24 July 2009

By email: economics.sen@aph.gov.au

The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

Submission to Inquiry into the National Consumer Credit Protection Bill 2009 and related bills

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the National Consumer Credit Protection Bill 2009 (the **NCCP Bill**) and the three related bills recently introduced into Parliament. We apologise for the delay in making our submission.

We are very supportive of the transfer of responsibility for the regulation of consumer credit from the States and Territories to the Commonwealth Government. One national law should result in more comprehensive and consistent protection against unfair practices for all Australian consumers, minimise regulatory gaps and the time taken to make necessary amendments to the laws and be easier and less costly for both governments and businesses to ensure compliance.

Consumer Action supports the overall intention of the NCCP Bill and the other bills, and many of the features of the legislation such as the provisions requiring most parties involved in the credit process to be licensed and join an external dispute resolution (**EDR**) scheme. We also commend the Government for including important changes in the NCCP Bill since the draft legislation was released for consultation, including prohibiting brokers from using caveats to secure payment of broker fees, ensuring consumer leases are subject to responsible lending requirements, and including a presumption that a loan will be unsuitable for a borrower if they could only repay it by selling their home.

Despite many positive elements in the bills, however, Consumer Action believes that the NCCP Bill needs to be amended to meet its stated objectives and close obvious opportunities for regulatory avoidance.

Our comments are detailed more fully below and, where case studies are provided, they are summaries of real Consumer Action matters. We also support the comments and recommendations made in the submission by the Consumer Credit Legal Centre (NSW), which has significant experience in dealing with consumer credit matters and has made significant submissions on important concerns with the bills.

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About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation.

Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. A large proportion of our advice and casework representation relates to consumer credit and debt issues.

Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Avoidance

One of Consumer Action's principal concerns with the NCCP Bill is that it has no overarching framework to counter inevitable attempts at avoidance once it has been enacted. The bills have not been subject to any process of "stress-testing" that would give confidence they will be effective in practice in their objectives of implementing a national regime that 'will assist in ensuring that consumers are better protected in their dealings with credit products and credit providers, including brokers and advisers',[1] will 'prohibit irresponsible lending to consumers by all types of credit providers',[2] and 'will see consumers benefit through robust licensing that will bar unscrupulous operators from the industry; and lead to improved standards in the way lenders and brokers operate'.[3]

It is important to understand that consumer credit legislation has a long history in Australia under State and Territory legislation, including for over ten years as a uniform legislative scheme under the Consumer Credit Code (the **Code**) regime. During this time there have been numerous examples of practices that have been developed by businesses specifically to avoid one or more aspects of the Code or to exclude the operation of the Code entirely. The more prescriptive any consumer credit legal definitions, requirements and provisions are drafted, the more opportunities are created to comply with the letter but not the underlying intent of the laws.

Further, avoidance practices tend to be developed by non-mainstream or fringe lenders who target the more vulnerable or disadvantaged members of our community. The result is that those people who most need protection against unfair lending practices are often least likely to obtain it.

Below we list a number of the more common examples of avoidance practices that have appeared over the years. Our point is that attempting to narrow down legislation and make specific amendments to close off new loopholes does not address the fundamental problem that

[1] Council of Australian Governments, *Communiqué*, 3 July 2008, p3.
[2] Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, ' New National Responsible Lending Laws', *Media release No. 038*, 27 April 2009.
[3] Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, 'Public Exposure of National Consumer Credit Protection Bill 2009', *Media release No. 037*, 27 April 2009.

some businesses intentionally create new and creative contractual structures to avoid the strict wording of the law.

Examples of avoidance practices

There are numerous examples of lending practices developed by businesses in Australia over the years to avoid some or all regulation under existing consumer credit legislation, of which some notable examples are:

- "Interest-free" deals - credit charges hidden in an inflated cost for the item being purchased with the credit (also sometimes called "tiny terms" contracts)

  These deals were often marketed as "interest-free". By providing credit at "no charge", the Code was avoided entirely, including the requirement to disclose the cost of the credit to the consumer, the ability of the consumer to the contract as unjust and obligations to follow repossession procedures. Amendments to the Code were passed last year to provide that if the cost of the item being purchased was inflated, the "credit" is deemed to be the difference between the market value of the item and its purchase price.

  For example, we have represented several clients in disputes with a company called Motor Finance Wizard, which structured its contracts in this manner. A case study is set out below. Since the amendments to the Code were passed to close this "loophole" for avoidance, the company has changed its contracts to structure them as consumer leases, in circumstances where the consumers expect a loan. In fact, the telephone number for Motor Finance Wizard is 1300 CAR LOAN. The issue of consumer leases is discussed below.

  Case study - "interest-free" finance

  Jan (name changed), a single mother whose sole source of income was Centrelink benefits, entered a contract to purchase a 1993 Holden Commodore from Motor Finance Wizard (MFW) for $11,990 (total price including warranty, stamp duty and transfer fee $14,195.30). The vehicle's 'Red Book' value was between $1,600 and $3,600. Jan paid $660 up-front, with the remainder being financed by so-called 'interest free' finance from MFW's related company, Kwik Finance. Jan was told by MFW's representative that repayments would be $105 per fortnight, whereas they were in fact $220 per fortnight. Jan's fortnightly income at the time of entering the contract was only $710 and MFW's representative was aware of this.

- Consumer leases

  Consumer leases are covered by the Code but various important provisions that apply to loans do not apply to them, particularly the obligation to disclose the cost of the credit and an interest rate to the consumer, and some consumer rights around repossession. The use of consumer leases also enables the lender to include payments for something similar to an insurance product under the contract, to cover the goods being hired, but which is not technically an insurance product, meaning consumers do not have rights

under insurance law or access to the Financial Ombudsman Service's insurance division if there is a dispute.

The Code deems a lease or hire contract to be a sale (using finance) if the consumer has a right or obligation to purchase the goods being hired under the contract (which itself is a provision designed to prevent Code avoidance by structuring a sale with finance as a lease). However, modern consumer leases are structured so that a consumer has a right to purchase the item being leased in practice, but clever wording in the contract ensures that the consumer may or does not have a right to purchase at law, thereby avoiding the provisions that would deem these deals a sale by instalments.

For example, Radio Rentals do not give their customers the right to purchase the goods they are hiring, but the right to purchase "similar" goods. One of Flexigroup's Flexirent contracts (offered through, for instance, Harvey Norman stores) allows the consumer to sell the goods as Flexirent's agent, and to retain all but $1 as sales commission. More recently, Consumer Action has advised consumers who have "bought" cars from Motor Finance Wizard since the Code amendments referred to above were enacted, and their contracts have been structured as consumer leases under which, at the end of the contract term, the consumer can offer to purchase the car from MFW for an extra payment above the payment of all rental instalments. Although under the contract MFW does not have to accept this offer, consumers believe they will have the right to purchase.

- Business purpose declarations

This is one of the most common devices used by fringe lenders to avoid the Code's application. The Code applies to lending provided or intended to be provided wholly or predominantly for personal, domestic or household purposes. However, the Code provides that if a consumer signs a standard-form declaration that the credit is to be applied wholly or predominantly for business or investment purposes, it is presumed conclusively that the Code does not apply.

Many unscrupulous lenders routinely require consumers to sign a "business purpose declaration" amongst other documentation when arranging a loan, to exclude the operation of the Code.

Case study - business purpose declaration

David (name changed) needed to borrow $4,500 to give to his ex-wife quite urgently. He knew he could not get the loan with mainstream bank lenders because he had previously tried to get one and had been declined due to his credit record. David saw an advertisement in the Herald Sun newspaper for a lender which said it could get customers quick cash in hand. David called them and told the lender's representative on the phone that he needed a personal loan, and the representative didn't ask any questions about the loan purpose. The representative asked David if he owned a house, which David confirmed. The representative then said that the lender could get David a $3,500 loan at a low rate of 4%, failing to advise that this was in fact a rate per month and

not per annum. David was told to come into the lender's offices that afternoon and papers would be ready.

David attended the offices for not more than 10 minutes and was given various documents to sign, one of which required him to tick what the purpose of the loan was. He was told at this point that if he wanted the money then, he would have to tick that it was a business loan. Otherwise, it would take more time to get the money and the lender would have to do a credit check. David ticked that it was a business loan because he needed the money quickly and did not turn his mind to why the lender would require this. He also signed a business purpose declaration that was not explained to him. Again, he thought he had to do so in order to get the money. The lender asked nothing about David's personal situation other then to get some pay slips, and David does not have a business.

David could not afford the loan repayments and the lender threatened to repossess his home under the mortgage it obtained over his property. The loan had a total interest rate of 60% per annum with an establishment fee of $990, which would render it unenforceable under the Code, except that David signed a business purpose declaration.

- Hiding behind an intermediary (such as a broker)

  A loan or the conduct leading up to the making of a loan may be in breach of the Code, but the lender may claim no knowledge or responsibility for this conduct because a broker was involved in arranging the credit.

  For example, a business purpose declaration will be ineffective if the person who obtained the declaration from the debtor 'knew, or had reason to believe, at the time the declaration was made that the credit was in fact to be applied wholly or predominantly for personal, domestic or household purposes' (Code s.11(3)). However, even if a business purpose declaration is found to be defective, it does not always follow that the lender cannot still rely on the document as an indication that the loan was for business purposes.[4] A broker may knowingly obtain a "false" declaration from the consumer to pass onto the lender, which does not make further inquiries and can later argue that it was unaware of the purposes of the loan. As other examples, a consumer may be unable to challenge an unjust contract or establish a linked credit provider relationship if a broker conducted the transaction and stands between the consumer and lender.

- Using fees to avoid the interest rate cap

  In Victoria, a 48% cap applies to the annual percentage rate on unsecured consumer loans (and 30% on mortgages).[5] Several fringe lenders use fees and charges to avoid the interest rate cap. For example, they charge an annual interest rate below 48% but charge a very high establishment fee and ongoing administration fees instead. For this reason, New South Wales (**NSW**), the ACT and Queensland have implemented interest

[4] See, eg, *Neuendorf v Rengay Nominees Pty Ltd* [2003] VCAT 1732 (3 September 2002).
[5] Consumer Credit (Victoria) Act 1995 ss.39-40.

rate caps that expressly provide for fees and charges on a loan to be included in the calculation of the overall annual rate applying to that loan.

It is also worth noting that Queensland only implemented its "comprehensive" interest rate cap in July 2008 and reports indicate that it has been successful in reducing harm to consumers from usurious loans[6] but, again, many new practices have already been introduced by Queensland business to try to avoid the laws.[7]

- Bills of exchange and promissory notes

  The Code previously expressly exempted all lending arising out of a bill facility as these facilities were a commercial lending tool, but several fringe lenders structured their consumer loans as bills of exchange or promissory notes as a simple way to avoid the application of the Code. This loophole was closed by regulations made in 2007.[8]

- Continuing credit instead of one-off loan

  A lender who intends to provide credit to a consumer only once (for example, a lender who finances vacuum cleaner sales made door-to-door) may structure their loan as a continuing credit agreement instead of a loan agreement. Continuing credit arrangements carry significantly reduced disclosure requirements, for example around repayment amounts.

Anti-avoidance

In the cases Consumer Action sees in which avoidance practices have occurred, compliance with the Code may or may not have assisted the consumer further. However, the fact that a particular lender structures its agreements to avoid consumer credit regulation is generally a strong indicator of its general approach to its relationships with consumers, and a strong indicator of where problems are likely to arise for consumers.

Consumer Action strongly recommends that the legislation be put through a "stress-testing" process before enactment. We envisage that this would involve analysing existing case studies, including court-decided matters and other matters that have, for instance, come to financial counselling agencies and consumer credit legal services, and considering how the new legislation would apply to those fact situations, how courts would be likely to interpret the new provisions, whether consumers would be more or less protected, and whether unfair practices in those cases would be captured by the NCCP Bill as drafted. We are unaware that any such process has taken place.

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[6] Minister for Tourism and Fair Trading, The Honourable Peter Lawlor, ' Fair trading inspectors recover $978K for payday lender customers', *Media Release*, 16 June 2009; Patrick Lion, 'Ripped-off borrowers get their cash back', *The Courier-Mail*, 16 June 2009.

[7] For example, Cash Converters was reported to have began structuring some loans as a "pawnbroking" transaction in which the consumer bought a CD or DVD for $1 from the company, then pawned it to the company in exchange for the loan. Another business, Fast Access Finance, was reported to be offering an arrangement by which it sold a diamond to the consumer with the consumer taking out a$250 no-interest loan to pay for the diamond, then provided the consumer with the opportunity to on-sell the diamond immediately to another company for $125 cash: Patrick Lion, 'Sky-high loan rates exposed as lenders skirt new law', *The Courier-Mail*, 17 August 2008.

[8] Consumer Credit (Bill Facilities) Amendment Regulation (No. 1) 2007 (Qld).

Further, we strongly recommend that the NCCP Bill be amended to insert a set of general anti-avoidance provisions, following the model set by the taxation anti-avoidance regime in Part IVA of the *Income Tax Assessment Act 1936* (Cth). In a similar manner, the national consumer credit laws could provide that a scheme, arrangement or activity is deemed to be a credit contract or credit activity, or deemed to be a credit contract or credit activity of a particular sort (for example, a credit contract not a consumer lease), if it has been structured in a particular manner for the purpose of avoiding some or all parts of the legislation. Unfair and irresponsible lending cannot be properly tackled unless the legislation acknowledges the reality that some lenders will always attempt to structure their practices to avoid a strict reading of the wording of the legislation.

Recommendations

Subject the legislation to a "stress-testing" process before enactment, involving comparing proposed provisions to existing case studies and fact scenarios to determine their impact.

Amend the legislation to insert a set of general anti-avoidance provisions, following the model set by the taxation anti-avoidance regime, providing that a scheme, arrangement or activity is deemed to be a credit contract or credit activity, or a credit contract or credit activity of a particular sort, if it has been structured in a particular manner for the purpose of avoiding some or all parts of the legislation.

Responsible lending

Another of Consumer Action's main concerns is that, while the bills aims to stop irresponsible lending to consumers, the NCCP Bill's responsible lending conduct provisions that are the principal means of addressing this goal take a prescriptive and narrow approach that will encourage literal compliance but not genuine changes and improvements in lending practices.

The NCCP Bill's Chapter 3 responsible lending conduct provisions are framed around two elements: disclosure (through providing a credit guide; and assessment of whether a contract is not unsuitable for the consumer. We are concerned that these provisions are drafted so narrowly that lenders will reasonably be able to argue that they have complied with them and that this therefore means that they are lending "responsibly" in the broader sense of the term, including how it would be understood in judging whether a lender had engaged in activities efficiently, honestly and fairly as required by their general conduct obligations.

We can envisage many situations in which activities might not fall foul of the responsible lending provisions but are unfair, due to the individual circumstances or the repeated nature of a practice. For example, repeated lending conduct that put many borrowers into some (but arguably not 'substantial') hardship, or repeated placements of consumers into credit products that are perhaps not completely unsuitable for them but clearly less suitable and more expensive than available alternatives, may not be able to be addressed. The regulator may want to argue that engaging in activities in this manner is not doing so efficiently, honestly and fairly, but the licensee could defend itself by arguing that parliament's intention was only to prevent lending covered by Chapter 3.

These provisions stand in contrast to the United Kingdom's (**UK**) responsible lending regulation, which takes a broader, principles-based legislative approach. The UK *Consumer Credit Act 1974* was amended in 2006 following a major review of consumer credit issues in the UK. Consumer credit providers, brokers, debt collectors and other credit businesses must obtain a licence to carry on business, and the regulator grants licences based on whether the applicant is a 'fit person'. It is through this broad "fitness" requirement that appropriate conduct and practices are managed. The regulator can take into account any relevant matters in determining fitness, including evidence of deceitful, oppressive or otherwise unfair or improper business practices, whether unlawful or not, and such practices explicitly include irresponsible lending. The regulator also assess the competence of the applicant to engage in the credit activities for which it requests a licence, being its skills, knowledge and experience.[9] Further, the regulator has announced that it is examining issues including advertising and marketing, selling techniques, product design, the use of appropriate credit scoring techniques, the handling of defaults or arrears and behaviour and practices around a borrower's ability to repay credit in its project to develop and publish a guidance on how it will assess irresponsible lending.[10]

As an immediate step, we recommend an amendment to the NCCP Bill to clarify that the general conduct obligation of licensees under section 47(1)(a) to 'do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly' is not limited by the chapter 3 responsible lending conduct provisions. As a second step, we recommend that the Government actively review how it might implement broader responsible lending and unfair lending practices provisions into the legislation, similar to the UK approach, during phase 2 of the work on the national consumer credit reforms.

Recommendations

Amend the NCCP Bill to provide that chapter 3 does not limit licensee's obligations under section 47(1)(a) to engage in credit activities efficiently, honestly and fairly.

Recommend to the Government that it review how it might implement broader responsible lending and unfair lending practices provisions into the legislation during phase 2 of the work on the national consumer credit reforms.

Responsible lending conduct - verification of broker assessment

As the NCCP Bill explains, Part 3-2 Division 3 requires a licensed credit provider, before entering or increasing the credit limit of a credit contract, to make an assessment as to whether the contract will be unsuitable for the consumer. The NCCP Bill also explains: 'To do this, the licensee must make inquiries and verifications about the consumer's requirements, objectives and financial situation. The licensee must give the consumer a copy of the assessment if requested.'[11]

[9] *Consumer Credit Act 1974* (UK) section 25. See also Office of Fair Trading, *Consumer credit licensing: General guidance for licensees and applicants on fitness and requirements*, January 2008.
[10] Office of Fair Trading, 'Irresponsible lending consultation response published', *Press Release*, 147/08, 19 December 2008.
[11] NCCP Bill section 125 - Guide to this Part.

The requirement for credit providers (and others such as brokers) to make an assessment of whether a loan should responsibly be extended to a consumer is at the heart of the new laws. The obligation on credit providers to make reasonable inquiries and take reasonable steps to verify information relevant to making these assessments is obviously crucial because it ensures licensees cannot make meaningless assessments hiding behind wilful blindness or ignorance.

However, section 130(3) - 'When not required to take steps to verify' - excuses credit providers from the crucial obligation actually to inquire into and verify information being used to make an assessment of the suitability of a loan for a consumer. It does so whenever a broker has already made an assessment not more than 90 days before the contract is entered into or the credit limit increased. We have repeatedly raised concerns about this section, as have other stakeholders.

In fact, Consumer Action believes that this section will encourage more, not less, irresponsible lending practices than the current consumer credit laws. It allows a lender to rely on information and the assessment of suitability provided by a broker, regardless of whether a reasonable party would have questioned that information or taken steps to verify it. This will encourage poor practices, as a lender that responsibly sought to verify suspect information would potentially put itself at more risk of liability under the legislation than a lender that simply relied on the broker's assessment without taking any further steps, regardless of its suspicions. This section is highly likely to become one of the major avenues for avoidance of the legislation, with many lenders insisting that loan applications be made through brokers and deliberately ensuring that their processes rely on broker information and assessments.

Consumer Action's experience is that some of the most serious consumer problems relating to lending have resulted from lenders accepting information provided by a broker without any verification.

Case study - failure to verify broker information

Margaret (name changed) was a 73 year old pensioner (having last worked in 1956 before marrying) who owned her own home but little else of value. She was approached by her son asking that she take out a loan for his benefit. Her son approached a broker to source a loan for his mother, and he and Margaret attended the broker's office together for Margaret to sign a loan application for $280,000. The broker had sourced previous loans for Margaret's son and knew that the funds from Margaret's loan were intended to be gifted to Margaret's son to pay out his debts.

As well as containing a declaration that the loan was for business or investment purposes, Margaret's loan application, prepared by the broker, contained statements that Margaret was earning $130,000 per year as a self-employed electronic engineer, that she held bank account funds of $15,000 and shares and/or superannuation to the value of $250,000, that she owned other personal effects worth $100,000, that her business was valued at $100,000 and that the loan was sought was to refinance a property for investment purposes.

The loan application was approved by a lender, which provided Margaret with a $280,000 variable interest rate loan secured over her home for as term of 27 years. Loan funds were deposited directly into the bank account of a business registered to Margaret's son. The lender never met nor spoke with Margaret and made no inquiries or steps to verify any of the loan

application information despite her age, the loan term (which would have ended when she was 100 years old), her unlikely purported employment and income status and the fact the loan funds were not directed to her.

When Margaret's son did not maintain repayments on the loan, the lender commenced Supreme Court proceedings against Margaret seeking possession of her home and obtained default judgment.

We believe section 130(3) will place many borrowers in a worse situation than they would face under the current laws, by limiting the ability to challenge lender conduct where a broker was involved, whereas currently it is still possible to point out that if it was not reasonable for a lender to rely on the broker's information the lender cannot hide behind the broker. This provision will limit the ability of courts and EDR schemes to find that a lender acted unreasonably or irresponsibly in relation to disputes involving lenders and brokers.

We understand that lenders are concerned about their risk in dealing with brokers who operate somewhat independently from them and over whom they do not have complete control. However, in advocating for this provision lenders want consumers to bear 100% of the risk involved in dealing with brokers, even though it is lenders who are in a far greater position to manage this risk through the processes they employ to determine which brokers they deal with and the way in which they deal with them, including by requiring certain information and undertaking verification measures. For consumers the broker transaction is a once-off, whereas the lender is in a position to use its systemic experience.

Recommendation

Delete section 130(3) from the NCCP Bill.

Credit assistance

The NCCP Bill defines 'credit assistance' in section 8. Brokers are the most obvious example of persons who provide credit assistance. Credit assistance providers must obtain a licence and comply with responsible lending conduct provisions, because providing credit assistance to a consumer is a type of 'credit service' under section 7, and in turn providing a credit service is a type of 'credit activity' under section 6. Section 29 of the NCCP Bill requires all persons who engage in a credit activity to hold a licence.

However, under this section 8 definition of credit assistance, a person only provides credit assistance if they provide various forms of assistance or suggestions in relation to a *particular* credit contract or consumer lease or a *particular* credit provider or lessor.

This means that persons providing *general* advice about credit or a type of credit product, but not a particular product or products with a particular lender, will not have to be licensed nor be subject to the responsible lending provisions, such as the requirement not to recommend unsuitable products.

We believe that this could allow for widespread avoidance practices, by allowing one “credit activity” to be divided between two businesses – one that is regulated and one that is not. For example, an unregulated business could give advice about the benefits of consolidating debts or engaging in "mortgage reduction" (areas in which the stated benefits are often questionable) and then inform the consumer that a business in the same office (or next door) can arrange such loans. An employee at a department store could recommend that a computer would be best purchased by way of a lease, and then refer the consumer to a broker to arrange the lease with the lender. This could all be done without the consumer even being aware that there is a broker between the store and the lease or loan provider. Further, because the consumer then arrives at the broker or lender with their plan or objectives already "determined", the broker or lender is easily able to satisfy its responsible lending obligations to assess whether the contract it is offering meets the consumer's objectives.

We are familiar with a number of examples where credit businesses have structured as two businesses (as opposed to one) in order to avoid current laws. For instance, in order to avoid the 48% comprehensive interest rate cap in NSW and Queensland, some payday lenders document loans by way of a brokerage agreement with a broker and a loan with the lender. The broker and lender may operate from the same address and the borrower may be unaware that they are dealing with two “separate” entities. The cost of the loan is then divided between interest on the loan and a separate broker fee, thereby keeping “within” the 48% interest rate cap. As another example, some years ago the Consumer Credit Legal Service (Vic) (now Consumer Action) encountered a business that charged $3,000 for misleading “mortgage reduction” plans which involved completing loan application documents. The Legal Service identified some breaches of the Victorian finance broker legislation in the way the fee was disclosed, however, the business structure was quickly changed to create two entities. One business provided the “mortgage reduction” plans for a fee, and then referred the consumer to a broker business to arrange the loan.

It appears that similar structures could be established to defeat the intention of the new laws in relation to credit advice and assistance due to the narrow drafting of section 8. Consumer Action recommends that section 6 (or 7 or 8 if more appropriate) of the NCCP Bill be amended to provide that a person also engages in a credit activity if they provide general credit advice but are "linked" or "tied" to a person that engages in a credit activity or a benefit accrues to them (or associates such as a related business or a family member) from the arrangement. The current linked credit provisions in the Code and National Credit Code could provide a useful model for defining when products or parties are "linked" or "tied".

Recommendation

Amend section 6 (or 7 or 8 if more appropriate) of the NCCP Bill to provide that a person that provides general credit advice but is "linked" or "tied" to a person who engages in a credit activity, or derives a benefit from an arrangement whereby they refers consumers to a person who engages in a credit activity, is also engaging in a credit activity.

Enforcement and remedies regime

The provisions of Part 4-2 of the NCCP Bill have been drafted too narrowly and currently exclude the ability to seek compensation or other remedies in a range of important circumstances. They should be redrafted to reflect best practice regulation in this area, as reflected both in other current comparable legislation and in the Government's own proposals for reform in this area contained in another bill currently before parliament.

Background - current consumer protection enforcement regimes

Currently, Part 2 Division 2 of the *Australian Securities and Investments Commission Act 2001* (Cth) (the **ASIC Act**) covers unconscionable conduct and consumer protection in relation to financial services, including credit. These provisions prohibit persons from engaging in unconscionable conduct, misleading and deceptive conduct and other unfair practices in relation to the supply of financial services including consumer credit. They also provide the Australian Securities and Investments Commission (**ASIC**) with enforcement powers in relation to these consumer protection provisions. Part 2 Division 2 of the ASIC Act largely mirrors the relevant provisions in the *Trade Practices Act 1974* (Cth) (the **TPA**) dealing with the same matters in relation to the supply of goods and services generally (other than financial services).

The enforcement and remedies regimes in the TPA and ASIC Act provide for a range of possible remedies to address contraventions of the consumer protection provisions:

- injunctions are available on the application of any party, including the regulator (ASIC or the Australian Competition and Consumer Commission (**ACCC**) as relevant), in relation to conduct that constitutes or would constitute a contravention of the relevant provisions;

- a person who suffers loss or damage by conduct of another person that contravenes a relevant provision may recover the amount of the loss or damage by action against that other person;

- the regulator can seek other non-punitive orders such as community service orders to address a contravention (and punitive adverse publicity orders nut only if the conduct was an offence, not just a contravention); and

- a range of other orders are available to the court to compensate, prevent or reduce loss or damage if any of the other proceedings listed above are brought; or these other orders can be made directly on the application of a person who has suffered, or is likely to suffer, loss or damage due to conduct in contravention of the relevant provisions; or the regulator can apply directly for these orders on behalf of such persons, but only if *each person* on whose behalf the application is made has consented, *in writing*, and *before* the making of the application.

Importantly, all of these remedies (apart from punitive adverse publicity orders) are available to address any *contravention* of the relevant provisions. They are not limited to civil penalty provisions or offence provisions.

The limitations on ASIC or the ACCC seeking orders on behalf of affected consumers (or other parties), due to the unworkable requirements to obtain prior written consent from each individual consumer affected, have been the subject of numerous criticisms and the Productivity Commission recommended in 2008 that consumer regulators should be given the power to take representative actions on behalf of consumers, whether or not the consumers are parties to the proceedings and have consented in writing beforehand.[12] Following on from this recommendation, the issue is now proposed to be addressed in another bill currently before parliament (discussed below).

Current reforms to enforcement regimes

The Government introduced the Trade Practices Amendment (Australian Consumer Law) Bill 2009 (the **ACL Bill**) into parliament one day before introducing the NCCP Bill and related bills into parliament.

The ACL Bill will update the ACCC's and ASIC's enforcement powers to bring them up to date with best practice flexible and practicable enforcement and remedies provisions. Amongst other matters, this includes adding new provisions into the ASIC Act and the TPA enabling ASIC and the ACCC to seek "orders to redress loss or damage suffered by non party consumers" where there has been a contravention of relevant provisions and the contravention has caused or is likely to cause loss or damage to a class of persons.

This addition is proposed precisely because the current provisions that enable ASIC or the ACCC to seek orders on behalf of consumers affected by contravening conduct do not work in practice, as recognised by the Productivity Commission in making its recommendation to implement these reforms.

Deficiencies in the enforcement regime under the NCCP Bill

Part 4-2 of the NCCP Bill provides for the remedies (other than civil penalties and private individual legal actions) that will be available to address contraventions of the new national consumer credit laws.

Taking a similar approach to the enforcement and remedies regimes under the TPA and the ASIC Act, described above, Part 4-2 provides for injunctions, compensation orders and other orders to compensate, prevent or reduce loss or damage.

However, a close reading reveals that the provisions in the NCCP Bill are, in fact, drafted more narrowly than the comparable provisions that currently operate under the TPA and ASIC Act. In all three regimes, injunctions will be available on the application of any party, including the regulator, in relation to conduct that constitutes or would constitute a *contravention*. However, unlike under the TPA and ASIC Act, the NCCP Bill proposes that compensation orders (section 178) and other orders to compensate, prevent or reduce loss or damage (section 179) will only be available for contraventions of a civil penalty provision or an offence, not for contraventions generally.

[12] Productivity Commission, *Review of Australia's Consumer Policy Framework*, Productivity Commission Inquiry Report: Volume 2 – Chapters and Appendixes, No. 45, 30 April 2008, pp215-218.

It is unclear why the NCCP Bill would limit the availability of compensation orders in this manner and the Explanatory Memorandum to the NCCP Bill (the **EM**) is misleading on this question. First, the NCCP Bill expressly provides that compensation orders are not available for breaches of the National Credit Code (Schedule 1 of the NCCP Bill, largely based on the current Code). The EM therefore notes this exclusion, explaining that it has been done because the National Credit Code contains its own remedies provisions. However, the EM states: 'Both types of compensation orders are limited to offences or contraventions of the Credit Bill other than the Code'.[13] This is incorrect, as compensation orders are *not* available for general contraventions of the NCCP Bill, only for contraventions of civil penalty provisions in the NCCP Bill. Secondly, the EM states: 'Section 179 is modelled on section 1325 of the Corporations Act.'[14] However, section 1325 of the *Corporations Act 2001* (Cth), like the TPA and the ASIC Act, provides that these orders are available for general contraventions, not only for contraventions of civil penalty provisions or offences.

Sections 178 and179 of the NCCP Bill should be amended to provide that compensation orders are available if a person/defendant engages in a contravention of the Act generally, as is the case under the section 177 injunctions provision.

Further, the NCCP Bill provides that ASIC can apply for compensation orders on behalf of an affected person under sections 178 and 179, and also section 180, but only if the affected person has given consent in writing before the application is made. The NCCP Bill therefore replicates the current provisions of the ASIC Act and the TPA in this regard, which have not only been recognised as deficient but are currently the subject of proposed amendments in a bill introduced into parliament only a day prior to the NCCP Bill.

It seems incongruous that the Government would have recognised the current deficiencies in the TPA and the ASIC Act with regard to seeking redress for consumers and other parties affected by contraventions of consumer protection laws, and is moving to fix them, while at exactly the same time it is re-enacting them in its new consumer credit laws.

The NCCP Bill should be amended to include the same non-party redress provisions that are contained in the ACL Bill, which would enable ASIC to seek orders for non-party redress if a person contravenes the consumer credit laws. Otherwise ASIC will not, in practice, ever be able to facilitate appropriate orders to assist consumers affected by a contravention. It would also lead to the strange situation that ASIC could obtain compensation orders for consumers affected by, say, misleading conduct in supplying credit but not irresponsible lending conduct in supplying credit.

Recommendations

Amend sections 178 and179 of the NCCP Bill to provide that these compensation orders are available if a person (the defendant) engages in a contravention of the legislation, not just a contravention of a civil penalty provision or an offence.

[13] *National Consumer Credit Protection Bill 2009: Explanatory Memorandum*, 2008-2009 The Parliament Of The Commonwealth Of Australia House Of Representatives, p132.
[14] As above, p133.

Amend the NCCP Bill to include provisions enabling ASIC to obtain orders to redress loss or damage suffered by non party consumers caused by conduct contravening the consumer credit legislation.

Jurisdiction and procedure of the courts - interstate proceedings against consumers

It can be very difficult for an individual, let alone a disadvantaged or vulnerable consumer, to deal with or defend legal proceedings issued against them in an interstate court. The EM recognises that:

> In adopting the UCCC in the Commonwealth context as the National Credit Code (Code), the Code's jurisdiction is no longer limited to the State and Territory where the contract was made. This could make it difficult for consumers in another jurisdiction to respond to or engage with those proceedings. This may cause particular vulnerabilities for debtors who could not afford or have the capacity to challenge a proceeding in another jurisdiction.[15]

In fact, this is already a significant problem, with many consumer credit proceedings initiated against consumers in a court of a jurisdiction interstate to where they reside. This is because once a proceeding is issued against the consumer in relation to an alleged debt, the onus is on the consumer, as the defendant, to defend the claim and raise any jurisdictional issues that would support granting a stay/transfer. Most debt proceedings proceed to default judgment, meaning a credit provider or debt collector that issues interstate is not challenged. Further, the issuing of proceedings interstate itself makes it less likely a consumer will defend the proceedings, as court documents can be imposing and it can be difficult for consumers to appreciate their import, let alone when the court documents come from an interstate court with little apparent relevance or immediacy to the consumer. This is particularly the case for disadvantaged or vulnerable consumers.

Case study - interstate proceedings

Martin (name changed), a Victorian resident, was suffering financial hardship as a result of a loss of income following the death of his best friend and business partner early last year. Martin had moved onto Centrelink payments for income and fell behind on his credit card, and a debt of approximately $10,000 became owing to his bank on his credit card. Martin wrote to his bank early and requested a variation to his repayment arrangements due to hardship but this was refused. He was then harassed for payments he could not afford and Martin's bank eventually issued proceedings against him, but in NSW. Martin sought our help to deal with these interstate proceedings. We had to assist Martin to file a defence and a stay application under the *Service and Execution of Process Act 1992* (Cth) and then issued in the Victorian Civil and Administrative Tribunal (VCAT) seeking an order for a hardship variation. Martin planned to sell two vehicles to satisfy the debt, but he needed time to repair them first and thus a hardship variation was warranted. The matter settled at mediation at VCAT.

The court transfer provisions in the NCCP Bill do not address the problem of credit providers (or debt collectors) issuing against consumers in an interstate court. While they provide for a party

[15] As above, p141.

to apply to have a proceeding transferred, this presupposes that consumers will be able to make transfer applications in practice, which simply does not occur. We strongly agree with Legal Aid Queensland's submission on this issue, in which it points out that consumers can rarely access low cost legal advice about proceedings in another state, defending interstate proceedings is extremely time intensive and costly, consumers will generally have to pay for video conferencing, telephone appearance or travel and accommodation even if successful in obtaining a stay or transfer and many consumers are simply overwhelmed by the prospect of attempting to enforce their legal rights in another state. Further, under the new national laws it actually appears less likely that a consumer would be successful in a stay application, both because section 193 of the NCCP Bill directs the court to make a decision on a transfer application based on various considerations which do not necessarily suggest that an interstate court will always be an inappropriate forum in which to issue proceedings against a consumer, and because the debtor residency requirements in the Code that helped determine the relevant state or territory jurisdiction will not be replicated in the National Credit Code.[16]

Consumer Action recommends that amendments be made to the NCCP Bill to require credit providers (and debt collectors) to commence proceedings against debtors in the jurisdiction appropriate to the debtor. This could be done by inserting requirements into either Part 4-3 and/or the National Credit Code Part 5 (ending and enforcing credit contracts, mortgages and guarantees), requiring proceedings to be issued in the jurisdiction in which the debtor resides (or in which the contract was made if the debtor's residence is unknown). These provisions should enable debtors to object to proceedings issued in an incorrect jurisdiction and to obtain a stay automatically, with the credit provider required to pay any costs of the debtor in making that objection/application. Further, to address the issue that many consumers will still find it difficult to deal with interstate proceedings, these provisions must also be enforceable by the regulator, with a penalty attached for non-compliance.

Jurisdiction and procedure of the courts - small claims procedure

We commend the NCCP Bill's recognition, in sections 199-200, of the need for a small claims procedure for consumer credit disputes that is less formal than a traditional court forum and in which costs are only awarded if a party acts vexatiously or unreasonably. Regulations will provide for matters such as filing fees and we note that these will need to be set at a low amount, and with the ability for low-income consumers to seek a waiver, if the small claims procedure is to be accessible in practice.

Consumer Action and other consumer organisations strongly recommended the creation of a low/no cost court jurisdiction before the NCCP Bill was introduced. At Appendix A we attach a copy of a joint Briefing Paper put together in March which sets out in more detail the reasons why such a forum is important and, critically, why access to an EDR scheme does not negate the need for viable consumer access to the judicial system.

However, as presently drafted the small claims procedure in the NCCP Bill does not, in fact, address the concerns behind its inclusion in the legislation.

[16] See discussion in above, p242-243.

Forum of choice

First, the small claims procedure should operate as the forum of choice due to its low/no cost nature, and build expertise in consumer credit issues as a result. It should not be merely one of various alternative fora for bringing or transferring proceedings. The low/no cost state and territory tribunal jurisdictions that it will replace have operated as the primary or exclusive forum for hearing consumer credit disputes. This ensures that important obligations under the consumer credit laws can be challenged or enforced by consumers, because these matters go to the inexpensive and informal jurisdiction rather than potentially going through a traditional court forum. The EM notes that this is one of the changes wrought by the NCCP Bill, stating that jurisdiction for civil matters will be extended to the Federal Court, the Federal Magistrates Court and all state and territory Courts, compared with the current situation in which some states and territories permit credit matters only to be heard in tribunals.[17]

This is an important distinction because, in practice, many consumer credit disputes find their way to the court system through the lender, not the consumer, first commencing legal action, and lenders commence legal actions in a state court. Further, in home loan matters, this will be the Supreme Court of a state, not merely the Magistrates' or Local Court. A consumer with a related or counter claim, such as for a hardship variation or to reopen an unjust contract, needs to have a realistic (in other words, affordable and accessible) avenue to be able to make this claim, which is through the low/no cost jurisdiction. Currently, this is what occurs in NSW and Victoria where consumers can apply to the tribunal with their related or counter claim, without first having to apply to the Court for a stay or transfer of the issued proceedings. For example, our case study above on interstate proceedings demonstrates how this operates in practice and enables a consumer to have a matter fairly considered.

It would be fanciful to expect a consumer to make an application for a hardship variation in the Supreme Court, where proceedings will take longer to be concluded and will incur large costs that are out of proportion to the claim. The tribunals progress consumer credit applications within a matter of weeks, even complex cases. This is crucial in the consumer credit context, as by their nature these matters arise when a debtor is in financial difficulty, meaning that the longer the dispute goes on, the more a debtor's finances are eroded (with default interest, enforcement charges and other costs also accruing on the outstanding debt), and the less ability a consumer has to continue with their claim. Delay is a strong weapon against consumers in this area, as debtors can quickly run out of funds. Without a presumption that such matters should be heard under the small claims procedure, the Court in which the original proceedings are issued by the lender can rightly claim that it has the ability to hear all related claims and thereby lock the consumer into that more expensive and imposing court jurisdiction.[18]

Further, at present the transfer provisions in the NCCP Bill do not even contemplate related proceedings, only covering the transfer of a particular proceedings to a different court. Amendments are needed to deal with the situation that arises in practice in this field, which is

[17] As above, p127.

[18] Note that delay is also one of the reasons why consumer access to an EDR scheme to resolve the dispute is not a sufficient response. EDR schemes can take significantly longer (in many cases years) to resolve a dispute than a low/no cost judicial forum and consumers in these situations with a contract still on foot are not able to wait so long as costs continue to accrue on the debt. (For consumers whose contracts have already ended, costs no longer accrue but the delay may exclude them from bringing an application for review of an unjust transaction because there is a two year limitation period to bring such an action from the date the contract is rescinded or discharged.)

that a consumer needs to commence related (not the same) proceedings in a lower cost forum and have the original proceedings issued by the lender stayed until the debtor application is determined.

The NCCP Bill must therefore be amended to include provisions enabling a debtor to make an application under the small claims procedure even after related proceedings have been commenced in another Court. The lower court hearing the consumer's application under the small claims procedure must also be able to issue a stay on the related proceedings which the other Court must abide by.

Unreasonable limitations on access

Secondly, section 199(2) of the NCCP Bill unreasonably limits the types of proceedings that can be heard under the small claims procedure:

- Injunctions

  Section 177 injunctions cannot be sought using the small claims procedure. Injunctions are specifically intended to be available to consumers, not just ASIC, and for all types of contraventions, including contraventions of the National Credit Code.[19] However, injunctions will rarely be accessible to an individual consumer in a typical consumer credit dispute without access to a low/no cost forum.

- Straightforward compensation orders above $40,000

  Section 178 compensation orders can only be sought under the small claims procedure if the amount being claimed is $40,000 or less.

  The EM explains that the NCCP Bill provides for two different types of compensation orders - under sections 178 and 179 - to enable consumers to make use of the small claims procedure for straightforward monetary compensation applications under section 178, while requiring more complex compensation applications to be considered by a court.[20] This is sensible, but there is then no reason to place such a low monetary limit on the straightforward compensation orders that may be sought under the small claims procedure. The $40,000 limit effectively remove's a consumer's ability to seek a remedy for unfair lender practices relating to home loans (as well as any debts over $40,000 such as a large credit card debt).

  See also further discussion below under 'Other enforcement, possession and compensation orders'.

- Statements of account and determinations of a disputed liability

  Sections 37 and 38(7) of the National Credit Code give debtors the important rights to apply for an order that the lender (or an assignee such a debt collection firm that has

[19] See also as above, pp130-131.
[20] As above, p132.

bought the debt) provide a statement of account if the lender has not done so, and to apply for an order determining the amount owed in the event of a genuine dispute.

These remedies are particularly important in the modern marketplace, in which many lenders "factor" or sell old or disputed debts to specialist debt collection companies, which then pursue the alleged debtors for repayment but may not have appropriate or accurate records to prove the alleged debt exists. Consumer Action has assisted many consumers in cases in which further rights, if any, cannot be determined or pursued, or even a simple repayment plan fairly negotiated, because statements of account are not being provided and must be sought using these provisions (which currently exist in the Code).[21]

However, under the NCCP Bill, consumers can only use the small claims procedure to pursue these rights if the value of the credit contract, mortgage, guarantee or consumer lease to which the order relates is not more than $40,000. Again, this effectively ensures that a consumer will not be able to seek statements of account or a determination of a disputed liability relating to home loans, let alone relating to debts under other larger credit contracts. We do not see why any such limitation is required - obtaining a statement of account should be a basic right.

- Unjust transactions and unconscionable interest and charges

Similar to above, the consumer rights to apply for a review of an unjust transaction or unconscionable interest or charges under sections 76 and 78 of the National Credit Code cannot be pursued under the small claims procedure if the value of the credit contract, mortgage, guarantee or consumer lease is more than $40,000.

Again, we do not understand why the small claims procedure would be limited in this way. These are some of the most important and most commonly used consumer rights, for example, over-commitment matters are a type of unjust transaction application. Currently, they can be pursued in the low/no cost state tribunals (where relevant) without any monetary limit on the relevant loan contract.

The NCCP Bill ensures that, in practice, consumers will be unable to challenge unjust transactions or unconscionable interest or charges relating to home loans, including home loan refinances and other contracts over $40,000.[22] Typically, consumers do not consider whether they have an action in relation to an unjust contract until they are in default, or until proceedings for repossession have been issued. These actions must be able to be brought in a low/no cost jurisdiction.

[21] See, for example, a recent Consumer Action case in which we took action on behalf of a consumer to obtain statements of account from a major bank, the NAB, after it did not provide statements for six months: Consumer Action, 'NAB fails to assist client despite banks agreeing to help people in financial hardship', *Media Release*, 23 April 2009; Daniella Miletic, 'Single mum tackles bank over credit', *The Age*, 24 April 2009.

[22] For example, in December 2008 Consumer Action took action in the Victorian Civil and Administrative Tribunal against a home lender on behalf of a consumer who was charged a $12,000 early termination fee on her variable rate home loan, after she chose to switch mortgages because the lender had made large increases to her interest rate well above the increases of other lenders in the market: Consumer Action, ' Consumer Action launches test case against mortgage exit fees', *Media Release*, 8 December 2008; Emily Bourke, ' Exit fees tested before courts', *ABC Radio PM*, 8 December 2008, available at www.abc.net.au/pm/content/2008/s2440892.htm.

The EM makes it clear that unjust transaction and unconscionable interest and charges cases relating to contracts of a value over $40,000, including home loans, have been intentionally excluded from the small claims procedure because:

> it is considered that more complex and serious cases may benefit from more formal consideration by the court. These include matters that relate to a person's residential property.[23]

Frankly, the example of the current state tribunals commonly handling such cases demonstrates that even more complex matters can be dealt with in a timely and cost effective manner by a body other than a superior court. We cannot stress enough how significant a reduction in consumers' access to justice for genuine consumer credit disputes this limitation on the accessibility of the small claims procedure will entail.

- Other enforcement, possession and compensation orders

As with other rights discussed above, access to the small claims procedure in relation to consumer rights under sections 106, 107(3), 108 and 118 is limited by reference to the $40,000 monetary threshold.

We simply do not see why practical access to justice should be denied to a consumer simply because of the value of their claim or contract. The EM states that the monetary limit for compensation orders under sections 106, 107(3) and 118 of the National Credit Code, as well as section 178 of the NCCP Bill, is set at $40,000 because matters seeking greater than that amount 'are likely to be more complex and should attract more formal consideration of the Court'.[24] However, complexity is not a function of the amount of a claim or contract but a variable that depends on the facts and legal arguments in the case. These can be either simple or complex whether the credit contract or damage suffered was $10,000 or $300,000. Further, the argument that a no/low cost court forum cannot deal with a more complex matter is simply not borne out by the evidence provided by current experience with state tribunals.

The EM also states that the small claims procedure, with the $40,000 monetary threshold, should cover most claims, using the Victorian Civil and Administration Tribunal's (**VCAT**) 2007-08 Annual Report as support:

> This procedure should cover most claims under the Code. For example, the Victorian Civil and Administration Tribunal noted in its 2007-08 Annual Report that claims under $10,000 comprised 87 per cent of all its general civil applications, including credit matters.[25]

However, these statistics relate only to Civil Claims List at VCAT, which the Annual Report clearly explains handles fair trading and owners corporation matters.[26] Consumer credit disputes are handled in the Credit List.

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[23] *National Consumer Credit Protection Bill 2009: Explanatory Memorandum* , above n13, p146.
[24] As above, p145.
[25] As above.
[26] Victorian Civil and Administrative Tribunal, *Annual Report 2007–2008*, p18.

Federal Magistrates Court

Finally, we note that the Government recently announced its intention to merge the Federal Magistrates Court into the Federal Court.[27] The NCCP Bill currently provides for the small claims procedure to be available in state magistrates or local courts and in the Federal Magistrates Court. We ask for a formal acknowledgement that the legislation will be amended at the relevant time to retain a small claims procedure in the Federal Court once the Federal Magistrates Court is dissolved.

Why is access to a small claims procedure so important?

The EM explains that the NCCP Bill sets up a dispute resolution framework that encourages parties to resolve disputes through internal dispute resolution and EDR processes, and provides access to the courts for cases in which these have not resolved the matter or where EDR is considered inappropriate.[28] It might be asked why access to a small claims procedure remains so important given that the NCCP Bill provides for expanded access to EDR schemes for consumers.

In fact, Consumer Action does not disagree that most consumer claims will, appropriately, be handled through the EDR schemes, which do provide an accessible and low cost process for most matters. However, some cases are more appropriately dealt with through the courts, for example cases in which delays will impact negatively on the consumer's ability to pursue their claim due to interest and costs accruing, given the EDR schemes can take much longer to resolve disputes and their timeframes are expected to increase further once new members join the schemes pursuant to the new licensing requirements.[29]

Case study - EDR scheme delays

In May 2007, ASIC obtained Federal Court orders that Sample & Powers (**S&P**), a mortgage broking business, engaged in misleading and deceptive conduct. The orders required S&P to provide information to consumers about how to claim for loss and to deal appropriately with claims for compensation, but Consumer Action alleged that S&P breached those orders. S&P's conduct contributed to long delays in having the matters resolved at the Credit Ombudsman Service, and our experience is that most consumers gave up and settled for much less than they were entitled to.

In cases such as this, particularly where there is a record of poor conduct by the industry member, access to a judicial forum could assist consumers to resolve their matters more efficiently and could encourage the industry member to respond more appropriately to disputes being handled by the EDR scheme.

Another simple reason for the need for an accessible court forum is that EDR schemes do not have jurisdiction to hear all consumer credit disputes. For example, the schemes themselves have monetary limits, cannot make determinations involving non-members (for example in linked

[27] Attorney-General, Robert McClelland, ' Rudd Government to reform Federal Courts', *Media Release*, 5 May 2009.
[28] *National Consumer Credit Protection Bill 2009: Explanatory Memorandum* , above n13, p118.
[29] See n18 above.

credit matters where the consumer may have a complaint against both the credit provider and the original service provider, such as in relation to unfair conduct in the sale of a car and the related finance), can refuse to consider cases in which there are evidentiary disputes or oral evidence needs to be taken, and it seems may not be able to hear unconscionable interest or fee cases.

Arguably even more importantly, though, the fact that consumers have a realistic judicial alternative to an EDR scheme actually strengthens the operation of those schemes. For instance, EDR schemes cannot determine the law or create precedent, and rely on important consumer credit disputes being taken through the court system. Although the numbers of consumer disputes that would use the small claims procedure would be small, it is critically important that the court system is accessible so that these sorts of cases can proceed. Limiting access by the value of the claim or contract does not make sense in this context, particularly as it is often larger-value cases that proceed and result in important precedents. Currently, in jurisdictions that do not have a specialist consumer tribunal, Code disputes are heard by a court and negligible consumer legal actions are taken. The number of consumers who take consumer credit legal actions in states with a tribunal is low, but certainly not negligible, and the majority of the important legal precedents in the consumer credit area, relied upon by EDR schemes in resolving disputes, arise from Victorian or New South Welsh cases that were commenced in the low cost tribunals.

Further, a basis for consumer support of industry-based EDR schemes is that accessing the schemes is a choice for the consumer. Closing access to low cost judicial fora would mean that, for most consumers, there is no real choice.

As noted above, Appendix A contains more details about these and other reasons why a small claims procedure is important.

Recommendations

Amend the NCCP Bill to include a set of provisions requiring credit providers (and debt collectors) to commence proceedings against debtors in the jurisdiction in which the debtor resides (or in which the contract was made if the debtor's residence is unknown), enabling debtors to object to proceedings issued in an incorrect jurisdiction and to obtain a stay automatically with the credit provider required to pay any costs of the debtor in making that application, and carrying penalties for non-compliance enforceable by ASIC.

Amend the NCCP Bill to include provisions enabling a debtor to make an application under the small claims procedure even after related proceedings have been commenced in another Court and enabling the small claims procedure court to issue a stay on the related proceedings which the other Court must abide by.

Amend the table in section 199(2) of the NCCP Bill to enable access to the small claims procedure for orders under sections 177 and 178 of the NCCP Bill and orders under National Credit Code sections 37, 38(7), 76, 78, 106, 107(3), 108 and 118 without monetary limits.

The Government should commit to amending the national consumer credit legislation to retain a small claims procedure in the Federal Court once the Federal Magistrates Court is dissolved.

Administration

We support the inclusion of section 245 in the NCCP Bill, which provides that the operator of an approved EDR scheme may give information to ASIC about a person becoming or ceasing to be a member of the scheme.

In our submission to the draft legislation in May, we noted that it can be difficult for an EDR scheme to deal with non-compliance by a member of its scheme, as ultimately it would have to enforce its decisions through the courts as a contractual matter. In addition, such enforcement action can have the effect of undermining the relationship between the EDR scheme and its members. We therefore recommended that EDR schemes should be required to report to ASIC on key events which may impact on a licensee's ongoing eligibility for a licence.

Section 245 goes some of the way to address this issue but only provides for an EDR scheme to report on the key event of a person ending membership of the scheme. We recognise that this would be directly relevant to the general conduct obligations of licensees under section 47 of the NCCP Bill, however, other events relating to participation in an EDR scheme are also relevant to licensees' conduct obligations and section 245 should empower EDR schemes also to report these to ASIC. Such events include non-payment of amounts due and failure to comply with determinations, decisions, directions or requests for information from the EDR scheme. These would indicate that a licensee is not engaging in credit activities efficiently, honestly and fairly, for example.

In addition, section 245 only provides that an EDR scheme operator *may* give the listed information to ASIC, but does not require it. The problem that EDR scheme action can undermine the scheme's relationship with its members is not resolved, because decisions made under this section to communicate information to the regulator remain voluntary, putting unnecessary pressure on EDR schemes to justify decisions to members.

Recommendation

Amend section 245 of the NCCP Bill to require, not merely enable, the operator of an approved EDR scheme to give the information listed in the section to ASIC, and expand the information listed to include matters relating to a licensee's non-compliance with the EDR scheme rules and requirements.

Hardship

The Consumer Credit Legal Centre (NSW) has made detailed submissions regarding the issue of borrowers in financial hardship and the improvements that need to be made to the NCCP Bill to address current inadequacies in the way in which lenders are allowed to respond. We strongly support these submissions.

Consumer Action agrees that addressing hardship is not an issue that arises due to the current economic conditions, although it can of course be exacerbated by such conditions. Even a few years ago, at the height of prosperous economic times, Consumer Action fielded regular requests for help from consumers suffering financial difficulties and struggling to maintain repayments on a home loan and/or other credit arrangements. Sometimes lender conduct contributes significantly to whether such cases can be resolved and the consumer placed "back on track" or simply to whether the consumer can exit the arrangements (for example by selling their home to repay the credit) without unnecessary stresses, pressures and while maintaining dignity.

The National Credit Code re-enacts and improves on the current Code provisions enabling a debtor to seek a temporary variation to repayment arrangements on the grounds of hardship - a hardship variation. We support the changes to increase the threshold amount contract value under which debtors have the right to seek a hardship variation to $500,000 (National Credit Code section 72(5)) and the provisions requiring a lender actually to respond to a hardship variation request and to do so within a specified time frame, rather than simply allowing lenders to ignore such requests as is currently the case (National Credit Code sections 72(3)-(4)).

However, the provisions remain inadequate to ensure credit providers deal appropriately with consumers in hardship. First, the new threshold noted above will not apply to credit contracts made before the national laws come into force,[30] even though credit contracts can run for many years (25-30 years for standard home loans) and hardship is an issue that arises sometime after the credit contract is first made. We agree that it would be inappropriate to apply the new provisions retrospectively to hardship variation applications made before they came into force, but we do not see why the new provisions should not apply to hardship variation applications made after the new laws are enacted.

We also note that the licensing provisions in the NCCP Bill will not to apply in relation to existing contracts, meaning that lenders or debt collectors managing only an existing portfolio of loans but not taking on new loans will not be covered, including not having to join an EDR scheme.[31] This will impact significantly on consumers trying to manage a dispute with, or seek a hardship variation from, such a lender. Such disputes do occur, for example the Consumer Action case described in footnote 22 above related to a lender managing existing loans but no longer making new loans, and we received over 100 complaints from other consumers regarding this same lender once this initial case was publicised.

However, in addition to these transitional issues, the Consumer Credit Legal Centre (NSW) has identified several other changes that must be made to the substantive requirements under the provisions. These include requiring the lender not only to respond to hardship variation applications within a certain time frame, but actually to give reasons for any rejection of an application, and providing for a more flexible range of options for varying the repayment arrangements than the three narrow options currently listed. Of course lenders can always voluntarily agree to more flexible variations than the three options listed in National Credit Code section 72(2), but lenders could agree to hardship variations generally without any provisions being included in the law. The purpose of the legal provisions has always been to enable a

[30] National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009 Schedule 1 items 3(2), 3(3)(e) and 3(5).
[31] National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009 Schedule 1 item 18.

consumer to apply to the court for an order for a hardship variation where lenders do *not* reasonably negotiate, not where they do, and the court is limited to ordering one of the options listed. Note that it is not only fringe lenders who do not always respond appropriately to reasonable hardship variation requests but major lenders (and their debt collectors) as well.[32]

Recommendations

Amend the National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009 to ensure the new hardship variation and licensing requirements in the NCCP Bill apply to existing contracts.

Amend sections 72-74 of the National Credit Code in the NCCP Bill to implement the other changes recommended by the Consumer Credit Legal Centre (NSW), including to require lenders to consider hardship variation applications reasonably and in good faith and to give reasons for rejecting a hardship variation application as part of their response under National Credit Code section 72(3)(b), to provide for more variation options under National Credit Code section 72(2) and to ensure all default and enforcement fees from the date of the application to the lender are waived if the application is successful under either section 72 or 74.

National Credit Code

The National Credit Code largely re-enacts the current Code as Federal law, save for some specific amendments as explained in the EM.[33] Consumer Action welcomes the amendments made to reflect improved protections, including the amendments to raise the threshold for access to hardship variations and to address several fringe lending practices that had been previously agreed by the States and Territories, including to prohibit mortgages over essential household property and to narrow the pawnbroking exemption to genuine pawnbroking transactions. We also support the provisions enabling ASIC to make an application to review unjust transactions or unconscionable interest and other charges in relation to one or more contracts if the regulator considers it is in the public interest to do so.

Time limit - section 80

This section imposes the time limit for bringing an action in relation to an unjust transaction under section 76. A consumer must bring an application for a review of an unjust transaction before the end of two years after the relevant contract comes to an end.

We agree that, for the most part, this is a reasonable time limit. However, it creates a specific problem in the case of equity stripping achieved by multiple refinances.

"Equity stripping" is the refinancing of a loan secured against residential property in which the consumer still has equity, in other words, owes less than the likely sale price of the home, but where the consumer is struggling financially to make repayments and is unlikely to be able to

[32] See, eg, Consumer Action, 'Major bank outsources its responsibility for financial hardship to notorious debt collector', *Media Release*, 14 October 2008; Consumer Action, 'Citibank lacks compassion for client after taking legal action over $10,000 debt', *Media Release*, 20 February 2009.

[33] *National Consumer Credit Protection Bill 2009: Explanatory Memorandum* , above n13, p240.

maintain repayments under the refinanced loan. This practice is often facilitated by short-term loan contracts that provide for interest-only payments, sometimes with all or part of the interest pre-paid (capitalised). At the end of the loan term (often 12 months), the borrower has no choice but to sell the property or refinance. Where multiple refinances occur prior to the equity in the home being depleted, the two year time limit will often have expired by the time the consumer seeks help or advice (usually in relation to a statement of claim received in relation to the last loan in the chain). The same effect is brought about by multiple refinancing of longer-term loans, where the borrower has not been properly assessed for capacity to repay and immediate financial difficulties have been resolved by refinancing.

Consumer Action has seen many examples of borrowers who have started with a mainstream loan and have then refinanced 2-4 times every 1-2 years with non-conforming lenders who have a higher appetite for risk (and thus higher prices) until the equity in the property has been exhausted. While this problem may be addressed somewhat by the six year time limit for the new responsible lending conduct provisions, there may be other aspects of unjustness covered by section 76 but not included in Chapter 3 of the NCCP Bill.

Recommendation

Amend section 80 of the National Consumer Credit Code to provide for a time limit of either two years after the relevant contract has been rescinded, discharged or otherwise comes to an end or within six years of the day the relevant contract was entered into or changed, whichever is the later (in line with the time limit for applications for compensation orders under sections 178-180 of the NCCP Bill).

Exemption for lawyers - solicitor lending

Schedule 2 item 42 of the National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009 allows for regulations to be made exempting a person or class of persons, or a credit activity or class of credit activities, from various provisions.

While final regulations to be made under this provision are not available, the draft regulations released for consultation in April 2009 proposed a very broad exemption for activities engaged in by lawyers.[34]

While an ordinary legal advice or opinion to a client about a particular loan that the client is considering entering into falls within the type of activity that might reasonably be exempted, a number of law firms are actively involved in arranging loans. In these solicitor loan arrangements, money is lent to consumers on behalf of individual clients, or on behalf of a lending body, which may have a relationship with the lawyer or law firm.

A 2004 report for Consumer Credit Legal Service (Vic) found that, most commonly, solicitor lending arrangements included situations where:

[34] Draft National Consumer Credit Protection (Transitional and Consequential Provisions) Regulations 2009 reg.5.2, available at www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1523.

- a solicitor facilitates or brokers a loan between an individual client (or a client's company) and a borrower (this is distinguished from the situation where the solicitor merely provides advice and/or draws up documentation for a loan that has already been agreed in principle between the parties);

- a legal practice pools funds from a number of clients, holds those funds on trust, and establishes loans between the borrower and investor clients, with the clients recorded on the documents as the mortgagees and credit providers;

- a legal practice pools investor funds for lending, again holding those funds on trust, and the solicitor's nominee company is the mortgagee and credit provider;

- a legal practice is very closely associated with a responsible entity that operates a mortgage investment scheme, seeking and pooling investor funds and managing the loans that are provided by the scheme (this situation occurs in a number of firms that had large mortgage practices and then transferred the mortgage management to a separate company when the *Managed Investments Act 1998* (Cth) came into effect); or

- a lawyer or legal practice lends funds directly to individuals or businesses.[35]

The report also found that solicitor lending could cause severe problems for consumer borrowers, with the family home often at serious risk if the borrower is unable to meet monthly interest payments or unable to repay the principal when it is due (in a lump sum).

Case Study - solicitor lending

Consumer Action recently represented Edna (name changed), who was in her late 70s. Before Edna's husband died, aged 97, he had been manipulated by their son, who had convinced his father to obtain a $200,000 loan for his benefit.

This loan had been secured by a mortgage on the family home, and the repayments exceeded the father's pension. At the date of the loan, Edna's husband was 93. The son had made the initial contact with a broker and it appears that the broker was aware of the circumstances. The broker submitted the loan application to a solicitor lender. A law firm acted in the role of the lender, representing a lending business which was apparently owned by the law firm. The law firm and lending business may not have been fully aware of the circumstances, but the age of the borrowers alone should have led to further enquiries by them. The lender referred Edna's son and husband to an accountant (to verify that the borrower could afford the loan) and to another solicitor (to verify that he understood the loan). Edna's son failed to pay the loan and the lender owned by the law firm took legal action to sell Edna's home for an amount exceeding $300,000.

Solicitor loans are usually interest-only, fixed-term (normally 1-5 years) loans, secured by a first mortgage, and are high risk for consumer borrowers. We therefore strongly urge the Committee to recommend that only a limited exemption for lawyers be provided for in the regulations to be

[35] Nicola Howell, *Solicitor lending to consumers: a study of interest only loans and asset-based lending practices in Victoria*, Consumer Credit Legal Service Inc (Vic), September 2004.

made under the legislation, one that does not exempt solicitor lending arrangements listed above from the consumer credit legislation.

Recommendation

Recommend to the Government that its regulations to be made under the consumer credit legislation not exempt solicitor lending credit activities from the legislation.

Exemption for point-of-sale retailers

In introducing the NCCP and related bills into parliament, the Government announced that "point-of-sale retailers" that facilitate credit assistance to consumers, being retail outlets and intermediaries such as car dealerships and other point of sale retailers, will be made exempt from the legislation under regulations, with a review of the appropriate regulatory oversight for point-of sale retailers providing credit assistance to occur within 12 months.[36]

This is unreasonably broad. Point-of-sale retailers have become a significant feature of the consumer credit market and are one of the major channels through which consumers are directed to loan or lease contracts. For example, we understand that for some car retailers profit margins are generated primarily from the sale of finance to the customer to purchase a vehicle, not from the sale of the vehicle itself. As another example, major retailer Harvey Norman's annual report for 2008 indicates significant consumer financing operations.

More importantly, retail sales staff in many stores do not merely provide consumers with general advice about different ways to finance the purchase of an item, they suggest particular credit or lease contracts and particular credit providers. The advertising of particular contracts and particular credit providers is commonplace in Australian retail outlets today.

Further, point-of-sale retail is a broader category than established retail outlets or stores. For example, in our experience we have seen considerable consumer problems relating to loans consumers have been placed in through attending Henry Kaye property investment seminars, being visited in their homes by door-to-door sellers selling maths educational software and attending high pressure timeshare sales seminars.

Retailers providing only basic general advice will not be covered by the legislation, thus we do not see the need for this exemption. To exclude all point-of-sale retail situations not only ignores modern consumer credit market realities, it denies important protections to consumers and provides a very large avenue for avoidance.

Recommendation

Recommend to the Government that its regulations to be made under the consumer credit legislation not provide an exemption from the legislation for point-of-sale retailers.

[36] Minister for Financial Services, Superannuation and Corporate Law, The Hon Chris Bowen MP, ' National Consumer Credit Protection Reform Package', *Media Release*, 25 June 2009.

Thank you for the opportunity to make submissions on these important bills. Please contact us on 03 9670 5088 or at nicole@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE

Carolyn Bond
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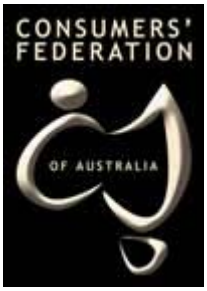
Director - Policy & Campaigns

Appendix A



Consumer issues in the implementation of a national consumer credit law

Briefing paper: Ensuring access to justice

Prepared by Nicola Howell, Associate Lecturer, QUT School of Law

1. Executive summary

Under the new Commonwealth consumer credit regulatory regime, consumers must have viable and realistic access to the court system.

For this to occur, there must be access to a judicial venue that is low-cost, flexible, informal, specialist and not overly legalistic. This includes protection from the risk of adverse costs orders, which have a chilling effect on the initiation of legal action by consumers.

Some jurisdictions have established such venues in the form of specialist consumer tribunals, notably New South Wales and Victoria, meaning that the majority of Australian consumers currently have realistic access to the court system to resolve consumer credit disputes. However, it is unlikely that state and territory consumer tribunals will be able to continue to hear credit disputes under the new Commonwealth laws.

Unless such a judicial venue is established at the federal level, the only alternatives to the industry-based external dispute resolution (EDR) schemes will be the Federal Court and/or Federal Magistrates Court, or the state and territory Courts. None of these venues currently provide an affordable jurisdiction for consumer credit claims.

Improved access to EDR schemes is welcome, but a gap will remain if the state tribunals no longer have jurisdiction over consumer credit matters.

The following principles should therefore be adopted in the implementation of the new national consumer credit law:

> **Principle 1:** Consumers should have access to a low-cost jurisdiction that can hear and determine claims under the consumer credit legislation. This must be achieved by developing a no-cost division in the Federal Magistrates Court or Federal Court for consumer credit claims.

Principle 2: It should be clarified, legislatively if possible, that EDR schemes have the power to determine the broadest range of disputes possible, including applications to vary the terms of a contract under s 68 of the Consumer Credit Code. ASIC's Regulatory Guide 139 should also be amended to ensure that these disputes are included in the terms of reference for the relevant schemes.

Principle 3: Regulators should be given standing to take consumer credit matters to a tribunal or court on behalf of consumers, including claims under sections 70 and 72 of the Consumer Credit Code.

Principle 4: State and Territory legislation should provide for a stay of debt recovery proceedings on application to an EDR scheme and/or consumers should have the ability to apply to the State/Territory to transfer proceedings to the low cost tribunal having consumer credit jurisdiction. ASIC's Regulatory Guide 139 should also be amended to make it clear that schemes can restrain members from commencing or continuing with enforcement proceedings once a complaint to an EDR scheme is made.

2. Access to justice in consumer credit matters

Under the proposed new Commonwealth consumer credit regulation, consumers will have access to industry-based EDR schemes to resolve most consumer credit disputes with credit providers.

This is a welcome improvement to current arrangements. However, effective access to the judicial system will remain a vital compliment to more widespread access to EDR schemes. EDR schemes were never intended to replace access to the court system but to provide consumers with an alternative to the formal court system for resolving disputes. Further, there are some functions that EDR schemes cannot fulfil and the existence of realistic judicial alternatives actually increases confidence in, and strengthens, the operation of EDR schemes.

Access to a low or no cost judicial forum for consumer credit disputes is essential to ensure that consumers can, in practice, take disputes through the judicial system where appropriate. With the transfer to federal regulation of consumer credit, it is unlikely that low cost state tribunals will be able to continue to hear consumer credit disputes. It is therefore critical that a low/no cost judicial forum be established at the federal level to handle consumer credit matters.

3. The need for a low cost judicial forum

For low-value consumer disputes, the traditional court system is an inappropriate venue for resolving disputes. In the majority of cases, the costs of litigation would outweigh any potential benefit from a successful claim; in fact, in many cases the court filing fees alone may be prohibitively high in comparison with the amount claimed.[37] In addition, there is the risk of an adverse costs

[37] The current fee for filing a document commencing a general proceeding in the Federal Court is $785 for natural persons (although some people are exempt from paying fees, such as if they hold a pensioner or health care card, and the Registrar can waive the filing fee if satisfied that payment of the fee would cause the person financial hardship). The equivalent filing fee in the Federal Magistrates' Court is currently $374, with similar exemption and fee waiver provisions. By contrast, for example, the current filing fee for consumer credit applications by debtors at the Victorian Civil and Administrative Tribunal is $35.20 (this fee may also be waived if it would cause financial

order if a claim is unsuccessful. Without alternative mechanisms for resolving disputes, many consumer disputes would simply go unchallenged.

In recognition of these barriers to accessing justice, specialist consumer tribunals have been established by the State or Territory governments in a number of Australian jurisdictions. These include the Victorian Civil and Administrative Tribunal and the Consumer, Trader and Tenancy Tribunal (in NSW).

Under the various Consumer Credit Acts, these tribunals are given jurisdiction to hear consumer claims under the Consumer Credit Code, including:

- an application to vary a contract on the grounds of hardship under section 68
- an application for an unjust transactions to be re-opened under section 70
- an application for a annulment or reduction of an unconscionable fee or charge under s 72
- an application to postpone enforcement proceedings under section 88.

Advantages of a specialist consumer credit tribunal (or specialist list in a general consumer tribunal) over the traditional Court system include:

- lower filing fees;
- much lower, if any, risk of an adverse costs order being made;
- cases are heard by a member with expertise in consumer credit legislation;
- proceedings are more flexible and informal;
- formal evidence rules are relaxed;
- alternative dispute resolution mechanisms are used;
- legal representation is limited or excluded, and self-representation a right;
- matters can proceed in a more timely manner.[38]

These benefits are, of course, often found in EDR schemes. However, an accessible judicial forum is needed to complement EDR. In jurisdictions that do not have a specialist consumer tribunal, proceedings under the Consumer Credit Code are heard by a court (for example, the Magistrates Court in Queensland for disputes under $50,000). Consumers in these jurisdictions have been noticeably disadvantaged by the lack of access to a low or no cost jurisdiction. While the numbers of consumers who take legal action in relation to consumer credit matters is relatively low, the number of such legal actions in jurisdictions without a specialist low cost jurisdiction is negligible. Further, the majority of the important legal precedents in the consumer credit area, which are relied upon by EDR schemes in resolving consumer credit disputes, arise from Victorian or New South Welsh cases that were commenced in the low cost tribunals.

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hardship). Note that the filing fee for a human rights application with the Federal Court or Federal Magistrates' Court is only $50.

[38] See generally, "The role of VCAT in a changing world: the President's review of VCAT" Speech delivered to the Law Institute of Victoria 4 September 2008 by Justice Kevin Bell – President, VCAT http://www.vcat.vic.gov.au/CA256902000FE154/Lookup/Media/$file/speech_the_role_of_VCAT_in_a_changing_world.pdf.

4. Access to industry-based EDR schemes is not a complete solution

Industry-based EDR schemes, such as the Financial Ombudsman Service (FOS), were established as another level of accessible dispute resolution for consumers and small business. These schemes were initially established to differentiate particular industries and, in some cases, to avoid further regulation that may have been imposed to address consumer concerns. Funded by industry, these schemes depend on public confidence. A key element that ensures ongoing confidence is that the schemes' decisions are not binding upon the consumer, and that the consumer is free to reject the decision and have the dispute heard in the legal system.

The EDR schemes will continue to exist when the Consumer Credit Code is implemented as Commonwealth law. With the proposed introduction of a licensing obligation to join an ASIC-approved EDR scheme, all consumers will have access to an EDR scheme for consumer credit disputes. This is a very welcome development.

The EDR schemes will remain an important option for resolving consumer credit disputes when the Consumer Credit Code is implemented as Commonwealth law. Consumer advocates also strongly support improving the accessibility of EDR. In particular, EDR schemes should be able to determine matters of law, for example, applications for financial hardship variations.

However, access to an EDR scheme is not sufficient. Once all credit providers have joined an EDR scheme, it will still be critically important that consumers retain a realistic option to take proceedings to a body that is formally part of the legal system, for the following reasons:

1. EDR schemes cannot determine the law or create precedent

   - EDR schemes focus on resolving disputes; they do not determine the law.

   - EDR schemes cannot develop the law, or make decisions that bind future decisions of the scheme; other schemes; or the courts.

   - In the consumer credit arena, important recent decisions of the State Tribunals include *Director of Consumer Affairs v City Finance Loans (Credit)* [2005] VCAT 1989 (30 September 2005); and *Lewis v Ormes (Commercial)* [2005] NSWCTTT 481 (18 July 2005). These and other cases can provide useful statements on the interpretation of the law, and can then be used by the EDR schemes in their resolution of disputes. Litigated cases can also highlight inadequacies with the law, which can then be used to agitate for law reform. Unlike many areas of law, consumer disputes are subject to alternative dispute resolution processes to such an extent that there is often inadequate guidance for the Courts and the EDR schemes.

   - Relying simply on EDR schemes to resolve disputes provides limited guidance for future development of the law. The strength of EDR schemes has always been in their existence as an alternative to the judicial system, not as a replacement for viable access to courts. Of course, properly constituted EDR schemes can and sometimes do issue Guidelines in relation to commonly occurring problems, which advise how the scheme proposes to approach similar cases. While such Guidelines constitute good practice by EDR schemes and provide useful and transparent guidance for scheme members and consumers, they do not have the same impact as tribunal decisions because they are not

judicial considerations of legal questions and, in fact, EDR schemes generally use judicial decisions to inform their Guidelines.

2. As a matter of principle, consumers should be able to access the formal legal system for determination of the law

- Judicial adjudication of legal issues is a public function, and access to this function should be open to all. EDR schemes are private arrangements, and their existence does not obviate the obligation of the government to provide public judicial services.

- The establishment of EDR schemes was a development intended to increase, not limit, consumer access to justice. In addition, where a case involves a matter of public interest, it can be appropriate to have the matter publicly ventilated, and to seek a precedent. Otherwise, the court system is accessible only by corporations or the very rich, which is not only generally unfair but also inevitably skews judicial outcomes in favour of the interests of such parties over time, as only they have the ability to determine which cases are taken to court and these cases go on to set the relevant precedents in the area.

3. EDR schemes do not have jurisdiction over all potential consumer credit matters:

- The EDR schemes have limits on the types of disputes that they will consider, including monetary limits. A consumer with a dispute above the monetary limit cannot have their full matter resolved by the EDR scheme.

- Some EDR schemes (including FOS and the Credit Ombudsman Service Limited) have determined that they have no powers to order a hardship variation under s 68 of the Consumer Credit Code. Thus, if a credit provider refuses a variation request under s 66 of the Code, but has followed an appropriate *process* in considering the request, some EDR schemes will not be able to resolve the matter.

- EDR schemes retain a power to determine that a matter falls outside the terms of reference for the scheme because it is a matter that is more appropriately dealt with by another body, including a court or tribunal. In particular, where there is an evidentiary conflict between the parties, the EDR schemes will often determine that the matter falls outside their terms of reference.

- Some EDR schemes will not consider a hardship application after a Statement of Claim for possession of property has been filed. Thus, if access to the tribunals is removed, consumers would have to lodge a claim in a Court.

- Generally, EDR schemes do not have oral hearings, or capacity to take oral submissions from consumers. Some EDR schemes are beginning to develop procedures to consider oral evidence, however, they have so far been reluctant to use them and often determine that the need to consider oral evidence means a case is more appropriately dealt with by a court or tribunal. Further, no tradition and culture surrounds the use of procedures for considering oral evidence by EDR schemes to ensure their fairness and effectiveness as in a court or tribunal system.

- Civil penalty applications under the Consumer Credit Code cannot be heard by the EDR schemes.

- EDR schemes have no capacity to deal with representative claims, or for the regulator to bring an action on behalf of an individual (as is currently the case in some jurisdictions).

- EDR schemes have no jurisdiction to consider matters once judgment has been entered in Court. In contrast, in cases of unjust transactions for example, consumers can make an application in a court or tribunal for judgment to be set aside, and the transaction re-opened.

- Some EDR schemes require consumers to go through an internal dispute resolution process before the scheme will consider the dispute. In many cases this is appropriate, however, in some cases this requirement is inappropriate and leads to unreasonable delays, and dissuades consumers from taking the matter further.

While some of these problems could be resolved under the new Commonwealth consumer credit laws, others cannot.

Further, there is a risk that by conferring more and more functions on EDR schemes, their core role as a free and accessible dispute resolution service will be placed under pressure. There is a limit to what should realistically be expected of EDR schemes to deliver.

4. EDR schemes cannot make determinations involving non-members

- For example, in linked credit matters, the consumer may have a complaint against both the credit provider (a member of an EDR scheme) and the original service provider (not a member of an EDR scheme), such as in relation to unfair conduct in the sale of a car and the related finance.

5. EDR processes are not always quick

- EDR schemes receive a large volume of complaints. At some schemes the "waiting list" for a complaint to be considered is now very long and, in many cases, dispute resolution through an EDR scheme takes months or years simply because of the scheme workload.

- There are some cases for which a tribunal is a better option for consumers, particularly in relation to urgent matters and/or matters in which costs such as interest are continuing to accrue while a dispute is being determined. Relatedly, costs can increase substantially whilst a matter is being considered by an EDR scheme. Delays in credit/debt matters can increase the amount of interest payable and in some cases can place assets such as a home at risk. In contrast, issuing proceedings in a court or tribunal can encourage quicker settlements.

6. A viable judicial alternative provides for more effective and accountable EDR schemes

- As noted above, EDR schemes cannot determine the law and must rely on legal precedents set in the court system for the resolution of disputes. If only an expensive

court forum is available as an alternative, consumers are unable to take the sorts of legal actions that can assist in determining and developing the law.

- The existence of a viable judicial alternative can enhance the accountability mechanisms that maintain high quality EDR and encourage some credit providers to co-operate with the EDR process. Conversely, if consumers have no realistic alternatives to the EDR schemes, the pressure on schemes to ensure accountable decision-making will be reduced. At the same time, credit providers will feel less pressure to act responsively in the EDR process if there is no alternative venue for consumers realistically to pursue their complaint.

- Also as noted above, EDR schemes depend on public confidence in their processes and decisions, which is supported by the non-binding nature of their decisions upon the consumer and the consumer's ability to reject the decision and have the dispute heard in the legal system. A lack of any realistic alternative will damage this confidence.

5. Access to the State and Territory Courts is not a complete solution

The vesting of concurrent jurisdiction in State and Territory Courts would not resolve the need for consumer access to a low-cost consumer credit judicial forum. As with the Federal Courts, State and Territory Courts are also unrealistic options for consumer disputes. The number of consumers who initiate consumer credit matters is small but important in those States that currently have a specialist consumer credit tribunal, but negligible in other jurisdictions that currently vest jurisdiction in the ordinary court system.

This problem is illustrated in home mortgage foreclosure disputes. These are already issued by lenders in State Supreme Courts, however, it is simply unrealistic to expect a consumer with a legitimate hardship variation claim to also defend and counter-issue on this question in the expensive Supreme Court jurisdiction. In states with a specialist tribunal, these matters are currently able to be routinely transferred to the tribunal to determine.

While not all States and Territories currently have specialist consumer tribunals, the majority of Australian consumers do currently have access to these tribunals for consumer credit disputes. A low/no cost consumer credit jurisdiction is needed at the federal level to maintain this realistic access to the court system for consumers.

An alternative might be to vest jurisdiction under the credit legislation to the State and Territory consumer tribunals (in those jurisdictions that have tribunals). However, this would not be constitutionally valid unless the tribunals can be considered 'courts of the State' which is far from certain. In addition, this option misses the opportunity to increase access to justice in those jurisdictions that do not currently have a consumer tribunal and suffer for it.

6. What is needed in the Commonwealth consumer credit law

To ensure access to justice for consumers, viable and realistic access to the court system must be maintained under Commonwealth consumer credit regulation. For this to occur, there must be access to a judicial venue that is low-cost, flexible, informal, specialist and not overly legalistic. In

addition, consumers need to have protection from the risk of adverse costs orders – these have a chilling effect on the initiation of legal action by consumers.

Until now, at least in some jurisdictions, this venue has been the specialist consumer tribunals. However, with the transfer of consumer credit regulation to the Commonwealth, it is likely that the various State and Territory Consumer Tribunals will no longer have jurisdiction to hear matters under the consumer credit legislation.

The only alternatives to the EDR schemes will then be the Federal Court and/or Federal Magistrates Court, or the State and Territory Courts if vested with concurrent jurisdiction. As currently structured *none of* these venues provide an affordable jurisdiction for consumer credit claims. If an alternative is not provided, for many consumers the benefits arising from increased EDR coverage could be offset by the loss of an accessible judicial forum.

The following principles should therefore be adopted in the implementation of the new national consumer credit law:

> **Principle 1:** Consumers should have access to a low-cost jurisdiction that can hear and determine claims under the consumer credit legislation. This must be achieved by developing a no-cost division in the Federal Magistrates Court or Federal Court for consumer credit claims.[39]
>
> The benefits from the consumer credit matters determined in the judicial system flow far beyond the small number of individual consumers directly affected by those cases. In particular, they play a critical role in setting precedents which guide both industry practice and EDR scheme decisions. This is especially important in the consumer credit area, in which there are relatively few legal precedents, particularly around issues of what is reasonable conduct in given factual situations.
>
> Access to a low-cost jurisdiction would not prevent the majority of consumer disputes from continuing to be determined by the EDR schemes. Even in those states that currently have specialist low-cost tribunals the vast majority of consumer credit disputes are taken to EDR schemes where this option is available. However, where it is appropriate for a matter to be determined in the court system, this can only occur if the consumer has a practical option for accessing that system.
>
> Low filing fees are a crucial element of an accessible court forum. High court filing fees are not necessary to discourage consumers from taking court action inappropriately, given that almost all consumers with consumer disputes approach the free EDR schemes. Instead, high court fees discourage the small number of complaints that might more appropriately go through the court system. Further they tend to discourage only those complaints from low-income or vulnerable consumers who cannot afford the fees.
>
> A low, if any, risk of an adverse costs order is also a critical element of an accessible court forum. It is difficult to overstate the effect that a risk of an adverse costs order has on a consumer's willingness to take a consumer dispute to court. Particularly in the consumer credit field, where people are often already in financial difficulties and at risk of costs such as

[39] The low fees for making a human rights application provide a precedent for lower filing fees, and section 17 of the *Independent Contractors Act 2006* provides a precedent for a no adverse costs rule, in the Federal Court or Federal Magistrates' Court.

interest accruing, the risk of further costs being incurred through an unsuccessful action is a major deterrent to challenging lender conduct. If a home is at risk, the deterrent effect of potential costs orders is even greater.

Consumers tend to be reluctant to challenge a lender's negative response to their requests, for example to vary repayment arrangements due to hardship or to limit an excessive fee. Without court oversight of such conduct there is likely to be a negative impact on industry practices.

A federal jurisdiction for consumer credit matters must have low upfront access costs, including waivers for low-income consumers, and must carry little to no ability for adverse costs orders to be made. This is especially the case for important consumer disputes such as those involving hardship variations, applications for unjust transactions to be re-opened, challenges to unconscionable fees or charges and applications to postpone enforcement proceedings.

Principle 2: It should be clarified, legislatively if possible, that EDR schemes have the power to determine the broadest range of disputes possible, including applications to vary the terms of a contract under s 68 of the Consumer Credit Code. ASIC's Regulatory Guide 139 should also be amended to ensure that these disputes are included in the terms of reference for the relevant schemes.

Principle 3: Regulators should be given standing to take consumer credit matters to a tribunal or court on behalf of consumers, including claims under sections 70 and 72 of the Consumer Credit Code.

In Victoria this is already the case. Recent legislative amendments have given the regulator the authority to institute and defend proceedings on behalf of consumers in all matters under the Consumer Credit Code.[40] The Victorian Government has also supported a recommendation that the regulator should have the ability to bring proceedings in its own right involving multiple or a class of contracts under sections 70 and 72 of the Code, and the Victorian Government is committed to progressing this issue nationally.[41]

Principle 4: State and Territory legislation should provide for a stay of debt recovery proceedings on application to an EDR scheme and/or consumers should have the ability to apply to the State/Territory Court to transfer proceedings to the low cost federal jurisdiction having consumer credit jurisdiction. ASIC's Regulatory Guide 139 should also be amended to make it clear that schemes can restrain members from commencing or continuing with enforcement proceedings once a complaint to an EDR scheme is made.

March 2009

[40] *Credit (Administration) Act 1984* (Vic) s.13, inserted by *Consumer Credit (Victoria) and Other Acts Amendment Act 2008* (Vic) s.26.
[41] Consumer Affairs Victoria, *Government Response to the Report of the Consumer Credit Review*, 2006, pp 14, 37.