consumers to the law changes, prior to them taking effect. For example, the Commission publishes a range of guidance on its website, which typically outlines its approach to enforcing different prohibitions, and provides examples of conduct that is, and is not, likely to be in breach of the prohibitions. Commission guidance is often informed by case law, and the approach taken by the Australian courts to date could potentially inform Commission guidance until a body of New Zealand case law develops.

### 6.2 What are the implementation risks?

The benefits associated with intervention will depend on the extent to which the new protections are enforced. Even with additional legislative protections, many smaller businesses are unlikely to want to risk harming their relationship with their suppliers or business customers by asserting their rights, and consumers are often not well-equipped to self-enforce the law. As such, enforcement by the Commerce Commission will play an important role in the success of any new protections. In the case of UCT protections, the Commission will play the sole role in enforcing the protections, until an Amendment Bill implementing changes resulting from a broader review of the FTA takes effect.

Given this, the main implementation risk is if the Commerce Commission is not adequately resourced to enforce the additional protections. MBIE is currently undertaking a baseline review of Commerce Commission funding, which will take into account the potential additional funding necessary to effectively enforce these new protections.

## Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

As the enforcement agency for the FTA, the Commerce Commission will play a key role in monitoring the proposed changes. In particular, complaints to the Commerce Commission, and subsequent Commission investigations and enforcement action, will provide a valuable source or intelligence as to the effectiveness – or otherwise – of the proposals. There will be an opportunity for MBIE to receive this information on an ongoing basis as part of our regular engagements with the Commerce Commission, as well as through more formal Commission reporting, such as through its annual consumer issues report.

Other potential data sources include MBIE's National Consumer Survey, which is run periodically, and complaints to MBIE's contact centres.

More generally, officials regularly engage with businesses, law firms, and consumer organisations. These engagements provide an opportunity to test the impacts of the proposed reforms.

### 7.2 When and how will the new arrangements be reviewed?

While there are currently no plans for a formal review of these proposals, MBIE regularly evaluates and reviews amendments to the law it administers. The changes could, for example, be evaluated three to five years after coming into force (subject to resource constraints). An evaluation or review at this time would allow the changes to have bedded in and any anticipated and desired impacts to show.

Stakeholders with concerns about the policy proposals will have the opportunity to raise these through the Parliamentary Select Committee process, and through engagement with MBIE. Any issues or concerns that stakeholders have in relation to implementation or enforcement of the changes can be directed to the relevant enforcement body, the Commerce Commission.