

In Confidence

Office of the Minister for Small Business

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

Unfair Commercial Practices: Release of Discussion Document

Proposal

1. We are seeking Cabinet's agreement to release a discussion document which:
 - 1.1. seeks feedback on whether existing protections for both businesses and consumers against unfair commercial practices need to be strengthened; and
 - 1.2. presents a number of possible options for reform, including prohibiting unconscionable or oppressive conduct, and prohibiting the use of unfair contract terms in relation to businesses.

Executive Summary

2. We propose to release a discussion document which seeks feedback on whether existing protections for both businesses and consumers against unfair commercial practices need to be strengthened.
3. What is an unfair commercial practice is subjective, but may be viewed as including the use of pressure tactics, deception, and contract terms which are very one-sided (for example, by shifting risks onto one party, or allowing one party to unilaterally vary the terms of a contract). While there are already a number of legislative protections against unfair practices, there is some evidence to suggest that there may be a gap in existing protections.
4. The discussion document seeks feedback on a number of possible options to address unfair practices, including prohibiting conduct that is 'unconscionable' (based on Australian law), 'oppressive' (based on consumer credit law), or 'unfair' (based on European law), and extending existing protections for consumers against unfair contract terms to also protect businesses.
5. Unfair commercial practices can prevent markets from functioning effectively, restrict competition and innovation, and impact on the ability of businesses to grow and thrive. They can also lead to high levels of detriment for consumers. However, it is not the role of government to protect consumers or businesses from all practices that they consider to be unfair, or any transaction that they might ultimately regret. We also want to make sure that any measures to protect individual businesses do not over-reach, and ensure that honest businesses can continue to compete effectively, negotiate firmly, and freely enter into contracts that reflect their wishes. The discussion document asks whether New Zealand currently has the balance right.

Background

6. The New Zealand Government has a goal of building a more productive, sustainable and inclusive economy. Unfair commercial practices can undermine this objective. What is 'unfair' is highly subjective. However, it can broadly be grouped into two categories:
 - 6.1. **Unfair contracts.** This may include contract 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.
 - 6.2. **Unfair conduct** outside of the terms of a contract itself. This may include the use of pressure tactics to induce a party to enter into a contract, deceptive conduct, or the way a contract is enforced.
7. Unfair commercial practices can prevent markets from functioning effectively by decreasing trust, increasing search and transaction costs, and skewing the playing field in favour of businesses that act dishonestly. They may restrict competition and, with it, productivity and innovation. Even where practices are not strictly anti-competitive, they may restrict the ability of firms to grow and thrive, by diverting their attention away from their core businesses. They can also lead to high levels of financial detriment and stress for consumers.
8. It is for these reasons that legislation such as the Fair Trading Act 1986 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. These prohibitions include harassment and coercion, misleading and deceptive conduct, and anti-competitive conduct.
9. However, it is not the role of government to protect consumers or businesses from *all* practices that they consider to be unfair, or any transaction that they might ultimately regret. We also want to make sure that any measures to protect individual businesses do not over-reach, and ensure that honest businesses can continue to compete effectively, negotiate firmly, and freely enter into contracts that reflect their wishes. For example, we do not want to prohibit robust commercial negotiations between businesses and their suppliers, as this can lead to lower prices for consumers.
10. We propose to release a discussion document to ask whether New Zealand currently has the balance right in terms of the protections that are offered to businesses and consumers against unfair commercial practices.

Extent of the problem

11. One of the purposes of the discussion document is to understand the scale of the problem associated with unfair commercial practices at present. However, we already have some indications of the size of the problem.

Unfair business-to-business practices

12. Despite the existing legislative protections against unfair commercial practices, a recent survey by MBIE found that a significant proportion of businesses reported experiencing unfair conduct or contract terms. In particular, 45 per cent of businesses surveyed felt that they had been offered unfair contract terms in the last year, and 47 per cent felt that they had otherwise been treated unfairly.
13. Some of these concerns are unlikely to justify a response from government, and many businesses noted that they have successfully taken their own action in response to the unfair practices that they have experienced. Nevertheless, these results indicate that there might be a gap in the protections available to businesses, particularly those that are small and without effective bargaining power.

Unfair business-to-consumer practices

14. Officials do not hold the same evidence about the extent to which consumers are experiencing unfair commercial practices. However, Commerce Commission staff have provided a few examples of businesses engaging in conduct towards consumers which is not easily addressed under existing law. The examples included:
 - 14.1. Traders who used aggressive sales tactics in shopping malls to sell skincare products to vulnerable consumers, including people with autism and the elderly.
 - 14.2. Mobile photo studios which approached young parents in shopping malls to take photos of their children without clearly specifying the total price (up to \$4777), and imposing high cancellation fees once a contract had been signed.
 - 14.3. A mobile trader who 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.
15. As with businesses, this suggests there may be a gap in the protections available to consumers.

Possible options to address unfair commercial practices

16. Officials have considered a number of options to address unfair commercial practices. These include:
 - 16.1. introducing a high-level protection against unfair conduct; and
 - 16.2. extending the existing protections against unfair contract terms in standard form consumer contracts to also protect businesses.

Introducing a high-level protection against unfair conduct

17. There are various ways that a high-level prohibition against unfair conduct could be designed, including prohibiting conduct that is:
 - 17.1. 'unconscionable' (based on Australian law);

17.2. 'oppressive' (based on the approach taken in the Credit Contracts and Consumer Finance Act 2003); or

17.3. 'unfair' (based on European law).

18. The first two approaches would have a relatively high threshold before they were breached, and act as a 'safety net' to target relatively rare cases of particularly egregious conduct not prohibited under current legislation. As such, while there could be some initial uncertainty as to extent of the prohibitions, officials do not expect that they would have any significant impact on the ability of firms that act fairly and reasonably to go about their business. The third approach would have more uncertain – but potentially broader – impacts.

Extending the protections against unfair contract terms in standard form consumer contract terms to also protect businesses

19. At present, the Fair Trading Act provides protections for consumers against unfair contract terms in standard form contracts (contracts which have not been subject to effective negotiation). Officials have considered whether these protections could be extended to businesses, as has been done in Australia, where the protections apply to businesses with fewer than 20 employees.
20. This would mean that in standard form contracts with other businesses, those businesses would not be able to include terms that:
- 20.1. would cause a significant imbalance in the parties' rights and obligations arising under the contract;
 - 20.2. are not reasonably necessary; and
 - 20.3. would cause detriment if they were enforced.
21. The protections against unfair contract terms would not extend to the main price or subject matter of the contract.
22. Extending these protections would impact on a wide range of business contracts and there could be some transition costs for businesses in reviewing and amending their contracts. However, because of the design of the regime (in particular, that it does not apply to the main subject matter of the contract, the upfront price, or terms that are reasonably necessary), officials do not expect that these changes would significantly inhibit businesses' ability to enter into efficient or pro-competitive contracts.

Design features

23. If any of the above options are introduced, decisions will need to be made about:
- 23.1. whether the protections only apply to consumers, to consumers and some businesses (and if so, which ones), or to all consumers and businesses;
 - 23.2. whether the protections should only apply to transactions below a certain monetary threshold; and

- 23.3. the penalties and remedies that would be available in respect of breaches of any new prohibitions, and who may enforce the prohibitions.

The discussion document

24. The attached discussion document seeks feedback on:
 - 24.1. whether there is a case for additional government intervention in respect of unfair commercial practices; and
 - 24.2. the costs, benefits, and feasibility of the options outlined above.
25. The discussion document 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.
26. The discussion document does not identify preferred options at this stage. However, it does provide initial views in some areas.
27. The discussion document contains some complex content and is most likely to be read by industry bodies and law firms. However, officials have also prepared two short-form summary documents aimed at small businesses and consumers, to support their engagement in the consultation.

Proposed process

28. We propose to release the discussion document for a period of 11 weeks. This is a longer consultation period than normal, reflecting that the release will fall over the Christmas period.
29. Following consideration of submissions and advice from officials, we will report back to Cabinet with any proposals for legislative change by 31 July 2019.

Link to other work

30. The Government is undertaking a number of other reviews relevant to 'unfair' commercial practices. These include.
 - 30.1. **Payment practices.** The Ministry of Business, Innovation and Employment (MBIE) is considering how to improve business-to-business payment practices. Legislative and other interventions are being considered, potentially including a disclosure regime, penalties or fines for late payments, and/or maximum payment timeframes.
 - 30.2. **Consumer credit.** The Government has signalled its intent to introduce legislation that will strengthen protections for consumers against irresponsible and high-cost lending.
 - 30.3. **Insurance contract law.** Currently, some terms in insurance contracts are exempt from the Fair Trading Act's protections relating to unfair contract terms

in consumer contracts. MBIE is considering whether these exemptions should be amended or removed.

30.4. **Section 36 of the Commerce Act.** Section 36 prohibits anti-competitive unilateral conduct by firms with market power. The Government has signalled its intention to review section 36 on the basis that it is costly and complex to enforce, and may not be sufficiently deterring this type of anti-competitive conduct.

30.5. **Consumer law.** MBIE is evaluating the consumer law reforms that came into effect between 2013 and 2015. The focus of the evaluation is on the effectiveness of the individual law changes that were made. This differs from the focus of the discussion paper, which is on whether any significant gaps exist in the overall framework for protecting businesses and consumers from unfair conduct.

Consultation

- 31. Treasury, the Ministry of Justice, the Ministry for Primary Industries, and Commerce Commission staff have been consulted on this Cabinet paper and the attached discussion document. The Department of Prime Minister and Cabinet has been informed.
- 32. In addition, as noted above, MBIE conducted a survey of (mainly small) businesses in June of this year, which supported the development of the discussion document.

Financial Implications

- 33. There are no financial implications arising from the recommendations in this paper.

Legislative Implications

- 34. There are no immediate legislative implications arising from this paper. However, the consultation may result in policy recommendations being made to Cabinet which would require amendments to legislation.

Impact Analysis

- 35. The Treasury Regulatory Quality Team has determined that no Regulatory Impact Assessment is necessary at this stage, since it would substantively duplicate the analysis contained in the proposed discussion document.

Human Rights

- 36. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Publicity

- 37. We intend to issue a media statement accompanying the release of the discussion document. The discussion document will be made publicly available on the MBIE website.

Proactive Release

38. MBIE will publish this Cabinet paper along with the discussion document on the MBIE website.

Recommendations

The Minister for Small Business and the Minister of Commerce and Consumer Affairs recommend that the Committee:

1. **note** that the attached discussion document seeks feedback on whether existing protections against unfair commercial practices need to be strengthened;
2. **note** that the attached discussion document presents a number of possible options to strengthen protections against unfair commercial practices, including prohibiting unconscionable or oppressive conduct, and prohibiting the use of unfair contract terms in relation to businesses;
3. **agree** to the release of the attached discussion document for public consultation, subject to any minor or technical amendments that may be required;
4. **invite** the Ministers to report back to the Cabinet Economic Development Committee by 31 July 2019 with the outcomes of consultation and any proposed policy changes;
5. **note** that this Cabinet paper and the discussion document will be published on the MBIE website.

Authorised for lodgement

Hon Stuart Nash
Minister for Small Business

Hon Kris Faafoi
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