Law Council
OF AUSTRALIA

Business Law Section

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Mr David Pearl
Assistant Secretary
Competition and Consumer Branch
Markets Group
The Treasury
Parkes ACT 2600

By email: david.pearl@treasury.com.au

Dear Mr Pearl

Reforms to unfair contract terms regime—Corporations Committee submission

1. We refer to the *Treasury Laws Amendment (More Competition, Better Prices) Act 2022* (Cth) (**UCT Reforms**) that is due to come into effect on 9 November 2023.

2. This submission concerning the UCT Reforms is made by the Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committee**).

Key Points

3. The key matters the Committee wishes to bring to Treasury's attention are as follows:

   (a) A consequence of the UCT Reforms, in particular the expanded definition of "small business contract" as inserted in the *Australian Securities and Investments Act 2001 (Cth)* (**ASIC Act**), is that certain institutional financial market contracts between sophisticated financial market participants will be inadvertently caught by the regime.

   (b) Not only is this inconsistent with the policy objectives of the UCT Reforms, which focus on the protection of consumers and small businesses with limited resources and bargaining power, but it will also have an unintended and detrimental effect on how Australian institutional financial market transactions are conducted.

4. The Committee expresses its concerns with this (presumably) unintended effect, and requests a suitable and prompt solution to this issue.

Submissions

What is the issue to be resolved?

5. The UCT Reforms cause certain institutional financial market contracts between sophisticated financial market participants to be caught by the unfair contract terms (**UCT**) regime.

6. While it is clear that this is not the legislative intent of the UCT Reforms, the effect is that Australian institutional financial markets, which rely on certain standard form contracts to operate effectively and efficiently, will be prevented from operating in accordance with market demands and expectations.

What are the policy objectives of the UCT Reforms?

7. The Regulation Impact Statement for the UCT Reforms makes it clear that the UCT regime was introduced to "*deal with terms that cause a significant imbalance in the parties' rights and obligations*" and to address situations where "[*c*]*onsumers and small businesses generally lack the resources and bargaining power to effectively review and negotiate contract terms*".

8. In the Committee's submission, the regulation of institutional financial market contracts between sophisticated financial market participants, and by extension the effective operation of institutional financial markets, is entirely inconsistent with these stated policy objectives. These are contracts entered into between professional or sophisticated financial market participants (not consumers or small businesses), and are in standard form for the purpose of meeting market expectations rather than as a result of inequality in the resourcing or bargaining power of either party. We submit that these contracts should not be captured by the UCT regime.

What is the cause of the issue?

9. The issue primarily arises from the expanded definition of "small business contract" which is proposed to be inserted in section 12BF of the ASIC Act as part of the UCT Reforms.

10. Under the UCT Reforms, a "small business contract" is a contract where one party employs fewer than 100 employees or has less than $10 million annual turnover, and the upfront price payable does not exceed $5 million.

11. This definition fails to take into account the practicalities of corporate group structuring and the operation of institutional financial markets and, as a result, will inadvertently capture certain institutional financial market contracts between sophisticated financial market participants, as illustrated by these examples:

    (a) *One party employs fewer than 100 employees*

        (i) Many large corporate groups have a single subsidiary for employment purposes, which often results in other subsidiaries and the ultimate parent company having few or no employees. Under the proposed expanded "small business contract" definition, a standard form contract entered into with a non-employing subsidiary or a non-operating head company would be caught by the UCT regime.

(ii) For example, a counterparty could enter into a standard form contract with a non-employing subsidiary of a major Australian financial institution or ASX100 company, and that contract would be caught by the UCT Reforms. Hedge funds, both on and off balance sheet special purpose vehicles (i.e., holding title to aircraft or office buildings), investment managers, trustees and custodians are all potentially caught based on their number of employees alone as the proposed expanded definition fails to take into account their status within a corporate group more generally.

(b) *One party has less than $10 million annual turnover*

(i) By introducing an annual turnover threshold, it appears the legislative intent was to exempt larger businesses from being caught by the UCT Reforms. However, the use of "or" in the definition of "small business contract" means entities that have more (and potentially significantly more) than an annual turnover of $10 million dollars will nevertheless be caught where they have fewer than 100 employees.

(ii) This means that entities that would not ordinarily be considered small businesses (such as listed entities, entities that hold financial services licences, or entities that are regulated by the Australian Prudential Regulation Authority, etc.) can all receive the protection of the UCT regime.

(iii) Similarly, the turnover test may not accurately reflect the size of an organisation where the contracting entity itself has lower turnover but is part of a much larger group.

(c) *Upfront price payable does not exceed $5 million*

(i) By introducing a value threshold of $5 million, it appears that the legislative intent was to exempt larger contracts from being caught by the UCT Reforms. However, the threshold refers to the "upfront" price which can be determined as at the execution date of the contract.

(ii) For many financial markets contracts, the consideration that can be determined as at the execution date may be for a much lower amount than the overall value of the contract. The value of ensuing financial transactions may be for large sums that are contingent at the time the contract is entered into or not clearly determinable (e.g. loan commitments, options, best endeavours underwrites). So, while the overall value of the contract will be greater than $5 million, these contracts would fall within the scope of the UCT Reforms.

(iii) Similarly, many relationship agreements have no upfront price when entered into (e.g., ISDA Master Agreements, prime brokerage and repurchase/stock lending arrangements, "umbrella" stock trading platform agreements). Again, the overall value of the contract may be greater than $5 million, but these contracts would still be captured.

(iv) Finally, many counterparties in financial markets enter into a stream of small value but frequent repeat transactions which would add up to well over $5 million in aggregate but would not be outside the scope of the UCT Reforms.

12. In addition, section 12AC of the ASIC Act extends the application of the UCT regime to some conduct outside of Australia (i.e., "to engaging in conduct outside of Australia by bodies corporate incorporated or carrying on business within Australia"). As a result:

- Standard form contracts, used by Australian entities through their branches in other jurisdictions on terms considered market standard in those foreign jurisdictions (and which otherwise have no connection to Australia), will be subject to the UCT Reforms. This means that those foreign branches will need to have their standard templates reviewed to comply both with their own domestic laws and the UCT regime.

- Foreign incorporated entities that do business in Australia may be caught by the UCT regime even in circumstances where the small business contract was entered into wholly outside of Australia, with all parties resident outside of Australia and all aspects of the transaction being outside Australia.

13. In the Committee's submission, it seems unlikely to have been the legislative intent for the UCT regime to capture contracts of this type.

What are the implications if the issue is not resolved?

14. Institutional financial markets commonly rely on various standard form contracts to operate efficiently and to meet market requirements. The use of these contracts underpins liquidity, speed and certainty of execution as required by these markets, and they have often been developed over many years to accord with best risk management practice, global norms, liquidity considerations and both statutory and case law.

15. The list of standard form institutional financial markets contracts that will be inadvertently caught by the UCT Reforms is potentially extensive. Set out below are some of the more commonly used contracts that we expect will be caught—in most cases on the basis that their upfront value can often be less than the $5 million threshold notwithstanding that their overall value will greatly exceed this threshold:

- repurchase and securities lending documentation—such as ISDA Master Agreements and AMSLA, GMSLA, GMRA Master Agreements for stock lending and other OTC transactions;

- securitisation agreements and security agreements;

- trade finance documentation and letters of credit;

- equity capital markets documentation—for example the industry-wide Master ECM Terms, co-manager agreements, institutional / broker firm confirmation letters, sub-underwriting letters and non-disclosure agreements;

- debt capital markets documentation—for example trust deeds, bonds/notes, non-disclosure agreements and mandate letters; and

- environmental products contracts—such as Carbon Credit Contracts and the Environmental Products Addendum.

16. These contracts are almost always between professional financial market participants. If caught by the UCT regime, there would need to be a degree of tailoring that could never practically work in a fast-moving financial market. There is no indication from the existing market regulator (**ASIC**) that standard form contracts utilised in financial markets give rise to consumer protection issues or coercive behaviour. Not only would applicability to sophisticated market participants be inconsistent with the policy objectives of the UCT Reforms, but it would also, in our submission, have wide ranging and detrimental effects for the markets in which these contracts are used—some examples of which are set out below:

    - *Equity capital markets*—Equity capital markets transactions often happen at a very fast pace involving dozens, hundreds or thousands of investors. For this reason, industry standard terms (namely the Master ECM Terms) have been developed to allow investors to understand what the terms will be for most deals, minimising the internal approvals they may need in order to participate and the need for negotiation on a deal-by-deal basis. It would not be commercially feasible to negotiate these contracts individually with each investor given the delays this would cause, and the expenses associated with it. Further, the market may also move away from the agreed offer price before these contracts had been properly negotiated, creating heightened underwriting risk.

    - *Debt capital markets*—Likewise, debt capital markets transactions often happen at a very fast pace and standardised agreements allow investors to understand what the terms will be for most deals. Again, the delays and costs associated with negotiating these contracts on a deal-by-deal basis would make it commercially unfeasible to enter into the transactions contemplated by these contracts, effectively forcing many participants out of the market.

17. In addition to the market impacts identified above, while historically a UCT was merely voidable by a court, the UCT Reforms introduce penalties through a proposed update to section 12GBA(6) of the ASIC Act which completely change the compliance risk profile. Unlike before, the civil penalty regime in the ASIC Act will apply to having a contract that includes a UCT even if that provision is never enforced. There is a separate contravention for each time a UCT is included, which has the potential to result in very significant penalties where the same provision is used in multiple contracts.

18. Overall, this change will make it more costly and legally risky to serve Australian counterparties. It could adversely affect the ability of Australian parties to provide or receive related financial services offshore, and potentially increase the costs of having access to those services. There is also a risk that any enforcement actions could result in a market-wide chilling effect and make it difficult, if not impossible, to transact in Australia in a commercial manner or at all. This in turn could, among other things, prevent the efficient and safe re-allocation of risk via intermediation in local and offshore markets.

19. There is also a real possibility that the risk of facing a civil penalty or other enforcement action may be used as a bargaining chip by less scrupulous counterparties which, while falling within the new definition of "small business", are actually a big business. In our submission, this was never the legislative intent.

20. The Committee submits that the proposed UCT Reforms create an unintended area of legal uncertainty and risk, which is not aligned with legal requirements for safe and efficient financial markets.

How can the issue be resolved?

21. This issue could be resolved through a number of methods. However, it is important that any proposed solution does not derogate from the policy objectives of the UCT Reforms.

22. The Committee submits that the exemption of a standard form contract with a "wholesale investor" from the application of the UCT regime would be a simple and effective solution.

23. The concept of a wholesale investor is already captured within the existing law with the distinction between wholesale and retail clients, and the importance of the protections and disclosure obligations to retail clients being recognised throughout the Corporations Act and existing financial markets practice.

24. This approach, if adopted, would resolve the issues set out in this submission, and at the same time maintain the policy objectives of the UCT Reforms, which focus on the protection of small businesses and consumers and are not intended to regulate institutional financial market contracts between sophisticated and professional investors.

Conclusion and further contact

25. The UCT Reforms are due to commence on 9 November 2023. Prompt resolution of this issue is paramount.

26. The Committee would be pleased to discuss any aspect of this submission.

27. Please contact David Friedlander of King & Wood Mallesons (david.friedlander@au.kwm.com) or Robert Sultan of Norton Rose Fulbright (robert.sultan@nortonrosefulbright.com) if you would like to do so.

Yours sincerely



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