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

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# BUSINESSES ARE PEOPLE TOO?

## ANOMALIES IN WIDENING THE AMBITS OF 'CONSUMER' UNDER CONSUMER CREDIT LAW

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# INTRODUCTION

- ❖ 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

# AUSTRALIAN CONSUMER LAW

- ❖ Section 3 ACL contains a broad definition of 'consumer' – includes B2B transactions
- ❖ Ensures access for businesses to 'consumer guarantees' (eg, fitness for purpose, etc)

# THE CONSUMER IN AUSTRALIAN CONSUMER CREDIT LAW

- ❖ 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

# PROPOSED NCCPA AMENDMENTS

- ❖ 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

# COMPARISONS

## **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’

# SO WHAT IS A 'SMALL BUSINESS'?

- ❖ 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



# CURRENT REGULATION OF SMALL BUSINESS CREDIT

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)

# EDR SCHEMES

- ❖ 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 BUSINESS ACCESS TO EDR

- ❖ 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

# SMALL BUSINESS ACCESS TO EDR

- ❖ 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

# SMALL BUSINESS ACCESS TO EDR

- ❖ 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

# SMALL BUSINESS ACCESS TO EDR

- ❖ 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?

# EDR REGULATION: PRACTICAL IMPLICATIONS

- ❖ 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

# EDR REGULATION: PRACTICAL IMPLICATIONS

- ❖ 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

### HEAD OFFICE

[Director + 6 employees]



BRANCH

BRANCH

BRANCH

4 employees

4 employees

4 employees

**CR1** \$1.8M loan →  
(COSL member)

**CR2** →

**CR3** →

**CR4** →

# EDR REGULATION: INSOLVENCY CONCERNS

- ❖ 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

# CONCLUSION

- ❖ 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

# CONCLUSION

- ❖ 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