Min-it Software

Financiers Assocation of Australia

Joint Submission –

TREASURY Consultation –
Extending Unfair Contract Term Protections to Small Businesses

15 May 2015

Contact:

Haydn Cooper
Director
Min-it Software
PO Box 1367
Sunnybank Hills
QLD 4109

Telephone:: 07 3038 3044
Fax: 07 3870 0813
Mobile: 0413 722 223
e-mail: haydn@min-it.net

Background Information

This submission is made on behalf of the Financiers Association of Australia ("FAA") and Min- it Software clients.

The Financiers Association of Australia ("FAA") and Min-it Software ("Min-it") welcomes the further opportunity to make this submission on Treasury's consultation on extending unfair contract terms to small businesses.

We take this opportunity also of thanking Treasury for the extension of time granted for making this submission.

Introduction

In August 2014, when we made our last submission on what was then a proposal to afford the same degree of protection to small businesses as consumers, we stated our opposition to it. We reminded Government that at the Treasury Credit Industry Working Group meetings that followed the initial Green Paper[1] issued by the Consumer Credit Unit, Retail Investor Division of Treasury, all industry participants, except for the consumer advocates, were unanimous in not wanting to see such a proposal implemented.

[1] The Treasury, 2010. "National Credit Reform: Enhancing confidence and fairness in Australia's credit law", July 2010. Available online http://archive.treasury.gov.au/documents/1852/PDF/National_Credit_Reform_Green_Paper.pdf viewed 29 July 2014.

We saw this same view was held by a number of other submitters to the August 2014 submission process and it is disappointing that Government has felt the need to respond with these knee-jerk legislative changes when it has done little to justify the need for change. Analysis of those submissions that supported changes to the legislation reveals the major dissatisfaction was predominantly with just a few industries.

There is undoubtedly dissatisfaction between franchisors and franchisees but we question why some of these concerns were not or could not be more properly dealt with under the Franchise Code that was recently amended. We note the statement made by Service Station Australia Ltd that the Oilcode doesn't apply, "[p]etroleum products retailing is still dominated by master – servant relationships[2]" and that "[i]n too many cases, the incoming franchisee, commission agent or independent operator is simply buying a job[3]". This appears to be a clear example of why this industry's concerns should be dealt with under an amended Franchise Code along with an updated Oilcode rather than supporting these legislative changes.

Retail and commercial leases are another clear area of concern and as the Australian Retailers Association noted in its submission "[e]ven after an in-depth and substantial 'Productivity Commission Report – The Market for Retail Tenancy Leases in Australia 2008' which proposed nine specific recommendations to promote transparency towards a more informed market with the view to addressing directly these imbalances, no positive action nor steps

[2] Service Station Australia, 5 August 2014, "Unfair Contracts Legislation". Available online http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2014/Extending%20Unfair%20Contract%20Term%20Protections%20to%20Small%20Businesses/Submissions/PDF/Service%20Station%20Australia.ashx viewed 02 May 2015.

[3] Ibid 2

have taken place to date.[4]" One has to question why not when a specific Industry Code would appear to be a more appropriate tool.

There will always be a number of businesses that go to the extremes and for many that support this legislation, a large number of small business operators still have an employee state of mind rather than the entrepreneurial state required to be successful. This is clearly demonstrated when one looks at why businesses fail. According to a study[5], "[o]f those surveyed, 61% of SME operators said small businesses failed because of an inability to manage costs, 50% said inexperienced management, 50% said poorly designed business models or no business plan, 49% said insufficient capital, 37% said poor or insufficient marketing, and 35% said insufficient time managing the books".

Government should be asking why these people should be protected at all rather than simply enacting legislation to protect them. If they haven't the nous to manage their businesses, should they be in business at all? According to the Australian Bureau of Statistics[6], as at June 2014, "61% of actively trading businesses in Australia had no employees, 27% had 1-4, 10% had 5-19, 2% had 20-199, and less than 1% had 200 or more". That means this legislation will impact on just over 97% of the 2,100,162 business actively trading at that time[7].

[4] Australian Retailers Association, 2014. "Extending Unfair Contract Term Protections to Small Business – Retail Shop Leases", August 2014. Available online http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2014/Extending%20Unfair%20Contract%20Term%20Protections%20to%20Small%20Businesses/Submissions/PDF/Australian%20Retailers%20Association.ashx viewed 03 May 2015.

[5] Waters, C, 2013, "Top reasons for small business failure: Study", Smartcompany, 12 April 2013. Available online http://www.smartcompany.com.au/growth/31229-top-reasons-for-small-business-failure-study.html# viewed 30 April 2015

[6] Australian Bureau of Statistics, 02 March 2015, "8165.0 - Counts of Australian Businesses, including Entries and Exits, Jun 2010 to Jun 2014", available online http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0 viewed 30 April 2015

[7] Ibid 8

New Zealand implemented similar changes to its Fair Trading Act legislation on 17 March 2015 and we note the New Zealand Law Society[8] made reference to this in its submission. The Society inferred Australia should wait to see how the New Zealand experience pans out before Australia following suit.

The Government has not provided any serious or factual need for these changes to be made and one suspects this is ideological. Given the rush to develop this legislation and the lack of further consultation, it does not appear to have considered any unintended consequences.

With the Treasurer, the Hon Joe Hockey's "get out there and have a go" message in his recent Budget[9], in light of the current unemployment rate and the new immediate deduction for assets costing less than $20,000, there will be a number of Australians that will contemplate establishing a small business. Coupled with this draft legislation, the problem with this message is it's exactly like the Insulation Scheme that saw a few installers lose their lives because Government had not thought through the consequences in its rush to pass legislation that would allegedly stimulate the economy[10]. By the time these are known, it may well be too late for many that did what the Treasurer suggests.

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[8] New Zealand Law Society, 2014, "Extending Unfair Contract Terms Protections to Small Businesses – consultation paper", 1 August 2014. Available online http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2014/Extending%20Unfair%20Contract%20Term%20Protections%20to%20Small%20Businesses/Submissions/PDF/New%20Zealand%20Law%20Society.ashx viewed 01 May 2015

[9] Australian Broadcasting Authority, 2015, "Budget 2015: Billions for small businesses the centrepiece as Hockey urges Australians to 'have a go", 12 May 2015. Available online http://www.abc.net.au/news/2015-05-12/billions-for-small-business-centrepiece-in-have-a-go-budget/6464246 viewed 12 May 2015

[10] Parker, J, 2013, "How government freed itself of liability in insulation deaths", Sydney Morning Herald, 8 July 2013. Available online http://www.smh.com.au/comment/how-government-freed-itself-of-liability-in-insulation-deaths-20130707-2pk12.html viewed 11 May 2015

Whilst creating employment is an urgent need for the Government, with 49% of SME's citing insufficient capital as a prime cause of failure in the study[11], for many small businesses, that question will more than ever fall on financial institutions to decide. Having had discussions with a small number of our clients in recent days that currently provide business loans, all are extremely concerned about the impact of this legislation if it goes ahead as in the draft.

This legislation will merely increase their risks and over 50% of the number we surveyed indicated they may withdraw from providing finance to this sector altogether as the number of small businesses currently failing to pay their loan, lease or insurance premium funding repayments on the due date(s) is rapidly increasing. For some, the default rate exceeds that for their consumer loans right now and so we alert government that rather than the Treasurer saying to individuals to "have a go", lenders may start to say "go find a job" instead. Even for those with substantial capital, if the perceived risks are too high, this will have particular concern for immigrants who come in on Business Innovation and Investment (Permanent) visas under subclasses 888 and 890.

As we stated in our earlier submissions, this may well turn out to be another case of *kanseifukyo*[12] *which, a*ccording to Takehiro Sato, the chief Japanese economist at Morgan Stanley in Tokyo (in 2007), "*kanseifukyo*" means 'a recession caused by the government due to over-regulation' and the well intentioned regulatory interventions that Japan introduced led to it being "yet another example of unintended economic consequences".

[11] Ibid 5

[12] Clenfield, J. 2007. "Kanseifukyo Threatens Koizumi Prosperity as Japan ReRegulates", Bloomberg.com, 26 November 2007. Available online http://www.bloomberg.com/apps/news?pid=20670001&refer=home&... viewed 27/11/2007.

The Draft Legislation

Commencement Date

Implementing this legislation with only 6 months lead time is rather farcical given this will drastically affect almost every Australian business. It highlights just how little Government understands the issues involved. A more appropriate time frame is 12 or 18 months.

Definition of small business

For small businesses to understand exactly what constitutes a small business, the definition needs to be very clear and easily understood by all. It should not require a court case to clarify the proposed definition as to whether a casual employee is employed by the business on a regular and systematic basis and thus should be counted in the number of qualifying employees. We see this as unclear and will lead to argument on the basis of what amounts to “regular and systematic”.

For example, it is unclear whether employees engaged on a permanent part-time basis are to be counted on the number of hours worked so as to get a full-time equivalent or simply a head count? Is a casual employee that works a set number of hours per week rather than set hours on specific days engaged on a regular and systematic basis? Many companies will argue they are not so that they may not be classified as permanent part time. Industry needs consistency and clarity and this definition provides neither.

Examples of Unfair Terms (Application of s.12BH (1) of the ASIC Act 2001 and s.25 of Schedule 2, Competition and Consumer Act 2010) to small business contracts

Due to the lack of significant consultation by Government with businesses on this subject and a clear understanding of why the existing clauses relating to consumers should not be used without either exceptions being noted for business contracts or a completely new section being created altogether, we would like to point out some issues that do not exist for consumer contracts but do for business contracts.

For example, taking some of the existing sub-clauses:

(a) a term that permits, or has the effect of permitting, one party (but not another party) to avoid or limit performance of the contract

Consumer credit contracts are covered by the National Consumer Credit Protection Act 2009 but for businesses providing goods or services under a contract of supply, one method of ensuring payment may be to include such a term. Without it, a contracting party could easily claim such a term is unfair and demand continued supply of goods or services even if that party is determined not to pay the supplier and is a technical default under the contract. This would be an outrageous situation if a supplier is not able to withhold supply pending receipt of payment.

(b) a term that permits, or has the effect of permitting, one party (but not another party) to terminate the contract

Suppliers of goods or services should be allowed to include such terms where their client:

a) imposes costs on it over and above what it costs the supplier to supply similar goods or services to other clients; or
b) damages or will damage the supplier's reputation or the reputation of its clients through inappropriate use (particularly of services).

No business should be forced to retain a client if the benefits to it are outweighed or considerably diminished by an overly-demanding client. Equally, businesses work hard and spend considerable amounts of time, effort and money to build brand reputation. For consumer contracts, this isn't a consideration but this matter requires more than mere clarification by guidance notes and we believe needs to be enshrined in the legislation.

(j) a term that permits, or has the effect of permitting, one party to assign the contract to the detriment of another party without that other party's consent;
How or who will determine detriment? For a business, a receiver of goods or services may not want to deal with another supplier because of, for example, previous history or market reputation. If that other supplier then makes an offer to acquire the business from the current owner, is Government seriously suggesting that the current owner must give each contracting party the opportunity to consent or a right to terminate? For many small business owners, selling the business effectively forms the owner's superannuation fund and the possible consequences of current clients not consenting could have serious repercussions for both purchaser and the vendor.

These are just some examples we believe need bringing to your attention that require exemption but others submissions will no doubt have provided others. In our opinion, this just highlights why this draft legislation needs more time to be considered and wider industry consultation made.

Recommendation

Regardless of COAG agreement, we believe Government has not yet established a substantiated and detailed case for implementing these changes. As we have pointed out, the definition of what constitutes a small business needs to be both practical and easily understood and the current draft definition fails this test.

There are valid reasons why some clauses, which may be unfair for consumer contracts, should be allowed to be retained by businesses and these need to be specifically permitted in the legislation.

This legislation has the potential to cripple small businesses and requires more than the rushed, knee-jerk reaction presented. If enacted as is, it may actually deter some suppliers, whether they are suppliers of goods, services or credit, from providing goods or services to small businesses and that will have far wider, if unintended, consequences.

We urge Government to undertake wider consultation with industry so that the regulatory burden does not cripple entrepreneurship, redraft the legislation so that the examples given as to what constitutes unfair contract terms are appropriately defined and listed separately for consumers and small businesses and amend or create Industry Codes that deal more appropriately with the relevant industry sector concerns raised in the August 2014 round of submissions.