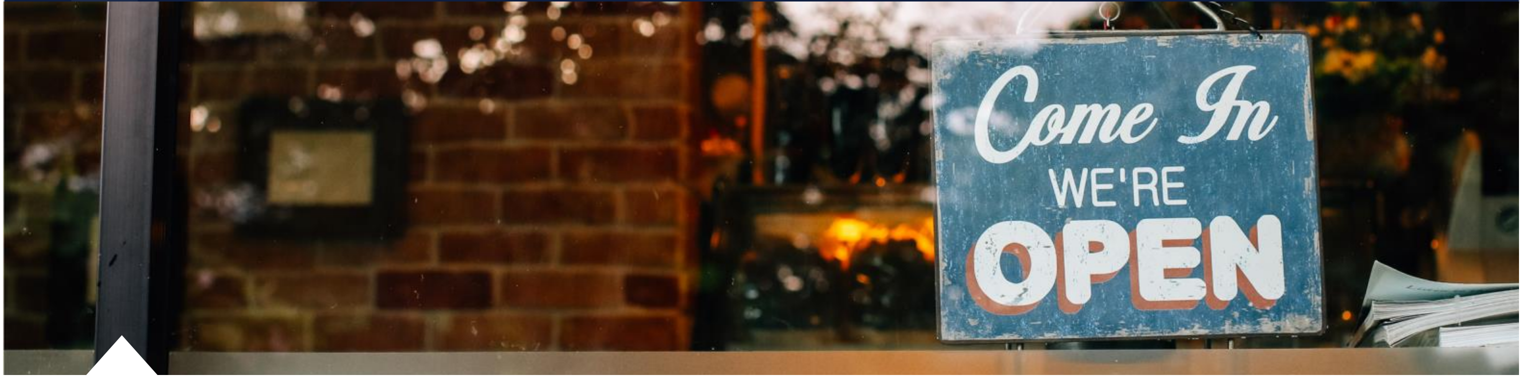

Small business loans: it's not so "take it or leave it" anymore!

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In March this year, ASIC published a report on how the unfair contract terms regime applies to loans made to small businesses. Generally, a loan contract will fall within this regime if at least one of the parties has fewer than 20 employees and the loan amount does not exceed $1 Million (or $300,000 if the loan is for 12 months or less).

If you are a small business borrower, put your reading glasses on and move closer to your computer screen, because your relationship with your lender is changing. Your time has come; all (small business) borrowers unite. Cue "Do you Hear the People Sing" from *Les Miserables*.

If only ASIC's report was like a movie. It's not (but if you really want to read it, it's here).

We have summarised below some key terms that you (small business borrower) should look out for in your standard loan agreement, as they have been identified by ASIC as terms commonly found to be "unfair".

1. **Entire Agreement Clauses**

   These are clauses stating that the written loan agreement represents the entire agreement between the parties and prevent the lenders from being held contractually responsible for conduct, statements or representations made to small business borrowers outside the written contract.

   Most of the major banks now do not have an Entire Agreement clause in their small business standard loan agreements. This means that statements and representations made by your lender's staff or representatives about your loan arrangements may form part of the loan contract. The bank can't turn around and say, hey, if it's not in the contract, it doesn't exist. Wrong.

2. **Broad Indemnity Clauses**

   What are indemnity clauses!? You throw your hands in the air. There is no need to panic, indemnities can be legitimate and reasonable in contracts. Lenders place indemnity clauses in the agreement so that they are protected from losses suffered due to the borrower's action /default. However, such clauses would be unfair if they require you (poor small business borrower) to cover losses incurred due to the fraud, negligence or misconduct of the bank (or its agents or representatives).

   As set out in ASIC's report, borrowers should not be responsible for costs incurred due to the fraud, negligence or wilful misconduct of people or entities who are outside the borrower's control or who act on the instructions of the lender. Phew, we hear you utter. Rightly so. Because why should you (the borrower) be the one cleaning up the bank's mess?

3. **Event of Default Clauses**

   These clauses normally set out some circumstances in which the borrower would be in

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"default" and will entitle the lender to exercise a range of actions. ASIC's report noted that such event of default clauses should not be overly broad and the consequence of a default should not be disproportionate to the risk.

You should also know that, as a borrower, you should be given a reasonable period for you to remedy a breach of a specific event, and before the lender can take any enforcement action, a materiality threshold must be reached to the point where there is a material risk to the lender. If say, you misspelled your name in the loan contract (admit it, it could happen), it should not justify the lender calling a default and demanding repayment of the loan.

4. **Financial Covenants Clauses**

   These financial indicator covenant provisions require the borrowers to meet certain financial positions, such as, loan to valuation ratio (LVR). These clauses would be unfair if maintaining such a ratio is not reasonably necessary to protect the legitimate interests of the lender and yet, if breached, would cause detriment to the borrower (e.g. would put the borrower in default). However, they are not always unfair; it depends on the nature and purpose of the loan. For example, a borrower's compliance with certain financial indicators may be quite important in property development or specialised loan types.

5. **Unilateral Variation Clauses**

   Lenders should not be able to "do whatever they want" and be given broad discretion to unilaterally vary terms of the loan contract, without consent or reasonable notice to the borrower. ASIC's report provides that where such a variation would cause the borrower to want to exit the contract by repaying or refinancing, the lender should provide sufficient period (between 30 and 90 days) for the borrower to do so before the variation takes effect.

So there you have it – some highlights from the ASIC report. You should be getting notifications from your bank about potential changes to its standard loan agreements too. When you are in doubt, just give us a call.