

4. Effect of Unfair Contract Terms on Small Business Owners: A Comparative Study of Australian and Indian Laws

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i. Abstract

In recent times there have been recurring accounts of small business vulnerability, their exploitation, and disadvantages arising from unfair contract terms. Small Businesses are very viable for the economy in terms of job and employment, innovation. To save time and resources, large businesses prepare standard forms of contracts and present them to small business owners on ‘take it or leave it’ basis. Small Businesses due to lack of resources and expertise have no choice but to agree to the terms of the contract proposed by large businesses and may not be in a better position to manage the risk allocated to them through contract. There was an urgent need to create a legal framework to protect the commercial interest of small business owners from such unfair terms in the contract. This paper studies, analyzes, and compares the position of law in India and Australia regarding unfair contract terms.

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1. Introduction

In today's era, contracts are a fundamental part of business facilitating transactions made between business owners by identifying promises, allocating the risk, and providing a mechanism for enforcement. Standard form of contracts are mostly pre-prepared by one party to the contract and the other party has either has to accept it or reject it, thus leaving behind no scope for negotiation. In the standard form of contract, the party who is offering contract generally holds most of the bargaining power and often uses this power to include such terms which may exploit the weaker party to the contract. Small business owners may face a similar experience of exploitation from the hands of large business owners. Large Business owners may present them with the standard form of contract which is in most of the cases are one-sided or largely favors the large business parties. Small business owners due to lack of economic resources, legal and technical expertise, and lack of negotiating power are not able to critically analyze the terms of the contract which may later be proved to be unfair for such small business owners. Small business set-ups may have little or no choice but to accept the terms of the contract in a belief that this is the only avenue to explore commercial opportunity. It is generally observed that large business set-ups offering a standard form of contract have better knowledge about the terms and conditions of contract and they use such knowledge and privilege to enhance their commercial interest and dominance over the small business owners which may go beyond the reasonable legitimate commercial interest. Hence some terms and conditions may unfairly advantage one party at the expense of others, with the potential to transfer all or much of the risk involved in the transaction to the weaker party to the contract. Such unfair contract terms may have broader implications on the economy and may bring undesirable economic costs.

It becomes essential to enact legislation and create a legal framework in order to protect the commercial interest of small business owners and other weaker parties from such exploitation of unfair contract terms. Since 1984, significant developments can be seen taking place in other countries to deal with the 'unfairness' in contracts. Many countries came up with, voluminous reports of law commissions, statutes, and a piece of legislation to address the issue of unfairness in the contract. This paper aims to study the existing position of law in India and Australia regarding the unfairness in the contract in relation to small business owners. The article

discusses the past provision and sections and the law which were there in these countries to protect the interest of the small business community and the present position of law existing now to deal with unfairness and unfair terms in the contract. The entire paper is divided into three chapters followed by the conclusion in the end. The first chapter talks about the position of law in India, Second chapter talks about the position of law in Australia and the third chapter compares the position of law existing in these two countries.

2. Position of Law in India

In matters of unfair terms in the contract, there have been significant developments taking place in other countries and detailed legal framework and statutes have been proposed or enacted. In India also, the subject of unfair terms in contracts has attracted grave significance in recent times with respect to not only consumer contracts but also with regards to other contracts like business to business contracts. In view of the growing importance of this subject and recent developments taking place in other countries, Law Commission of India had taken the detailed study on this subject suo-moto and proposed a separate legislation for dealing with unfair terms in contracts, apart from the provisions of Indian Contract Act and Specific Relief Act, just like other countries such as UK, Singapore or Australia has enacted.

Law Commission of India recognized the disadvantages of a standard type of contracts that are one-sided and the weaker party has no choice but to abide by the contract, therefore it felt necessary to regulate unfairness arising in the contract. Keeping in the mind the tremendous expansion in business activities in India, there was a need for a separate legislation to address the problem of unfairness in the contract and thus protect the interest of weaker party against the stronger one.⁶⁰ Thus on the recommendations of the Law Commission of India, Parliament has proposed a bill in 2018 called, ‘UNFAIR (PROCEDURAL AND SUBSTANTIVE TERMS) CONTRACT’.

The Indian Contract Act has several provisions such as undue influence, coercion, misrepresentation, mistake, fraud, etc which are related to ‘voidable contracts’. These

⁶⁰ Law Commission, *Procedural and Substantive Terms in Contract* (Law Com No 199, 2006) pg.10.

provisions are indeed procedural. Similarly, the Indian Contract Act also contains provisions dealing with the ‘void contracts’ or ‘void terms’ and these provisions are substantive provisions. Likewise, the Specific Relief Act also contains provisions for granting relief in case of substantive and procedural unfairness. This bill declares certain provisions of the Specific Relief Act and India Contract Act as procedural and substantive and provides guidelines to courts for each of their determination and further provides remedies to remove such type of unfairness in the contract. It was felt that, in the absence of such guidelines, there would be uncertainty in judicial interpretations and thus affecting the interest of the parties involved. A clear demarcation would bring clarity and certainty in the law and therefore would be relevant to protect the interest of the parties.⁶¹

Procedural Unfairness means whether there is unfairness in relation to how the terms of the contract arrived or entered into between the parties. Procedural unfairness involves looking into the conduct, knowledge, and positions of parties immediately before the contract and whether one party has imposed standard terms on the other party without any negotiations.

Substantive Unfairness may be termed as harsh or oppressive or one-sided. For an instance, one party to the contract may have excluded itself from the liability arising from negligence or breach of contract or might have given the power to it to alter the terms of the contract unilaterally.

2.1. Position Before The Bill on ‘Unfair (Procedural and Substantive Terms) Contract’

Before this bill, there were numerous laws such as the India Contract Act, Specific Relief, and even the provisions of the constitution, to protect the interest of the small business community. Under the relevant provisions of these laws, a contract may be declared void on the grounds of unconscionable, unreasonable, or unfair.

⁶¹ *Id.* at 13.

Section 16: Undue Influence (Indian Contract Act)

Section 16 of the Indian Contract Act is one of the provisions which deals with the inequality in the bargaining powers and unfair advantage of one party over the other. Section 16 talks about undue influence where the relations between the party are such that one party is in a position to dominate the will of the other party and use that dominant position to obtain unfair advantage of the other party, then the contract can be said to be induced by undue influence.⁶² Further section 16(3) states that the burden of proof that such a contract was not unconscionable and not induced by undue influence lies on the party who was in a dominant position.

Unconscionable in relation to contract means absence of choice on the part of one party to the contract to avoid and not bound by the contractual terms which unfavorably favors the other party to the contract. In *Poosathurai*,⁶³ the Privy Council held that both the elements of unconscionable nature and dominant position need to be satisfied before the contract can be called as unfair to the other party.

Section 27: Agreement in Restraint of Trade (Indian Contract Act)

According to section 27, an agreement that restrain the other party from exercising lawful business, trade, or profession is void to that extent.⁶⁴ Restraining one of the parties to the contract from carrying on lawful profession contains monopolistic tendencies and is aimed at avoiding competition and against the party's interest as well as the society.⁶⁵ Supreme Court in *Gujrat Bottling Co. Ltd.*⁶⁶ held that if the negative stipulation (restraint of trade) is confined or restricted to the period of the agreement only and not beyond that and further such negative stipulation is necessary to protect the business interest of another party then negative stipulation would be termed as valid.

⁶² The Indian Contract Act 1872, sec 16.

⁶³ *Poosathurai v. Kannappa Chettiar* (1920) 22 BOMLR 538.

⁶⁴ The Indian Contract Act 1872, sec 27.

⁶⁵ Law Commission, *Procedural and Substantive Terms in Contract* (Law Com No 199, 2006) pg.26.

⁶⁶ *Gujrat Bottling Co. Ltd. v. The Coca Cola Co. & Ors.* 1995 SCC (5) 545.

Section 28: Restraint on Legal Proceedings (Indian Contract Act)

Section 28 states that agreements which restrict the party absolutely from enforcing any rights in relation to contract by usual legal proceedings or by limiting the time by within which such time can be enforced or by discharging any party from any liability in respect of any contract on the expiry of a specified period to restrict the other party from enforcing rights.⁶⁷ In *Hakam Singh*,⁶⁸ Apex Court ruled that restriction imposed must be absolute and the party is wholly precluded from using any legal remedy. However partial restrictions would not be considered as void.

Section 67A (Indian Contract Act)

According to section 67A, if the court concludes that terms or any part of the contract is unconscionable then the court may refuse to enforce the contract or any part of it which is unconscionable.⁶⁹

Section 20 (Specific Relief Act)

Section 20 deals with the discretion of the court to grant or refuse to grant the decree of specific performance. The court may not grant the decree of specific performance if the terms of the agreement are unfair and gives undue advantage to the other party.⁷⁰

Article 14 (Constitution of India)

Generally, standard forms of contracts are tainted with unfair provisions as there is little scope for negotiation. Further existing provisions of the Indian Contract Act may not be adequate to rescue weaker parties if the terms of the contract may not fall within in ambit of section 16, 27, or 28 of the Indian Contract Act. However, Judiciary has come to rescue the weaker party who under the pressure of circumstances (mainly economic or due to ignorance) arising out of the

⁶⁷ The Indian Contract Act 1872, sec 28.

⁶⁸ *Hakam Singh v. Gammon (India) Ltd* 1971 AIR 740.

⁶⁹ The Indian Contract Act 1872, sec 67A.

⁷⁰ The Specific Relief Act 1963, sec 20.

inequality in the bargaining powers agreed to such terms, by using article 14 of the constitution since unfairness in contractual terms by authorities can also fall within the meaning of ‘State’ under article 12.⁷¹

In *Central Inland Water Transportation Corporation Ltd.*,⁷² Apex Court broadens the applicability of unconscionable terms and unfairness beyond the provisions of the Contract Act. Supreme Court in this case emphasized the term ‘distributive justice’ where the law must aim at removing economic inequalities and rectifying injustice resulting from transactions and dealings between the unequal in the society. Regarding unconscionable bargain, Supreme Court held that such contracts where the weaker party enters into a contract under pressure arising generally through economic circumstances, then such a contract would be regarded as void as opposed to public policy. In this case, Supreme Court ruled that conditions related to the termination of employees beyond any reasonable cause and merely on a three-month notice were unfair, unreasonable, and unconscionable and against the public policy and thus violative of Article 14 of Indian Constitution.

2.2. Proposed Bill: ‘Unfair (Procedural and Substantive Terms) Contract’

Procedural Unfairness under Indian Contract Act

Section 3 has categorized some provisions of the Indian Contract Act into procedural unfairness. They are section 15 (coercion), Section 16 and 19A (Undue Influence), Section 17 (fraud), Section 18(Misrepresentation) and Section 19 (agreements without free consent).

Procedural Unfairness under the Specific Relief Act

Section 4 has categorized some provisions of the Specific Relief Act into procedural unfairness. They are Section 20(2)(a) which talks about the conduct and circumstances of parties before entering into a contract, Section 20(2)(c), where the party entered into the contract under the circumstances which though not make the contract voidable but makes it inequitable. Section

⁷¹ Law Commission, *Procedural and Substantive Terms in Contract* (Law Com No 199, 2006) pg.32.

⁷² *Central Inland Water Transportation Corporation Ltd v. Brojo Nath Ganguly & Anr* 1986 AIR 1571.

27(1)(a), where the contract is voidable by one party and interested person in the contract sues to have it rescinded and such rescission is adjudged.

General provision related to Procedural Fairness

Apart from these, section 5 provides for General Procedural Fairness, where any contract or any term of it results in an unjust advantage to the one-party with regards to the conduct of the other party.

Guidelines to determine Procedural Unfairness

Section 6 provides for the guidelines in order to determine procedural unfairness for the purpose of section 5. Some of the important guidelines are: a) knowledge and understanding of the terms and their effects, b) bargaining strength of each party, c) commonly accepted standards of fair dealing, d) whether the terms of the contract were subject to negotiation, e) whether it was reasonable or practicable for the party to negotiate for the alteration of the contract or term therein or to reject the contract or a term therein, f) whether expressions in the contract are incomprehensible or unreadable.

Substantive Unfairness in the India Contract Act

Section 7 talks about substantive unfairness in the India Contract Act. They are section 10 (free consent, lawful object, and lawful consideration, Section 20(both the parties were under a mistake), section 23 and 24 (Object or consideration of the contract is unlawful), Section 25 (agreements without consideration), Section 26 (agreements in restraint of marriage), Section 27 (agreements in restraint of trade), Section 28 (agreement in restraint of legal proceedings), Section 29 (uncertain agreements), Section 30 (agreement by way of wager) and Section 56 (agreement to do impossible act).

Substantive Unfairness in the Specific Relief Act

Likewise, section 8 talks about substantive provisions of the Specific Relief Act with regard to unfairness. Section 18(a), where on account of mistake, misrepresentation or fraud, the performance of a contract is sought which is different from what parties to the contract agreed to or does not contain all the terms agreed between the parties on the basis of which one of the parties entered into the contract, shall be substantive.

General provision related to Substantive Unfairness

Further section 9 defines a contract as substantively unfair if the contract or any term excludes or restricts the liability arising from negligence or exclude liability from breach of contract without justification. Apart from these sections, section 12 talks about the general substantive unfairness, where the term of the contract is harsh, unconscionable or oppressive to one of the parties.

Guidelines to determine Substantive Unfairness

Section 13 provides guidelines for section 12 to determine whether the contract or term is substantively unfair. Some of them are: a) whether the imposed conditions of the contract were unreasonably difficult to comply with, b) not reasonable to protect the legitimate interest of the other party, c) whether a contract has led into an unequal exchange of monetary values or has created a substantive imbalance in the party, d) impose disproportionate penalties or e) entitles one of the parties to modify the terms of the contract unilaterally.

Remedies Available

If the court finds the contract or terms as procedural or substantively unfair to one of the parties then as per section 17 court is empowered to grant any relief such as refusing to enforce the contract or any term of it, declare the contract or term void, altering the terms of the contract to remove unfairness, refund of consideration, allowing compensation or damages, injunction or any other relief necessary in the interest of justice.

3. Position of Law in Australia

In Australia, based on the report submitted by the Productivity Commission – Review of Australia’s Consumer Policy Framework (2008)⁷³, provisions related to the protection of consumers from unfair contract terms in standard form of contract were introduced in Australian Consumer Law (ACL) and the Australian Securities and Investment Commission Act 2001 (ASIC). Standard forms of contracts distort the relationship between buyer and seller and result in the imposition of one-sided contracts and thus leaving no rescue to the weaker party (consumer). Therefore Australia brought the relevant provisions to ameliorate the imbalance existing between the parties and to empower the court to determine any unfair terms in standard form of contract and thus make that term or contract void.

However, it was not until 2014, when the unfair terms in the contract can be used to protect the interest of small businesses. In Treasury Review (2014), Queensland Law Society submitted that the majority of small business do not possess the same level of bargaining power due to lack of economic resources when dealing with large business thus there is strong need to extend the protection unfair terms to small business and improve the access to justice for another vulnerable and marginalized group which is equally at risk.⁷⁴ As a result, Australia brought the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015. The Act amends ACL and ASIC Act 2001, extending the protection from unfair contract terms which were currently available to consumers, to small business as well and came into effect in 2016.

⁷³ The Treasury (2018), Australian Government, *Review of Unfair Contract Term Protections for Small Business*, https://consult.treasury.gov.au/market-and-competition-policy-division-internal/c2018-t342379/supporting_documents/Discussion_Paper_Review_of_UCTs%20%20Final.pdf (last visited May 27, 2020).

⁷⁴ The Treasury (2014), Australian Government, *Extending Unfair Contract Term Protections to Small Businesses*, https://treasury.gov.au/sites/default/files/2019-03/C2014-025_E53165D4D8B24B4799395680E68FE0B0.pdf (last visited May 27, 2020).

3.1. Key features of the Act

Standard Form of Contract

In order to determine whether the contract is a standard form of contract or not, the Court is required to take into account whether: a) One of the parties hold all or most of the bargaining power, b) the contract was prepared and drafted by one party without any discussion and negotiation, c) other party was offered to either accept or reject the offer (leave it or take it), d) the terms of the contract take into account or consider any specific characteristic of other party or the particular transaction and e) any other matter prescribed by regulations.

Unfair Defined

Unfair is defined in the legislation as those contract terms which: a) cause a significant imbalance in the parties' rights and obligations arising in the contract, b) are not considered as reasonably necessary to protect the legitimate interest of the party and which would advantageous position to one party, c) it would be a detriment (financial or otherwise) to the party if such term/s were to be relied upon.

The Act is Confined to Small Business Contracts

Small businesses lack resources (economic or otherwise), legal and technical expertise, and bargaining power to negotiate the terms of the contract with large business therefore the Act aims to prevent small businesses from injustice arising due to such unfair terms and inequality in bargaining power.

The Act defines a small business as: a) a business that employs less than 20 people, b) the upfront price payable under the contract does not exceed \$300,000 or \$ 1 million if the contract runs for more than twelve months. Further, the Act uses the 'headcount method' to determine how many people are employed in business and it does not include full-time equivalents nor does it include casual employees.⁷⁵ The legislation introduced sub-section 12BI(2) in AISC

⁷⁵ Competition and Consumer Act 2010, sec 12BF.

Act and sub-clause 26(2) in ACL in order to define ‘up-front’ price as: a) the amount provided for the supply or sale as per the contract, b) disclosed at or before the parties entered into contract and c) does not include any other consideration that is contingent on the happening or non-happening of any particular event.

Exemptions

Certain terms of the contract are exempted from the ambit of ‘Unfair Terms’. The Unfair Contract Term protections do not apply to the terms that: a) forms the main subject matter of the contract, b) set the ‘upfront price’ which is payable under the contract, c) which are required by the law of Commonwealth. Further contracts that are subject to protection under a law that is prescribed by the regulation are also exempted from ‘Unfair Terms’. In addition provisions of Unfair Contract Terms, does not apply to the marine contracts, contract for the carriage of goods by ships.

Remedies Available to Small Business

Small Business (a party to the contract) may request before the court to declare certain terms in contract as unfair. The unfair term may be separated from the entire contract so that the remaining part of the contract can operate without any unfair terms involved in it. The court after concluding that any term in the contract is unfair can impose pecuniary penalty or order compensation and can also issue an injunction. Other remedies the court can use are: a) to declare the unfair term or the contract void, b) altering the contract to remove unfairness c) to return or refund the property d) repair or providing the parts of goods supplied under the contract, e) ordering resupply of services f) amend or reconvey transfer of interest inland.

4. Comparative Study of Position of Law on Unfair Contract Terms in India and Australia

Few countries in the world have legislation on unfair contract terms and Australia is one of them. The provisions related to unfair contract terms are legislated in two statutes: Australian Consumer Law (ACL) and the Australian Securities and Investment Commission (ASIC). These two legislations were amended in 2016 to expand the protection from unfair terms in the contract to small businesses also. The former deals with the issues of unfair terms arising in the contract of goods, services, and land while later deals with the issue of unfair terms in financial products and services. However, in India, the separate legislation to deal with the unfair terms in the contract is still in the nascent stages. The bill on the Unfair Contract has not become an Act. Further, the bill does not provide any demarcation between unfair terms in the contract for goods, services, land, and the contract for financial products and services.

In the recent amendments made in ACL and ASIC, small business has been defined as the party which employs fewer than 20 persons and either the upfront price payable under the contract does not exceed \$100,000 or if the contract is for 12 months then the upfront price payable under the contract does not exceed \$250,000. But in India, the bill on Unfair Terms in Contract does not provide any such definition for ‘small businesses’.

The bill on Unfair Contract Terms in India has demarcated unfairness into ‘procedural’ and ‘substantive’ unfairness. The bill declares certain provisions of the Indian Contract Act and Specific Relief Act as procedural or substantive unfairness along with the statutory guidelines to determine the same. However, in Australian Law, there is a lot of confusion and mismatch of substantive and procedural unfairness. Unlike Indian law, no such demarcation has been made between procedural and substantive unfairness. Australian law simply defines ‘unfairness’ as causing a significant imbalance of rights and obligations, giving one party an advantageous position or been detrimental (financial or otherwise) to the interest of one party.

The remedies provided under Australian and Indian law regarding unfair terms are almost similar such as declaring such term or contract void and unenforceable, ordering injunction, compensation or damages, or altering the terms of contracts to remove unfairness and many others.

It is to be noted that Australia has amended provisions of ACL and ASIC to expand the protection to small businesses which was earlier given to the consumers. Thus with such amendments, Australia has enacted provisions which specifically caters to the need of small businesses. In 2019, Australia announced to strengthen the current laws protecting small businesses from unfair terms in the contract such as making unfair terms as illegal and attaching civil penalties.⁷⁶ However, no such specific legislation or provisions are there not even under the new proposed bill to specifically take care of the interest of the small business community. The newly proposed bill can be termed as an umbrella which covers and accommodates the need of various interest holders such as consumers, suppliers, business owners.

5. Conclusion

The tremendous expansion in the commercial sector has opened the door of opportunities for the business community. In this regard, the matter related to unfair terms in the contract has attracted profound significance. To protect the interest of the weaker party, it was important to enact a comprehensive set of laws that deal with the unfair terms in the contract and provide justice to the weaker party and provide a conducive environment for doing business. In the last decades, many major countries such as the USA, UK, or Australia have undertaken the initiative to frame laws for the consumers and small business owners and granting them protection from the exploitation of standard terms of contracts which are majorly one-sided.

In India, the Law Commission of India recognized the disadvantages of a standard type of contracts that are one-sided and the weaker party has no choice but to abide by the contract, therefore it felt necessary to regulate unfairness arising in the contract. On the recommendations of the Law Commission of India, Parliament has proposed a bill in 2018 called, 'UNFAIR (PROCEDURAL AND SUBSTANTIVE TERMS) CONTRACT'. Before the coming of this legislative framework, the Indian Contract Act and Specific Relief Act were the two important legislations that protected the party from the unconscionable and unfair terms in the contract. These provisions dealt with coercion, mistake, misrepresentation, fraud, undue

⁷⁶ Jonathan Casson, *Small Business and Unfair Contract Terms: Changes on the Horizon*, Holman Webb Lawyers, <https://www.holmanwebb.com.au/blog/299/small-business-and-unfair-contract-terms-changes-on-the-horizon>(last visited May 27, 2020).

influence, agreement in restraint of trade, etc. Similarly, the Specific Relief Act also contains the provisions which empower the court to refuse to grant decree if it will put one party in an advantageous position over the other. However, it was felt that there is a need for proper and separate framework of provisions which deals with the unfairness in the contract so that weaker party to the contract can have access to easy and simple remedies. Moreover, the Indian Parliament considered that the division of ‘unfairness’ into procedural or substantial was necessary to avoid confusion and mis-mash of substantive and procedural fairness. Thus it provided in the bill the clear demarcation of certain provisions of Indian Contract and Specific Relief Act as substantive and procedural unfairness along with the statutory guidelines for the determination by the court. The bill also contains various remedies available to the small business owner if the term/s of the contract is unfair such as declaring such term or contract void, issue injunction, order damages, alter terms of the contract to remove unfairness. Thus under Indian laws, a separate framework and clear demarcation would ensure uniformity, certainty, and clarity of law which would be of extreme importance to the small business owners.

Australia also introduced a legislative framework to protect the interest of weaker parties such as consumers against unfair contract terms. It enacted Australian Consumer Law and Australian Securities and Investments Commission Acts to address the issue of unfair terms arising in the contract. Later in 2016, Australia expanded the protection from unfair terms to the small business owners also as it was felt that small business owners due to limited resources and lack of expertise may face exploitation from large businesses. The provisions of ACL were amended to address the issues unfair terms arising in the contract of goods, services, and land, and similar provisions of ASIC were amended to incorporate unfair terms for financial products and services. Unfair Contract Terms have been defined in the legislation as those contract terms which would cause a significant imbalance in the parties’ rights and obligations arising in the contract or which are not considered as reasonably necessary to protect the legitimate interest of the party and by which one party would be in an advantageous position by such term in the contract or which would be a detriment (financial or otherwise) to the party if such term/s were to be relied upon. Further, Australia recently announced to introduce relevant amendments to strengthen the current laws protecting small businesses from unfair terms in the contract such as making unfair terms as illegal and attaching civil penalties, further changing the definition of ‘small business’, removing the ‘upfront price’ payable threshold.

Small businesses are very crucial to the economy in terms of innovation, employment, and productivity. A legislative framework to address the issue of unfairness in the contract is necessary to ensure the efficient allocation of risk in the contracts and providing confidence to small business owners in agreeing to the contracts. Removal of unfair terms in contracts would boost the confidence of small business owners in dealing with other large businesses thus helping them to expand their operations and creating the environment of healthy competitiveness which would also be beneficial for the whole economy.