Businesses are people too? Anomalies in widening the ambits of "consumer" under consumer credit law

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In Australia approximately 95% of actively trading businesses are regarded as ‘small businesses’

Potential inclusion of ‘small business’ as consumer under Australian consumer credit law – issue of current concern

Compare treatment of small business in EDR schemes – FOS & COSL
Section 3 ACL contains a broad definition of ‘consumer’ – includes B2B transactions

Ensures access for businesses to ‘consumer guarantees’ (eg, fitness for purpose, etc)
Consumer credit regulated by *National Consumer Credit Protection Act 2009* (NCCPA) – includes *National Credit Code* (NCC)

‘Consumer’ currently only includes natural persons and strata corporations (body corporates) – s 3 NCCPA

‘Consumer credit contract’ – covers credit provided for personal, domestic or household purposes, or to purchase, renovate or improve residential property for investment purposes

Small businesses not included
Draft legislation included ‘protected small business credit contracts’ and regulation of credit provision to small businesses

But Treasury announcement of 15 February 2013 – deferred small business inclusion for further consideration

Currently small business continues to be excluded from consumer credit legislation
Are businesses generally included in consumer credit law?

- European law does not include small business as consumer – recognises only ‘a natural person who … is acting for purposes which are outside his trade, business or profession’ (European Parliament Directive 2008/48/EC)

- UK *Consumer Credit Act* 1974 (as amended by *Consumer Credit Act* 2006) – provides protection for individuals, sole traders, partnerships and unincorporated bodies, but not companies

- US *Consumer Credit Protection Act* 1968 – the term ‘consumer’ means ‘a natural person’
Small business as defined may be a corporation under Corporations Act:

- Defined as ‘Less than 100 employees if a manufacturer, otherwise less than 20 employees’

But credit providers have a different way of identifying small business customers: eg, the RBA typically classifies a loan as being ‘small business’ if the loan principal is under $2M – creates inconsistency with legislation and Codes of Practice definition.
Currently combination of legislation and self regulation under:

- **Federal law**
  - Limited protection under *ASIC Act* – unfair practices

- **State-based law**
  - State *Hire Purchase Acts* – different levels of coverage

- **Industry Codes of Practice**
  - Banking Code of Practice
  - Mortgage and Finance Association of Australia (MFAA) Code of Practice
  - Mutual Banking Code of Practice

- **External Dispute Resolution Schemes**
  - Financial Ombudsman Service (FOS)
  - Credit Ombudsman Service Limited (COSL)
Both FOS and COSL apply *Corporations Act* definition of ‘small business’ and deal with complaints from small businesses

- **COSL** defines ‘consumer’ as a natural person or small business (including a company)
- **FOS** Terms of Reference include a small business (whether a sole trader, … company, partnership, trust or otherwise)

This effectively allows regulation of small business credit by EDR schemes
Small businesses regarded as consumers – thus can complain to EDR providers at no cost to complainant

Credit provider charged complaint fees as soon as complaint received by FOS or COSL

Complaints can include ‘hardship’ or ‘financial difficulty’ – ie, inability to pay their debt

Note: As from 1 January 2014 – jurisdiction in respect of debt recovery complaints limited to credit contracts up to $2M
FOS and COSL also have determinative powers to make binding decisions on business loans such as:

- directing the credit provider to release the security held for the complainant’s debt
- waiving or varying fees or interest rates
- staying the execution of a default judgment
- releasing the complainant from the credit contract
As soon as a complaint is made, member must cease legal action until determination of complaint – whether or not EDR scheme has power to vary contract terms

However, other creditors of complainant business (ie, non FOS or COSL members) can continue to recover their debts – places members’ security interests at risk of erosion
Both schemes claim not to vary business contract terms but can compel lenders ‘to give genuine consideration to hardship requests on commercial loans’ – in practice delays amount to pressure and force variation of contracts.

**Net effect:** These powers extend further than what would be regarded as mediation or dispute resolution powers – effectively assuming the role of the Courts?
All Australian Credit Licence (ACL) holders required to be members of either FOS or COSL

Non-compliance with EDR determinations means loss of membership, thus loss of credit licence

Members have limited possibilities for review – no appeal from Ombudsman decision

EDR schemes not bound by legal rules of evidence

Must pay complainant and EDR scheme costs upfront before contesting decision in Court
Purpose of EDR schemes – regulatory tool to provide assistance to consumers facing problems with financial services industry

An inconsistent application of ‘consumer’ definition compared to NCCPA and NCC – which only regulate natural persons and strata corporations

Danger that regulation by EDR schemes may exceed legislative purpose

Medium to large corporations that meet this definition could benefit from ‘hardship provisions’ – not reflecting intention of legislation
EDR REGULATION: PRACTICAL IMPLICATIONS

EXECUTIVE CARS PTY LTD

CR1 $1.8M loan (COSL member)
CR2
CR3
CR4

HEAD OFFICE
[Director + 6 employees]

BRANCH 4 employees
BRANCH 4 employees
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The business may be trading in insolvent circumstances

Disparities with Corporations Act:

- ‘A person is solvent if … the person is able to pay all the person’s debts, as and when they become due and payable.’
- ‘A person who is not solvent is insolvent.’

EDR provisions facilitate continued trading by complainant – legal action by member held in abeyance
Continued exclusion of small business from consumer credit law is appropriate – interference with commercial transactions should be limited

Otherwise could lead to abuse of process and reduction in availability of finance –

‘The potential for abuse by small businesses … is huge and is proving increasingly costly for the finance industry, reducing availability of credit, and reducing competition by the withdrawal of participants from this sector’: MFAA submission on Draft Bill

Intersection of credit law with insolvency law and Corporations Act requires more investigation and consideration
Current regulatory powers of EDR schemes should be reviewed in this context – considering far reaching effects

EDR delays – time limits should be placed on EDR schemes’ resolution of complaints (ASIC Review October 2012 failed to recommend this) – unfair vis-à-vis other creditors

Restriction of EDR hardship provisions to individuals, not businesses, would be appropriate