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25 May 2015

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[redacted]

EXTENDING UNFAIR CONTRACT TERM PROTECTIONS TO SMALL BUSINESS – EXPOSURE DRAFT

The Australian Finance Conference (AFC), a national financier association, appreciates the opportunity to provide feedback on the exposure draft of the *Treasury Legislation Amendment (Small Business & Unfair Contract Terms) Bill 2015* [the draft UCT B-2-B Bill] and apologises for the delay in response. While we have been aware for some time of the broad commitment by the Government to this proposal, we have not been in a position to assess its implications for our Members until the detail was published on 28 April. We also note that the limited timeframe provided for comment on the exposure draft has challenged our ability to fully consider the proposals in the context of the complexities of our Members' operations. Nevertheless with a view to assisting the Government to meet its commitment to the small business constituency to progress this proposal to meet a proposed early 2016 commencement we provide the following.

Background

The AFC membership includes a range of credit providers, vendor and general financiers, receivables managers and the three principal Australian business and consumer credit reporting entities. AFC Members' operations cover the full range of lending in both the consumer and commercial markets. For those that provide commercial finance, a significant component of their customer-base is "small business".

Small business finance is also of particular interest for Members of our associated bodies that focus on providing finance in the commercial market; the Australian Equipment Lessors Association (AELA), the Debtor and Invoice Financing Association (DIFA) and the Australian Fleet Lessors Association (AFLA). Collectively members of these associations account for several billion dollars of finance provided to the small business sector in Australia.

General Comment

AFC reiterates the concerns expressed in our 1 September 2014 submission on the earlier Discussion Paper and note that these haven't been addressed in the draft UCT B-2-B Bill and the RIS despite the Government's ongoing commitment to red-tape reduction and best practice regulation-making; in short, a regulatory response that is proportional to, and targeted at, addressing an identified market failure or consumer protection risk. We remain unaware of any general problem with standard form contracts in the finance sector that merits the proposals applying to the contracts with their commercial customers.

The reference in the RIS to concerns with a contract for the supply of ATM services does not in our view present a case for coverage of financial products. Also, the lack of detail around references in the RIS to allegations of 'fee farming' and 'equity stripping' in the business finance market make it difficult to understand how the proposed blanket UCT extension will be a solution nor why the existing unconscionable conduct provisions have failed. Similarly, the absence of evidence concerning perceived unfairness in non-monetary covenants in credit contracts undermines the rationale for extension.

AFC nonetheless appreciates the Government's policy dilemma in this matter given its commitments.

While we do not believe current standard form contracts include terms that are unfair, we expect that Members will prudently seek external advice to confirm this in the light of the enacted provisions, adding further to the cost of Australia's regulatory burden. Whether, given the definitional issues referred to below, any subsequent revisions will be limited to "small business" contracts is a moot point.

Specific Concerns

The AFC and our affiliated associations have four key concerns with the provisions proposed:

1. Definition of Small Business

The key element of the proposal is how small business is to be defined as this largely sets the parameters of application. However, the proposed definition based on number of employees (20) presents a challenge for a range of reasons. This includes the interpretative challenge that would see the UCT protections available to a different range of entities than other small business protections contained in the ASIC Act (and other relevant components including the jurisdiction of the External Dispute Resolution Schemes) based on a different small business definition test. And while the business may be required to prove it meets the number of employee criteria, it is our Member that bears the legal risk in event of challenge.

Further, and more importantly, a definition based on number of employees does not reflect the normal operations of our Members and others within the financial services sector in their delineation of commercial customer segments. Nor is it a measure that is currently captured within their processes and consequently cannot be easily incorporated into their current operations to minimise red-tape or implementation costs. There is no reasonable way for a financier at the time of application, contracting, renewal or variation, to know with compliance certainty the applicant's number of employees let alone distinguish regular casuals (what about contractors) from irregular ones. Sighting and verifying all the applicant's contracts of employment where they exist or the employee attendance records, does not represent a major reduction in red-tape! Further, it ignores the fact that many businesses can have large turnover with few employees and their bargaining position may therefore not see them

warranting protection. Also neglected are the situations where the borrowing arm of a large group is a company with no or few employees.

The alternative of a Government register with verifiable ASBN would overcome problems with a Small Business Declaration response but is probably not presently under active consideration.

Definitions of 'small business' are many and varied along the spectrum from unincorporated micro-businesses to manufacturers with 100 employees, however most suffer from difficulty of verification at a point in time. Annual Financial Statements and annual Payroll Tax Reconciliations respectively will show revenue and employee numbers but for historical periods that won't be coincident with when a contract is entered into. Interestingly the Government manages to resolve this difficulty for itself with the recent Budget's small business accelerated depreciation incentive defining a small business in the current income year as one which had aggregated turnover in the previous income year of less than $2 million. By similarly breaking the timing nexus in the proposed Bill, compliance certainty and red-tape reduction can be achieved, for example by applying the provisions to entities with "annual turnover of less than $2 million as per their Financial Statements for the year immediately prior to the contract being entered into". AFC recommends that this be considered.

2. Transitional arrangement – effective retrospective application

We note the intention for the proposed amendments to effectively have "retrospective" application through the application to contracts in existence pre-commencement for contracts that are renewed, or terms which may be varied post-commencement. In practice, the default compliance likely to result for our Members for the protected market segment would be entry into a new contract rather than renewal or variation to minimise compliance risk. Again, this will add cost with no justification to substantiate the expense.

It would also affect variations in contract terms that are negotiated for work-outs and more generally for businesses in managing hardship. While the pre-commencement contract may have been in 'standard form' when originally made, the effect of the transitional provisions is to make a term varied by negotiation and often at the request of the business customer, subject to the UCT regime. AFC recommends that this situation be removed from the scope of the Bill.

Further the proposed application will present difficulty for what is a standard business process for our Members; namely the entry into an equipment or other financing arrangement based on a master agreement containing all relevant terms and conditions. Point of entry into the contract is dynamic as the commercial customer looks to acquire equipment driven by business demands over time. These individual equipment acquisitions / tranches result each time in a new contract subject to the terms and conditions of the master finance agreement which would trigger in turn a potential need for our Member to assess whether the business is a "small business" or not. The default alternate would see the Member effectively having to replace pre-existing arrangements with new arrangements to minimise compliance risk with the attendant (and unjustifiable) costs.

3. Term and Monetary Thresholds

We further note that the proposed additional criteria of a "small business contract" relating to term and monetary threshold based on an "up front price." We question how these should be applied in the context of a range of finance products offered by our Members that may

see a contract entered into without any clear term or price (eg in the case of continuing credit contracts or revolving credit facilities payable on demand).

Further it is also unclear to what extent the carve out of interest payable when calculating the up-front price payable under a contract under which "credit" is to be provided has application for non-loan finance products. We expect that it is intended for "credit" to be interpreted in accordance with the broad meaning attributed to it elsewhere in the ASIC Act (eg through the operation of ASIC Regulation 2B(3)). If so, this would potentially see all products offered by our Members and those of our affiliated associations captured and the need for a clear understanding of how the up-front price and carve out for interest payable become crucial.

The concept of "up front price" also has the potential to create distortion of application between products. For example, while a commercial loan to purchase equipment would be assessed presumably on the amount financed (ie. excluding the interest payable), there is insufficient clarity about what figure should be used for a lease or hire-purchase product which may incorporate implicit interest in the contractual total. Should the figure be based on the amount of the rentals only? Or should it be based on the total contractual obligation of the customer under the lease or hire-purchase contract which might see our Member having to factor in other components (eg the residual under the lease or the balloon payment under the hire-purchase agreement)? AFC recommends that the "up front price" be defined to include all amounts that are required to be paid, including any agreed or residual value at the end of the contract or on termination.

And as noted above, determination of the "up front price" is unclear in the case of master supply/finance agreements under which an overall credit limit is set for the master agreement, with individual supplies or drawdowns over time being for specific amounts. For certainty AFC recommends that the legislation defines the "up front price" in such instances as the credit limit set at the time that the master agreement is entered into, not the lesser periodic draw-down amounts. This is because it is the master agreement which embodies and reflects the commercial arrangement including the contract terms. Alternatively, an approach similar to that taken under the component pricing provisions of the Australian Consumer Law (s.48) which carves out pricing in contracts where the services or payments are made over time.

4. Implementation Time Frame

At present, the amendments if enacted are to take effect 6 months from date of assent. We submit that this implementation timeframe would present a challenge for our Members. Based on feedback with other similar regulatory reforms, our Members have indicated a period of 12 months from date that the detail of the amendment is finalised and the commencement date to optimise their ability to efficiently and effectively implement requisite change. We strongly urge the Government to revisit the proposed timeline to align the outcome with its commitment to red-tape reduction.

Conclusion

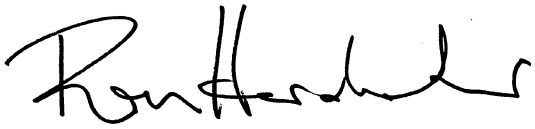
The foregoing concerns of AFC and our affiliated associations flow from the inclusion in the Government's B2B UCT commitments of standard form loan and like finance product contracts which we previously argued against and which in our view the RIS fails to justify on best practice regulation and red-tape reduction principles. In the main these relate to compliance certainty for the financier in the event that the Bill proceeds.

A broader concern regularly expressed to B2B UCT advocates over the years is the potential adverse impact on commercial certainty for small businesses (however defined) themselves. Along the spectrum of businesses from smallest to largest, the advocates' assumption is that unfairness is forced upon the small by the large because if the small player were to attempt to force an unfair contract term on the large, the latter's market power would ensure that the contract term in question would be removed; likewise the market power of the large can enforce an UCT on the small. While such an assumption holds at the opposite ends of the spectrum, for slightly larger/slightly smaller/equi-sized businesses where market power is not the issue, an UCT regime opens the way for significant litigation and consequential commercial certainty around what is fair and what is not, among the erstwhile protected species. This could lead to an increased risk profile for the B2Bs so defined.

AFC would welcome the opportunity to discuss this further with a view to working with the Government to revise the draft UCT B2B Bill to ensure a solution that provides proportional protection to the small business customers of our Members in a way that minimises cost or other unintended collateral damage including to small business confidence and risk profile. Please feel free to contact me via email through ron@afc.asn.au or our Corporate Lawyer, Helen Gordon, helen@afc.asn.au or both by phone through the AFC Office 02 9231 5877.

Kind regards,

Yours truly,



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