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**BUSINESSES ARE PEOPLE TOO?
ANOMALIES IN WIDENING THE AMBITS OF “CONSUMER”
UNDER CONSUMER CREDIT LAW**

Franci Cantatore¹ and Brenda Marshall²

Abstract

The Australian government has recently proposed affording small businesses some of the same protections enjoyed by consumers under consumer credit legislation.³ Such a step would enable manufacturing businesses with fewer than 100 employees, and other businesses with fewer than 20 employees, to be treated as “consumers” with the range of privileges that this classification implies, including the ability to rely on hardship provisions when unable to pay their debts.

For now, the reform proposals have been shelved, but small businesses already benefit from hardship provisions under compulsory external dispute resolution (EDR) scheme provisions imposed on Australian Credit Licence holders, with some anomalous results. The definition of “consumer” under the Rules of the Credit Ombudsman Service Limited (COSL) – one of the two appointed EDR schemes for Australian consumer credit providers – includes sole traders, partnerships and corporations, thus widening the ambit of the scheme to include commercial dealings between credit providers and businesses. The Financial Ombudsman Service (FOS) likewise regulates the provision of credit to small businesses. This effectively enables small businesses to lodge hardship complaints and avoid payment of their debts for extended periods until complaints are resolved, while continuing to trade. Although it may be argued that this inclusion is in line with protections available to small businesses under the Australian Consumer Law, the effects are more far-reaching in relation to consumer credit transactions, potentially impacting on the power of the Courts to make winding-up orders under the Corporations Act 2001 (Cth) and also countenancing insolvent trading.

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³ National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Cth).

I Introduction and Scope

This article examines the position of the small business as “consumer” under existing consumer protection legislation, and the incongruities arising from this characterisation in the area of consumer credit regulation. Whilst the inclusion of small businesses is appropriate under the *Australian Consumer Law*, it is contended that this is not the case in consumer credit regulation. It is arguable that such an inclusion impacts significantly on commercial dealings and could have a lasting effect on the availability of credit to small businesses.

In Australia approximately 95 per cent of the two million actively trading businesses are regarded by the Reserve Bank of Australia as ‘small businesses’.⁴ This categorisation is based on the definition of a small business in the *Corporations Act*, which defines it as having “less than 100 employees if a manufacturing business, and otherwise less than 20 employees; or no employees.”⁵

This is a large sector of the Australian economy, and how the law treats commercial transactions between businesses is important to a viable credit industry. In this context the article will specifically focus on the regulation of small business credit and the inclusion of small businesses as consumers under the external dispute resolution (“EDR”) schemes servicing the consumer credit industry, namely the Credit Ombudsman Service Limited (“COSL”) and the Financial Ombudsman Service (“FOS”). Under the *National Consumer Credit Protection Act 2009* (Cth) (“the NCCPA”) all consumer credit providers are required to hold an Australian Credit Licence and membership to either one of the schemes.⁶

In considering these issues, the article will deal firstly, with current small business protections under Federal, State and other regulation. Secondly, it will more specifically focus on consumer credit law, with reference to proposed changes in the NCCPA relating to small businesses, which have been deferred at the time of this article.⁷ Thirdly, the treatment of small businesses under the hardship provisions of the COSL Rules and FOS Terms of Reference will be examined. Finally, the article will highlight potential conflicts and imbalances in the current treatment of small businesses under the

⁴ E Connolly, D Norman and T West, *Small business: An economic Overview*, Reserve Bank of Australia Report, 2012.

⁵ Corporations Act 2001 (Cth), s 761G.

⁶ National Consumer Credit Protection Act 2009 (Cth), s 47(1)(i).

⁷ Statement by B Shorten, Treasurer Australian Government: “There is a need to further examine a number of key issues. The release of the exposure draft has raised consideration of whether the benefits could be delivered in a more targeted and effective way, through the development of a different model from that in the Phase 2 Bill. As a result, any reforms to small business finance will be deferred ... and the Government will not be seeking passage in the life of the current Parliament,” 15 February 2013, Canberra.

consumer credit law and illustrate the potential impact of this classification on commercial dealings between businesses.

II Current protections for consumers and small businesses

To provide some context for the argument, it is necessary to consider the broad protection measures enjoyed by natural persons and small businesses under Australian law. Consumer protection is principally regulated by the following Commonwealth statutes:

- (i) *Australian Consumer Law* (“ACL”), which is contained in Schedule 2 of the *Competition and Consumer Act 2010*;
- (ii) *Australian Securities and Investments Act 2001* (“ASIC Act”); and
- (iii) *National Consumer Credit Protection Act 2009*.

Whilst the ACL provides Australian consumers with a range of protections discussed below, the ASIC Act specifically guards against misleading and deceptive conduct and unconscionable conduct in relation to financial products and services.⁸ Furthermore, the NCCPA includes the *National Credit Code* which regulates the provision of credit to natural persons and strata corporations.⁹

In addition, consumers have the benefit of State based legislation such as the *Sale of Goods Acts*, which contain implied conditions and warranties in respect of the sale of goods,¹⁰ and the various *Fair Trading Acts*, which also include the ACL to regulate purveyors of the sale of goods and provision of services.

However, there are inconsistencies in how a ‘consumer’ is defined under the various pieces of legislation and to what extent small businesses enjoy consumer protection under these statutes.

Who is a “consumer” under the ACL?

Section 3 of the ACL defines a ‘consumer’. For the purposes of the ACL, a person is a ‘consumer’ if they acquire goods or services that are priced at less than \$40,000.¹¹ A person is also a ‘consumer’ if they acquire goods or services that are priced at more than \$40,000 but they are ‘of a kind ordinarily acquired for personal, domestic or household use or consumption’.¹² Additionally, a person who acquires a vehicle for use in the transport of goods on public roads, irrespective of price, is also considered to be a consumer for the purposes of the ACL.

⁸ Australian Securities and Investments Act 2001 (Cth), s 12BC(1)(c).

⁹ National Consumer Credit Protection Act 2009 (Cth), National Credit Code, s 5(1)(a).

¹⁰ Eg. Sale of Goods Act (Qld) 1896 ss 13-18.

¹¹ Competition and Consumer Act 2010 (Cth), Schedule 2, s 3(1)(a).

¹² Competition and Consumer Act 2010 (Cth), Schedule 2, s 3(1)(b).

It is relevant that corporations and sole traders are included in the definition of ‘person’ in this definition, as the *Acts Interpretation Act* provides that:

In any Act, unless the contrary intention appears: (a)
expressions used to denote persons generally (such as “person”, “party”, “someone”,
“anyone”, “no-one”, “one”, “another” and “whoever”), include a body politic or corporate as
well as an individual.¹³

These provisions mean that business to business transactions enjoy similar protections under the ACL as natural persons. The ACL protections include access to consumer guarantees contained in the Act, such as fitness for purpose,¹⁴ correspondence with description,¹⁵ and acceptable quality.¹⁶ Furthermore, the Act provides protection against unfair Trade Practices, including instances of misleading and deceptive conduct¹⁷ and misrepresentations.¹⁸ Lastly, the Act regulates unconscionable conduct in the provision of goods and services.¹⁹ Thus, the ACL ensures protection for small businesses in ‘consumer transactions’ as defined in section 3 of the Act, whether they are companies or sole traders.

What is a ‘small business’?

Whilst protection of these defined business transactions are regulated by the ACL in respect of any corporate or non-corporate entity, small businesses are specifically defined in the *Corporations Act 2001 (Cth)*. As stated above, a small business includes businesses with fewer than 100 employees if it is a manufacturing business, and otherwise any business with fewer than 20 employees or no employees.²⁰

The same definition of a small business is employed in the *ASIC Act*,²¹ *Code of Banking Practice*²² and Mortgage and Financiers Association of Australia (“MFAA”) Code definition, where small businesses are treated in the same way as natural persons. Another definition of ‘small business’, used by the Australian Bureau of Statistics (“ABS”), describes a small business as “businesses employing less than 20 people, including sole traders.”²³

¹³ Acts Interpretation Act 1901 (Cth), s 2C(1).

¹⁴ Competition and Consumer Act 2010 (Cth), Schedule 2, s 55.

¹⁵ Competition and Consumer Act 2010 (Cth), Schedule 2, s 56.

¹⁶ Competition and Consumer Act 2010 (Cth), Schedule 2, s 54.

¹⁷ Competition and Consumer Act 2010 (Cth), Schedule 2, s 18.

¹⁸ Competition and Consumer Act 2010 (Cth), Schedule 2, s 29.

¹⁹ Competition and Consumer Act 2010 (Cth), Schedule 2, ss 20-21.

²⁰ Above n 4.

²¹ Australian Securities and Investments Act 2001 (Cth), s 12BC(1).

²² Australian Bankers’ Association Inc., *Code of Banking Practice*, Part H, para 42.

²³ Australian Government Report: Department of Innovation, Industry, Science and Research, 2011, *Key Statistics-Australian Small Business*, Canberra.

Significantly, financial institutions apply different parameters for the classification of businesses as “small business customers”, in line with the Reserve Bank of Australia categorisation of a loan as being a “small business loan” if the loan principal is under \$2 million. This use of a different yardstick in defining small businesses creates the possibility of conflict with the legislation and Codes of Practice definitions.

III The regulation of small business credit in Australia

As noted above the provision of consumer credit is regulated by the *National Consumer Credit Protection Act 2009* (“NCCPA”), which includes the *National Credit Code*, and the *National Consumer Credit Protection Regulations 2010*. The definition of ‘consumer’ in the NCCPA currently only includes natural persons and strata corporations.²⁴ Furthermore, a ‘consumer credit contract’ covers credit provided for personal, domestic or household purposes, or to purchase, renovate or improve residential property for investment purposes²⁵ by consumers.

It is instructive to note briefly how the Australian approach compares with those in Europe and the USA. Broadly speaking it can be observed that Australia is in line with European and US credit law. European law does not include small businesses as consumers – it recognises only “a natural person who ... is acting for purposes which are outside his trade, business or profession.”²⁶ Hesselink points out that “European legislation assumes a rigid distinction between commercial and consumer law.”²⁷

Similarly, the *US Consumer Credit Protection Act 1968* defines a “consumer” as “a natural person.”²⁸ However, in the United Kingdom UK the *Consumer Credit Act 1974* provides protection for individuals, sole traders, partnerships and unincorporated bodies, but not companies.²⁹

Proposed amendments to the NCCPA set out in the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Cth)* (“the Bill”) incorporated the inclusion of “protected small business credit contracts”, which would apply to the provision of credit to small businesses in certain circumstances, including the introduction of limited responsible lending

²⁴ Above n 9.

²⁵ *National Consumer Credit Protection Act 2009 (Cth)*, *National Credit Code*, s 4 and s 5(1)(b).

²⁶ *European Parliament Directive 2008/48/EC*

²⁷ M W Hesselink, ‘Towards a Sharp Distinction between B2B and B2C? On Consumer, Commercial and General Contract Law after the Consumer Rights Directive’ (2010) 18 *European Review of Private Law* 57 at 60, viewed on 7 September 2013 at SSRN: <http://ssrn.com/abstract=1416126>.

²⁸ *Consumer Credit Protection Act 1968* (15 USC s 1693a)(6).

²⁹ *Consumer Credit Act 1974* (as amended by *Consumer Credit Act 2006*), s 189(1).

obligations in respect of credit provided for investment purposes,³⁰ and applying the NCC to “small business consumer leases”.³¹

To this end the definition of ‘small business’ defined as in the *Corporations Act* was applied, i.e. businesses with fewer than 20 employees or in the cases of manufacturers, fewer than 100 employees.³²

The amendments were due to take effect on the 1st July 2013 and 17 submissions were received from stakeholders by 1 March 2013.³³ However, Treasury announced on the 15th February 2013 that the inclusion of small business under the consumer credit legislation had been deferred for further consideration and that a more targeted approach was required.³⁴

At the time of this publication small businesses continue to be excluded from the NCCPA, and no further announcements have been made by the Australia government to suggest a revival of the small business provisions proposed by the Bill.

The question then arises – if they are not included under the NCCPA, what protections do small businesses enjoy under Australian credit law? An investigation reveals that small business credit is primarily regulated by Industry Codes of Practice, but that surreptitious regulation by COSL and FOS of small business credit through the preemptory requirement of EDR scheme membership for credit providers has the effect of effectively treating small businesses as natural persons under the provisions of these schemes.

The Industry Codes of Practice regulating the provision of credit to small businesses can be identified as follows:

- The *Code of Banking Practice*, which has a binding effect on its members, sets out standards of good conduct in the provision of credit to small business.³⁵ Adopting the Code is voluntary.³⁶
- The voluntary MFAA *Code of Practice*, which similarly has a binding effect on its members, sets out standards of good practice and fair dealings with customers.³⁷

³⁰ National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Cth), Schedule 2, ss 133FB-133FE.

³¹ National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Cth), Schedule 2, s 6.

³² Above n 5.

³³ Australian Government Treasury website, viewed 7 September 2013,

<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/Credit-Reform-Phase-2-Bill-2012>

³⁴ Above n 7.

³⁵ Code of Banking Practice 2013, Part 1, s 27.

³⁶ Code of Banking Practice 2013, Part 1, s 1.

³⁷ Mortgage and Finance Association of Australia Code of Practice 2012, ss 3-4.

- Likewise, the *Mutual Banking Code of Practice* is a voluntary binding code, and makes provision for small businesses in financial difficulties.³⁸

As stated above, all three industry Codes of Practice apply the *Corporations Act* definition of “small business.”³⁹ Subscription to at least one of these codes of practice is desirable but voluntary, and credit providers do not suffer any regulatory penalties for non-subscription.

In contrast with these codes of practice, membership of either one of the two EDR schemes regulating the consumer credit industry (FOS or COSL), is a requirement for all Australian Credit Licence holders.⁴⁰

Both schemes apply the *Corporations Act* definition of “small business” and deal with complaints from small businesses; more specifically:

- COSL defines a “consumer” as “a natural person or small business’ (including a company),”⁴¹ and
- FOS includes a “small Business (whether a sole trader,...company, partnership, trust or otherwise),” under its jurisdiction.⁴²

Thus, significantly, although they are not covered by consumer credit law under the NCCPA, the EDR scheme provisions include small businesses, which effectively allows regulation of small business credit by EDR schemes. The implications of this inclusion are discussed in depth below.

In an apparent effort to limit the powers of the EDR schemes and provide some conformity with the RBA definition of a “small business”, ASIC (in its capacity as regulator of the credit industry) has issued a limitation on EDR scheme jurisdiction in respect of debt recovery proceedings, which takes effect from 1 January 2014. Specifically, the direction provides that the Terms of Reference of an EDR scheme must exclude small business lending disputes, where the credit limit of the credit contract that is the subject of the dispute exceeds \$2 million, from its debt recovery legal proceedings jurisdiction.⁴³ It is evident that this limitation, whilst providing some relief for credit providers in the conduct of their commercial dealings, still fails to address those commercial transactions which fall under the \$2 million mark.

³⁸ Mutual Banking Code of Practice 2010, Part B.

³⁹ Above n 5.

⁴⁰ National Consumer Credit Protection Act 2009 (Cth), s 47(1)(i).

⁴¹ Credit Ombudsman Service Limited, Rules, r 45.

⁴² Financial Ombudsman Service, Terms of Reference, para 4.1(d).

⁴³ Australian Securities and Investment Commission Regulatory Guide 139, 2013, p 20.

IV Small business access to COSL and FOS

As explained above, small businesses are regarded as consumers under the EDR schemes and thus benefit from all the provisions under the schemes, including the right to register a complaint against a credit provider who is a member of that scheme. A complaint does not incur any fee to complainant, at the time of registration or at any time thereafter.⁴⁴

However, a credit provider is charged a complaint fee as soon as a complaint against it is received by COSL or FOS,⁴⁵ e.g. for hardship complaints COSL charges the credit provider an initial review fee of \$1,095 per complaint, with ongoing fees in excess of \$3,000 plus additional costs incurred by the scheme in respect of legal or expert costs.⁴⁶ All fees are payable by the credit provider irrespective of the outcome of the complaint.⁴⁷

The value of this service to consumers is evident and indisputable; however, this article questions the desirability of the scope of complaints in respect of small businesses, in particular the ability of a small business to make a hardship complaint in respect of its debts. Suffering hardship is regarded by COSL as a complainant who is or “may be in financial difficulties.”⁴⁸ whereas FOS refers to a business as suffering “financial difficulty.”⁴⁹ Significantly, the COSL Guidelines provide that: “*Rule 18 applies to members... whether or not a credit contract is regulated under the Consumer Credit Code or the National Credit Code,*” illustrating a clear intention on the part of the scheme to regulate hardship claims under commercial credit contracts which are unregulated by the NCCPA and NCC.

In respect of hardship complaints both FOS and COSL can consider a claim for loss of up to \$500,000 under these provisions, and award compensation of up to \$280,000.⁵⁰ An extract from a FOS Circular provides an explanation of this:

“For example, if a small business held a commercial overdraft facility of \$800,000 and requested assistance because it was in financial difficulty, we would consider a dispute lodged after 1 January 2010 despite the commercial overdraft facility exceeding the monetary limit provided the claim for loss was less than \$500,000 (subject to the maximum award of \$280,000).”⁵¹

⁴⁴ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 1.2 and 11.1.

⁴⁵ Credit Ombudsman Service Limited, Complaints Fee Schedule 2012.

⁴⁶ Above n 45.

⁴⁷ Above n 44, r 11.1 and n 45.

⁴⁸ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 18.2.

⁴⁹ See e.g. Financial Ombudsman Service Bulletin 60 2008, p 9.

⁵⁰ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 45.1; Financial Ombudsman Service Terms of Reference 2012, para 9.7, Schedule 1.

⁵¹ Financial Ombudsman Service Circular, Issue 2, 2010. Available at http://www.fos.org.au/centric/home_page/publications/the_circular/issue_2_april_2010/dealing_with_customers_in_financial_difficulty_small_business.jsp, viewed on 9 September 2013.

Thus, both FOS and COSL can order the payment of a sum of money to a business found to be in financial difficulty where required.⁵² FOS specifically states: “We may also make an award of compensation for non-financial loss for the associated distress (of the financial difficulty).”⁵³

The jurisdiction of the EDR schemes further includes determinative powers to make binding decisions on business loans such as:⁵⁴

- 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; and
- releasing the complainant from the credit contract.

It may be argued that these powers extend much further than what would be regarded as mediation or “dispute resolution” powers, and that the schemes are effectively assuming the role of the Courts. Significantly, EDR schemes are not bound by any legal rule of evidence and “may inform itself about the complaint and all matters relating to it in whatever manner and by whatever means” in its discretion it deems appropriate.”⁵⁵

Furthermore, as soon as a complaint is made by the small business the member must cease legal action until determination of the complaint.⁵⁶ This may raise a concern that the credit provider is being disadvantaged as against other credit providers of the debtor, placing its security interests at the risk of erosion (especially in the absence of formal security registration), as explained in the next section. Although COSL and FOS claim they do not ‘vary business contract terms,’ they can compel lenders ‘to give genuine consideration to hardship requests on commercial loans.’⁵⁷ In practice the net effect of these powers amounts to delays and pressure on credit providers, which in many instances may force a variation of the contract, as discussed below.

Non-compliance by credit providers with a COSL determination has the potential effect of a loss of membership⁵⁸ and thus a loss of their credit licence.⁵⁹ Conversely, consumers are not bound by the

⁵² Financial Ombudsman Service Bulletin 60, 2008, p 10 and Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 12.2(h), r 25.3.

⁵³ Financial Ombudsman Service Bulletin 60, 2008, p 10.

⁵⁴ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 9.6 and Financial Ombudsman Service Terms of Reference 2012, para 9.1.

⁵⁵ Financial Ombudsman Service Terms of Reference 2012, para 8.1, Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 3.3.

⁵⁶ Financial Ombudsman Service Terms of Reference 2012, para 13.1, Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 17.2

⁵⁷ Above n 51.

⁵⁸ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 27.1(b)(ii); National Consumer Credit Protection Act 2009 (Cth), s 47(1)(i).

decision of the Ombudsmen, and can elect whether to accept a determination or not.⁶⁰ Members have limited possibilities for review and no appeal from the Ombudsman decision, and should a member decide to challenge the decision, it is required to pay the complainant's and EDR scheme's costs upfront before contesting decision in Court.⁶¹

V EDR Regulation of small businesses: Practical implications

Considering the fact that all Australian Credit Licence holders are required to be members of a prescribed EDR scheme, and that the schemes' jurisdiction extends to commercial contracts which are otherwise excluded from consumer credit legislation, it is inevitable that the EDR regulation will impact on commercial transactions in various ways.

One may validly observe that the purpose of these EDR schemes is essentially to provide dispute resolution assistance to consumers who are experiencing problems with financial services.⁶² The question begs whether the Regulator gave sufficient consideration to the potential impact of the inclusion of commercial credit contracts within the scope of this jurisdiction. This is especially so as the schemes apply a definition of "consumer" which is inconsistent with the NCCPA and NCC Commonwealth legislation, which only include "natural persons and strata corporations,"⁶³ and excludes small businesses. In this sense it appears that FOS and COSL - essentially private bodies, companies limited by guarantee as defined in the *Corporations Act*⁶⁴ to which the functions of external dispute resolution have been outsourced by ASIC,⁶⁵ and who are only answerable to their own Boards for complaints decisions⁶⁶ - are imbued with broader jurisdiction than the NCCPA and NCC.

It is widely recognised that it is a requirement that "regulatory means adopted are compatible with laws and regulations,"⁶⁷ and where discrepancies arise, such as in this case, it should be considered

⁵⁹ Above n 40.

⁶⁰ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 20.2, r 26.2.

⁶¹ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 29.4, r 29.6.

⁶² Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 1.2 and Financial Ombudsman Service Terms of Reference 2012, para 1.1.

⁶³ Above n 9.

⁶⁴ *Corporations Act 2001* (Cth), s 9.

⁶⁵ Australian Securities and Investments Commission, *Regulatory Guide 139*, April 2011. Available at <http://www.asic.gov.au/asic/asic.nsf>, viewed on 9 September 2012.

⁶⁶ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 2.3.

⁶⁷ G Hodge, 'Evaluating what will work in nanotechnology Regulation: In pursuit of the public interest' in G Hodge, D Bowman and K Ludlow (Eds), *New global frontiers in regulation: The age of nanotechnology*, Edward Elgar, Cheltenham, 2007, p 11.

whether the objectives of the legislation are duly met or whether EDR schemes are exceeding their legislative purpose.

A significant consideration is the extent of the FOS and COSL powers in relation to small business complaints, stated above. The requirement of cessation of legal action by the member once a complaint is lodged,⁶⁸ effectively places members of EDR schemes in limbo in respect of debt recovery proceedings, irrespective of the validity of the complaint. The time for resolution of a complaint is undetermined. COSL has claimed that it generally takes up to 6 months to resolve complaints and that 79 per cent of claims are resolved within this time frame.⁶⁹ In the case of FOS no specifications are given but there is anecdotal evidence of a complaint continuing in excess of two years without resolution.⁷⁰ In that case a development company in NSW claimed financial difficulty after being refused a request for further funding by the credit provider. The debtor company applied to FOS for relief on basis of financial hardship, leaving the credit provider unable to enforce its debt and being engaged in a dispute for a period in excess of two years. In answer to the credit provider's frustration at its inability to enforce its credit contract, a letter from FOS to the credit provider stated:

"FOS has power to decide whether the lender's reasons are *'legitimate considerations and are referable to a particular customer's circumstances.'*"⁷¹

These indeterminate time delays – even a 6 month delay is substantial in the realms of commercial dealings – have the effect of impacting on the availability of capital in small to medium tier lenders, as they are unable to take action to recover their capital until the resolution of a complaint. In addition, they are being charged complaint fees at each stage of the dispute resolution process, irrespective of whether the complaint is found to be without foundation.⁷² There is of course also a possibility of an award being made to the complainant on the grounds of hardship, which is payable by the credit provider.

Below follows an illustration of the type of debtor who may have access to the hardship provisions under the current EDR schemes:

⁶⁸ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 17.2, Financial Ombudsman Service Terms of Reference 2012, para 13.

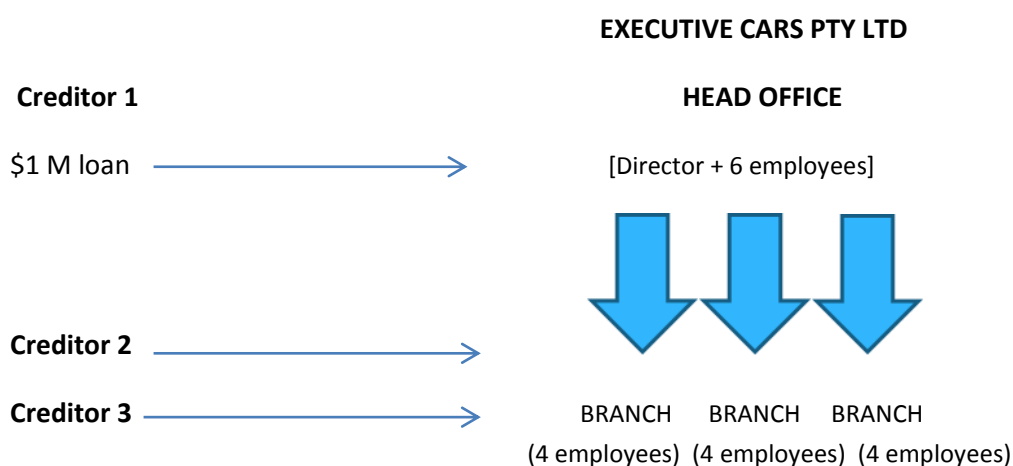
⁶⁹ COSL News, Issue 2 May 2013, p 2. Available at <http://www.cosl.com.au/cosl/assets/File/COSL%20News%20-%20May%202013.pdf>, viewed on 9 September 2013.

⁷⁰ Matthew Bransgrove, *Why the EDR regime is hurting capital availability in Australia* (2012 White Paper) p.8, Available at http://www.bransgroves.com.au/documents/White_Paper.pdf, viewed on 9 September 2013.

⁷¹ Above n 51.

⁷² Above n 45.

Figure 1:



In this example, if our fictional nationwide motor dealer, Executive Cars Pty Ltd obtained a loan of \$1 M from Creditor 1 (an Australian Credit Licence holder), the transaction would be subject to the jurisdiction of COSL. The company would be regarded as a consumer as it employs fewer than 20 people, thereby meeting the *Corporations Act* definition.⁷³ Creditors 2 and 3, financiers who are non-Credit Licence holders would be exempt from EDR scheme membership. Supposing that Executive Cars experienced financial difficulties, it would be able to lay a hardship complaint with COSL, thereby preventing Creditor 1 from taking any legal action beyond the minimum preservation of its rights.⁷⁴ However, nothing would prevent Creditors 1 and 2 from proceeding against the debtor, taking judgment and seizing and disposing of its assets (subject to registered interests). Creditor 1 would be at a distinct disadvantage as opposed to other creditors, facing undetermined delays in the resolution of the complaint, unless it acceded to the debtor's demands. Additionally, it would face the loss of its credit licence if it failed to comply with COSL's eventual determination, or prohibitive costs if it wished to contend the matter further in Court.

This example serves to demonstrate the inequities that may arise as a result of the inclusion of medium to large corporations under the 'small business' definition in EDR schemes, who are thus able to rely on 'hardship provisions' – a result which was presumably not the intention of the consumer credit legislation, as hardship provisions under the NCCPA and NCC are restricted to natural persons and strata corporations. It also raises the question: Why should an Australian Credit Licence Holder be disadvantaged in its business dealings vis-à-vis purely commercial lenders who do not require a Credit Licence? Clearly a level playing field should be the norm for all credit providers, with an equal ability to enforce their legal rights in respect of commercial contracts.

⁷³ Above at n 4.

⁷⁴ Credit Ombudsman Service Limited, Rules (Eighth Edition) 2011, r 17.3(a).

VI EDR Regulation of small businesses: Insolvency issues

The final issue which must be considered here is the very real possibility that a debtor business claiming hardship relief could be factually insolvent. As stated previously, the COSL grounds for a hardship complaint is 'being', or 'possibly being' "in financial difficulties,"⁷⁵ and FOS similarly refers to a business suffering "financial difficulty".⁷⁶ Once a hardship complaint is lodged, the EDR provisions facilitate continued trading by the complainant, whilst holding legal action by the member in abeyance.⁷⁷

These hardship provisions create a conflict with the *Corporations Act* 2001, which deals with instances of insolvency⁷⁸ as follows:

*"A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable."*⁷⁹

and further

*"A person who is not solvent is insolvent."*⁸⁰

Furthermore, the *Corporations Act* provides that the Court may order the winding up of a company if it is found to be insolvent.⁸¹ Other provisions relating to winding up of companies are s 462 - which provides that a creditor may apply for a winding up order where grounds exist under s 461 of the Act – s 459B, and s 459J, pursuant to which statutory demands are commonly issued. Ordinarily, if a company commits an act of insolvency, such as being unable to pay its debts, a creditor will be entitled to bring an application for the winding up of the company on that basis under these provisions; however, the operation of the hardship provisions prevents the taking or continuation of any legal action by a member, thus rendering the *Corporations Act* provisions practically inoperative.

In the meantime the complainant can continue trading, even though it is, by its own admission "unable to pay its debts." This raises the dilemma that the complainant business may be trading in insolvent circumstances, countenanced by FOS or COSL, as the case may be. Even if the "cash-flow" test is applied as a measure of solvency – i.e. can the company meet its debts as and when they fall

⁷⁵ Above n 48.

⁷⁶ Above n 49.

⁷⁷ Above n 68.

⁷⁸ *Corporations Act* 2001, s 95A(1), s 95A(2), s 459B, s 461, s 462 and s 459J.

⁷⁹ *Corporations Act* 2001, s 95A(1).

⁸⁰ *Corporations Act* 2001, s 95A(2).

⁸¹ *Corporations Act* 2001, s 459B.

due? – the debtor company fails to meet the solvency test and can be seen as factually insolvent.⁸² It is therefore arguable that the EDR schemes' provisions give rise to regulatory conflict and make drastic inroads on insolvency principles.

In general, these outcomes suggest a danger of abuse of process by errant debtor companies, an increased risk to credit providers and the likelihood of a decrease in the availability of finance to small businesses. The risk of an abuse of process and a reduction in the availability of finance was recognised by the MFAA, who relevantly stated:

“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.”⁸³

This problem was also recognised by Matthew Bransgrove in his White Paper,⁸⁴ where he referred to the potential losses suffered by construction credit providers through EDR delays, and the resulting perception by lenders that it was no longer considered safe to provide credit to small businesses, causing a scarcity of finance for small businesses.

VII Conclusion

In conclusion, and in view of these discrepancies, it is arguable that the continued exclusion of small businesses from consumer credit law is appropriate, to maintain regulatory certainty, avoid inconsistencies with existing legislation,⁸⁵ and specifically the possibility of allowing insolvent trading by companies. Additionally, including small businesses as consumers under consumer credit law may lead to increased abuse of process by debtor companies claiming financial difficulty in order to avoid legal action being taken against them. The resulting time delays and disadvantage to credit providers in relation to other creditors of debtor businesses once a complaint is made, may cause a significant reduction in the availability of finance to the small business sector.⁸⁶ Although it is appropriate and desirable to provide small businesses with protection under the ACL, the consumer credit legislation goes much further than mere protection. Before any further changes are proposed to the legislation in respect of small business inclusion - or before the small business provisions in the Bill⁸⁷

⁸² *Bank of Australia v Hall* (1907) 4 CLR 1514; *The Bell Group Pty Ltd (in liq) v Westpac Banking Corp No.9* (2008) 39 WAR 1.

⁸³ MFAA Submission on National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Cth), 28 February 2013, p 1.

⁸⁴ Above n 70 at p 8.

⁸⁵ Above n 78.

⁸⁶ Above n 83.

⁸⁷ National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 (Cth), Schedule 2.

are revived - a thorough investigation should be made into the interaction between credit regulation and other legislation, such as the *Corporations Act*, to avoid any unintended conflict.

Furthermore, it is desirable that the regulatory powers of the EDR schemes should also be reviewed in this context, considering the far reaching effects of their powers and the resultant effect on the operation of insolvency laws. It is evident that their current jurisdiction already impacts significantly on commercial dealings by interfering with legal proceedings in commercial matters. In order to minimise this interference and allow members to be on equal footing with other creditors, it would, be appropriate to place time limits on the resolution of hardship complaints by EDR schemes.⁸⁸

Finally, it would be apposite that EDR schemes' hardship provisions apply only to individuals and not businesses, to provide consistency with the consumer credit legislation (the NCCPA and NCC) and thereby avoid current anomalies. At the very least, corporations should be excluded from accessing hardship provisions, to provide consistency with the *Corporations Act*.

⁸⁸ An ASIC review of the EDR proceedings in Report 308, *Response to submissions on CP 172 Review of EDR jurisdiction (debt recovery legal proceedings)*, October 2012, failed to recommend time limitations for the resolution of complaints.