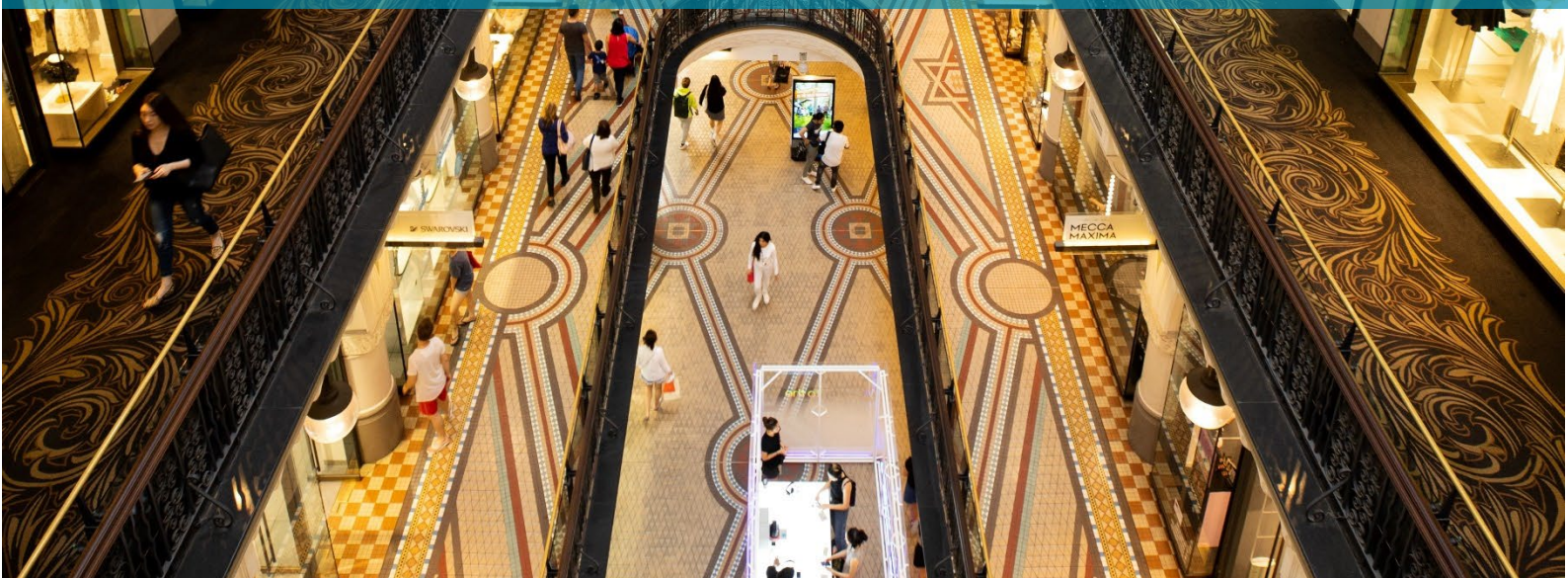




The extension of the unfair
contract terms regime to 'small
trade contracts'



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Disclaimer

This guide has been produced for the purpose of providing general information and should not be construed or acted on as legal advice. There are several legal and other considerations that are not mentioned, or not explained fully, in this guide. Specific advice should be sought to ensure that the information contained in this guide applies correctly to your situation and has not been subsequently altered by developments in law or otherwise.

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1. Introduction

The Fair Trading Amendment Act 2019 (**Amendment Act**) received royal assent (the final stage in a bill becoming an act of parliament) on 16 August 2021. The Amendment Act makes changes to the Fair Trading Act 1986 (**Act**).

In 2015, the Act was amended to introduce an unfair contract term regime which currently applies to 'standard form consumer contracts'¹. The Amendment Act extends the unfair contract term regime to 'standard form small trade contracts'².

The Amendment Act makes other changes to the Act, such as prohibiting unconscionable conduct in trade and strengthening the ability of consumers to require uninvited direct sellers to leave (or not enter) their property. Those other changes are not discussed in this guide.

2. Commencement

Section 7 of the Amendment Act (which will extend the unfair contract term regime to apply to standard form small trade contracts) will:

- take effect on 16 August 2022 (being the first anniversary of the date the Amendment Act received royal assent) (the **effective date**)³; and
- not apply to a standard form small trade contract entered into prior to the effective date unless that contract is varied or renewed on or after the effective date⁴.

3. What is a 'small trade contract'?

A contract is a 'small trade contract' if:

- each party to it is engaged in trade;
- it is not a consumer contract; and
- it does not form part of a trading relationship that exceeds \$250,000.00 (including GST, if applicable) when the first (or only) contract of the relationship is entered into.

A 'trading relationship' means, in relation to a contract, a relationship consisting of that contract and any other contract (whether current or prospective) that is between the same parties and on the same or substantially similar terms.

¹ Sections 26A and 46H to 46M of the Act.

² Section 7 of the Amendment Act.

³ Section 2(2) of the Amendment Act.

⁴ Section 21 of the Amendment Act (and Schedule 1AA of the Act).



The Amendment Act provides for regulations to define classes of contract that are to be treated as a 'small trade contract' (or excluded from that definition).

The Amendment Act provides a few examples, which are set out below.

Example 1

Facts:

- A and B enter into a contract on 1 December 2022. The contract includes a transparent term under which A is to pay B \$253,000 (\$220,000 plus GST) for services to be provided before 1 December 2023.
- On 1 November 2023, A and B enter into a contract on substantially similar terms. The second contract includes a transparent term for A to pay B \$57,500 (\$50,000 plus GST) for services to be provided in 2024.

Answer: Neither contract is a small trade contract because the annual value threshold is exceeded when the trading relationship first arises.

Example 2

Facts:

- C and D are both engaged in trade. They enter into 2 contracts for C to buy fruit from D. The contracts are on the same terms except that the first contract relates to grapes and is entered into on 1 January 2023, and the second contract relates to apples and is entered into a year later, on 1 January 2024.
- Neither contract is a consumer contract and there are no other contracts in the trading relationship.
- The parties' expectation when entering into the first contract is that C will spend approximately \$120,000 per year under it and that from 2024 it will also spend \$180,000 per year under the second contract.

Answer: Neither contract is a small trade contract because, despite the different subject matter, they form part of the same trading relationship and the annual value threshold is exceeded when the trading relationship first arises.

Example 3

Facts:

- On 1 May 2024, E and F, who are both engaged in trade, enter into an open-ended contract for E to supply stationery to F. The contract is not a consumer contract, and the trading relationship contains no other contracts.



- The contract does not include transparent terms setting out the consideration to be paid but based on their previous interactions the parties expect that F will spend \$100,000 under it each year. However, after several years F is purchasing significantly more stationery than originally anticipated. E is now supplying \$300,000 worth of stationery to F each year. There has been no variation of the contract.

Answer: The contract starts as and remains a small trade contract because the annual value threshold is not exceeded when the trading relationship first arises.

4. What is a standard form contract⁵?

The unfair term regime will not apply to every small trade contract, only those that are standard form contracts.

A court may determine that any contract, in which the terms⁶ have not been subject to effective negotiation between the parties, is a standard form contract. In determining whether a contract is a standard form contract, the court must take into account:

- whether one of the parties has all or most of the bargaining power;
- whether the contract was prepared by one or more parties before any discussion occurred;
- 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;
- the extent to which the parties had an effective opportunity to negotiate the terms of the contract; and
- the extent to which the terms of the contract take into account the specific characteristics of any party to the contract.

If a party alleges that a contract is a standard form contract, the contract is presumed to be a standard form contract unless any other party proves otherwise⁷.

⁵ Section 46J of the Act.

⁶ Other than a term which defines the main subject matter, sets the upfront price or is required or expressly permitted by an enactment.

⁷ Section 46J(3) of the Act.



5. What terms are unfair⁸?

A term is unfair if the court is satisfied that the term:

- 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 term⁹; and
- would cause detriment (whether financial or otherwise) to a party if it were applied, enforced, or relied on.

In determining whether a term is unfair, the court may take into account any matters it thinks relevant but must take into account the extent to which the term is transparent and the contract as a whole¹⁰.

6. Examples of unfair contract terms¹¹

The Act provides the following examples of terms that may be unfair contract terms (this list is not exhaustive):

- a term that permits one party (but not another party) to avoid or limit performance of the contract;
- a term that permits one party (but not another party) to terminate the contract;
- a term that penalises one party (but not another party) for a breach or termination of the contract;
- a term that permits one party (but not another party) to vary the terms of the contract;
- a term that permits one party (but not another party) to renew or not renew the contract;
- a term that permits one party to vary the upfront price payable under the contract without the right of another party to terminate the contract;
- a term that permits one party unilaterally to vary the characteristics of the goods or services to be supplied, or the interest in land to be sold or granted, under the contract;

⁸ Section 46L of the Act.

⁹ A term is presumed not to be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, unless that party proves otherwise (section 46L(3) of the Act).

¹⁰ Section 46L(2) of the Act.

¹¹ Section 46M of the Act.



- a term that permits one party unilaterally to determine whether a contract has been breached or to interpret its meaning;
- a term that limits one party's vicarious liability for its agents;
- a term that permits one party to assign the contract to the detriment of another party without that other party's consent;
- a term that limits one party's right to sue another party;
- a term that limits the evidence one party can adduce in proceedings relating to the contract; and
- a term that imposes the evidential burden on one party in proceedings relating to the contract.

7. Terms that may not be declared to be unfair¹²

A court may not declare a term to be an unfair contract term to the extent that the term:

- defines the main subject matter of the contract;
- sets the upfront price payable under the contract; or
- is a term required or expressly permitted by any enactment.

The upfront price is defined as the consideration (including any consideration that is contingent upon the occurrence or non-occurrence of a particular event) payable under the contract, but only to the extent that the consideration is set out in a term that is transparent¹³.

8. How is a term declared unfair¹⁴?

The Commerce Commission will be able to apply to the court for a declaration that a term in a standard form small trade contract is an unfair contract term.¹⁵ The court can make that declaration only if it is satisfied that:

- the term is in a contract that is a small trade contract (see paragraph 3 above);
- the small trade contract is a standard form contract (see paragraph 4 above);
- declaration is not prohibited by section 46K(1) of the Act (see paragraph 7 above); and

¹² Section 46K of the Act.

¹³ Section 46K(2) of the Act.

¹⁴ Section 46I of the Act.

¹⁵ A person can ask the Commission to apply for that declaration in relation to a contract to which that person is a party (section 46H(2) of the Act).



- the term is unfair in the sense described in section 46L of the Act (see paragraph 5 above).

9. What is the effect of a term being declared unfair?

If the Court declares a term unfair, it will be an offence for a person to include, apply, enforce, or rely on the term in a small trade contract¹⁶. The offence is punishable by a fine of up to \$200,000 for an individual or up to \$600,000 for a body corporate¹⁷.

Terms can continue to be enforced until they are declared to be unfair. Even so, businesses should be mindful of the risk that, following a declaration, the unfair term will be unenforceable (it is not re-written by the court to something that is considered fair). There may also be negative publicity from a Commerce Commission investigation and/or court proceedings.

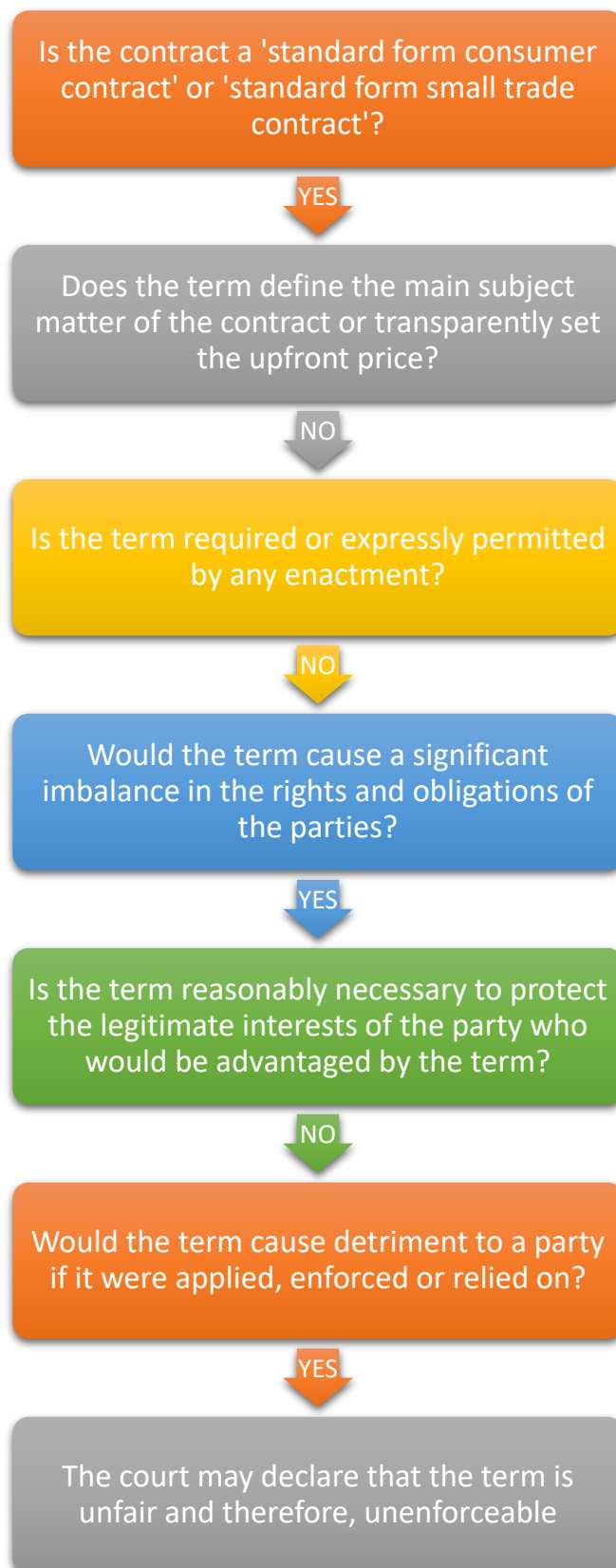
¹⁶ Section 26A of the Act.

¹⁷ Section 40 of the Act.



10. Application of the unfair contract term regime

We have illustrated below how the unfair contract term regime will apply to standard form consumer contracts and small trade contracts.



11. More information

If you have any questions or would like our assistance in reviewing and/or preparing your contracts, please get in contact with us.

kempsewir.co.nz/contact

