

Banking and finance update

March 2016



New lending protections – for small business

ASIC releases guidance on new protections for small businesses against unfair lending contract terms

The *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* extends the protections contained in the Australian Consumer Law against unfair contract terms to small business as from 12 November 2016.

While the new protections apply to small business generally, the focus on this article is on how they will apply to, and influence, lending activities.

The Australian Consumer Law, contained at Schedule 2 in the *Competition and Consumer Act 2010* (Cth), currently gives “consumers” protection against unfair contract terms contained in standard form loan contracts.

The new changes will extend the scope of the Australian Consumer Law to capture lending to small business (explained later) where a loan is made pursuant to a “standard form contract”. Changes have also been made to the *Australian Securities and Investments Commission Act 2001* (Cth)

In February 2016 ASIC released an information sheet (INFO 211) foreshadowing the imminent changes and giving guidance on the new protections available for small business in circumstances where they borrow. [click here](#)

The extension of the Australian Consumer Law reflects an attempt by the Government to offer some protection to small business against unfair contract terms which unfortunately seem to be prevalent in the Australian lending market. Philosophically for the Government this is a more acceptable way of proceeding rather than seeking to regulate lending to small business directly. Earlier proposals to regulate business lending were put on hold (abandoned?) some time ago (refer to our earlier email alert in this regard). [click here](#)

What does this mean for lenders? If a lender makes or varies a standard form loan contract involving a small business borrower as from 12 November 2016, the lender will need to make sure that the standard terms and conditions of the loan contract do not contain any provisions which might be considered to be “unfair contract terms”.

1. APPLICATION OF THE NEW LEGISLATION

The new unfair contract terms protections will apply to all standard form contracts used by lenders entered into or renewed on or after 12 November 2016. For the protections to apply at least one party to the contract must be a "small business".

2. WHAT CONTRACTS ARE COVERED?

The unfair contract terms legislation only applies where a "standard form" contract is involved.

Most lending to small businesses involves use by lenders of "standard form" contracts.

Realistically, the new provisions will apply to most transactions involving loans to small business.

3. WHAT IS A SMALL BUSINESS?

For the purposes of the Australian Consumer Law a small business is a business employing less than 20 people and where the contract is worth up to \$300,000 in a single year or \$1,000,000 if the contract runs for more than one year. (Refer section 23(4) of the Australian Consumer Law and section 12BF(4) of the ASIC Act.)

4. WHAT IS A STANDARD FORM CONTRACT?

As ASIC points out in its information note, a standard form contract is one which has been prepared by one party to the contract and is not subject to negotiation between the parties – that is, it is offered on a "take it or leave it" basis.

If a small business asserts that a contract is a standard form contract, then the contract is presumed to be so unless proved otherwise. There are various matters that can be taken into account by a court in determining whether or not a lending contract is a standard form contract and it must take the following matters into account whether:

- One of the parties has all or most of the bargaining power relating to the transaction.
- The contract was prepared by one party before any discussion relating to the transaction occurred between the parties.

- Another party was, in effect required either to accept or reject the terms of the contract in the form in which they were presented.
- Another party was given an effective opportunity to negotiate the terms of the contract.
- The terms of the contract take into account the specific characteristics of another party or the particular transaction.

5. WHO DETERMINES WHETHER OR NOT A TERM IS AN UNFAIR CONTRACT TERM.

The first step is for the allegation to be made by a small business that the contract is a standard form contract and a contract term is unfair. When that allegation is made the onus of proof then reverses and it is for the lender to demonstrate that the contract is not a standard form contract.

ASIC states in its information sheet that ultimately it is for the court to determine whether or not a contract term is unfair. While that might be correct in theory, in practice most matters do not reach the courts. ASIC, ACCC and State and Territory consumer offices all have jurisdiction in this area and have traditionally taken an active stance in this area with consumer contracts.

ASIC and other Government regulators have many weapons in their armoury to use in circumstances where unfair contract terms or practices are in play. What this means in practice is that it is not often a court is called upon in this area to adjudicate on such matters. Most outcomes are negotiated or subject to quasi-judicial procedures.

6. NOT ALL CONTRACT TERMS WILL BE COVERED.

It is important to note that not all standard form lending terms fall within the ambit of the unfair contract terms legislation. The protections do not cover:

- Terms that define the main subject to the contract.
- Terms that set the upfront price payable.

- Terms that are required or expressly permitted by law of the Commonwealth, or a State or Territory.
- In information sheet 211, an example is given as to what is meant by the upfront price payable for a consumer contract. ASIC states

“the upfront price payable for a loan includes the amount borrowed (principal), the interest payable and any fees disclosed at the time the contract is entered into. It does not include contingent fees, such as fees arising from a default on the loan.”

7. REVIEW OF SMALL BUSINESS LOAN CONTRACTS

It is now important that lenders to small business undertake a comprehensive review of their loan and security documentation to ensure that they are not open to challenge under the unfair contract terms legislation as from November 2016. Areas which may warrant particular attention include:

- Obligations imposed upon borrowers during the currency of the loan;
- Default provisions and how they operate;
- Fees and charges payable after default has occurred;
- Review of any right to unilaterally vary terms of the loan contract.

8. BROADER IMPLICATIONS FOR LENDERS

Small business lending relies upon lenders being able to take speedy and effective action against borrowers in circumstances where there is a default.

The freedom of lenders to small business to continue to act as they have in the past may well be limited in the future. In addition, the area of fees charged to borrowers after default has occurred has often been an area of some consternation for small business and this is an area also likely to come under scrutiny.

Lenders to small business need to treat these impending changes seriously. In the past ASIC, ACCC and the State and Territory Government consumer authorities have not been shy in taking action and becoming involved in situations where they consider there is an unequal bargaining power situation and one party is acting in an “unfair” manner to another party. The mobile phone market is an example where involvement by consumer authorities has resulted in vastly different principles of contracting in this area. [See here](#)

Similar changes occurred in the fitness industry with their standard form contracts.

9. FURTHER RESOURCES

While most of the information published to date is related to unfair contract terms insofar as they affect consumers, the principles enunciated are still relevant. The main external resources, in addition to ASIC Information Sheet 211 are :

- A guide to the unfair contract terms – law (jointly published by relevant Government authorities). [click here](#)
- See also the State and Territory Government websites such as [New South Wales](#) and [Victoria](#)

WHERE TO NEXT?

Please contact your local Hunt & Hunt Lawyers office for further information or specific advice.

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