



**A Principled Approach to the
Review of Australia's Consumer
Policy Framework**

June 2007

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Executive Summary

It is time to reshape Australia's consumer policy framework to deal with the opportunities and challenges that consumers face in the 21st century. Our consumer policy framework has delivered many benefits to consumers over the last few decades, but it is increasingly ill-equipped to deal with contemporary market issues. The policy framework has not kept pace with the growth in services, with technological innovation, and with advances in understanding about consumer decision making and behaviour. Too often policies impose costs on businesses without improving market outcomes. Too much of the legislation that ensures the health of consumer markets in Australia is out of date. It is time to modernise Australia's consumer policy framework.

If we are to improve Australia's consumer policy framework for both consumers and businesses, then a first step is moving beyond tired and unhelpful rhetoric that sees markets and regulation in opposition. Efficient, well functioning markets are underpinned by well designed regulation that takes into account the specific features of each market. We want as little regulation as possible, but as much as is necessary to achieve competitive markets and confident consumers.

It is time to put consumers at the heart of market reforms across all sectors of the economy. This will require *national* leadership on consumer policy issues, rather than fragmentation across different levels of government, and fragmentation across different industry sectors. At present there is an unproductive "silo" approach to consumer issues across different portfolios – financial services, health, product safety, telecommunications, energy, food and so on. This contrasts with the approach found in the UK and other parts of Europe and North America, where a coherent cross-market approach to consumer policy and competition policy can be found.

There are great opportunities to improve the consumer policy framework. We can draw on advances in consumer research and economics, as well as innovative approaches by government agencies, consumer organisations and industry participants. This will improve our understanding of consumer markets and allow us to refresh our policy toolkit to address current market developments.

CHOICE's submission sets out a range of policy recommendations that will improve the policy framework. These recommendations, if taken up, will improve the performance of agencies responsible for consumer policy and consumer protection in markets. They will improve our research and analytical capacity, so that policies can be better targeted at significant consumer detriment without imposing excessive costs on business.

The policies CHOICE has proposed will improve the ability of consumers to play their part in activating market competition by ensuring that they can make better decisions and act with confidence. They will help those consumers who are more vulnerable in the face of market problems. They will help ensure that those businesses that respond to consumer needs find it easier to operate while those businesses that give consumers a bad

deal can be more readily identified and driven out of the market. The policies will improve consumer trust in the marketplace, and reduce transaction costs.

Economic research is demonstrating that confident consumers are fundamental to innovative and competitive markets. We have the opportunity to create a policy framework that helps ensure that consumers can understand the consequences of their choices and decisions both on their own wellbeing and more broadly on our shared environment.

Recommendations

Note: Our recommendations do not appear in this order in the body of this submission – the section of the submission in which they appear is noted in parentheses.

Develop a National Consumer Strategy

1. A 5 year consumer strategy should be developed by the Federal government with the clear aim of putting consumers at the heart of market and competition reforms (Section 1.3).
2. Consumer Affairs should be given Ministerial status within the Commonwealth government. The Consumer Affairs Portfolio should be combined with responsibility for competition policy to ensure that both demand and supply side competition issues are considered together, and to make the important link between consumer policy and core economic portfolio responsibilities (Section 3.1).
3. The development and administration of consumer policy should be a federal responsibility. The current split of consumer policy responsibilities between federal and state and territory governments should be significantly rewritten so that consumer policy primarily operates at the national level (Section 3.1).
- 3A The National Consumer Strategy should articulate principles for ensuring that best practice consumer policy and consumer regulation is adopted across all industries (Section 4.2).
- 4 The Commonwealth should significantly increase the resources allocated to consumer policy development and regulatory agencies (Section 3.1).

Reform the Trade Practices Act and equivalent regulation

5. A package of reforms to the *Trade Practices Act* and equivalent legislation should be implemented to modernise consumer and competition regulation so that regulators have the tools to make markets work better. This includes powers to eliminate unfair contract terms and unfair practices and outlaw practices that reduce demand side competition (Sections 4.1).
6. Commonwealth and State/Territory enforcement agencies should each be given a consistent set of powers to:
 - ask a court to impose civil pecuniary penalties,
 - issue cease and desist orders,
 - require substantiation of claims,
 - issue ‘show cause’ and cease trading’ orders,
 - obtain a court order to compensate a class or group of consumers where a trader is found guilty of an offence or contravention of a statutory prohibition,
 - obtain a court order for disgorgement of illegally obtained profits, and

- ask a court to establish a trust to hold on behalf of consumers any unclaimed monies from disgorgement or class compensation orders (Section 5).
7. Disclosure requirements in industries such as financial services should be reduced and simplified once the reforms as recommended in this submission are in place (Sections 2.5 and 4.1).
 8. State-based regulation should be reviewed once the reforms as recommended in this submission are in place (Section 2.5).

Enhance the policy toolkit

9. The nation-wide introduction of unfair contracts terms legislation based on the Victorian model is urgently required (Section 4.1).
10. Reforms should be introduced to enable regulators and consumer policy makers to better address anti-competitive demand side issues. These would include powers to address barriers to consumer-driven switching, stronger powers to limit bundling and loyalty arrangements that actually inhibit competition (Section 2.3).
11. Industry, consumers and government should work together to develop and implement better mechanisms, standards and contracts to enhance consumer confidence and market practices. These should include:
 - a better use of “default options” in markets to ensure that that consumers who are less able to exercise informed choice can still access good quality products or services at a fair price (for example default superannuation funds),
 - development of minimum standards for products in particular consumer markets (eg across the range of children’s products), and
 - greater use of standard form contracts (Section 4.2).
12. The UK “super-complaints” mechanism should be adopted in Australia so that consumer protection regulators are required to formally investigate and respond to complaints made by accredited non-government organisations (eg consumer organisations) about systemic market problems, including markets where competition is not working (Section 4.1).
13. Regulatory agencies should be required to regularly “shadow shop” industries for which they are responsible so as to better understand consumer risks and service standards, and to publish their results (Section 5).
14. A generic set of principles and procedural requirements for Codes that affect consumer contracts or conduct in consumer markets should be developed. Codes which do not comply with these requirements should be deemed to be prima facie anti-competitive. The authorisation provision of the TPA should be amended accordingly. Government should adopt these principles as policy in relation to Codes required, authorised or permitted in particular industries.

Those procedures should cover:

- Code development - equal consumer and industry participation should be required.
- Code coverage - full industry coverage should be required.
- Code compliance monitoring - the relevant regulator should be satisfied it is effective.
- consumer redress - consumers should have access to a best practice dispute resolution scheme (equivalent to those compliant with ASIC Policy Statement 139).
- Code review - regular transparent review should be incorporated (Section 4.1).

Bring Australian consumers into the heart of policy development

15. Significant ongoing funding should be provided to peak consumer organisations to provide evidence based input to policy development. Where possible, funding should be raised through statutory levy arrangements (Section 3.2).
16. Government agencies with consumer policy or consumer protection responsibilities should establish consumer consultation strategies, including the establishment of a consumer committee (if not already established). Agencies should commit to using those strategies in relation to all consumer policy matters. The Treasury should provide upgraded secretariat support to the Commonwealth Consumer Affairs Advisory Council (Section 3.1).
17. Consumer representation should be built into the ongoing policy development and industry monitoring of utilities and other regulated industries along the lines of the UK “Energywatch” model (Section 3.1).

Build research capacity and evidence based policy

18. A government funded consumer research body - an Australian Bureau of Consumer Economics (“ABCE”) - should be established to undertake long term research on policy issues. It should also undertake the “consumer impact assessments” recommended below. This is essential to ensure an evidence-based approach to consumer policy development and administration (Section 3.2).
19. The Australian Bureau of Consumer Economics or the Productivity Commission should be commissioned to undertake an inquiry into anti-competitive demand side practices in consumer markets (particularly financial services and communications). The inquiry should focus on:
 - barriers to consumer-driven product switching,
 - structural conflicts of interest,
 - ways to avoid unnecessary complexity, and
 - the impact of product bundling including loyalty programs.
 The Inquiry should identify ways to remove the anti-competitive impact of these practices (Section 3.2).
20. Key policy development agencies, including the Commonwealth Treasury and key regulators, should be provided with significant research capacity to enhance their understanding of demand side issues in relevant consumer

markets so that consumer policy can be better designed and targeted (Section 2.3).

21. A review of the practical impacts of behavioural economics on consumer policy and competition policy should be undertaken by a review team from across the agencies and regulators responsible for consumer policy (including Treasury, Health and Ageing, Communications Information Technology and the Arts, ACCC, ASIC and ACMA), reporting in 2008 (Section 2.3).
22. The Australian Bureau of Consumer Economics should be given resources to monitor and report on the impact of developments in competition on prices in consumer markets so that those developments can be better assessed and understood, particularly in the retail grocery sector (Section 3.2).

Consumer policy - performance and accountability

23. A new consumer policy assessment process should be approved and implemented within the COAG framework to ensure more timely and efficient policy development and assessment. This would be substantially assisted by the research capacities outlined above (Section 3.1).
24. Policy proposals which impact on consumers should be required to be accompanied by a consumer policy cost-benefit analysis provided by the Australian Bureau of Consumer Economics. This requirement would apply across all affected portfolios and industry sectors and promote a consistent approach to consumer policy as well as integrating consumer and competition reform (Section 3.2).
25. The Commonwealth Consumers Affairs Advisory Council, supported by the Australian Bureau of Consumer Economics and the Commonwealth Treasury, should produce an annual “Report Card on Australian Consumers” that outlines developments in consumer markets and provides information on the performance of all agencies with a consumer policy and/or consumer protection role (Section 1.3).
26. Enforcement agencies should be required to enter into a *Consumer Enforcement Compact* aimed at ensuring agencies meet their obligations to consumers. The *Compact* would require agencies to:
 - set enforcement priorities according to an assessment of the risk of harm to consumers likely to flow from non-compliance with the law, and the likelihood of that non-compliance,
 - publish details of how they propose to undertake their compliance, monitoring and enforcement work,
 - conform to a new set of consistent reporting requirements for their enforcement activities, and
 - undertake the shadow shopping and consumer consultation in line with recommendation 13 set out above (Section 5).
27. A model *Compact* should be developed by the ABCE in consultation with regulators, policy development agencies and other stakeholders (Section 5).

28. Processes should be developed to ensure consumer interests are taken into account when developing, acceding to, implementing and reviewing the effects of binding international agreements (Section 3.1).
29. More effective systems should be developed and applied to evaluating the impact and effectiveness of regulations after they have been introduced (Section 2.5).

Respond to changes in the digital age

30. The Commonwealth should work with the consumer policy agencies in other countries to improve consumer redress across borders (Section 2.4).
31. Unfair contract terms legislation and minimum standards approaches should be used to mitigate potential for consumer harm in online contract formation and online trading (Sections 2.4 and 4.1).
32. Drafting principles should be developed to ensure that when preparing consumer protection legislation consumers are not made vulnerable due to developments in technology. These principles should ensure regulations avoid technology specific provisions where possible and include broad catch-all provisions (Section 3.3).

Enhance consumer redress

33. The use of external dispute resolution mechanisms should be extended to industries and sectors where they are not currently available including consumer credit and mortgage broking, motor car repairs and sales, privacy and credit reporting and the travel and tourism industries (Section 4.1).
34. Consideration should be given to establishing a single point of initial entry for all consumer complaints based on examples such as LawAccess NSW or Consumers Direct in the UK (Section 4.1).
35. Action should be taken by the Commonwealth and Victorian governments to remove the cost barriers and other impediments to the successful use of the class action procedures introduced in those jurisdictions. Other jurisdictions should enact a version of the Federal Court procedure as improved in accordance with this recommendation (Section 4.1).

Vulnerable and disadvantaged consumers

36. Action should be taken to improve the position of vulnerable and disadvantaged consumers by simplifying consumers' interactions with the market, enhancing consumer redress and improving policy development as recommended above. Action to increase the fairness of standard contracts is particularly important (Section 6).
37. Increased funding should be made available for financial counselling and community legal services to provide consumer education, advice, advocacy and representation to vulnerable and disadvantaged consumers (Section 6).

38. Increased funding should be made available to non-government organisations capable of providing empirical information about the experience of and representing the interests of vulnerable and disadvantaged consumers in the policy development process. These include the Consumers Federation of Australia, the Australian Financial Counselling and Credit Reform Association and Consumers Telecommunications Network (Section 6).
39. The Australian Bureau of Consumer Economics should be required to regularly review and report on particular issues which impact on the ability of vulnerable and disadvantaged consumers to benefit from competition and to exercise their consumer rights (Section 6).
40. Legislative provisions on unconscionable conduct should be reviewed in light of so few claims being successfully brought, even by the ACCC, on behalf of individual consumers (Section 6).

Industry Specific Recommendations

Removal of anti-competitive provisions harming consumers

41. The Commonwealth should remove current regulatory restrictions on competition which cause harm to consumers without any countervailing public benefit. These include the restrictions on allocation of landing rights to international airlines on certain routes, the Pharmacy Agreement and the limitations on allocation of broadcast television licenses (Section 8).

Sustainable Consumption

42. The ABCE should review labelling and claims made by suppliers about the environmental impact of products and services, with the aim of:
 - improving standards and eliminating misleading claims.
 - identifying key energy intensive products services and/or environmentally damaging products or services to establish what mandatory consumer information would assist consumers to make more informed decisions about the impact of their consumption (Section 7).

Financial Services

43. The regulation of credit should be reviewed with the aim of moving regulatory responsibility to the Commonwealth level like other financial services (see Section 9).
44. Australia should implement Financial System Guarantee arrangements as soon as practicable, as was recommended by the HIH Royal Commission and the 2004 Financial System Guarantee report. An insurance policyholder protection scheme should be introduced as was strongly recommended by the HIH Royal Commission. A depositor protection scheme should also be introduced for prudentially regulated ADIs notably banks, credit unions and building societies (Section 9).
45. A compensation scheme for financial services should be introduced that incorporates both compulsory professional indemnity insurance and a “safety

- net fund” to cover situations where a financial firm goes out of business before it can compensate consumers for negligent advice (Section 9).
46. Regulatory agencies should be given the power to abolish unfair or inappropriate exit fees, and to abolish or limit the amount of penalty fees in financial products (Section 9).
 47. A risk rating system should be introduced for investments targeted at retail consumers (Section 9).

Communications

48. The communications regulatory structure should be reformed so that it puts consumer needs at the heart of the Code development and complaints handling processes. Key requirements are:
 - that there is one complaints handling agency for all communications complaints,
 - that the complaints handling procedures comply with good practice (for example as represented by ASIC policy statement 139 in relation to financial services),
 - that there is one consumer code for telecommunications developed within a co-regulatory framework by a body with equal consumer and industry representation, and
 - that the Code and the complaints handling system apply to all telecommunications companies, ISPs and resellers (Section 9.2).

Food

49. Regulations should prevent marketing of unhealthy food to children as part of a broader strategy to combat childhood obesity (Section 9.3).
50. The regulation and enforcement of health claims should be undertaken by the Commonwealth (Section 9.3).
51. A simplified food labelling system that includes some evaluation of the contribution of the food to a healthy diet should be introduced (Section 9.3).

Product Safety

52. There should be a comprehensive review of product liability provisions in the TPA (Parts VA, Part V Div 2A and 2), and disparate state legislation, particularly in light of inconsistent reforms to the TPA and state laws on negligence since 2002 (Section 9.4).
53. The Productivity Commission’s recommendations on product safety of 2005 should be implemented as a matter of urgency (Section 9.4).
54. In addition, a General Safety Provision along European lines should be introduced together with a requirement for manufacturers and importers to report serious product related accidents to the responsible Commonwealth agency (Section 9.4).

Health

55. The Commonwealth should commission an independent inquiry into all aspects of pharmaceutical marketing in Australia, its impact on medical practice and its contribution to cost pressures on the health system. Such an inquiry should consider:
- a ban on pharmaceutical promotion in doctors' prescribing software,
 - a new, independent regulator for pharmaceutical marketing together with an appropriate co-regulatory code of conduct for pharmaceutical marketing backed by effective monitoring and sanctions, and
 - the introduction of independent drug detailers to replace drug representatives visiting general practitioners to inform them about new drugs on the market (Section 9.5).
56. The Health Act should be amended to require pre-market evaluations of the efficacy and safety of complementary health products (Section 9.5).

About CHOICE

CHOICE is a not-for-profit, non-government, non-party-political organisation, established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and we campaign for change when regulation or markets fail consumers.

CHOICE is independent: we do not receive ongoing funding or advertising revenue from any commercial, government or other organisation. With more than 200,000 subscribers to our information products, we are the largest consumer organisation in Australia. We earn the money to buy all the products we test and support our campaigns through the sale of our own products and services.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns. CHOICE Campaigns Update is a regular email newsletter which informs subscribers about our policy work. You can subscribe at www.choice.com.au/ccu.

About this submission

This submission sets out CHOICE's views on the main issues that should be considered in the course of the inquiry.

In section 1 we identify the significant changes in the marketplace over the last 30 years that impact on consumers and ask how well the current consumer policy framework is responding to those problems. The remainder of the submission focuses on the key changes that are needed to improve the consumer policy framework.

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1 A National Consumer Strategy

There has been an increasing appreciation of the importance of economic study of the ‘demand side’ of consumer markets. Efficient markets depend critically on the confident and informed participation of consumers. Innovative and competitive industries and firms are driven by consumers¹. The UK Government has explicitly stated that their approach to economic policy involves “putting consumers as the heart of an effective competition regime”². This is the approach now required in Australia.

CHOICE recommends that Australia develop a 5 year national consumer strategy based on principles and objectives similar to those identified by the UK. The elements of the strategy are summarised and the UK principles and objectives set out in Section 1.3 below.

1.1 The changing consumer landscape

Australia’s consumer policy framework and consumer protection regulators have delivered many benefits to the community since the Trade Practices Act was introduced in 1974. However, the approach to consumer policy needs to be modernised so that it can ensure today’s markets work effectively.

The market environment has changed dramatically since the basic elements of Australia’s consumer policy framework were put in place in the 1970s. But too much of today’s consumer policy starts from assumptions that have not factored in these changes. For example, the heavy emphasis on more information disclosure as the answer to many market problems is likely to be less effective in an era characterised by overwhelming amounts of information in most markets. In some instances it is likely to be counterproductive, imposing additional costs without solving market problems.

A modernised consumer policy framework will need to take account of the pervasive nature of *technological change*, including the growth in e-commerce, and the impact on business models, contract formation and access to redress. It must also take into account *the impact of globalisation*³.

The inquiry must recognise the increased *importance of services* for consumers and the related increase in the *importance of intermediaries* such as financial planners, mortgage brokers and telecommunications sales people, in industries which by and large did not exist 30 years ago.

¹ See, for example ‘Venturesome consumption: In Praise of America’s fearless consumers of new ideas and products’ *The Economist* 29 July 2006.

² Department of Trade and Industry (UK) *A Fair Deal for All: Extending Competitive Markets: Empowered Consumers, Successful Business* (2005) at <http://www.dti.gov.uk/files/file23787.pdf> (accessed June 2007).

³ Eighty percent (80%) of goods now cross at least one international border on their way to Australian consumers.

Many new and not-so-new practices diminish the ability of consumers to play their vital role in making markets work. The inquiry should systematically address these *barriers to competition on the demand side*. Examples include *bundling of goods and services*, ‘*lock-in*’ contracts and *switching costs* which make it difficult for consumers to exercise choice by obfuscating the real cost of their choices.

Finally, and perhaps most profoundly, *consumer choice and information are no longer in scarce supply – but time and trust are*. The increase of consumer choice has been an animating idea in economic policy and consumer policy. But choice is not an unbridled good if the additional choices neither increase competition nor offer the consumer any real alternative or benefit⁴, as can happen in markets characterised by monopolistic competition and/or supply driven competition for distribution networks.

Risk and Regulation

In addition to observing the changes in the markets listed above, we also need to clearly understand the *key trends in the development and distribution of risk for consumers* in modern consumer markets.

Recent commentary as part of the ‘red tape’ debate has suggested that the growth in regulation is due in part to consumers and families seeking to unreasonably shift risk onto governments and businesses. This argument reflects an unhelpful misunderstanding of contemporary trends in risk allocation.

On the one hand, some risks for consumers have significantly declined compared to 10, 20 or 30 years ago. Cars are now safer, white-goods are more reliable. This should be seen as a significant achievement of consumer based market reforms.

On the other hand, other risks have increased. In particular, financial risk has grown considerably. The International Monetary Fund, in a recent analysis of financial risk, commented that “the household sector has increasingly and more directly become the “shock absorber of last resort” in the financial system”⁵. For example, the risks of saving for retirement (as longevity increases) have been transferred onto consumers and increasingly away from governments and firms. In other words, a very significant increase in regulation (the compulsory superannuation system) has had the explicit objective of *shifting investment risk onto consumers*. Similarly, the introduction of superannuation choice transfers the risk of choosing a poor superannuation provider⁶.

⁴ B Schwarz *The Paradox of Choice: Why More is Less* (New York Harper Collins 2004), Chris M Wilson and Catherine Waddams Price *Irrationality in Consumers’ Switching Decisions: When More Firms May Mean Less Benefit* Paper presented to OECD Consumer Policy Roundtable 2005 CCP Working Paper 05-04 ESRC Centre for Competition Policy, University of East Anglia.

⁵ International Monetary Fund *Global Financial Stability Report - Market Developments and Issues* April 2005 <http://www.imf.org/External/Pubs/FT/GFSR/2005/01/index.htm> (accessed 16 May 2007) p 5.

⁶ See, for example, ASIC’s investigation into disclosure practices and consumer risk in superannuation products at <http://www.asic.gov.au/asic/asic.nsf/byheadline/ir%2006-09%20asic%20puts%20the%20spotlight%20on%20superannuation%20disclosure?openDocument/> (accessed June 2007)

Of course some of these risks bring greater opportunities for consumers. For example, consumers have been able to enjoy the benefits of rising equity markets. But many opportunities are being undermined by poorly targeted regulations that do not adequately deal with the downside of those risks.

Unless we understand the key risks confronting consumers in modern markets and how they are distributed, we will not come up with effective policy options. The Productivity Commission could greatly assist our understanding of consumer markets by providing a dispassionate examination of this issue.

It is important that consumers are put firmly in the centre of this Inquiry. The Inquiry's terms of reference place a focus on identifying 'unnecessary regulation', 'regulatory burden' and removing 'red tape'. It is of course necessary to avoid or remove ineffective and unnecessary regulation, but the proper focus should be on identifying the best consumer policies and how to achieve them. Some will require market solutions, others effective incentives including targeted regulation. It is in the public interest to have as little regulation as possible – but as much as is needed for markets to function effectively⁷. The public interest should be the fundamental motivation of regulatory decision-making in the market place, not some preordained bias to particular outcomes⁸.

1.2 How well is the current framework performing?

Learning from successes and failures

The current consumer policy framework has clear strengths and weaknesses. The Inquiry should attempt to identify the strengths and build on them, and make recommendations to overcome the weaknesses.

Successes

It is important to identify and learn from the successes in the current policy framework. Perhaps the most significant examples are the following:

- The development of consumer protection regulatory agencies with a focus on enforcement has had a critical longer term impact on markets, notably the ACCC (which also has a critical role in competition policy) and ASIC in financial services. Building effective regulatory capacity has been a major achievement in consumer protection over the last 10-15 years.

⁷ See P Cullum *Consumers and Regulation* National Consumer Council UK (2005) at http://www.ncc.org.uk/regulation/consumers_and_regulation.pdf (accessed June 2007).

⁸ For a detailed analysis of the role of regulation from a consumer perspective see CHOICE *Submission to Taskforce on Reducing the Regulatory Burden on Business* (2005) at <http://www.choice.com.au/files/f122128.pdf>.

- The development of Ombudsman schemes within a co-regulatory framework, particularly in the financial services sector, has significantly increased consumers' ability to exercise their right to redress⁹.

Other successes include:

- The investigation into and subsequent reform of the life insurance industry by the then Trade Practices Commission in relation to investment linked life insurance products. The significant decline in the sale of these inflexible and opaque products, which had punitive exit charges and high commissions, was a significant reason why Australia avoided some of the extreme financial mis-selling that occurred in the UK.
- The improvement in product safety standards over time in key children's products, such as cots. While this took far longer than necessary, the improvement in these standards has saved lives in Australia.
- The ban on door-to-door sales of financial products under the Financial Services Reform changes. This has had significant positive impacts for vulnerable consumers (eg remote indigenous communities). This ban should be extended to credit as soon as practicable.
- The improved consultation arrangements established by some agencies, such as the establishment of ASIC's Consumer Advisory Panel, the ACCC Consumer Consultative Committee and ACMA's consultation arrangements.

Weaknesses

Weaknesses in the current consumer policy framework include the following:

- The objectives of the consumer policy framework are not clear.
- There is no consistent approach to consumer policy between industries. Consumers face the same kinds of issues across service based industries as diverse as health, food, financial services, communications, and energy. But because the regulatory structures are in silos different approaches are taken for no good reason.
- Coordination between state and federal agencies is inadequate. There are inconsistencies between States where uniformity would be both fairer and more economically efficient; there are areas such as product safety and health claims on food where responsibility is dispersed across too many Commonwealth and State/Territory regulator bodies.
- Neither policy development nor enforcement has sufficient focus on major consumer risks, including systemic issues.
- The framework is very poor at responding in a timely manner to emerging issues, especially when jurisdictional responsibilities are not sufficiently clear.

⁹ Schemes have seen many thousands of consumers have their disputes resolved in circumstances where they could not have used the court system. Nevertheless these schemes are not perfect, as reviews undertaken in accordance with ASIC Policy Statement 139 have pointed out. In particular there is no reason for seven different schemes in financial services, non-bank consumer credit is not covered, and consumer awareness of the schemes remains low.

- There is a very limited approach to the “policy toolkit” - the set of market interventions available to policy-makers and regulators. In particular there is too much reliance on consumer education and disclosure in situations where analysis and experience shows that they won’t work.
- Policy development is not supported by adequate research or consumer advocacy.
- The framework fails to ensure wider consumer input into policy making.
- There is a tendency to build on existing regulatory structures, often creating red tape, rather than consider new approaches where existing approaches have failed.
- Enforcement performance by regulators is uneven.

Market problems and regulatory gaps are often identified but not addressed. Current policy thinking has not been able to deal with key features of the market that are at the root of some consumer problems including conflicts of interest and deliberate strategies to undermine competition.

It is a key weakness that policy is developed in isolation in each industry with little or no reference to the experience in other industries. Obvious failings include weaknesses in the telecommunications industry code development and complaints structures and the ineffective self regulatory arrangements in place in relation to complaints about broadcasting, complementary medicines and pharmaceutical marketing.

Lessons for the current inquiry

In addition to the specific priorities for reform identified in the balance of this submission, policy development and administration could benefit from more systematic learning from past experience and from the experience across regulatory and non regulatory interventions in different industries. Depending on the circumstances this learning could take the form of standards, best practice statements or checklists for policy development. The appropriate tool will vary according to the nature of the issue.

The Australian Standard on Complaint Handling effectively sets a minimum acceptable level for complaint handling systems in consumer industries (among others). That Standard has been adopted by at least one regulator in its work on co-regulatory complaints schemes¹⁰. Standards or other best practice statements could be developed on a number of issues that face all regulators and policy makers, for example on consumer consultative processes, on when self regulatory, co regulatory or regulatory structures should be considered, on the best array of remedies available for enforcement agencies or on the levels of penalty that should apply to particular classes of conduct and/or particular classes of transgressor.

There are also lessons for the Inquiry in recent initiatives in other countries. In particular, as noted above, the UK government has adopted a deliberate strategy to put consumers at

¹⁰ ASIC Policy Statement 139 at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps139.pdf/\\$file/ps139.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps139.pdf/$file/ps139.pdf) (viewed June 2007).

the heart of consumer policy¹¹. We also think there is merit in examining proposals use in the Netherlands to encourage fair contracts in consumer industries¹².

1.3 A National Consumer Strategy

In response to the changing market and the failure of current arrangements to deliver optimum outcomes for consumers we propose a National Consumer Strategy. The strategy should ensure that consumers are at the ‘heart of consumer policy’. We need to:

- base consumer policy on an intellectual framework that recognises the role of consumers in driving competition and responds to the way consumers actually behave, in short that we pay as much attention to the ‘demand side’ as the ‘supply side’ (Section 2 below);
- change the institutional arrangements that govern policy development to increase responsiveness, research capacity and consumer advocacy (Section 3 below);
- increase the range of tools available to policy makers and regulators (Section 4 below); and
- increase the powers available to regulators, and their accountability (Section 5 below).

In taking this approach, it is necessary to consider the broad principles and objectives underpinning the consumer policy framework. CHOICE views the statement of principles as articulated in the UK Government’s *A Fair Deal for All: Extending Competitive Markets, Empowered Consumers, Successful Business* set out below as a useful starting point.

UK Principles for Consumer Policy¹³

“Executive Summary

1. The Government is committed to improving Britain’s consumer regime. We want a regime that delivers social justice, economic and environmental progress, and which is as fair to business as it is to consumers. We have set ourselves the target of raising our consumer regime to the level of the best in the world.
2. This means we want a regime where:
 - Consumers are equipped with the skills, knowledge, information and confidence to exercise their rights to get a good deal.
 - Strong consumer advocacy exists at the general policy making level and in special cases.

¹¹ Department of Trade and Industry UK *A Fair Deal for All: Extending Competitive Markets, Empowered Consumers, Successful Business* at <http://www.dti.gov.uk/files/file23787.pdf>; see also Energywatch UK *Annual Report and Accounts 2005-06* p 19

http://www.energywatch.org.uk/uploads/Annual_Report_2005_2006.pdf (accessed June 2007).

¹² See Section 4.1 below.

¹³ Department of Trade and Industry UK *A Fair Deal for All: Extending Competitive Markets: Empowered Consumers, Successful Business* (2005) p 3 at <http://www.dti.gov.uk/files/file23787.pdf> (accessed June 2007).

- Consumers have access to appropriate and convenient sources of advice and redress, including effective alternative dispute resolution (ADR).
- Consumer rights are proportionate, balanced with responsibilities, and clear and simple enough to be well understood.
- Consumers are able to understand the impacts of their own consumption decisions on our shared environmental and social wellbeing.
- Vulnerable consumers are protected without placing undue restraints on markets overall.
- Enforcement is fair, consistent, effective and proportionate.
- Markets are regarded as fair by both consumers and business.

And this is underpinned by:

- A strong competition regime, and
- A rigorous evidence-based approach that ensures:
 - problems are identified,
 - interventions are justified by the evidence using appropriate risk assessment,
 - the effectiveness of interventions is evaluated, and
 - there are no unnecessary costs to business, consumers or Government.”

Recommendations

1. A 5 year consumer strategy should be developed by the Federal government with the clear aim of putting consumers at the heart of market and competition reforms.
2. The Commonwealth Consumers Affairs Advisory Council, supported by the Australian Bureau of Consumer Economics and the Commonwealth Treasury, should produce an annual “Report Card on Australian Consumers” that outlines developments in consumer markets and provides information on the performance of all agencies with a consumer policy and/or consumer protection role.

2 Consumer Markets and Consumer Behaviour

Good consumer policy underpins efficient markets. Well designed consumer policy:

- Establishes, shapes and creates markets (eg telecommunications deregulation, energy markets, compulsory third party vehicle insurance),
- Facilitates competition through strengthening the demand side of markets,
- Builds trust in consumer markets, thereby reducing transaction costs and facilitating innovation,
- Rectifies market failures arising from information problems,
- Provides devices to improve the balance between short term and long term consumer objectives and default mechanisms to improve market outcomes (for example, compulsory superannuation, cooling off periods for timeshare scheme purchases),
- Provides additional protections to vulnerable consumers, and
- Helps sharpen up industry to deal with the tough world of global competition.

Too often critics note the direct costs of market intervention, including regulation, neither acknowledging nor pausing to quantify the direct and indirect benefits of those interventions for the competitive economy. There are, of course, regulations in place which we do not need and which harm consumers. There is also a need to ensure that unnecessary regulation is not created. But market interventions which promote consumer confidence and create the conditions which enable a market to operate successfully create positive benefits. We consider these issues in greater detail below.

In order to develop and implement a national consumer strategy we need to develop a more sophisticated understanding of the consumer market place as it now operates. In this section we argue:

- good consumer protection underpins effective markets (Section 2.1),
- we need to understand how consumers actually behave (Section 2.2),
- we need to tackle particular anti-competitive demand side structures and practices (Section 2.3),
- digital contract formation raises new problems (Section 2.4), and
- we need a balanced approach to regulation (Section 2.5).

2.1 Good consumer protection underpins effective markets

Effective competition is the most efficient mechanism for ensuring consumers get a fair deal and business can fairly compete against each other.

But there is rarely perfect competition and markets rarely function as they should. Competition policy and consumer policy are designed to tackle market imperfections on the ‘supply side’ and ‘demand side’ respectively. While competition policy is generally concerned with the structure and functioning of the market, consumer policy attempts to improve the demand side of markets, for example by assisting consumers to make informed decisions and avoid poor decisions flowing from deception or unfair trader behaviour. As Ken Henry, secretary of the Treasury has noted:

It is well understood that markets will deliver sub-optimal outcomes for consumers if firms form a cartel, for example. It is perhaps not so well understood that markets will fail if consumers don't have enough knowledge to make sound choices or don't trust suppliers sufficiently to participate fully in the market. Critically, consumer policy supports market participation ... consumer policy also ensures the continued viability of the legitimate market operators, underpinning a more competitive market¹⁴.

In other words, consumers play an important role in *activating markets and making competition work*. Competition and consumer policy are mutually supporting parts of the one equation. John Vickers, Chairman of the Office of Fair Trading UK, has written of the importance of the “stance and effectiveness of consumer policy” on market competition between firms¹⁵. To similar effect, the former head of the Trade Practices Commission, Ron Bannerman notes:

Consumers not only benefit from competition, they activate it and one of the purposes of consumer protection law is to ensure that they are in a position to do so¹⁶.

Essentially competition policy and consumer protection policy have the same goal – a fair and efficient market place. Markets will work best for consumers and the economy when optimal policy responses are in place on both sides. Understanding this interface between competition policy and consumer protection policy is thus essential.

2.2 We need to understand how consumers actually behave

The policy framework must be built on a stronger understanding of actual consumer behaviour, market trends and risks. Developments in the field of behavioural economics will assist policymakers in this objective, as will a greater investment in consumer research.

Consumer policy development proceeds on the basis of particular assumptions of how consumers (and businesses) behave in the market and the likely impact of proposed interventions on consumer and trader behaviour. If the assumptions at odds with how consumers actually act in markets then policy is less likely to be effective, and may even be counterproductive. The conclusions of more recent research on actual consumer behaviour suggests that this issue needs urgent consideration.

¹⁴ K Henry *Connecting Consumers and the Economy: The Big Picture* Closing Address to the National Consumer Congress Melbourne 15 March 2007 pp 6-7.

¹⁵ John Vickers FBA, British Academy Keynes Lecture ‘*Economics for Consumer Policy*’ October 2003. See also B Schwartz *The Paradox of Choice: Why More is Less* (New York Harper Collins 2004).

¹⁶ Ron Bannerman, in Trade Practices Commission *Annual Report 1983-1984* (AGPS Canberra 1984) p 184.

Neoclassical economics developed powerful theories of the economy based on a model of perfect competition, information and rationality by market actors. Subsequent economic work identified and responded to the fact that, in most markets, competition is not perfect and market participants rarely have equal access to relevant information¹⁷. Competition policy responds to the first of these issues, while much existing consumer protection regulation is a response to the need to increase the availability of information or reduce information search costs.

Plainly, the assumption of perfect rationality is also a theoretical rather than real world attribute of markets. Nonetheless, much consumer policy has either explicitly or implicitly assumed that consumers in the “real world” act according to the economic definition of rationality.

One of the outcomes of this disjuncture between the assumed economic rationality of consumers and their real world behaviour is ineffective and costly regulation. The experience with disclosure in financial services provides some examples. Here we have seen enormous (and costly) efforts devoted to providing information to consumers on the assumption that they will use this information in an economically optimal manner to make financial decisions. When this does not occur, and consumers continue to make poor decisions (eg by failing to understand conflicts of interest), the response has been to place further requirements on firms to provide more disclosure, so that consumers are better placed to make optimal decisions. When this still does not produce improvements in the market, further tinkering with disclosure is undertaken. This unproductive and costly cycle has ultimately failed to deliver better consumer decision making in the financial services market, yet has imposed significant costs on industry. What is needed is a different approach – one that asks how and why consumers make decisions, rather than taking consumer behaviour as an already established feature of the policy process. What is needed is an approach that looks to a wider range of tools to address market problems.

Behavioural economics is a field of study which offers useful analysis of the ways in which consumer behaviour systematically deviates from that which would be expected of the assumed economically rational market actor¹⁸. There is extensive evidence of numerous systematic deviations from a narrowly defined rationality which might enable policy makers to devise policy responses which produce more efficient and fairer markets¹⁹. In real life, consumers may not be able to optimally utilise all information available. For instance, they make mistakes, use intuition²⁰, overestimate the value of

¹⁷ C Camerer, S Issacharoff, G Loewenstein, T O’Donoghue and M Rabin ‘Regulation For Conservatives: Behavioural Economics and the Case for “Asymmetric Paternalism”’ (2003) *University of Pennsylvania Law Review* Vol 151, Jan 3, (hereinafter *Regulation for Conservatives*).

¹⁸ J Gans ‘*The Road to Confusopoly*’ Paper presented to ACCC Regulatory Conference Gold Coast July 2005; C Camerer, et al *Regulation for Conservatives*.

¹⁹ See, for example *Roundtable on Demand-side Economics for Consumer Policy, Summary Report* April 2006 at <http://www.oecd.org/dataoecd/31/46/36581073.pdf> (accessed June 2007).

²⁰ Use of intuition is effective for most decision-making, but it sometimes leads us astray.

recent events, discount the value of future events, overestimate the probability of events that are easy to imagine, are averse to risk and value certainty, convenience and time²¹.

Of course economic analysis has always recognised that consumers behave in ways that are at odds with the assumptions of perfect rationality. However, the tendency has been (at least in much policy development) to see these divergences from rationality as:

- Trivial in impact and cost
- Random, which means they cancel out (eg some consumer decisions are overly short-sighted, some overly long-sighted)
- Inexplicable and therefore unimportant to policy development.

However, what behavioural economics has clearly demonstrated is that in many markets consumer behaviour diverges from standard economic rationality assumptions in ways that are:

- Significant and costly
- Systematic and predictable rather than random (eg consumers overwhelmingly value losses more highly than gains)
- Explicable and predictable and therefore amenable to policy responses

There are numerous examples where Australian governments already make use of lessons from behavioural economics. Perhaps the most significant example is *compulsory* superannuation, which cannot be justified from a policy position where all consumers act rationally. Other examples include mandatory cooling off periods for particular products or services and in particular circumstances – this takes into account the well recognised behavioural trait whereby people make different decisions about the same product or service in different contexts (standard assumptions about rationality assume that context does not matter). Policy makers and academics are increasingly influenced by thinking drawn from behavioural economics at the OECD and in North America and Europe; however in Australia we are in danger of being left behind²².

Behavioural economics also shows that consumers are not one coherent group; it recognises that lower-income consumers generally do less research prior to buying than more affluent consumers and that the young are more brand conscious than older consumers, for example.²³ It also recognises that there are ‘behavioural costs’, which are the costs to consumers and the economy caused by the discrepancy between what an ‘economically rational’ consumer is expected to do and what a ‘real-life’ consumer actually does.

²¹ National Consumer Council UK *Imperfect markets* November 2006.

²² Ian McAuley reports from a recent US conference: “I was struck by the extent to which, in this audience (academics, public servants and FTC staff) there was a reasonable familiarity with behavioural research and findings. This is in contrast to Australia, where, in my experience, the field is virtually unknown outside financial circles (where the discipline of behavioural finance is well established) and among those academics that have seemed to focus on time variant preferences (mainly “hyperbolic discounting”) rather than the broader issues in behavioural economics and behavioural game theory. Our universities seem to lack the capacity for interdisciplinary studies in this area.”

²³ See generally National Consumer Council UK *Imperfect markets* November 2006.

There are particular problems with services which are amenable to the analysis of behavioural biases. The dynamic between a consumer and trader involved in a one off transaction to buy a good is very different from that where a consumer enters into a long-term arrangement or fixed term contract for the continual supply of a service such as superannuation, energy or a telecommunications product.

In both [financial services and utilities] consumers are buying streams of services over time, rather than one single product, often from very large corporations. In fact, for most goods, the mechanisms of competition when applied rigorously have delivered huge consumer benefits. It is in services, particularly where there are streams of payments over time, that difficulties from behavioural biases seem most likely to occur²⁴.

The insights into consumer behaviour afforded by behavioural economics encourage us to rethink prior regulatory approaches and to come up with new answers²⁵.

Behavioural economics can also offer some guidance in when not to regulate. In particular, it can draw our attention to the danger of regulating to attempt to prevent some terrible but very unlikely event. The phenomenon of ‘salience’ appears to mislead policy makers as much as consumers. In a recent speech Gary Banks, chair of the Productivity Commission created a scenario in which the graphic image of injury caused to a child led politicians to propose market intervention without an effective cost-benefit analysis²⁶.

In a recent real world example, regulations requiring increased cockpit door reinforcement to protect against the very remote possibility of a terrorist attack on small regional commuter planes have imposed perhaps unwarranted costs on business. It has probably also increased transport risk as, because of cost, more people travel by road rather than more safely by air. It's not just the cost of the door: it's also the weight, which has reduced the payload.²⁷ The office of Best Practice Regulation has identified a number of recent high profile political interventions which do not pass a cost-benefit analysis²⁸.

Interestingly these issues also apply to the behaviour of businesses. Arguably some of the excessive documentation provided in the financial services sector is because of a disproportionate fear of regulatory intervention in a climate of major regulatory reform (ie salience), which is reinforced by the behaviour of others in the industry and legal advisers.

²⁴ I McAuley unpublished 2007.

²⁵ C Camerer et al *Regulation for Conservatives* p 44.

²⁶ G Banks *Tackling the underlying causes of over-regulation: an update* 24 October 2006 p 3 at <http://www.pc.gov.au/speeches/cs20061024/cs20061024.pdf> (accessed June 2007).

²⁷ I McAuley personal communication.

²⁸ S Rimmer Office of Best Practice Regulation in course of a presentation to the ACCC Consumer Consultative Committee March 2007.

Despite exciting policy attention only over the last five or so years, behavioural economics has deep roots²⁹. It should not be seen as an alternative to more traditional economic analyses, rather behavioural insights readily complement theoretical economics and more recent work on competition policy and information and search issues.

There has been some confusion about the way in which behavioural economics adds to or relates to other economic analyses. Some are concerned that behavioural economic analysis can in some circumstances dictate an unwarranted paternalism, for example through preventing consumers learning from our mistakes. This is a reasonable concern in relation to high frequency, low value transactions, but not in relation to occasional high value purchases.

The point is not that blanket rules for public policy should be derived from behavioural economics, rather that all consumer protection issues require a case by case assessment of the costs and benefits of potential policy interventions, that that assessment must proceed from a clear eyed and real world understanding of how markets work and, in particular, it needs to take good notice of information asymmetries and systematic deviations from rational behaviour. As noted earlier, much existing defensible public policy can only be explained by the application of behavioural principles – compulsory superannuation, compulsory deductions of income tax from salary and banning cheap but dangerous products being three examples.

The work of economists such as Camerer provide useful policy guidance. We strongly endorse Camerer's view³⁰ that we need to design interventions which protect consumers when they make poor decisions without imposing significant costs on consumers when they are disciplined and well-informed - bearing in mind that it's likely large majorities of consumers fall into the first category some of the time. We are all subject to costly biases in some situations.

Recommendations

20. Key policy development agencies, including the Commonwealth Treasury and key regulators, should be provided with significant research capacity to enhance their understanding of demand side issues in relevant consumer markets so that consumer policy can be better designed and targeted.
21. A review of the practical impacts of behavioural economics on consumer policy and competition policy should be undertaken by a review team from across the agencies and regulators responsible for consumer policy (including Treasury, Health and Ageing, Communications Information Technology and the Arts, ACCC, ASIC and ACMA), reporting in 2008.

²⁹ Adam Smith based some of his work on insights which would now be classified as belonging to behavioural economics (see N Ashraf, C F Camerer, G Loewenstein 'Adam Smith, Behavioral Economist' *Journal of Economic Perspectives* Vol 19 Number 3 Summer 2005) as does the influential work of Herbert Simon in the 1950s.

³⁰ C Camerer et al *Regulation for Conservatives*.

2.3 We need to tackle particular anti-competitive demand side structures and practices

We have argued above that good economic outcomes depend on decisions made by consumers who activate competition by choosing the best value products and services. To the extent that consumer choice is made difficult by complexity, bundling (a form of complexity), and switching barriers, conflicts of interest, competition is undermined and its benefits lost.

Complexity

Complexity can reduce competition by making it too hard for consumers to make informed choices. Treasury secretary Ken Henry has recognised complexity as a difficult issue:

Complexity however, is more problematic. The question for policy makers – especially those charged with responsibility for consumer policy – is whether complexity can be reduced without compromising the achievement of the other things already mentioned: lower prices, better quality and a much richer set of consumer choices³¹.

As noted in section 1.2 above, problems for consumers can increasingly be caused by *too much choice* rather than too little. Too much choice, or a proliferation of hard to compare choices, is sometimes a deliberate strategy, one particularly employed by a dominant player in a market. Economist Joshua Gans has labelled this ‘confusopoly’ and analysed its impact³². In other cases too much choice arises as a result of market forces. Too much choice is a problem for consumers (and markets) where it increases search costs or allows sellers additional opportunities to trigger non rational levers in consumer decision making processes. Where too much choice is combined with deliberate complexity, consumers either refuse to choose or choose from only a small selection of available options. Sometimes this will involve the rational use of a ‘choice editor’ (that is, a person or organisation who assists consumers make a choice, for example, by using his or her expertise to recommend the most appropriate product or service). But often the choice will be made on bases that undermine competition and consumer utility.

Search costs can be increased by deliberate strategies to confuse the consumer, or simply by a proliferation of choice caused by other factors. There is some evidence of deliberate strategies to confuse. There is certainly evidence of ‘confusopoly’ causing consumer harm³³.

³¹ K Henry *Closing Address to the National Consumer Congress* Melbourne 15 March 2007.

³² J Gans *Confusion as a screening device* at <http://www.economics.com.au/?p=100> (accessed 23 May 2007).

³³ J Gans *Confusion as a screening device* at <http://www.economics.com.au/?p=100> (accessed 23 May 2007); B Schwarz *The Paradox of Choice: Why More is Less* (New York Harper Collins 2004); Chris M Wilson and Catherine Waddams *Price Irrationality in Consumers’ Switching Decisions: When More Firms May Mean Less Benefit* Paper presented to OECD Consumer Policy Roundtable 2005.

Bundling

Bundling is a particular form of complexity that can limit choice or makes choice substantially more difficult to exercise. In 2005 CHOICE reviewed some loyalty programs, a form of bundling, and found that most were poor value³⁴. But this information is not readily available to consumers, who in any case often have no choice as to whether or not to pay for loyalty programs which are offered on a take-it or-leave-it basis (domestic air travel, for example).

Bundling increases information asymmetry as it makes it difficult for consumers to determine the value of the deal as a whole compared to its component parts.

Bundling can also reduce consumers' access to remedies when things go wrong by adding complexity to the consumer complaint process. The correct supplier needs to be identified and found, along with the correct body to hear the complaint. Examples include the sale of mobile phones with phone network access contracts³⁵ where financing is provided by a separate entity to the product retailer and bundling telecommunications with pay-television - the Telecommunications Industry Ombudsman has no jurisdiction over any complaints on aspects of the pay-television part even though that service, and the rest of the bundle, may be provided by one of their members.

Switching

Impediments to switching include search costs, break fees and loyalty schemes such as discount coupons and frequent flyer programs. Switching costs (both structurally necessary and artificially created) make it difficult for consumers to easily change brands or service providers. Some of the barriers to switching are also intertwined with policy requirements³⁶.

The cost of switching superannuation funds is a specific example of a barrier to switching causing significant consumer harm – CHOICE's research suggests that the barriers to consolidation are costing consumers between one and two billion dollars each year³⁷.

There is contention about whether for any given market there is an optimum level of switching³⁸. Low switching rates may indicate a lack of competition and may be caused

³⁴ See CHOICE 'Searching for Aces' in *Money and Rights* December 2005 p 12.

³⁵ See CHOICE online April 2007 at <http://www.choice.com.au/viewArticle.aspx?id=105685&catId=100245&tid=100008&p=1&title=Phone+and+internet+bundles> (accessed 23 May 2007).

³⁶ See Paul Klemperer 'Competition when Consumers have Switching Costs: An overview with Applications to Industrial Organization, and International Trade' (1995) *Review of Economic Studies* Vol 62 "where products are artificially differentiated by switching costs, firm's incentives to differentiate their products in any real, functional way, are reduced" p 516.

³⁷ See CHOICE *The Super Secret: How multiple accounts cost consumers billions* CHOICE Research Report, November 2006 at <http://www.choice.com.au/files/f127162.pdf>. Subsequent research by Rice Walker suggests the range is a little lower but still unacceptably high.

by barriers to informed consumer choice. Increasing tendencies to differentiate products on the basis of non-core offerings and the trend towards lock-in contracts in some markets (energy, telecommunications), make switching difficult. But high or medium levels of switching do not in themselves indicate a competitive market³⁹. Indeed, there is significant evidence that consumers may switch against their interest in various circumstances (too much choice⁴⁰, high pressure selling).

Conflicts of interest

Conflicts of interest may affect consumers dealing with financial advisers, investment brokers, mortgage brokers, car dealers also selling financial products, superannuation trustees and even investment research firms, amongst others.

Some industry groups argue that conflicts of interest arising from commissions and other incentives can be “managed”. However, some of the methods used in financial services for managing or avoiding conflicts of interest do not diminish the conflict. In particular merely disclosing the conflict of interest does not solve the problems - how is the consumer able to assess the weight to be given to advice based on knowing an adviser will receive a 5% rather than a 2% commission? Indeed, research suggests disclosing conflicts increases consumers' trust in an adviser rather than acting as a warning to treat the adviser with caution⁴¹. Commission-related conflicts can only be prevented when the way advisers are remunerated is separated from the advice they give. Only then are advisers able to give unbiased advice.

Conflicts of interest are an area where a number of decisive policy responses are required to ensure consumers are adequately protected. Regulators such as ASIC should be given the power to prohibit particular conflicts of interest where they are satisfied that disclosure or management will not prevent inappropriate or biased advice⁴².

Recommendation

10. Reforms should be introduced to enable regulators and consumer policy makers to better address anti-competitive demand side issues. These would include

³⁸ National Consumer Council UK *Switched on to Switching? a survey of consumer behaviour and attitudes 2000-2005* at http://www.ncc.org.uk/access/switching_findings.pdf (accessed June 2007). See also analysis of switching in OECD Roundtable discussion, in particular Allan Asher ‘Consumer Experience in the UK Energy Market’ (2006) at <http://www.oecd.org/dataoecd/31/46/36581073.pdf> (accessed June 2007).

³⁹ See Ian McAuley’s analysis at Appendix B.

⁴⁰ Chris M Wilson and Catherine Waddams *Price Irrationality in Consumers’ Switching Decisions: When More Firms May Mean Less Benefit* Paper presented to OECD Consumer Policy Roundtable 2005.

⁴¹ D Cain, G Lowenstein, D Moore ‘The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest’ (2005) Volume 34 *Journal of Legal Studies* pp 1-25.

⁴² See CHOICE submission to ASIC’s *Conflicts of Interest Discussion Paper 2006* at <http://www.choice.com.au/files/f124888.pdf> (accessed 23 May 2007). See other policy strategies to protect consumers against conflicts of interest at <http://www.choice.com.au/viewArticle.aspx?id=105401&catId=100385&tid=100008&p=1&title=Conflicts+of+interest>.

powers to address barriers to consumer-driven switching, stronger powers to limit bundling and loyalty arrangements that actually inhibit competition.

2.4 Digital contract formation raises new problems

Current consumer protection legislation does not adequately protect consumers against unfair contracts that have been entered into through digital methods. The digitisation of our markets has made radical changes to the way consumers make many of their purchases. While shopping in bricks-and-mortar stores is still a common activity, increasingly many transactions take place online or through mobile devices. It is likely that there will be more alternative methods available in the future: already transactions can occur through consumers' entertainment systems such as internet connected game consoles or through pay-television digital infrastructure.

The increase in digital transactions has seen an increase in the prevalence of related End User Licence Agreements (EULAs) which give rise to a number of issues for consumers. It can be difficult for consumers to gain access to terms and conditions especially on mobile platforms. Likewise, terms and conditions stored digitally can be easily changed as there is no currently standardised system for independently verifiable archiving of contracts. CHOICE was notified of a complaint where a business had only added a notice of subscription terms to its website after a consumer had complained about unwittingly signing up to a subscription, and the business misrepresented to the consumer that those terms had always been there. This practice probably breaches current law, however the issues raised by online contract formation require a systematic response not only increased ability for consumers to obtain redress and regulators to monitor for compliance.

More fundamentally, the use of 'take it or leave it' standard contracts exacerbates the existing problems with such contracts. They are even less likely to be read than paper contracts – provided as they are as an immediate barrier to be overcome prior to the enjoyment of a product about to be purchased or already purchased.

While businesses may disadvantage consumers through poor disclosure of the existence of a contract and its terms, often the greater problem is that there are too many terms and conditions for a consumer to be expected to read or understand. It is not surprising then that consumers may not read these terms and conditions, expecting the terms to adhere to general principals of fairness. Businesses should not be allowed to rely on non-standard terms where they have not been specifically and adequately brought to the notice of the consumer. A requirement to read, think about, and negotiate contracts would increase transaction costs to such an extent that commerce could not proceed. One solution explored below is the development of standard contracts, vetted by independent agencies, with variations clearly signposted.

Issues of choice also need to be examined in relation to digital contract formation. Even where the consumer is aware of unfair provisions, often there may be no viable alternative product or service. This may be because that product or service is the only available, it is the market standard or because all other providers are making their offers

under the same conditions. Competition will generally not help in the absence of a realistic likelihood of consumers reading and understanding contracts and/or correctly discounting the likelihood of future events with various contractual consequences. Consumers should have protection from these unfair terms even if they knowingly agree to them. Where a business offers products and services to the general public, they should be prevented from offering those services under unfair conditions as consumers have little in the way of real bargaining power. Unfair contract terms, including “click-wrap” online contracts are discussed in CHOICE’s submission to the NSW Legislative Council Inquiry into unfair contract terms annexed to this submission⁴³.

Possible models to address this problem include greater use of negotiated fair standard term contracts for particular industry (with a right to vary by drawing specific attention to the variation) and/or an effective system for monitoring and prohibiting unfair terms.

Digital contract formation has massively increased consumers’ capacity to contract with sellers outside Australia with a consequential need to improve consumers’ redress across borders.

Recommendations

30. The Commonwealth should work with the consumer policy agencies in other countries to improve consumer redress across borders.
31. Unfair contract terms legislation and minimum standards approaches should be used to mitigate potential for consumer harm in online contract formation and online trading.

2.5 We need a balanced approach to regulation

From time to time commentators urge government to prefer self regulatory mechanisms to regulatory solutions. The suggestion is sometimes made that self regulatory solutions are intrinsically superior. CHOICE strongly believes that there should be no *a priori* preference for a particular form of regulation. Of course any intervention must pass a cost benefit analysis.

Similarly, commentators have suggested that regulation should be the last not first response of Government⁴⁴. On examination this is an unhelpful approach to improving markets and is likely to lead to greater inflexibility, because if a regulatory solution is the best option available, it should be the first response, not the last. Policy and regulatory intervention is justified only when (1) the market is unlikely to respond in a manner that adequately addresses an issue within an appropriate timeframe, and (2) only if the resulting benefits exceed the costs of the intervention. But the best form of intervention can only be assessed on a case by case basis⁴⁵.

⁴³ See Appendix D.

⁴⁴ Business Council of Australia *Business Regulation Action Plan for Future Prosperity* (no date) p vii.

⁴⁵ R Smith, S King *Combining the Insights: Understanding Consumer Risk – Laying the Building Blocks* (2006) Paper delivered at the 2006 Roundtable on Demand-side Economics for Consumer Policy. See ,

Experience with financial services suggests that good faith industry engagement in developing consumer protection rules, and strong industry participation in the creation, design and management of dispute resolution schemes, can produce superior outcomes to alternative approaches. But it is rare that a self regulatory arrangement can *by itself* deliver better market outcomes than one which is established in a framework that overcomes problems of consumer trust, weaknesses in industry-based policing of breaches and free rider issues.

It is true that policy makers should on each occasion consider whether a non-regulatory approach may successfully solve or contribute to the solution of a market problem at least cost. But there is no intrinsic reason why a non regulatory or self regulatory solution is better. The various mechanisms for implementing a particular policy approach have strengths and weaknesses. Those strengths and weaknesses must be considered on a case by case basis.

There are essentially three broad models for applying particular rules to a market:

- statutory regulation,
- co-regulation, and
- self regulation.

Regulation

For this purpose regulation includes legislation and various forms of delegated regulation including regulations, and orders and directions made by regulators (for example ASIC Policy Statements, ACMA Directives and the Orders that the Director of the proposed Australia New Zealand Therapeutic Products Agency (successor to TGA) will be able to make.

Regulations ideally have the virtue of public accountability, public participation in their development, certainty and enforceability. On the other hand, some forms of regulation, particularly legislation, can take a long time to come to fruition and can be difficult to change as circumstances warrant. There are instances where co-regulatory solutions produce more timely responses. In some cases regulatory responses may also suffer from a lack of ‘buy-in’ by industry participants which is said to result in industry participants feeling less obligation to comply with the law than with a body of rules developed with their input⁴⁶. There is some theoretical support from behavioural economics for this conclusion (norm re participation), however there are various examples where industry bodies better support regulatory processes. FSANZ, for example, adopts comparatively clear consultation processes when developing standards which in turn has led to better buy-in of regulation in that industry.

Summary Report (2006) at <http://www.oecd.org/dataoecd/38/53/38095786.pdf> (accessed June 2007). See generally CHOICE *Submission* to the Taskforce on Reducing the Regulatory Burden on Business (December 2005) at <http://www.choice.com.au/files/f122128.pdf>.

⁴⁶ Consumer Affairs Victoria *Choosing Between General & Industry-Specific Regulation* Research Paper No 8 November 2006.

Self regulation

Self regulation refers to rules developed by industry participants, usually through an industry body. Advantages *may* include a greater sense of ownership by industry participants and the activation of specialist industry knowledge which can provide better solutions so long as the willingness to solve a particular problem is in place.

Self regulation suffers a number of disadvantages. First, industry buy-in is reduced to the extent that the industry body does not truly represent all market participants. Second, it relies on voluntary monitoring and compliance and thus creates free rider problems. Third, solutions are often developed without adequate consultation with, or consideration of other stakeholder interests, notably consumers. Another disadvantage is that self-regulation can itself be very slow to respond to a problem as the short term interests of industry members often act as a barrier to speedy action.

Self regulation can often produce sub-optimal results in two distinct ways: creating rules that impose costs on compliant businesses (who may well have treated consumers fairly in any case) but not on those who do not comply and/or rules which impose costs on business but are ineffective or only partially effective to solve the problem at hand.

Self regulation is generally inappropriate where there is no industry body with wide coverage and where neither available sanctions nor market forces create incentives for industry participants to comply with self regulatory arrangements. These problems commonly arise where there are many traders in the market, where there are low barriers to entry and/or some traders have low reputational capital.

Co-regulation

Co-regulation refers to arrangements where regulation sets down broad parameters within which industry develops codes that flesh out or supplement the regulation.

Co-regulatory schemes can produce effective outcomes where properly designed. In addition to solving free rider and consultation problems, they can be effective in that they can target specific problems, impose lower compliance costs on business and usually offer quick and low cost dispute resolution mechanisms.

Co-regulation is most effective where it is underpinned by legislation enabling a regulator to enforce compliance with the code (assuming the regulator has the capacity and willingness to do so).

Reducing regulation

We argue throughout this submission for improvements to the policy analysis, institutional arrangements for policy development, tools for market intervention and performance of regulators. We believe that once these reforms are in place there would be many existing regulations at Commonwealth and State/Territory level which could be wound back, or which could be replaced by regulation or other market interventions which would have better outcomes for consumers and business.

Recommendations

7. Disclosure requirements in industries such as financial services should be reduced and simplified once the reforms as recommended in this submission are in place.
8. State-based regulation should be reviewed once the reforms as recommended in this submission are in place.
29. More effective systems should be developed and applied to evaluating the impact and effectiveness of regulations after they have been introduced.

3 Improving Policy Development

Policy development processes are a key element of the consumer policy framework. Good processes will ensure responsive and high quality decisions about whether or not to intervene in the market and the nature of that intervention.

In this section we discuss problems with the current policy structures and processes. We recommend creation of a national consumer agenda with consumer interests at the heart of policy development. We make specific recommendations to strengthen research and policy development capacity both within and external to government.

3.1 Problems with current structures and processes

The current consumer policy development process has the following weaknesses:

- insufficient and fragmented policy development capacity at Commonwealth and State/Territory levels of government,
- the relatively low priority given to consumer policy by both State/Territory and Commonwealth governments,
- historical rather than rational allocation of responsibilities between jurisdictions,
- competition between and protectiveness by jurisdictions and agencies,
- tensions about and imperfections in Regulation Impact Statement processes,
- an insufficiently transparent policy development culture, and
- insufficient consumer research and limited capacity for consumer advocacy.

Insufficient policy development capacity

There are a significant number of examples where consumer policy development in recent year has taken far too long. Sometimes these delays are the result of disagreement about the best way forward or the kinds of jurisdictional issues discussed later below. But all too often they result from a lack of adequate policy development resources. It is common to find a lack of capacity within government policy development agencies for all the policy development work with which they are charged, let alone the extra work that might be necessary. The detrimental effect on consumer policy development of this lack of resources may also be compounded by the low priority placed on consumer matters within some areas of government.

Examples include:

- delays in settling the regulation of finance brokers (see Appendix A),
- component pricing legislation (see Box),
- a system to ensure investors are compensated for negligent or fraudulent advice (see Section 9.1 below),
- the regulation of mobile premium services (see Box).

Component pricing

In 2002, the Full Federal Court held, contrary to accepted wisdom, that s 53C of the *Trade Practice Act* did not in fact prohibit ‘component pricing’ - that is, failing to include

in the stated price of goods or services amounts that the consumer must pay such as the GST, delivery charges or ‘taxes fees and charges’⁴⁷.

The Commonwealth Treasurer announced in April 2005 that the Commonwealth would introduce legislation to restore previous policy to require a ‘single figure price total’⁴⁸. On 10 March 2006, the Treasury released a draft bill designed to implement this announcement⁴⁹. As the explanatory memorandum notes, the Government considered that consumers should be able to readily identify the price they will pay for a product or service to enable consumers to easily compare prices between like products or services and make informed purchasing decisions⁵⁰.

Treasury sought submissions on the draft bill by 10 May 2006 but to date there has been no further information on the progress of the bill. More than four years after the Federal Court decision there has been no action. In the meantime, failure to provide the true minimum cost in advertising is rampant in a number of industries, including motor dealers and travel agents.

Mobile Premium Services

In May 2004, the then Australian Communications Authority (ACA) allocated a dedicated number range for the provision of mobile premium services following a trial period.

Mobile premium services are content or data services that can be accessed via a mobile phone. These service numbers may start with a 19 prefix or an international access code or may involve a higher rate proprietary service offered by telecommunications carriers. A wide and rapidly increasing range of content is available on MPS including video, internet access, information services, text chat, psychic lines, ring tones, weather services, voting lines for TV shows and competition entries, horoscopes and adult entertainment content. Premium content is an example of a product or service with ‘shrouded attributes’ – that is, cheap entry but high subsequent costs not evident at the time of purchase.

CHOICE has been concerned that consumers are subject to sharp marketing practices for mobile ring tones and chat services, the risk of incurring costs they are not aware of and exposure to inappropriate or unwanted content. There is also concern about the potential for price exploitation in relation to some services, including those offered by the major telecommunications companies.

⁴⁷ *Australian Competition and Consumer Commission v. Dell Computer Pty Ltd* [2002] FCAFC 434 and *Australian Competition and Consumer Commission v. Signature Security Group Pty Ltd* [2003] FCA 3.

⁴⁸ Trade Practices Legislation Amendment Bill (No.3) 2006 - *Explanatory Memorandum* <http://www.treasury.gov.au/contentitem.asp?NavId=014&ContentID=1085>.

⁴⁹ Trade Practices Legislation Amendment Bill (No.3) 2006 - *Draft Bill* see <http://www.treasury.gov.au/contentitem.asp?NavId=014&ContentID=1085>.

⁵⁰ Explanatory Memorandum para 1.4.

Recognising the potential for abuse of premium mobile services, the ACA proposed that a consumer protection arrangement in the form of an industry code be developed. An interim determination was registered on 29 June 2005⁵¹ which mainly covered content regulation and still left consumers unprotected for many other complaints, for example the absence of mandating options or timeframes for unsubscribing from premium mobile services. Carriers, content service providers and consumer groups commenced a process of developing a code under the auspices of the Telephone Information Service Standards Council. In November 2005, eighteen months after the release of the MPS numbers, a code was produced—though by now the mobile carriers had decided that it did not suit them and proposed an alternative code which was accepted by the Australian Communications and Media Authority (ACMA), the successor to the ACA, in September 2006.

Leaving aside, for present purposes, the unsatisfactory nature of the code development process, it is unacceptable that the code was developed so long after the product was available in the market⁵². A premium voice service using 19 prefix numbers had been in place for a number of years resulting in a large number of complaints⁵³, so it should have been foreseeable that these premium mobile services would also have raised issues. Given that the rollout of these numbers was controlled by the ACA, these issues should have been researched in the trial that did occur, with adequate consumer protection being put in place prior to the launch of the numbers to the general public.

These three examples illustrate different failings in the current policy development process.

In the first case, tensions between jurisdictions and around the Regulation Impact Statement process have caused unacceptable delays. In the second case, the cause of delay is less clear. It may be lack of resources within the policy development agency, it may be lobbying by industries whose short term interests may be adversely affected, there may be other reasons; in the third case, the delays flow from a lack of consumer orientation in the industry-specific legislation and policy development framework combined with an absence of any sense that policy needs to respond quickly to technological change.

In each case, there have been unacceptable delays in introducing laws necessary to protect consumer rights and increase market efficiency.

⁵¹ Telecommunications Service Provider (Mobile Premium Services) Determination 2005 (No 1).

⁵² See CHOICE submission to the proposed Code at <http://www.choice.com.au/files/f123124.pdf>.

⁵³ Australian Communications Authority (Service Provider Determination) Direction 2004 (No. 1), [http://legislation.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/8E601129AB6464FFCA25726700157885/\\$file/F2004B00514_RIS.pdf](http://legislation.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/8E601129AB6464FFCA25726700157885/$file/F2004B00514_RIS.pdf) (accessed 14 May 2007).

Priority accorded consumer affairs by Australian governments

High turnover of Consumer Affairs Ministers

From 1 Jan 2000 to 30 April 2007 – less than seven and a half years – there were 37 different State and Territory Ministers for Consumer Affairs⁵⁴ – on average four per jurisdiction. South Australia and New South Wales have each had six Ministers and Victoria has had four⁵⁵. Of the Ministers appointed after 1 January 2000, the served average period of office is only 20 months. The current Ministers have an average of only 13 months experience in the job. On the other hand, Ministers who were in office at 1 January 2000 served an average of 45 months, more than double the length of time of the average Minister in the 21st century. This suggests that the problem of high turnover in Consumer Affairs Ministers is of relatively recent origin. In any event, it is inevitable that the “revolving door” of Ministerial appointments to consumer affairs portfolios must result in a sub-optimal, fragmentary approach to progressing consumer regulation and policy initiatives.

Location of Commonwealth consumer affairs policy development

Consumer policy should be a national responsibility and primarily developed and implemented at a national level. This requires a ‘home’ in a properly resourced policy agency at the federal level, supported by effective regulators. There should also be much better coordination of agencies with consumer protection responsibilities, including more consistent accountability for their performance.

There has been some discussion about where consumer policy development should be located within the Commonwealth Government. In the 1970s, the key consumer policy development agency was located in the Industry portfolio. It was later moved to the Attorney-General’s Department and has for some subsequent time been located within Treasury.

In 1991 the National Consumer Affairs Advisory Council reviewed the ideal location of ‘consumer affairs unit’ in a government structure. They concluded that “such units achieve optimum results when they exist as a separate Ministry⁵⁶.”

The Council recommended that the Attorney-General’s Department would be its preferred Department with the departmental responsible for industry matters considered the ‘worst scenario’. It does not appear to have considered Treasury as a location. Perhaps more important than the *location* of the consumer affairs policy unit are its scope, resources and status.

⁵⁴ See Appendix C: The Revolving Door of Consumer Affairs Ministers. Two Ministers – Marsha Thompson in Victoria and Michael Atkinson in South Australia – have been in the position more than once.

⁵⁵ In South Australia Michael Atkinson has been Minister for Consumer Affairs twice in this period, so the portfolio has changed hands 7 times. In Victoria, Marsha Thompson has been Minister for Consumer Affairs twice in this period, so the portfolio has changed hands 5 times.

⁵⁶ National Consumer Affairs Advisory Council *Consumer Affairs Administration in Australia: How it works best* (1991) para 1.3.

An economics perspective would favour Treasury. In Treasury there is strength and the very basis of neoclassical economics is that all economic benefits in a competitive market should accrue to consumers – there are not valid interests other than consumer interests. A rights perspective may favour the Attorney-General’s Department.

Later in this submission we identify the serious problem of substantially divergent approaches to advancing consumer interests in different industries (communications, financial services, food, health, energy, household products and so on). Consumers have strong interest in the policy and administrative activities of very many government agencies. As noted in 1991 by the National Consumer Affairs Advisory Council:

Usually consumer affairs agencies will have responsibilities and powers for protection of consumers in the general market place and often for some specific markets such as credit, tenancy and motor trade. Other agencies will have such responsibilities and powers in respect of other particular markets. Consumer affairs agencies should be in a position to influence such specific market regulators to ensure a satisfactory standard of consumer protection. In pursuing this objective and in advising government generally consumer affairs agencies should have the opportunity to comment on all policy and legislative proposals going to governments.

In order to undertake this role the status of consumer policy needs to be enhanced. Additional resources need to be allocated to the Departmental consumer policy function - whether it is within Treasury or elsewhere. In addition an agency responsible for medium term consumer research and advocacy needs to be established within government - later in this submission, we recommend the creation of a new independent Australian Bureau of Consumer Economics (see Section 3.2).

Recommendation

2. Consumer Affairs should be given Ministerial status within the Commonwealth Government. The Consumer Affairs Portfolio should be combined with responsibility for competition policy to ensure that both demand and supply side competition issues are considered together, and to make the important link between consumer policy and core economic portfolio responsibilities.
4. The Commonwealth should significantly increase the resources allocated to consumer policy development and regulatory agencies.

Allocation of responsibilities between the States/Territories and the Commonwealth

The allocation of authority and responsibility between the States and Territories is governed by the Constitution, judicial interpretations, reference of State and Territory powers to the Commonwealth and *ad hoc* agreements made from time to time between governments. There is no logical structure to the current allocation of responsibility for particular consumer policy issues.

Developments in technology and market structures in Australia have increased pressure on Federal/State relations. Australia's consumer policy framework has failed to develop to reflect the fact that our market is now overwhelmingly national in character. Federal/State responsibilities in this area are by and large accidents of history rather than sensible divisions based on careful assessment of consumer markets and regulatory capacities. The Federal/State split of responsibilities slows policy making processes and frustrates businesses and consumers. In general, inconsistencies between different jurisdictions are undesirable as inconsistency causes uncertainty and confusion for business and consumers. For businesses trading across State boundaries – many of the major players in key consumer industries – this means additional compliance costs which in turn means increased prices for consumers.

Some consumer matters are Commonwealth responsibilities – these include most aspects of investor protection and specific consumer protection in key industries such as financial services, telecommunications, media and pharmaceuticals. But a large number of areas of concern to consumers such as credit and mortgage broking are dealt with on a State by State basis. The food industry is regulated by fragmented and inconsistent arrangements involving all jurisdictions and New Zealand. Overall there is no consistent approval across the range of consumer industries.

What may be a useful task for this inquiry is to identify the strengths and weaknesses of each level of government that are available to be brought to bear on the operation of the consumer policy framework.

We suggest that, in general, policy development needs to be undertaken nationally. There is rarely a good reason for different policy outcomes in the same industry in different States and Territories. Similarly, all consumers are entitled to expect reasonably consistent standards of complaint handling, monitoring, compliance and enforcement activity across the nation.

To do this we need a National Consumer Strategy. The elements of the Strategy are detailed below. A National Strategy would provide the coherence, vision and accountability required to improve the policy development process and the responsiveness and flexibility of consumer market regulation.

On the other hand complaint handling, consumer education and compliance monitoring need to have a regional presence. The need for regional presence does not necessarily dictate that States and Territories are always in the best position to undertake these tasks, nor that the potential for inconsistent outcomes outweighs any downside from a Commonwealth responsibility for each of these. The inconsistent enforcement outcomes in the food industry in relation to health claims made by national companies with head offices in different jurisdictions is an indictment of the federal system.

Recommendation

3. The development and administration of consumer policy should be a federal responsibility. The current split of consumer policy responsibilities between

federal and state and territory governments should be significantly rewritten so that consumer policy primarily operates at the national level.

Policy delays at the Ministerial Council for Consumer Affairs

The Ministerial Council on Consumer Affairs (MCCA), comprised of the Australian Government, the governments of the States and Territories, and the New Zealand Government, is responsible for considering consumer and fair trading matters and, where possible, developing a consistent national or trans-Tasman approach to these issues. But in many instances, reaching a consistent and timely response to important consumer issues has eluded it.

There are probably a number of reasons why MCCA does not operate as effectively as it should. These include:

- the high turnover in Ministers with consumer affairs responsibilities described above,
- the relatively low status of Ministers for Consumer Affairs,
- tensions inherent in a Federal system which include:
 - a reluctance to embrace the rational allocation of responsibility for particular areas of consumer policy where this may be perceived as undermining the role or prestige of an agency or jurisdiction,
 - opportunities for buck passing between Ministers, jurisdictions and agencies,
- failure to routinely seek public comment on policy proposals at an early stage,
- insufficient research and advocacy capacity in relation to consumer affairs (see Section 3.2 below),
- competing and unresolved approaches as to how best to respond to the need to balance necessary market intervention with calls to reduce red tape which in turn include:
 - changing goal posts in relation to the Council of Australian Governments (COAG) agreed Regulatory Impact Statement (RIS) process, and
 - reasonably widespread discomfort in government policy agencies with a RIS process that is primarily focused on easily measurable direct costs.

The following two examples illustrate how opportunities to develop and implement effective and efficient policy harmonisation and consumer protection have been hampered by the current MCCA arrangements.

Product Safety

The recent history of attempts to reform product safety law and administration demonstrate the difficulties in coming to rational arrangements in the face of the competing interests of ministers, jurisdictions and agencies. At best the State and Territory objections to pursuing the national scheme recommended by the Productivity

Commission⁵⁷ amount to suspicion that a Commonwealth agency will not adequately do the job. This suspicion may or may not be well-founded but an effective consumer policy framework would have processes and criteria to solve the problem. At worst States and Territories are motivated simply by fear that they will lose an important function.

Finance Brokers

The extraordinary and completely unacceptable delays in development of a final position on the regulation of the finance broking industry are described in detail at Appendix A.

A fairly simple licensing and dispute resolution scheme for mortgage and finance brokers is proposed. It would bring this part of the financial service industry into line with at least the main aspects of those parts of the industry regulated by the Corporations Law. The mainstream parts of the mortgage broking industry, mortgage originators (banks) and consumer organisations support these reforms (and have done so for several years). This straightforward, much-needed and popular regulation continues to be tied up in the red tape of the MCCA's policy development processes.

These delays appear harder to explain than those in relation to product safety. In part this is due to a lack of transparency in the policy development process. Those involved provide different excuses. There is no doubt that part of the problem has been an unnecessary officiousness on the part of the then Office of Regulation Review (now the Office of Best Practice Regulation). But there are clearly other problems which we have been told include an initial reluctance for the Commonwealth to have much involvement in this issue and differences in approach between states with evidently no clear mechanism to resolve them. We note the MCCA has only two formal opportunities each year to advance matters and the seemingly inexplicable absence of this issue from the MCCA agenda for three consecutive meetings (a 20 month period)⁵⁸.

Recommendation

23. A new consumer policy assessment process should be approved and implemented within the COAG framework to ensure more timely and efficient policy development and assessment. This would be substantially assisted by the research capacities outlined above.

Gate-keeping and regulatory impact statements

Consumers and businesses are better off when government decisions are based on an accurate economic assessment of the benefits and costs of alternative options. Over the past 10 years new regulation has generally been subject to regulation impact assessments. In 1997 the Commonwealth Government mandated that departments and agencies developing regulation with impacts on business or competition should prepare a Regulation Impact Statement (RIS) which is intended to provide a transparent record of whether key steps in good policy development have been followed, while summarising

⁵⁷ Productivity Commission *Review of the Australian Consumer Product Safety System* 16 January 2006 p 20.

⁵⁸ See Appendix A.

the results for the benefit of Cabinet or other decision-makers. A RIS must be prepared if an option to address a policy problem is likely to have a significant impact on business and individuals or restrict competition (whether in the form of compliance costs or through other impacts)⁵⁹. In response to the 2006 *Rethinking Regulation* Report of the Regulation Review Taskforce the Commonwealth made significant changes to the RIS process⁶⁰. It is now more difficult for a government to present legislation to Parliament without a RIS where one is required.

The RIS process is designed to control 'excessive' regulation and ensure proposed regulatory responses are cost-effective. The RIS process is managed by the Office of Best Practice Regulation (OBPR) within the Productivity Commission and has a central role in assisting departments and agencies to meet the Australian Government's regulatory impact analysis requirements and in monitoring and reporting on their performance. It also serves a similar role for the Council of Australian Governments (COAG) in relation to national regulatory proposals.

It is vital that we have high quality regulation and do not introduce regulations that will not work or will deliver net harm to consumers unless there is some over-riding policy reason for their introduction which is assessed as outweighing the net costs. Regulations also need to be evaluated for effectiveness after being introduced, not just when they are being developed.

The key challenges in developing and using effective gate-keeping processes such as an RIS are:

1. to ensure that benefits or costs which are less able to be directly measured are adequately taken into account (and to develop ways, including improved research capacity, to assist with such measurement),
2. to avoid incorrectly discounting the cost of not acting,
3. to increase the evidence, analysis and consideration of long term benefits over the influence of prejudice or lobbying by influential stakeholders.

Measurement problems

One of the main problems with the current RIS arrangements is that there is an excessive emphasis on currently measurable evidence of direct costs and benefits especially costs, rather than a willingness to evaluate the evidence of costs and particularly benefits of particular proposals from a broader range of sources. This can at times put policy proponents in the position of having to prove a negative, and/or weakens the benefits side of the equation given that a measure of benefits will only be available should the proposal come to fruition.

⁵⁹ See Office of Best Practice Regulation *Best Regulation Practice Handbook* (November 2006) at <http://www.obpr.gov.au/bestpractice/handbookchapters.pdf> (accessed May 2007).

⁶⁰ *Rethinking Regulation* Report at <http://www.regulationtaskforce.gov.au/finalreport/index.html> (accessed June 2007).

In the case of food regulation, for example, there is often no measurement and therefore little evidence of the possible costs and benefits to consumers. The lack of measurement and absence of evidence of harm may be taken by policy makers to mean that there *is* no harm, when in fact benefit or detriment has not entered the picture at all.

Naïve assumptions about consumer behaviour

A related problem with policy development in general and the RIS process in particular is that it often proceeds on the basis of assumptions about consumer behaviour developed from theoretical economics that are not consistent with actual consumer behaviour as discussed at Section 2.2 above.

Evidence to date does not inspire confidence that the RIS process is effectively grappling with these issues. In relation to mortgage brokers the then Office of Regulatory Review (ORR) has by most accounts set the bar too high: that is, it overemphasised the costs and was blind to the benefit. On the other hand, in the case of Treasury proposals released for comment in November 2006 for reforms to consumers' rights to compensation for loss caused by fraudulent activity by financial advisers, the OPBR has been prepared to set the bar too low and allowed a third best proposal to move forward despite a scandalously inadequate RIS that discloses no evidence of any benefit likely to be achieved⁶¹.

Decisions not to act

When government decides *not* to amend or repeal a regulation, no RIS is required. An example of a regulatory arrangement that fails all competition tests but exists for purely political reasons is the Pharmacy Agreement, the subject of a negative Productivity Commission assessment in 2000. Other examples include the protection of the free to air television oligopoly and the favourable treatment of Qantas, in particular on the Sydney – LA route. To be serious about removing red tape which harms competing businesses and consumers, government needs to develop policies that have the effect of eliminating those anti-competitive arrangements which have no net public benefit.

Similarly, no RIS is required if government proposes or decides not to introduce new regulation even where it will have a net public benefit. Failing to regulate where regulation is required can harm the public interest just as much as over-regulation. Again, the history of the slow development of the regulation of mortgage broking is an example. It has taken the Ministerial Council on Consumer Affairs more than four years to address problems in this industry despite a commitment to act given in 2003. In the meantime many consumers have suffered from the unscrupulous actions of a minority of mortgage brokers, to the detriment of the industry and ethical brokers as well as the affected consumers.

The proposed super complaint power discussed in Section 4 below might be crafted in such a way that a decision not to proceed on the complaint, or a decision to not take any

⁶¹ CHOICE *Submission on Compensation Arrangements for Financial Services Licensees Regulatory Impact Statement (RIS) and Draft Regulations* at <http://www.choice.com.au/files/f127506.pdf>.

action once a complaint was investigated, might be required to be supported by an approved RIS.

Increasing the importance of evidence, decreasing the influence of vested interest lobbying

Some measures that could be used to improve current processes include increasing non government research and advocacy capacity and requiring government policy development agencies to release options papers at an early stage in the policy development process and requiring RISs in the case of significant decisions not to act.

Transparency in Policy Development

Australia's policy development culture is too secretive. Policy proposals disappear for long periods of time without any accountability by the Minister or relevant agency. Examples include the proposal to develop an adequate system for compensation for loss suffered as the result of negligent or fraudulent financial advice (see Box below) and the extended period during which the Ministerial Council on Consumer Affairs neglected the pressing issue of finance broker legislation⁶².

Asleep at the Wheel

Reforms to the Corporations Act introduced by the *Financial Services Reform Act 2001*, required that financial services licensees providing a financial service to retail clients must have arrangements for compensating those persons for losses suffered due to breaches of relevant obligations under s 912B of the Corporations Act.

The problem was originally raised as far back as December 1997 during the consultations leading up to the enactment of the FSR reforms in 2000. In 2002 the then Minister asked that an issues paper be undertaken to obtain feedback from industry on the extent of the problem⁶³.

At the time of introduction, a number of concerns were raised about making arrangements to meet liabilities where compensation payments were ordered to be paid. Commencement of the obligations under section 912B have been repeatedly deferred, ostensibly to allow Government to consult on and finalise the details of prescribed compensation arrangements for financial services licensees.

In December 2006, Treasury published draft legislation based on hopelessly inadequate RIS. Current government proposals are limited to requiring advisers to take out PI insurance without prescription – which will fail comprehensively to deliver any effective consumer protection. Insurance will not cover all losses. Insurers regularly deny claims

⁶² The original report on the problem was prepared in March 2003, but the agreement to prepare draft legislation was only made in October 2006 - see Appendix A.

⁶³ See Treasury documents at http://www.treasury.gov.au/documents/1181/RTF/RIS_Compensation_arrangements.rtf (accessed June 2007).

where a licensee has been acting outside license conditions or selling non approved products, as has happened in Westpoint. Such a proposal, if implemented, would be an example of regulation that imposes a cost on business yet provides little or no benefit to consumers.

A compensation fund is an essential element of the compensation regime - see CHOICE's submission on the Draft Regulation for Compensation Arrangements for Financial Service Licensees⁶⁴.

Policy development proposals are sometimes developed behind closed doors with public consultation taking place only at the last minute. This can lead to poor quality proposals which are unworkable in practice and/or impose a burden on business but fail to provide any consumer benefit. The Business Council of Australia (BCA) has called for publication of proposals for regulatory reform at an earlier stage of development⁶⁵. CHOICE made similar arguments to the Regulation Review Taskforce.⁶⁶ The importance of policy implementation and the need for adequate consultation in the policy development process is set out in the Department of Prime Minister and Cabinet and Australian National Audit Office Best Practice Guide, *Implementation of Programme and Policy Initiatives*⁶⁷. And *Rethinking Regulation* pointed to the need for coordinated and comprehensive consultation practices at all stages of the regulation-making cycle⁶⁸ and set out criticisms and deficiencies in regulation-making⁶⁹. The Taskforce considered consultation so fundamental to achieving good regulatory outcomes that a whole-of-government policy is warranted⁷⁰.

⁶⁴ See CHOICE submission on Draft Regulation at <http://www.choice.com.au/files/f127506.pdf>.

⁶⁵ See BCA submission to the *Taskforce on Reducing the Regulatory Burden on Business* <http://www.regulationtaskforce.gov.au/submissions/sub109.pdf> (accessed June 2007) at p 34; see Final Report *Rethinking Regulation*, Report on the Regulation Taskforce 2006, at <http://www.regulationtaskforce.gov.au/finalreport/regulationtaskforce.pdf>.

⁶⁶ See CHOICE submission at <http://www.regulationtaskforce.gov.au/submissions/sub129.pdf>.

⁶⁷ Department of the Prime Minister and Cabinet and Australian National Audit Office *Implementation of Programme and Policy Initiatives* (October 2006) at http://www.anao.gov.au/uploads/documents/Implementation_of_Programme_and_Policy_Initiatives.pdf (accessed June 2007).

⁶⁸ See Final Report *Rethinking Regulation*, Report on the Regulation Taskforce 2006 <http://www.regulationtaskforce.gov.au/finalreport/regulationtaskforce.pdf> pp 150-155.

⁶⁹ See Final Report *Rethinking Regulation*, Report on the Regulation Taskforce 2006 which pointed to a recent government study that found only 25% of regulatory agencies engaged in consultations with the public when developing regulations at <http://www.regulationtaskforce.gov.au/finalreport/regulationtaskforce.pdf> p 152.

⁷⁰ See Final Report *Rethinking Regulation*, Report on the Regulation Taskforce 2006. The Taskforce also noted that the *culture* of consultation needs encouragement, by which policy-makers and regulators should demonstrate their commitment to consultation accompanied by allocation of resources to undertake consultation, and incentives to promote consultation by including it in business plans, staff performance and the like at <http://www.regulationtaskforce.gov.au/finalreport/regulationtaskforce.pdf> pp 152-153.

Finally, current policy development culture places too much emphasis on allowing better organised or resourced stakeholder groups early access to the policy development process in relative secrecy. There are many examples where interest group proposals are considered by government without revealing to the public that discussions about policy change are being held. In the interests of transparent and high quality policy development, government should generally require that the issue is discussed with other commentators and the public generally. Alternatively government could agree to consider the proposal on the basis that it will immediately invite public comment through well established consumer consultation strategies.

Recommendations

16. Government agencies with consumer policy or consumer protection responsibilities should establish consumer consultation strategies, including the establishment of a consumer committee (if not already established). Agencies should commit to using those strategies in relation to all consumer policy matters. The Treasury should provide upgraded secretariat support to the Commonwealth Consumer Affairs Advisory Council.
17. Consumer representation should be built into the ongoing policy development and industry monitoring of utilities and other regulated industries along the lines of the UK “Energywatch” model.

Consumer Input into Binding International Agreements

Governments may enter into binding international agreements that can adversely affect the interests and rights of consumers. A greater emphasis on the impact on consumers must be made in analysing these agreements for their potential public benefit. Hypothesised benefits for international political relations and select industry groups should not override the interests of general consumers.

Consumers must have more significant input and influence on the decision making processes involved in international agreements. Failure to incorporate real consideration of the impact of any agreement on consumers’ welfare raises serious concerns of the validity of arguments that those agreements are in the public interest.

The effect of policies resulting from international agreements on consumers also needs to be reviewed at appropriate intervals to ensure that unforeseen detriment is not perpetuated. Current international agreement making has very few processes built in to the system to allow for later modification of the terms of an agreement when harm is found to result from its provisions. As a general principle, agreements should not be entered into without mandated processes for review and change at a later stage if public interest is found to be genuinely threatened.

Recommendation

28. Processes should be developed to ensure consumer interests are taken into account when developing, acceding to, implementing and reviewing the effects of binding international agreements.

3.2 We need greater capacity for consumer policy research and advocacy

There is a clear need to ensure wider consumer input into policy development. There are a number of measures that could be taken to meet this need, all of which have merits.

1. Many consumer organisations provide legal or other advice to individual consumers. Resources could be directed to better harvest the knowledge gained from their regular face to face contact with consumers.
2. Peak consumer bodies such as the Consumers Federation of Australia and the Australian Financial Counselling and Credit Reform Association could be provided with resources to initiate research and advocacy projects to synthesise the experience of consumer advice agencies, direct membership consumer organisations and other consumer advocacy organisations. Below we recommend funding for such organisations to undertake this activity and to harvest the knowledge referred to in 1 above.
3. An Australian equivalent to the UK National Consumer Council (UK NCC) could be created. We have proposed the Australian Bureau of Consumer Economics which we propose would include the functions of the UK NCC.
4. Mechanisms to fund independent research on consumer policy issues could be developed.

Research capacity

We need an increased external capacity to research into consumer behaviour so we can understand the risks in modern markets, the impacts of technological change and developments in competition from the perspective of the consumer. Without adequate research there is a danger that consumer protection regulation will be based on ways of thinking about consumers and markets that do not reflect current realities. Instead policy makers will use models of how consumers should behave rather than how they actually behave. We need to improve the research capacity of the key consumer policy development agencies within government. We also need adequate independent research capacity to respond to emerging issues and consider problems that are not on the current political agenda. We have recommended improved status and resources for the Commonwealth agency responsible for consumer policy development together with the creation of an Australian Bureau of Consumer Economics to undertake longer term research and act as an independent advocate for good consumer policy within government. We have also recommended above (Recommendation 4) that additional resources be allocated to Commonwealth consumer policy agencies.

Consumer advocacy capacity

As well as increased research capacity, we need increased consumer advocacy capacity. This could be undertaken by (better funded) peak consumer organisations such as the Australian Financial Counselling and Credit Reform Association, Consumers Telecommunications Network, Consumers Health Forum and the Consumers Federation of Australia. These organisations play a key role in promoting the interests of consumers in an active and effective way, reflecting upon the impact of changes on consumers,

supporting the involvement of consumers in policy making and representing consumer interests in a range of forums, including the MCCA. They are efficient ways of building on the direct and the on the ground experience of their members and members' clients.

A large range of consumer organisations are regularly called upon by government agencies to provide evidence and advocacy to assist government policy development through submissions, informal consultations and formal representative arrangements⁷¹. But most consumer organisations are funded to provide casework or advisory services rather than advocacy, or do not receive government funding at all (for example the Consumer Federation of Australia).

CHOICE neither seeks nor receives government funding. We made more than 35 formal submissions in 2006. We declined to make a submission in response to many requests from government agencies and parliamentary inquiries due to lack of resources. We were also represented on or nominated other consumer representatives to a large number of government and industry committees (largely without recompense for those representatives). Once again, we declined many more offers to participate in or nominate representatives to government or industry committees. This demand for our input demonstrates a real need expressed by government and parliamentary inquiries for consumer advocacy. It is time that appropriate advocacy was funded at a level sufficient to meet this need.

At public hearings in April the Commission raised the suggestion that some consumer advocacy may be, or be seen to be, partisan. Consumer advocacy should not be politically partisan and in Australia it largely is not. On the other hand the purpose of consumer advocacy is to transparently work in the interests of consumers generally or a defined class of them (for example low income communication users in the case of the Consumers Telecommunications Network). Effective consumer advocacy is focussed on the broader public interest and often clashes with the immediate interest of producer groups, and where they are trying to satisfy producer groups, the interests of political parties. In short there will often be times when consumer advocacy is at odds with government policy but should never be politically partisan.

Recommendation

15. Significant ongoing funding should be provided to peak consumer organisations to provide evidence based input to policy development. Where possible, the funds should be raised through statutory levy arrangements.

Create an Australian Bureau of Consumer Economics

The UK National Consumer Council, an independent, non-departmental public body, which conducts research and generates debate on policy and law reform issues of

⁷¹ A small number of those organisations are funded in whole or part to undertake consumer advocacy. The National Electricity Market Advocacy Panel made grants of about \$600,000 to non-government organisations to undertake end user advocacy for domestic energy uses in each of the 1st few years. The Community Legal Services Program guidelines for Community Legal Centres (funded by the Attorney-General's Department) recognises that law reform and advocacy are roles of funded services.

importance to consumers. A similar organisation in Australia could look at both private and public provision of goods and services and include health, educational and social impacts and the cause and effects of disadvantage. Such an organisation would undertake long term research on policy issues and undertake “consumer impact assessments” to ensure that an evidence-based approach to consumer policy development and administration is adopted. This organisation could be tasked to inquire into, possibly with bodies such as the Productivity Commission, anti-competitive demand side practices in consumer markets, and identify ways to remove the anti-competitive impact of these practices.

Such a body, established and funded by government, could:

- undertake long-term research on policy issues,
- monitor and report on the impact of competition on prices in consumer markets,
- support other government agencies and bodies with consumer policy responsibilities to:
 - undertake consumer impact assessments and consumer policy cost-benefit analyses,
 - inquire into anti-competitive demand side practices in consumer markets, and
- produce “report cards” that outline development in consumer markets and provide information on the performance of agencies with consumer policy and/or consumer protection roles.

This body could also play a vital role in improving standards and eliminating misleading claims in the environmental sustainability of “green” goods and services (see Section 7 below).

Recommendations

18. A government funded consumer research body - an Australian Bureau of Consumer Economics (“ABCE”) - should be established to undertake long term research on policy issues. It should also undertake the “consumer impact assessments” recommended below. This is essential to ensure an evidence-based approach to consumer policy development and administration.
19. The Australian Bureau of Consumer Economics or the Productivity Commission should be commissioned to undertake an inquiry into anti-competitive demand side practices in consumer markets (particularly financial services and communications). The inquiry should focus on:
 - barriers to product switching,
 - structural conflicts of interest,
 - ways to avoid unnecessary complexity, and
 - the impact of product bundling including loyalty programs.The Inquiry should identify ways to remove the anti-competitive impact of these practices.
22. The Australian Bureau of Consumer Economics should be given resources to monitor and report on the impact of developments in competition on prices in consumer markets so that those developments can be better assessed and understood, particularly in the retail grocery sector.

24. Policy proposals which impact on consumers should be required to be accompanied by a consumer policy cost-benefit analysis provided by the Australian Bureau of Consumer Economics. This requirement would apply across all affected portfolios and industry sectors and promote a consistent approach to consumer policy as well as integrating consumer and competition reform.

3.3 Technology changes shouldn't leave consumers vulnerable

The current consumer policy framework does not have the capacity to react adequately, or in a sufficient time frame, to changes in technology that affect consumers. As a result new products, services and business models can leave consumers unprotected for considerable lengths of time until the regulation catches up.

While it is important that time and resources are allocated for research and consultation to be undertaken to identify whether market intervention is required and the most effective intervention, there is no provision for quick interim responses to ensure that consumers are kept protected in the meantime.

Examples of recent technology changes that have left consumers with little redress for complaints include mobile premium services and voice over Internet protocol (VOIP). As noted earlier in this submission was only very recently (Sep 2006) that the Mobile Premium Services Industry Scheme was approved by the regulator (ACMA) even though there had been consumer problems with this industry for nearly two years and the likelihood of those problems occurring was apparent long before mobile premium services commenced. Despite their growing popularity, VOIP services currently do not have any requirements for responses to faults unlike traditional telephone services.

Recommendation

32. Drafting principles should be developed to ensure that when preparing consumer protection legislation consumers are not made vulnerable due to developments in technology. These principles should ensure regulations avoid technology specific provisions where possible and include broad catch-all provisions.

4 Using the right tools to respond to market failure

A key function of the consumer policy framework is to identify market problems and to design, implement and review responses to those problems with the object of increasing overall consumer utility. Potential responses to market problems range from encouraging behaviour change by consumers and individual firms, through industry wide self or co-regulation, to various regulatory responses.

Unfortunately we have reached a point where the policy responses to market failure have become inflexible and outmoded in many areas of consumer policy. A set of largely unquestioned assumptions or policy biases inhibits more innovative policy approaches and can result in inflexible and poorly designed policies. Some key examples of these assumptions include:

- Self-regulation is intrinsically superior to formal legal regulation.
- Consumers always act in a manner consistent with the basic rationality axioms of “old style” neoclassical economics, and to the extent that they don’t behave in this way the divergences from the rationality model are insignificant.
- As a consequence of this, any divergence from rational behaviour is simply a matter of incomplete information, hence more information will generally fix market problems.
- Regulation always stifles innovation and market activity.
- Aggrieved consumers are individually able to use the legal system to obtain redress when things go wrong, or to the extent that this does not happen sufficient numbers of consumers can access the legal system to ensure market-wide changes to supplier behaviour.

CHOICE is not suggesting that these assumptions or ‘biases’ are present in all policy deliberations. Neither are we suggesting that all these propositions are wrong – in some markets they are certainly very relevant. Rather, we are suggesting that they tend to be implicitly adopted or applied in the consumer policy arena without sufficient consideration of alternative approaches to make markets work more effectively. In other words these biases are acting as a barrier to innovative and effective policy thinking. They are inhibiting the task of “refreshing” the regulatory toolkit to deal with new and emerging market challenges. The result is a regulatory approach which too often throws old solutions at new problems – regulation that increasingly does not work for consumers but still imposes costs upon industry participants. The following common characteristics of current policy development illustrate this problem:

- A tendency to add to existing regulation without considering whether existing regulation is part of the problem (eg disclosure in financial services).
- An undue reliance on disclosure as a policy tool to solve market problems irrespective of the nature of these problems.
- Undue reliance on regulating market *processes* rather than also regulating *substantive* matters. Such reliance usually follows from the mistaken belief that regulation of process will always involve regulation that is ‘lighter touch’ and so more market friendly.

- Unwillingness to consider a wider range of tools to address hard issues such as conflicts of interest, complexity and confusopoly.
- Insufficient attention to the need to establish mechanisms to address systemic consumer detriment.

4.1 Refreshing the tool box

A fundamental change required in our approach to consumer policy is a willingness to use the right tool for the job. A comprehensive set of tools would:

- use an evidence based education strategy to improve consumer skills including their financial literacy,
- ensure timely, clear, accurate and meaningful disclosure targeted at problems that disclosure can clearly fix,
- reduce the availability of deliberate attempts to confuse consumers (component pricing legislation, market inquiries into anti competitive effect of bundling and complexity,
- reduce the effectiveness of attempts to confuse or manipulate (cooling of periods),
- promote fairness, efficiency and confidence through disincentives for unfair contract terms (negotiated standard contracts, unfair contract terms legislation),
- prohibit products and market practices that undermine competition (most conflict of interests),
- prohibit products that are unsafe (including financially unsafe),
- provide regulators with enforcement tools for quick and sufficient responses to emerging problems,
- ensure consumer rights can be easily and effectively enforced through effective redress systems,
- include feedback mechanisms, to increase the responsiveness of the system on a whole (advocacy, super-complaints).

In reviewing the ‘craft’ of regulation, Sparrow argues that the essence of the craft lies in picking the right tool for the job, knowing when to use them in combination, and having a system for recognizing when the tools are inadequate so that new ones can be invented⁷².

Many of our current tools are not up to the tasks required of them, and our consumer policy framework is not good at recognising when they are inadequate and applying alternatives or developing new ones. As a consequence the current framework fails to find effective market-friendly solutions to key problems. A significant expansion of the consumer policy toolkit is urgently required so that today’s market issues can be addressed in more effective ways.

The required expansion needs to work at two levels. First, policy makers need to be prepared to intervene in markets in different ways. They should be willing to move beyond consumer education and mandated information disclosure where required. They need a greater willingness to use substantive regulation such as prohibition of particular

⁷² M Sparrow *The Regulatory Craft* (Brookings Institution 2000) p xvi.

behaviours, processes to encourage or require the development of fair contract terms, and use of cooling off periods, default options and mandatory standards. They need to give regulators clearly defined powers to respond to anti-competitive demand-side structures. In this regard the toolkit should include:

- Unfair contract terms legislation, and
- The power for a regulator conduct a market inquiry leading to a decision to prohibit particular conduct.

Second, a package of reforms to key consumer legislation is needed to give regulatory agencies greater flexibility and more cost-effective enforcement and consumer redress powers. The details of this package are set out in Section 5 below.

Consumer education and financial literacy

It is obviously desirable to improve consumers' financial literacy and abilities to make decisions that reflect their considered preference. Some but not all consumer problems would be avoided or ameliorated if a significant increase in those skills was achieved.

But there is no point spending resources on consumer education programs that are unlikely to work. To do this consumer education programs need to have a much greater understanding of how consumers learn:

Most of our departures from “rationality” involve violations of simple, easily understood rules. The mathematics of rational choice do not go beyond early high school levels – such as handling compound interest and basic probability calculations. Yet our “rationality” shows no correlation with our education. There is some evidence of learning by experience, but there is also evidence that our stock of learning soon depreciates...unless we understand how we learn rational behaviour we could waste a lot of resources on intensifying classroom teaching and financial literacy programs with little result⁷³.

Moreover we need to accept that there are many areas where consumer education will not provide a solution either in the short term or possibly at all. There is very little chance of consumer education or disclosure overcoming powerful incentives to mis-sell such as those produced by serious conflicts of interest⁷⁴.

Disclosure and its limits

Clear, concise, accurate, effective and timely disclosure is an essential pre-requisite for consumer-driven competitive markets. But good disclosure cannot solve all demand side

⁷³ I McAuley *Federal Trade Commission Conference on Behavioral Economics and Public Policy* unpublished paper 2007.

⁷⁴ See CHOICE *Submission to ASIC's Discussion Paper on Conflicts of Interest* at <http://www.choice.com.au/files/f124888.pdf> and recent research from the US which found that disclosure on conflicts of interest can in fact increase consumer trust in an advisor - see D Cain, G Lowenstein, D Moore 'The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest' (2005) Volume 34 *Journal of Legal Studies* pp 1-25.

market problems, and as experience with financial services reform demonstrates, too much disclosure can be counterproductive or at least ineffective.

Current regulatory approaches in many areas of consumer protection still look backwards for their intellectual justification⁷⁵ – there is an implicit assumption that underpins much of the ongoing focus with disclosure in financial services that comes from a time when there was very little information available to consumers. This engendered a belief that the answer to market failure was to throw more information at consumers. There was a time when more information was an understandable policy approach. Yet today consumers face the opposite problem – information overload and information excess, but still too much of it riddled with conflicts of interest. This undermines consumer trust and confidence. Further, the disclosure based protection regime, at the centre of the current framework, increases the paperwork burden on business, but doesn't assist in targeting vulnerable consumers and often has the effect of appearing to respond to the problem but not delivering.

1. Disclosure regimes should be closely aligned with the regulation of marketing. Current disclosure regimes permit sellers to be very 'clear, concise and effective' in their communication of the information that they want consumers to understand in their advertising, but obtuse, legalistic and complex in relation to product features they are less keen to emphasise.
2. Disclosure should not be relied upon to solve problems it cannot solve. No amount of disclosure can overcome a substantial conflict of interest or make simple an inherently complex product.
3. The seller and the consumer should share the onus of ensuring the consumer accurately understands the product and the transaction. Incentives for sellers to ensure consumer understanding should be created. (for example increased rights the right to exit a contract without penalty where the seller has failed to ensure the consumer understands its full implications).
4. When designing disclosure regimes policy makers should recognise that consumers make 'in-principle' decisions to purchase before they initiate a transaction. These decisions are influenced by the reputation of the seller and marketing information. Disclosure regimes should thus be supported by:
 - a) positive duties to include essential messages in advertising with similar prominence/effectiveness as the key marketing message,
 - b) requirements to make effective disclosure easily available prior to a consumer initiating contact (for example on a web site)
 - c) empowering regulators to name and shame companies that breach consumer protection law,
 - d) empowering regulators to issue a risk assessment in the absence of any breach of the law where it has concerns about the financial viability of a

⁷⁵ See also Luke Nottage, submission to this Inquiry.

- firm or the ethical conduct of the firm, its principals or senior managers, and
- e) effective redress systems for failure to communicate (not just disclosure) with vulnerable or disadvantaged consumers.

5. Disclosure requirements should be flexible. One model would be to state the objectives of disclosure in legislation but to leave the detailed requirement to be determined by the regulator after appropriate consultation or in appropriate cases through negotiation between representatives of industry and adequately resourced and appropriately skilled representatives of consumers.

Promoting fair contract terms

The market does not deliver fair contract terms. Before intervening to address this failure, policy makers should be satisfied on balance that unfair terms harm consumers and that policy responses to reduce that harm are available. The direct harm to consumers of unfair terms is largely obvious. Examples include the ‘rule of 78’⁷⁶ and harsh repossession terms in credit contracts now outlawed by the UCCC⁷⁷.

There are a range of possible policy responses, including unfair contracts legislation, minimum contract terms set out in legislation or industry codes of practice and negotiated fair standard form contracts (binding or presumptive). The question is to define the circumstances in which each response is appropriate. It would be useful to have a coherent principle based approach that applies across all consumer industries. We propose such an approach in the next section. In this section we review each of the possible types of market intervention.

Unfair contract terms legislation

Commerce works most effectively when consumers have confidence that they are treated fairly. Remedies available under the common law and statute have failed to protect consumers from detriment caused by unfair terms⁷⁸. They have only offered consumers protection from procedural unfairness arises from the *conduct* of parties making a contract, rather than the substantive unfairness of the terms themselves.

Some unfair contract terms may be sorted out by the market. In some circumstances the relative fairness of a particular contract will be transparent to a reasonable percentage of consumers and provide alternative products an advantage such that astute consumers at least will have the choice of taking a similar product or service on fair terms.

⁷⁶ A method for calculating amounts owing on hire purchase contracts which operated unfairly to consumers.

⁷⁷ See also our discussion of bank penalty fees below.

⁷⁸ See Standing Committee of Officials of Consumer Affairs *Unfair Contract Terms Discussion Paper* (2004) at <http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/Web+Pages/CD456F7C38F523684A256E240014EF7C?OpenDocument> (accessed June 2007).

But there are a wide range of circumstances where the market provides no incentive to avoid unfair contract terms. These include:

- where a supplier has a monopoly or is part of an oligopoly,
- where the unfair term is not relevant to consumers' purchasing decisions and thus where there can be no competitive advantage in having a more fair term (for example terms that relate to default fees or the right to unilaterally change contract terms),
- where consumers are faced with a 'confusopoly' – that is where it is in supplier's interest to confuse consumers, and
- where complexity means that unfairness is not apparent to large majority of consumers.

Legislative interventions to respond to unfair contracts have been introduced or recommended in several jurisdictions.

The EU's Unfair Commercial Practices Directive⁷⁹ requires EU member States to introduce a general prohibition on traders trading unfairly when dealing with consumers and a particular obligation not to mislead consumers through acts or omissions or subject them to aggressive commercial practices such as high pressure selling techniques. The Directive also lists 31 practices which are deemed to be unfair in all circumstances where a business deals with a consumer. The Directive will mean regulators throughout the EU can take action against practices that are unfair but not currently illegal, taking either civil or criminal enforcement action as appropriate. The UK has introduced relevant legislation and is adapting it to comply with the EU Directive⁸⁰.

Victorian unfair contracts terms legislation⁸¹ has been successfully used to address consumer detriment, notably in the telecommunications industry. The recent review of consumer credit in Victoria has set out the option of extending the unfair contract terms provisions to consumer credit contracts⁸², and the Victorian government has supported this option⁸³.

In 2006 the NSW Legislative Council recommended that NSW introduce similar legislation⁸⁴.

⁷⁹ EU Directive 2005/29 EC.

⁸⁰ UK, Department of Trade and Industry, *Government Response to the Consultation Paper on Implementing the Unfair Commercial Practices Directive* December 2006 p 3.

⁸¹ *Fair Trading Act 1999* (Vic) Part 2B.

⁸² J Merlino *The Report of the Consumer Credit Review* (2006) Consumer Affairs Victoria.

⁸³ *Government Response to the Report of the Consumer Credit Review* Option 5.3 pp 12-13 [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/\\$file/Credit%20Review%20-%20Government%20response%20\(web\).pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/$file/Credit%20Review%20-%20Government%20response%20(web).pdf) (accessed June 2007).

⁸⁴ See NSW Legislative Council Standing Committee on Law and Justice *Inquiry Report into Unfair Terms in Consumer Contracts* (November 2006) at

CHOICE believes unfair contracts terms legislation is an essential element of the regulatory tool kit. Our views are contained in our submission to the NSW Legislative Council Inquiry, a copy of which is at Appendix D.

Minimum standard contracts and Industry Codes on Consumer Contract Terms

In addition to unfair contracts legislation we need processes for promoting fair contracts. There are a number of existing examples of processes which go some way towards achieving this goal.

1. The *Insurance Contracts Act 1984* (Cth) includes minimum standard cover for a number of common insurance products. Industry members are entitled to deviate from standard cover where they make adequate specific disclosures. There are markets where similar approaches would be effective in relation to contract terms more broadly.
2. The telecommunications *Consumer Contracts Industry Code*⁸⁵ was negotiated through a process involving equal representation of industry and consumer interests in a code development committee. It sets minimum standards in contracts and can be enforced through the Telecommunications Industry Ombudsman.
3. The Banking Code provides for some agreed contract terms that ABA member banks agree to include in their contracts. These terms have become

The Social and Economic Council of the Dutch Sociaal-Economische Raad (SER) has the statutory task of promoting desirable trends in business and industry⁸⁶. To achieve this, the Self-Regulation Coordination Group of the SER facilitates consultation between business and consumer organisation other about mutually satisfactory general terms and conditions in consumer contracts. The result is the development of negotiated consumer contracts which include “equable General Terms and Conditions”. A successful negotiation also leads to the establishment of a bilateral complaints board. The decisions of the board feed back into further review of the general terms and conditions. In some cases (financial and network services) there is a legal requirement that the industry engage in the process. The Department of Justice may require that the agreed terms and conditions apply to non members of the industry body that negotiated the terms, however they do not do so unless such a directive is made⁸⁷.

Binding or presumptive minimum standards

For some industries or types of contract it is important that terms apply to all industry participants. The telecommunications industry Consumer Contract Terms Code applies a set of minimum terms to all participants.

[http://www.parliament.nsw.gov.au/prod/PARLMENT/Committee.nsf/0/3ecd89db93b4314eca25722f000b8bc9/\\$FILE/Unfair%20terms%20in%20consumer%20contracts%20Report%2032.pdf](http://www.parliament.nsw.gov.au/prod/PARLMENT/Committee.nsf/0/3ecd89db93b4314eca25722f000b8bc9/$FILE/Unfair%20terms%20in%20consumer%20contracts%20Report%2032.pdf) (accessed May 2007).

⁸⁵ ACIF C620:2005 *Consumer Contracts Industry Code* at http://www.acif.org.au/_data/page/12605/C620_2005.pdf (accessed June 2007).

⁸⁶ See http://www.ser.nl/overdeser/default.asp?desc=en_consumer (accessed June 2007).

⁸⁷ See http://www.ser.nl/overdeser/default.asp?desc=en_consumer (accessed June 2007).

An alternative approach would be to develop a model contract but allow sellers to propose alternative terms where they are sufficiently drawn to the consumer's attention including in marketing material.

Code Development Processes

There are many situations where developing fair terms through a Code has advantages over including them in legislation.

There are, however, some features of Codes and Code development processes which are far more likely to achieve effective consumer outcomes than others. We think it would be useful for a standard on Code development and features to be developed and to provide disincentives for the development of Codes which do not conform to the standard. Although our primary focus here is on codes that apply to contract terms, the principles with one addition would also be applicable to codes that regulate conduct.

Available disincentives may include

- a) government policy not to recognise or support codes which don't meet the standard,
- b) a presumption that a code which does not meet the standard is not in the public interest for the purposes of an application for authorisation under the TPA,
- c) requirements in specific industry legislation.

The suggested principles are

- (a) the Code should apply to all traders/transactions in a given market.

In some sectors Code coverage is promoted through a legislative incentive such as relief from a legislative provision, or relief from potential liability (eg Internet Industry Code). In others the Code is applied by direction by the regulator to those industry members that do not sign up to the Code.

- (b) the Code content should be developed through a process which gives equal weight to consumer and seller interests.

The Dutch model described above appears to meet this requirement. There are several Australian examples where industry code development has at least considerably taken into account consumer interest (Banking Code, Consumer Contracts Code in Telecommunications) if not given equal weight to them. There are other examples where sellers have initiated dialogue with consumer interests (for example, by establishing an evenly balanced Code development committee) but have taken their bat and ball away when they don't like the outcome – the Mobile Premium Service Code is an example⁸⁸.

⁸⁸ A Code was developed, however AMTA, representing the mobile telecommunications providers was not happy and simply prepared their own Code without consultation. ACMA to its shame simply registered the AMTA Code without a wimper.

There have of course been many examples of Code development with only token consumer input which is disregarded as the industry sponsors see fit. The Medicines Australia Code of Conduct and the Australian Advertising National Association the code on food marketing is another.

(c) the Code should provide for adequate accessible consumer remedies, for example through an industry complaints scheme that meets current good practice requirements.

(d) the Code should be supported by effective compliance monitoring structures.

There are three models of compliance monitoring in Australia:

- (i) monitoring by an appropriately resourced regulator (eg EFT Code, the Internet Industry Content Code),
- (ii) compliance auditing by an arms-length organisation (eg Banking Code), and
- (iii) ad hoc monitoring by an industry association/competitors (eg Medicines Australia Code of Conduct).

(e) in relation to conduct codes – satisfactory sanctions for non-compliance.

(f) the Code should have a process for regular review to ensure that it can be amended as required in response to technological change or market developments

Recommendations

5. A package of reforms to the *Trade Practices Act* and equivalent legislation should be implemented to modernise consumer and competition regulation so that regulators have the tools to make markets work better. This includes powers to eliminate unfair contract terms and unfair practices and outlaw practices that reduce demand side competition.
9. The nation-wide introduction of unfair contracts terms legislation based on the Victorian model is urgently required.
14. A generic set of principles and procedural requirements for Codes that affect consumer contracts or conduct in consumer markets should be developed. Codes which do not comply with these requirements should be deemed to be prima facie anti-competitive. The authorisation provision of the TPA should be amended accordingly. Government should adopt these principles as policy in relation to Codes required, authorised or permitted in particular industries.

Those procedures should cover:

- Code development - equal consumer and industry participation should be required.
- Code coverage - full industry coverage should be required.
- Code compliance monitoring - the relevant regulator should be satisfied it is effective.
- consumer redress - consumers should have access to a best practice dispute resolution scheme (equivalent to those compliant with ASIC Policy Statement 139).

- Code review - regular transparent review should be incorporated.

More accessible and effective consumer complaint and redress mechanisms

Consumer rights are no use when consumers do not have adequate means to enforce them. One of the successes of recent developments in Australia's consumer policy framework have been the industry based dispute resolution schemes in financial services and to a lesser extent telecommunications. Their strength lies in the combination of a co-regulatory framework, adequate consultation and participation by consumer advocates and the bringing to bear of industry commitment and know-how in their design.

There is an urgent need to develop adequate complaint and redress mechanisms in pharmaceuticals, media, food, some areas of telecommunications, non-bank consumer finance, and mortgage brokers.

There are too many consumer rights that are not able to be directly enforced by consumers in the real world, primarily due to the imperfect nature of the legal system. Examples include matters that concern relatively small value claims and matters involving repeat players in industry opposed to individual claimants.

Industry based complaint resolution schemes have proved to be a successful way to improve consumer redress, although in most industries they have proved to be truly effective only when established within an adequate co-regulatory framework.

Consumer confusion about rights and responsibilities and where to go for help could be addressed by investigating the establishment of a one-stop referral call-centre along the model of Law Access NSW or Consumers Direct UK. However, such a mechanism must not come at the expense of providing additional resources for face-to-face advice services provided by frontline service providers such as Community Legal Centres, advice bureaus and financial counsellors.

An adequate system of redress also requires some improvements to the legal system and the powers of regulators including improved class action procedures (see below in this section) and effective disgorgement powers following a successful civil or criminal action by a regulator (see Section 5).

Recommendations

33. The use of external dispute resolution mechanisms should be extended to industries and sectors where they are not currently available including consumer credit and mortgage broking, motor car repairs and sales, privacy and credit reporting and the travel and tourism industries.
34. Consideration should be given to establishing a single point of initial entry for all consumer complaints based on examples such as LawAccess NSW or Consumers Direct in the UK.

Class actions

In Australia class actions are only currently available in the Federal Court, since March 1992, and in the Supreme Court of Victoria, since January 2000.

In 1992 the then Commonwealth Attorney-General explained that class action procedure is needed for two purposes:

- To provide a real remedy where, although many people are affected and the total amount at issue is significant, each person's loss is small and not economically viable to recover in individual actions. It gives access to the courts to those in the community who have been effectively denied justice because of the high cost of taking action.
- To deal efficiently with the situation where the damages sought by each claimant are large enough to justify individual actions and a large number of persons wish to sue the respondent. Groups of persons, whether they be shareholders or investors, or people pursuing consumer claims, are able to obtain redress and do so more cheaply and efficiently than would be the case with individual actions.

Regrettably, however, the benefits promised above have been secured only occasionally. The limited use of the class action procedure is attributable to a number of factors, including a certain level of hostility towards class action litigation by a significant number of judges and a failure on the part of the Commonwealth and Victorian legislatures to remove the cost barriers that need to be overcome before commencing a class action. Class actions may represent the only realistic chance groups of consumers have to seek compensation when they are the victims of illegal conduct.

To redress this problem, the Federal and Victorian legislatures should introduce measures that will remove the problems that have stopped the class action procedure from delivering the benefits of access to justice and judicial economy that they were created to attain. Effective class action procedures should also be introduced in every Australian jurisdiction⁸⁹. A similar recommendation was made in 1994 by the Access to Justice Advisory Committee, a committee established by the Federal Parliament.

Recommendation

35. Action should be taken by the Commonwealth and Victorian governments to remove the cost barriers and other impediments to the successful use of the class action procedures introduced in those jurisdictions. Other jurisdictions should enact a version of the Federal Court procedure as improved in accordance with this recommendation

⁸⁹ CHOICE is one of the sponsors of an empirical study of the Federal and Victorian class action regimes that will be conducted by Associate Professor Vince Morabito of Monash University. This will be the first empirical study of Australia's class action regimes and will provide all governments in Australia with an objective and accurate analysis as to what aspects of these regimes have not operated well and recommendations as to how these problems may be addressed.

Super-complaints

In 2002 the UK introduced legislation⁹⁰ to enable designated non government agencies to make a ‘super-complaint’ to seven specified regulators including the UK Office of Fair Trading (OFT) and regulators for telecommunications, energy and water, rail and air travel. A super-complaint is a complaint that ‘any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers’⁹¹. Super-complaints are not intended to replace complaints leading to normal enforcement action, for example against a single firm or small group of firms engaged in breaches of consumer protection or competition law.

Designated agencies are expected to informed bodies who are in a strong position to represent the interests of groups of consumers and able to provide solid analysis and evidence in support of any super-complaint they may make. Those designated to date include the National Consumer Council, Citizens Advice, Energy Watch and Which? - the UK equivalent of CHOICE. As noted by the OFT, Super-complainants are not expected to provide the level of evidence necessary for the OFT or a Regulator to decide that immediate action is appropriate. However, they should present a reasoned case for further investigation⁹². A ‘super-complaint’ directed to a regulator requires the regulator to provide a reasoned response within 90 days.

Examples of ‘super-complaints’ by designated agencies include the following matters:

- The National Consumer Council about lack of competition in the home credit market - referred to UK Competition Commission and lead to new obligations on door stop lenders⁹³ – a practice generally not allowed at all in Australia.
- Which? on the lack of competition and absence of effective redress mechanisms in the private dentistry industry - an OFT inquiry lead to legislative changes including increased price disclosure requirements and establishment of a complaints service⁹⁴. Which? has made subsequent super-complaints about disability care, the Northern Ireland banking sector and credit card interest calculation methods⁹⁵.
- Energy Watch on systematic billing errors by energy companies⁹⁶.

⁹⁰ The *Enterprise Act 2002*.

⁹¹ *Enterprise Act* s 11(1); see Office of Fair Trading UK *Super-Complaints: Guidance for designated consumer bodies* 2003 p 4 and at http://www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft514.pdf (accessed May 2007).

⁹² OFT UK *Super-Complaints* p 6 at http://www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft514.pdf (accessed June 2007)

⁹³ National Consumer Council *NCC's first super complaint delivers 'excellent result' for Britain's 2m home credit customers* http://www.ncc.org.uk/cgi-bin/kmdb10.cgi/-load25668_nccviewcurrent.htm,

⁹⁴ Which? *Private Dentistry* http://www.which.co.uk/reports_and_campaigns/health_and_wellbeing/campaigns/dentistry/dentistry_supercomplaint/Dentistry_supercomplaint_560_75038.jsp (accessed May 2007).

⁹⁵ Which? *Our legal powers* http://www.which.co.uk/about_us/A/What%20we%20do/our_campaigning_priorities/Legal_powers_overview_559_113554.jsp (accessed 8 May 2007).

⁹⁶ Energywatch *Energywatch lodges first billing super complaint (06 April 2005)* http://www.energywatch.org.uk/media/news/show_release.asp?article_id=876&display_type=

- Citizens Advice about door to door selling - leading to tighter controls including improved cancellation rights and about payment protection insurance (consumer credit insurance in Australia)⁹⁷.

It is evident that the super-complaint process has been useful in focusing regulators' attention on issues in the industries that they are responsible for. While capable of leading to enforcement action it appears to have more frequently lead to changes in the rules and consumer protection structures applying in the affected market.

Recommendation

12. The UK “super-complaints” mechanism should be adopted in Australia so that consumer protection regulators are required to formally investigate and respond to complaints made by accredited non-government organisations about systemic market problems, including markets where competition is not working.

4.2 General consumer protection and industry specific legislation

The current consumer protection policy framework consists of a combination of general and industry-specific regulation. General provisions such as section 52 of the *Trade Practices Act* prohibit misleading and deceptive conduct in any industry. Industry specific provisions respond to the particular circumstances of a particular industry or issue within the industry. For example food labelling laws respond to a consumer right to safety and to choice in the specific context of what they eat.

The discussion about generic versus industry specific legislation needs to start from the proposition that both are required in most industries – it is not a question of one or the other.

Despite this acknowledgement there is no doubt that much industry specific regulation is similar in purpose or nature to specific regulation in other industries. Multiple industry specific regimes trying to achieve similar objectives suggest that some instances may be better than others - that some variation is wasteful and that efficiencies in design and operation could be achieved, particularly in relation to the regulatory structures that have been established to implement and review the industry specific regulation and to undertake any compliance role.

A 2006 paper by Consumer Affairs Victoria (“CAV”) sets out the comparative effectiveness of each type of regulation and the benefits of each⁹⁸.

(accessed May 2007).

⁹⁷ Citizens Advice *Citizens Advice delighted by OFT response to its supercomplaint on payment protection insurance* http://www.citizensadvice.org.uk/index/pressoffice/press_index/press-051207.htm (accessed May 2007).

⁹⁸ Consumer Affairs Victoria *Choosing between general and industry specific legislation* Research Paper No 8 November 2006 pp 7-10.

There are a number of problems with industry specific regulation which need to be addressed:

- first there is the risk of capture by industry to produce anti competitive barriers to entry
- second is a promotion of variation for no good reason in the nature, quality and effect of regulation. Such variation is apt to produce confusion or at least extra needs for legal advice for business and to result in sub-optimal outcomes for consumers.

We note the problems identified by CAV where an industry is exempted from the application of generic regulation.

- There is often uncertainty about the boundaries between the different areas of regulation, increasing the risk of regulatory gaps which may create incentives for traders to avoid regulation and leave consumers exposed.
- It silos responsibility for industry regulation increasing risk if regulatory inconsistency, which can be inefficient and unfair.
- Siloing responsibility also discourages cooperation between agencies – at odds with a joined up government approach.
- Fragments compliance and enforcement activity, reducing government agencies' ability to develop centres of excellence in understanding and interpreting the regulatory provisions and pass that expertise onto businesses trying to comply with the law.⁹⁹

Some jurisdictions such as Victoria and Queensland¹⁰⁰ have policy objectives that would reduce industry-specific legislation and emphasise fair trading acts as the key enforcement tool.

It may be possible and desirable to increase the uniformity and quality of industry specific legislation by setting some broad standards in generic legislation which can be implemented in relation to particular industries. For example it may be possible to prescribe in legislation of general application that all consumer contracts must be fair and to prohibit some notoriously unfair provisions across the board (eg the right to unilateral contract variation), but leave it to processes adopted in each industry to work out how to achieve that through a combination of standards, agreed standard minimum contracts and enforceable industry codes.

The more effective we can make generic regulation (and other interventions) the more likely we will be able to avoid the need for industry specific regulation.

⁹⁹ Consumer Affairs Victoria *Choosing between general and industry specific legislation* Research Paper No 8 November 2006 p 14.

¹⁰⁰ Consumer Affairs Victoria *Choosing between general and industry specific legislation* Research Paper No 8 November 2006 p iii.

Recommendation

11. Industry, consumers and government should work together to develop and implement better mechanisms, standards and contracts to enhance consumer confidence and market practices. These should include:
- a better use of “default options” in markets to ensure that consumers who are less able to exercise informed choice can still access good quality products or services at a fair price (for example default superannuation funds),
 - development of minimum standards for products in particular consumer markets (eg across the range of children’s products), and
 - greater use of standard form contracts.

Consumer protection in specific industries: Financial Services, Telecommunications, Food and Pharmaceuticals

Historically, generic or industry-specific legislation is developed and implemented in an ad hoc manner. There is an opportunity for Government to develop a considered and rational approach. The nation-wide introduction of unfair contracts terms legislation based on the Victorian model is urgently required. Research into developing and determining how regulatory interventions, and non-regulatory alternatives, can be better formulated.

Our analysis suggests that the significant variations in the approach produce poor consumer protection outcomes in some industries. The ineffective self-regulatory processes that apply to marketing of pharmaceuticals¹⁰¹ and complimentary medicines¹⁰² are examples of where compliance monitoring is poor and sanctions are no deterrent. Food industry regulation is an example of an unnecessary fractured compliance regime¹⁰³.

There is a strong case for a systematic review of each of these industries (and possibly the energy industry as well) to respond to these weaknesses and build on these strengths.

Some of the issues that need to be examined and resolved include:

- principles for allocating responsibility to the Commonwealth or the States (for example consumer credit is left to the state while other financial services are allocated to the Commonwealth; there is no rational reason for this and it leads to a number of problems or at least irrational inconsistencies),
- principles for allocation of policy making, monitoring, compliance and complaints handling responsibility between government and industry bodies,

¹⁰¹ See

<http://www.choice.com.au/viewArticle.aspx?id=104825&catId=100386&tid=100008&p=1&title=Drug+advertising>

¹⁰² See CHOICE policy and campaign material on complimentary medicines at

<http://www.choice.com.au/viewArticle.aspx?id=105376&catId=100386&tid=100008&p=1&title=Complementary+medicines>.

¹⁰³

<http://www.choice.com.au/viewArticle.aspx?id=105606&catId=100384&tid=100008&p=1&title=Food+regulation>.

- principles for deciding on whether to address problems at a generic or industry specific level,
- principles for implementing industry specific responses in consistent ways which avoid known problems,
- comparable resourcing,
- comparable penalties,
- consumer access to remedies,
- processes for developing and implementing regulation best practice.

Recommendation

3A: The National Consumer Strategy should articulate principles for ensuring that best practice consumer policy and consumer regulation is adopted across all industries.

See also Recommendation 14 on principles for development of industry Codes.

5 Improving enforcement performance

Consumer protection ultimately depends on the quality of enforcement and the performance of regulators. Current debates, however, focus on issues such as the quantity and quality of regulation, and relate predominantly to the development of regulation (how to determine whether regulation is required, what form that regulation should take, how to remove unnecessary regulation). There is limited commentary on the role of enforcement in good regulation, and in the promotion of consumer protection and a thriving economy.

We believe that far more attention needs to be given to the theory and practice of enforcement in good regulation and consumer protection. Underpinning Sparrow's seminal work *The Regulatory Craft* is the observation that "The style and nature of their implementation can surely make or break any new set of rules" 104. CHOICE is currently conducting research to examine the enforcement practice of consumer protection regulators and suggest ways to make this practice more effective and in line with good regulation principles. Our recommendations below are influenced by the results of that research to date. We will provide a final report on that research to the Commission in due course.

Poorly enforced policies and regulations create a range of problems for policymakers. They tend to impose costs on compliant participants but allow non-compliant firms to undercut or free ride. They also lead to red tape as pressure grows for new rules when better enforcement of existing rules may be a superior approach.

At present there are inconsistent approaches to enforcement across industries and jurisdictions. Accountability for enforcement is inadequate. Enforcement needs to be better targeted to major areas of risk and harm to consumers.

There are a very large number of regulatory agencies with consumer protection enforcement responsibilities. Most of these agencies enforcement responsibilities have different legislative underpinnings. They take varying approaches to policy development, enforcement, interaction with industry, interaction with consumers, interaction with other consumer agencies etc. This picture is complicated by the range of industry-based bodies that have some compliance, monitoring or enforcement role.

Australia's consumer policy framework would benefit from improved coordination and accountability across agencies. It would also benefit in many cases through developing consistent approaches to enforcement agencies' legislative base, their operational approach, accountabilities including monitoring compliance, enforcement and reporting thereon and the tools and powers available to them to respond effectively to conduct that harms consumers.

¹⁰⁴ M Sparrow *The Regulatory Craft* (Brookings Institution 2000).

To achieve these aims CHOICE proposes that enforcement agencies be required to enter into an agreement, or compact, to ensure that agencies meet their obligations to consumers.

Recommendations

6. Commonwealth and State/Territory enforcement agencies should each be given a consistent set of powers to:
 - ask a court to impose civil pecuniary penalties,
 - issue cease and desist orders,
 - require substantiation of claims,
 - issue ‘show cause’ and cease trading’ orders,
 - obtain a court order to compensate a class or group of consumers where a trader is found guilty of an offence or contravention of a statutory prohibition,
 - obtain a court order for disgorgement of illegally obtained profits, and
 - ask a court to establish a trust to hold on behalf of consumers any unclaimed monies from disgorgement or class compensation orders.

13. Regulatory agencies should be required to regularly “shadow shop” industries for which they are responsible so as to better understand consumer risks and service standards, and to publish their results.

26. Enforcement agencies should be required to enter into a *Consumer Enforcement Compact* aimed at ensuring agencies meet their obligations to consumers. The *Compact* would require agencies to:
 - set enforcement priorities according to an assessment of the risk of harm to consumers likely to flow from non-compliance with the law, and the likelihood of that non-compliance,
 - publish details of how they propose to undertake their compliance, monitoring and enforcement work,
 - conform to a new set of consistent reporting requirements for their enforcement activities, and
 - undertake the shadow shopping and consumer consultation in line with recommendation 13 set out above.

27. A model *Compact* should be developed by the ABCE in consultation with regulators, policy development agencies and other stakeholders.

6 Protecting vulnerable and disadvantaged consumers

The position of vulnerable and disadvantaged consumers' interaction with the market needs to be improved.

Overall improvements to the consumer policy framework such as those recommended in earlier parts of this submission will assist it respond to the needs of vulnerable and disadvantaged consumers. For example, reducing reliance on a disclosure based protection regime as recommended in Section 4 above will assist vulnerable and disadvantaged consumers. A policy approach which focuses on actual consumer behaviour, choice-making and preferences will better identify situations of potential consumer risk and detriment, in particular for vulnerable and disadvantaged consumers.

Vulnerable and disadvantaged consumers often need greater assistance to resolve consumer issues. Their precarious financial situation and other vulnerabilities not only make them more likely to experience consumer harm, but they typically have less resources to respond. This is why it is important to have an adequately funded network of advice services such as financial counsellors and community legal centres.

Vulnerable and disadvantaged consumers are also often less able to fully participate in public debate about policy proposals and to raise problems they face. As a result problems can remain relatively hidden unless service providers that are exposed to them can contribute to policy debates. Government should make funding available to contribute to consumer policy development by supporting vulnerable and disadvantaged consumers to take advocacy themselves, and by funding peak organisations for advice services such as the Australian Financial Counselling and Credit Reform Association to provide input into policy development through systematically analysing and reporting the experiences of consumers as they are observed by advice services.

Earlier we recommended that legislative proposals should be subject to a “consumer impact assessment” undertaken by the proposed Australian Bureau of Consumers Economics. Such an assessment should be required to have specific regards to the interests of vulnerable and disadvantaged consumers and to seek input from those consumers and organisations that provide services to them.

The difficulties that regulators (ACCC, ASIC) have in taking collective actions impacts disproportionately on consumers with lower literacy, rural areas. In Section 5 we recommended reforms to assist regulators take collective action on behalf of consumers.

Some remedial legislative provisions intended to respond to the needs of vulnerable and disadvantaged consumers, such as the unconscionable conduct provisions of the Trade Practices Act need to be reviewed to understand why there have been so few successful claims brought by consumers and the ACCC.

CHOICE and vulnerable and disadvantaged consumers
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CHOICE advocates in the interests of consumers generally. Like other consumer organizations we are concerned that consumer policy pays particular attention to the needs of vulnerable and disadvantaged consumers.

Much CHOICE advocacy and information provision is targeted to vulnerable and disadvantaged consumers. Some of the activities, campaigns and policy reform work undertaken by CHOICE in the recent past has highlighted the particular impacts on vulnerable and disadvantaged Australian consumers. These include:

Multiple super accounts (priority campaign) - disproportionately impact on casual workers, those with various part time jobs and less financially experienced consumers. See further discussion of the problem with super accounts in Section 9.1 below.

Childhood obesity (priority campaign) - has greater impact on lower socio-economic groups.

Private Health Insurance - private health insurance industry has an inequitable distribution of resources which benefits those on higher incomes.

Pharmacy pricing - the pharmacies' closed-shop practices mean higher prices for necessary medicines¹⁰⁵.

Bank penalty fees - Excessive credit card late payment and over limit fees are most likely to be incurred by those in financial stress.

Unexpected high bills in telecommunications - While there are credit limits on pre-paid telecommunication services, most post-paid services do not create credit caps by default, the processes to voluntarily create a credit cap vary between providers and are often not available or difficult to access. The high cost of many premium content services and timed voice and data services can create unexpected high bills in very short amounts of time.

Healthcare reform - people in rural and remote areas don't have the same access to services as people living in metropolitan areas. It costs more and takes longer to access health services in the bush. Our health system also does not meet the needs of Indigenous Australians¹⁰⁶.

¹⁰⁵ CHOICE carried out a shadow shop which found that pharmacists were in some cases charging more than the allowable rates set out in the Pharmacy Agreement. We have written to the Productivity Commission outlining our concerns. There is evidence that a significant proportion of Australians do not fill their script because of the cost of the co-payment, which has increased by \$10.70 since 1997. See R J Blendon et al 'Inequities in Health Care: A Five-Country Survey' (2002) *Health Affairs* Vol 21(3) p 182 at <http://content.healthaffairs.org/cgi/reprint/21/3/182> (accessed June 2007).

¹⁰⁶ CHOICE is a member of the Australian Health Care Reform Alliance (AHCRA), made up of 46 consumer, healthcare and clinician organisations calling for reform of the Australian healthcare system. CHOICE also belongs to National Oral Health Alliance which is headed by ACOSS and the ADA (Australian Dental Association). We participated in a lobbying day in Canberra calling for more resources for low income Australians to access dental care.

Product safety - cheap, shoddy and dangerous products are disproportionately bought by low income consumers.

Regulator inaction or lack of capacity - Regulators may lack capacity, resources or will to undertake regulatory activity or litigation to protect groups and classes of consumers. This impacts disproportionately on consumers with lower literacy and those in rural areas (in particular parts of the indigenous population) that may collectively and efficiently benefit vulnerable and disadvantaged consumers.

Recommendations

36. Action should be taken to improve the position of vulnerable and disadvantaged consumers by simplifying consumers' interactions with the market, enhancing consumer redress and improving policy development as recommended above. Action to increase the fairness of standard contracts is particularly important.
37. Increased funding should be made available for financial counselling and community legal services to provide consumer education, advice, advocacy and representation to vulnerable and disadvantaged consumers.
38. Increased funding should be made available to non-government organisations capable of providing empirical information about the experience of and representing the interests of vulnerable and disadvantaged consumers in the policy development process. These include the Consumers Federation of Australia, the Australian Financial Counselling and Credit Reform Association and Consumers Telecommunications Network.
39. The Australian Bureau of Consumer Economics should be required to regularly review and report on particular issues which impact on the ability of vulnerable and disadvantaged consumers to benefit from competition and to exercise their consumer rights.
40. Legislative provisions on unconscionable conduct should be reviewed in light of so few claims being successfully brought, even by the ACCC, on behalf of individual consumers.

7 Sustainable consumption and the consumer policy framework

Many of the initiatives required to support and increase sustainable consumption lie outside the consumer policy framework. Examples include subsidies and other incentives to consumers, investors or business to make sustainable choices, for example recently announced subsidies designed to improve the attractiveness of solar hot water, or proposed subsidies to encourage consumers and particularly investors to retrofit housing stock.

Relevant areas of consumer policy include:

- ensuring credible, comparable and reliable information is provided to consumers about the environmental performance of goods and services by manufacturers and sellers, and that false and misleading claims are deterred and where made corrected.
- the introduction of standards and accreditation schemes in particular circumstances (for example the proposed one watt power standard or the existing GreenPower accreditation scheme).
- Ensuring equitable *access* to sustainable goods, in particular energy saving housing stock and energy saving appliances.
- Consideration of the impact of measures introduced for environmental reasons which impact on consumers. Examples include the likely increase in fixed and/or unit costs for energy, water and fuel, and the introduction of different pricing structures such as interval pricing of electricity which may or may not operate in consumers' interest.
- The introduction of a credible and effective national or international standard that influences industry behaviour, such as ISO 26000, currently in draft.

In general the policy development and compliance aspects of these issues can be dealt with in the same way as other consumer issues, and will benefit from the recommended improvements in the policy development and enforcement processes outlined above.

In particular, as we have noted earlier, introduction of measures to reduce the extent to which consumer policy is developed in industry specific silos should apply to consumer issues in energy as much as other industries.

Recommendation

42. The ABCE should review labelling and claims made by suppliers about the environmental impact of products and services, with the aim of:
 - improving standards and eliminating misleading claims.
 - identifying key energy intensive products services and/or environmentally damaging products or services to establish what mandatory consumer information would assist consumers to make more informed decisions about the impact of their consumption.

8 Identifying and removing regulations which harm consumers

In previous work we have identified a number of regulations that harm consumers by preventing or inhibiting competition¹⁰⁷. These are set out below.

13. ACA's [CHOICE] List of Regulations that are failing consumers.

1. The Pharmacy Agreement – this determines price structures for prescription drugs sold in pharmacies, sets up barriers to entry and protects high mark-ups.
2. Broadcast television – the licensing arrangements protect the three free-to-air commercial channels from competition; many other countries have 10 times this number.
3. Digital television – regulation restricts operators from adding value to their content, for example through multi-casting; combined with failure to increase the number of free-to-air channels available on digital, this has meant very low take-up by consumers.
4. The health insurance rebate – a clumsy, wasteful and hopelessly unsuccessful attempt by government to intervene in the market.
5. The 10% taxi credit charge surcharge – why?
6. Product safety laws – the dispersal of regulatory responsibilities between state and Commonwealth agencies creates inconsistency and weakens the enforcement of product safety laws.
7. Regulation of the professions – this often restricts competition for services that could be adequately performed by less qualified people (conveyancers, nurse practitioners etc); few professions have effective and independent consumer complaints processes.
8. Disclosure of conflicts of interest in financial services – requirements to disclose conflicts of interest create more paperwork but to little to protect consumers.
9. The *Air Navigation Act* and associated treaties protects Qantas from competition with rival airlines on some profitable air routes (eg Sydney – Los Angeles).
10. The Fire Service Levy on home building contracts in NSW and Victoria – an illogical rule that deters consumers from taking out home building insurance (due to higher price); this should be replaced with a levy paid by all building owners rather than only those who prudently insure.
11. Identification hurdles (for example, 100-point ID and authorisation by a JP) that make it difficult to change or consolidate super funds.

Recommendation

41. The Commonwealth should remove all current regulatory restrictions on competition which cause harm to consumers without any countervailing public benefit. These include the restrictions on allocation of landing rights to

¹⁰⁷ See CHOICE *Submission to Review of Regulation Taskforce* pp 21-22 at <http://www.choice.com.au/files/f122128.pdf>.

international airlines on certain routes, the Pharmacy Agreement and the limitations on allocation of broadcast television licenses.

9 Areas of Specific Concern

The Commission's primary task is to make recommendations to reform the overall consumer policy framework. However the Commission ought to take this opportunity to provide direction on some key current problems. Some of the priority areas in specific industries of financial services, health, telecommunications, food and product safety requiring attention are set out below.

9.1 Financial Services

Penalty Fees

For consumers, penalty fees for bounced cheques, overdrawn accounts and dishonoured periodic payments can be excessive. Other fees such as those associated with inward cheque dishonours and going over a credit card limit appear to be unjustified in their entirety. There are good reasons for thinking that the imposition of these fees is illegal¹⁰⁸ but on any view these fees are plainly unfair and may bear no relation to the cost incurred by the financial institution as a result of the consumers default. These fees have been increasing far more quickly than inflation – some have gone up by 40% in two years. Appendix F is a copy of a letter to the Commonwealth Treasurer dated 19 June 2007 which provides further information and recommends policy solutions.

Compensation for Bad Financial Advice

Consumers increasingly need access to sound financial products and independent, honest financial advice. The government requires financial product makers and sellers to be licensed which, amongst other things, gives increased legitimacy to financial advisers¹⁰⁹. The *Financial Services Reform Act 2001* requires financial advisers to have compensation arrangements in place to protect consumers when things go wrong. Despite the Act, regulations have delayed operation of the requirement to belong to a compensation scheme.

Current government proposals are limited to requiring advisers to take out professional indemnity insurance without prescription – which will fail to deliver adequate consumer protection. Insurance will not cover all losses. Insurers regularly deny claims where a licensee has been acting outside license conditions or selling non approved products, as happened in relation to losses suffered by consumers who were negligently or fraudulently advised to invest in the Westpoint group of companies. Such a proposal, if implemented, would be an example of regulation that imposes a cost on business yet provides little benefit to consumers. A compensation fund is an essential element of the

¹⁰⁸ See Consumer Action Law Centre *Unfair Fees: A report into penalty fees charged by Australian banks* 2004 at <http://www.consumeraction.org.au/downloads/DL56.pdf> (accessed 10 May 2007).

¹⁰⁹ See *Compensation for Bad Financial Advice* at <http://www.choice.com.au/viewArticle.aspx?id=105317&catId=100385&tid=100008&p=1&title=Compensation+for+bad+financial+advice>.

compensation regime - see CHOICE's submission on the Draft Regulation for Compensation Arrangements for Financial Service Licensees¹¹⁰.

Property investment advice and seminars

Property investment is not regulated in the same way as other classes of investment. Unlike stock broking or financial planning, you don't need to be licensed to give property investment advice, and there's no easy way to pursue a complaint – there's no Ombudsman scheme like there is for other investments.

CHOICE has campaigned for nationally consistent regulation of property investment advice. A 2005 Commonwealth Parliamentary Committee recommended that property investment advice should be a Commonwealth responsibility¹¹¹. No action has yet been taken.

To ensure adequate consumer protection, advisers should be required to hold a licence and belong to an external dispute resolution scheme. ASIC should have clear powers to take action against any misleading or unfair tactics, and ASIC should be adequately funded to regulate the industry. This may require State governments to provide some of their tax take from property transactions for this purpose.

Other problems include quality advice, failure to disclose commissions and the relationships promoters have with property developments, misrepresentations that proposed investment strategies are risk free or low risk, failure to provide promised refunds on seminars and courses and difficulties consumers experience in obtaining redress¹¹².

Mortgage Brokers

Changes to the mortgage market influenced at least in part by financial system reform and resulting increasing choice and complexity in mortgage products have led to opportunities for intermediaries in the mortgage market.

In 2003 the Consumer Credit Legal Centre (NSW) drew attention to a wide range of problems for consumers dealing with mortgage brokers. While the Wallis reforms had created a partly successful system for the management of financial service products and financial advisers regulated by the Corporations Act it had left a gaping hole in consumer protection legislation as a result of the fact that responsibility for consumer credit remains with the states.

¹¹⁰ See CHOICE submission on Draft Regulation at <http://www.choice.com.au/files/f127506.pdf>.

¹¹¹ See Report of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into property investment advice at http://www.apf.gov.au/senate/committee/corporations_cte/investment/report/report.pdf p 23 (accessed May 2007).

¹¹² For further information on CHOICE's work on property investment advice see <http://www.choice.com.au/viewArticle.aspx?id=104808&catId=100385&tid=100008&p=1&title=Property+investment+advice+and+seminars>.

Appendix A describes the tortuous process leading towards resolution of some of these problems. While the MCCA process appears to be working towards a satisfactory outcome, we note that if credit is to become a Commonwealth responsibility as we recommend, then it will be easier to incorporate a (compulsory) complaints scheme for finance brokers into the existing structures of financial service complaints schemes and to coordinate compliance strategies with other financial service industry strategies. For many businesses it will also reduce the number of regulators that they must deal with thus likely reducing costs.

Reverse Mortgages

Reverse mortgages are a relatively new product that presents particular risks for consumers. There is no doubt that the new product meets some consumer's needs and is a market innovation that brings benefit to those consumers. However the product also brings with it dangers through potential mis-selling and some inherent risks that the market is not able to deal with.

Under a reverse mortgage, a consumer borrows against the value of their home whilst interest compounds. The debt is settled on the property value when the consumer dies or moves out. Problems with reverse mortgages include the 'no negative equity guarantee' in these contracts - meaning that the consumer will never owe more than the value of their home. However, many of reverse mortgage contracts contain traps which mean the 'no negative equity guarantee' might not apply if the consumer is technically in default under their contract, potentially placing elderly consumers in financial danger at a time when they may be frail and vulnerable (such as when they have to sell their home to move into aged care). Many reverse mortgage products are sold on commission and also have trailing commissions. Commission payments - with no test for reasonable or appropriate advice - risk undermining the objectivity of advice. There is significant potential for reverse mortgages to be mis-sold. There are also different standards of advice on these products depending on whether they are sold by brokers or planners.

Existing laws in Australia don't adequately protect reverse mortgage consumers. The Uniform Consumer Credit Code only covers reverse mortgages where more than 50% of the loan is used for consumption purposes. Reverse mortgages are an example of a new and emerging consumer product that requires decisive and multi-pronged regulatory response to prevent consumer detriment. State governments must introduce uniform reverse mortgage laws in order to force the industry to standardise its contracts and clear up the problems and prevent excessive risks to borrowers in years to come.

As at November 2006, 20,000 reverse mortgages had been issued and around \$1 billion in loans outstanding. Rapid growth is forecast and many new lenders (non-bank lenders, specialist companies and mortgage managers) are releasing products.

Regulatory responses to address the problems of intermediaries selling reverse mortgages should include a requirement that all lenders and other companies dealing with consumers about a reverse mortgage contract be members of approved external dispute

resolution schemes. Mortgage brokers should also be licensed, especially if they're dealing with reverse mortgages, to help ensure that consumers receive proper and complete advice. Further, the proposed Finance Brokers Legislation should be extended to reverse mortgage and trailing commissions paid to advisers selling this product should be prohibited.

Measures should also be taken to improve the product design of these contracts including the requirement that a separate contracts for reverse mortgages be drawn up instead of an add-on section in a general home loan contract. Other remedial measures include a cooling-off period, a requirement they be written in plain English, default conditions should apply only in the case of serious contract breaches and the 'No Negative Equity Guarantee' to be clearly spelled out in the contract. Only a serious breach of the contract should void this guarantee. The guarantee should cover the net proceeds of the house in an orderly arm's length sale.

Attached as Appendix E is a copy of CHOICE research on this topic.

Digital Security

Personal and financial information is increasingly being transacted online. The costs of securing this information are high and some in industry want to shift this cost - and the risk of fraud - onto consumers. However, consumers do not have the resources to protect themselves against the rapidly evolving online scams and fraud.

Large businesses are in a better position to take the necessary steps to reduce fraud and to share any losses across all those who benefit from online transactions. Businesses have made many savings from shifting their business online. They need to accept that reinvestment in IT security, is critical to maintaining consumer confidence in online transactions. Failing to do so will cost them more in the long run if that confidence is lost. If businesses encourage consumers to make online transactions, they should also be prepared to shoulder the responsibility of any associated risk. Businesses need to invest in finding reliable ways to protect consumers' online security, catering for the wide spectrum in consumer computer skills and risk understanding.

ASIC is currently reviewing the Electronic Funds Transfer Code of Conduct (the EFT Code) - the code that regulates electronic transfers of money including taking money out from ATMs, using credit cards over the phone or Internet, and making purchases through EFTPOS. The EFT Code review is also looking at direct money transfers using Internet banking. Some in the finance industry argue that consumers should have a greater liability in cases of fraud by third parties. The EFT Code should not be changed to place liability on for fraud. But it does need to be updated to deal with new technology like Internet banking.

Superannuation accounts

Multiple superannuation accounts cost consumers billions. Each year, more than \$1 billion is paid in fees on unnecessary accounts. Consumers lose millions more through ‘lost’ superannuation associated with multiple accounts¹¹³.

The key barriers to account consolidation include unnecessarily onerous administrative requirements to consolidate accounts, poor communication and inadequate assistance to fund members, the absence of a mandatory industry wide protocol on consolidation, inadequate consumer education and difficulties obtaining cost effective financial advice high exit fees, in particular the prohibitively high exit fees on some older products. In addition, the system for managing ‘lost’ superannuation is not working.

Many of the barriers to account consolidation flow directly from current and past industry practices. Some exist because they make life easier for superannuation funds by transferring the effort and risk of dealing with multiple accounts to consumers. Government has failed to provide regulatory incentives required to respond to this market failure.

Recent welcome government announcements include greater use of tax file numbers and a shorter time frame to transfer super from one fund to another. We also welcome decision to consolidate and hold all ‘lost super’ for over 65 year olds with the ATO. These changes will address some of the problems with ‘lost super’ and barriers to account consolidation but will not be enough by themselves to reduce the number of superannuation accounts to an acceptable level.

CHOICE has recommended that the Commonwealth government take action to reduce the barriers to account consolidation and to address the problem of lost superannuation. This includes creating a specialist agency within the Australia Taxation Office to target the problem, establishing an electronic transfer system using tax file numbers set up a central fund to better manage ‘lost’ super, tightening up rules that apply to fund administrators when they receive a transfer request and providing assistance to superannuation funds to consolidate accounts automatically.

Recommendations

43. The regulation of credit should be reviewed with the aim of moving regulatory responsibility to the Commonwealth level like other financial services.
44. Australia should implement Financial System Guarantee arrangements as soon as practicable, as was recommended by the HIH Royal Commission and the 2004 Financial System Guarantee report. An insurance policyholder protection scheme should be introduced as was strongly recommended by the HIH Royal Commission. A depositor protection scheme should also be introduced for prudentially regulated ADIs notably banks, credit unions and building societies.

¹¹³ See CHOICE Research Report *Super Secret* at <http://www.choice.com.au/files/f127162.pdf>.

45. A compensation scheme for financial services should be introduced that incorporates both compulsory professional indemnity insurance and a “safety net fund” to cover situations where a financial firm goes out of business before it can compensate consumers for negligent advice.
46. Regulatory agencies should be given the power to abolish unfair or inappropriate exit fees, and to abolish or limit the amount of penalty fees in financial products.
47. A risk rating system should be introduced for investments targeted at retail consumers.

9.2 Communications

Recommendation

48. The communications regulatory structure should be reformed so that it requires puts consumer needs at the heart of the Code development and complaints handling processes. Key requirements are:
 - that there is one complaints handling agency for all communications complaints (other than content complaints?)
 - that the complaints handling procedures comply with good practice (for example as represented by ASIC policy statement 139 in relation to financial services)
 - that there is one consumer code for telecommunications developed within a co-regulatory framework by a body with equal consumer and industry representation
 - that the Code and the complaints handling system apply to all telcos, ISPs and resellers.

9.3 Food

Food Regulation

The three objectives of food regulation are:

- the protection of public health and safety,
- the provision of adequate information relating to food to enable consumers to make informed choices, and
- the prevention of misleading and deceptive conduct

To ensure the above objectives are met, policy development in food should ensure that consumers have a voice and meaningful input in food regulation and policy development and that decision-makers prioritise consumer interests and public health over the interests of the food industry. To facilitate this, regulators engage consumers through consumer research and consumer advisory panels. CHOICE notes that in 2006 Food Standards Australia New Zealand (FSANZ) established a Consumer Liaison Committee in an effort to increase consumer input into its decision-making processes and has devoted more resources to consumer research.

It is too early to tell the extent to which this will improve the consideration of consumer

issues in the development of food regulation. There is still considerable room for improvement needed at the food policy development level as the consultation processes used by the Food Regulation Ministerial Council and the Food Regulation Standing Committee are currently ad hoc and they differ from issue to issue.

Open and transparent processes for developing food policy and standards will also enhance consumer confidence in food regulation and the ability of regulation to protect public health and provide consumer information.

CHOICE notes that a number of reviews are looking into food regulation. The recent review *Rethinking Regulation* observed that problems with the current food regulation framework include overlap and duplication between state Food Acts and the Australia New Zealand Food Standards Code, inconsistencies in applying and enforcing standards across jurisdictions, lack of enforcement of some elements of the code, in particular, labelling and health claims; and the timeframes and complex processes associated with developing or amending food standards¹¹⁴.

Childhood obesity

Many factors contribute to childhood overweight and obesity, but we know that food advertising to children influences their food preferences and food choices. Poor nutrition is the most important factor that contributes to a child becoming overweight or obese.

Australian children are exposed to a significant number of TV advertisements for junk food. Around 25% of TV ads aired between 7am and 9pm are for unhealthy foods. The volume of unhealthy food ads increases when children are most likely to be viewing – early evening and Saturday mornings.

Kids are increasingly being exposed to junk food marketing through competitions, tokens, meal deals at fast food outlets, character merchandising, sports sponsorship, fundraising and online marketing. Junk food marketing makes parents' jobs hard by tempting children with salty, fatty or sugary foods which they inevitably pester their parents to buy.

Current regulation does not protect children from being bombarded with ads for junk food. The Commonwealth Government's Children's Television Standards place some limits on food ads. Beyond that regulation of food and beverage marketing to kids is largely left to the advertising industry itself.

Government should strengthen regulation of food marketing to children. This could be done by extending TV advertising regulations to PG rated programs as they are also popular with children (e.g. cartoons, soap operas and reality TV programs). Regulation of

¹¹⁴ Regulation Taskforce 2006 *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* Report to the Prime Minister and the Treasurer, Canberra, January 2006 at <http://www.regulationtaskforce.gov.au/finalreport/regulationtaskforce.pdf> p 57 (accessed 10 May 2007).

junk food advertising should apply to TV advertising of unhealthy food before 9pm and regulation should be extended to cover online marketing techniques used to promote foods and brands to children.

Those regulations should:

- address the dominance of ads for unhealthy foods compared to healthy foods
- require that marketing directed at parents must not mislead them about the nutritional value of a product by focussing only on positive nutritional attributes and ignoring negative nutritional attributes
- prohibit the use of promotions (such as competitions and giveaways) on packages of unhealthy foods
- prohibit the use of children's characters and sports and media personalities to promote unhealthy foods.

To assist consumers, there should be a single contact point for all advertising and marketing complaints so that consumers do not need a detailed understanding of the various forms of regulation and codes of practice in order to support the complaint.

Simplified Nutrition Labelling System

CHOICE has supported the introduction of mandatory nutrition information Panels on packaged foods to enable consumers to assess the nutrition content and compare products based on the particular nutrients of importance to them.

However, nutrition information required by governments and claims made by manufacturers to increase product sales compete for label space and the consumer's attention.

CHOICE welcomes the development of a *simplified* nutrition labelling scheme that further assists consumers to identify healthier options and easily distinguishes them from foods that are high in fat, sugar or sodium. CHOICE believes that a scheme offering an element of judgement about the healthiness of individual products would be most helpful in assisting consumers to choose healthier foods. A scheme like this would also provide an incentive for the food industry to reduce the fat, sugar and sodium content of processed foods.

CHOICE has developed a document setting out *Principles for a Simplified Nutrition Labelling System*¹¹⁵.

Recommendations

49. Regulations should prevent marketing of unhealthy food to children as part of a broader strategy to combat childhood obesity.

¹¹⁵ See Principles at <http://www.choice.com.au/files/f128134.pdf>.

50. The regulation and enforcement of health claims should be undertaken by the Commonwealth.
51. A simplified food labelling system that includes some evaluation of the contribution of the food to a healthy diet should be introduced.

9.4 Product Safety

Consumers generally trust that the products they buy have been designed for safety and adequately tested so that they will not present unexpected safety hazards to themselves or their families. However there remain weaknesses in the Australian product safety system.

There are not enough standards in force. And overlapping state and federal government jurisdictions result in poor enforcement of existing product safety laws. A new Commonwealth agency is required to oversee all product safety issues - with independent power to enforce the product safety law, collect and analyse data, act as an early warning system for removing imminently hazardous products from the market, guide business in conducting recalls and inform the public of product hazards.

CHOICE also wants to see a General Safety Provision. A general safety provision would impose a positive safety duty on all producers of products that are sold to consumers. Australia's current product safety regime doesn't impose that pre-market responsibility on producers¹¹⁶.

Recommendations

52. There should be a comprehensive review of product liability provisions in the TPA (Parts VA, Part V Div 2A and 2), and disparate state legislation, particularly in light of inconsistent reforms to the TPA and state laws on negligence since 2002.
53. The Productivity Commission's recommendations on product safety of 2005 should be implemented as a matter of urgency.
54. In addition, a General Safety Provision along European lines should be introduced together with a requirement for manufacturers and importers to report serious product related accidents to the responsible Commonwealth agency.

9.5 Health

Australian consumers' interests in, and access to, high quality and competitive health services and products have been poorly served by a historically fragmented government oversight of health policy issues and unsatisfactory regulation of health products and industry practices.

¹¹⁶ See

<http://www.choice.com.au/viewArticle.aspx?id=105097&catId=100476&tid=100008&p=1&title=Product+safety> for more of CHOICE's work on product safety including speeches and submissions to Ministers and the Productivity Commission.

Government agencies need to work together to identify and review areas of health policy arrangements in drug advertising, pharmaceutical benefits scheme, complementary medicines, amongst others, to enhance best practice in competition policy and consumer protection and relieve cost pressures on the health system.

In this section we set out some specific areas in this industry that require urgent reform.

Drug advertising

Some pharmaceutical companies employ sophisticated and potentially misleading marketing strategies to increase drug sales and that this can lead to leakage (drugs approved for one purpose being commonly used for another) and an increase in the cost of the Pharmaceutical Benefits Scheme (PBS). Pharmaceutical companies target doctors and consumers in a variety of ways. For example, pharmaceutical promotion in prescribing software (which occurs at the time of physician–patient consultation) has been found to be an effective form of advertising to doctors.

Medicines Australia, the peak body for the pharmaceutical industry, has developed a Code of Conduct on pharmaceutical marketing that sets the standards for the ethical marketing and promotion of prescription pharmaceutical products in Australia. The Code is ineffective in policing the industry¹¹⁷. Recommendations are set out below.

Complementary medicines

The current regulatory regime does not do enough to protect consumers from the range of claims made by manufacturers of complementary medicines. Although complementary medicines are considered ‘low risk’ by the Therapeutic Goods Administration (TGA), they can still interact with other drugs and can harm consumers.

There are over 16,000 complementary medicines listed with the TGA. Around 80% of new complementary medicines are not reviewed, investigated and evaluated by the TGA before being available in stores. While complementary medicines companies are required to hold evidence to support the claims they make on their packaging, companies often hold insubstantial evidence.

To protect consumers’ health, complementary medicines should be evaluated in the same way as pharmaceutical products. Undertaking post market evaluation of only 20% of new products does not protect consumers’ health. Further, consumers may be wasting money on products which have not been tested and simply do not work.

CHOICE is lobbying the TGA on these and other issues and participate as a member of the Complementary Medicines Implementation Group to ensure effective implementation

¹¹⁷ For more information on CHOICE’s work in this area see <http://www.choice.com.au/viewArticle.aspx?id=104825&catId=100386&tid=100008&p=1&title=Drug+advertising>.

of the recommendations made by an expert committee about changes to the complementary medicines industry¹¹⁸.

Recommendations

55. The Commonwealth should commission an independent inquiry into all aspects of pharmaceutical marketing in Australia, its impact on medical practice and its contribution to cost pressures on the health system. Such an inquiry should consider
 - a ban on pharmaceutical promotion in doctors' prescribing software
 - a new, independent regulator for pharmaceutical marketing together with an appropriate co-regulatory code of conduct for pharmaceutical marketing backed by effective monitoring and sanctions.
 - the introduction of independent drug detailers to replace drug reps to visit GPs to inform them about new drugs on the market.
56. The Health Act should be amended to require pre-market evaluations of the efficacy and safety of complementary health products.

9.6 Unit pricing

Manufacturers sometimes market 'bulk pack' products as economical – but in fact larger 'bulk buy' packs are sometimes no cheaper than buying the smaller pack, or may be more expensive. Manufacturers seem to use their knowledge about consumer behaviour to decrease the size of their product whilst the price remains the same

Unit pricing means displaying the price of goods per unit of measure (e.g. per 100 g, per kg or per litre). It is a simple way that supermarkets could help consumers get value for money, save time and make better choices. They already have to do it for meat, fruit and vegetables. Unit pricing would enable consumers to easily compare the prices of the different shaped and sized packets on the supermarket shelf.

Unit pricing is widely used in the US and Europe – it's even a legal requirement in some countries. Retailers in Australia are resistant to its introduction. But feedback CHOICE receives from consumers suggests that many consumers would use unit pricing if it was there.

CHOICE thinks supermarkets should display the unit price for most products that are sold by quantity and we've written to the Ministers for Consumer Affairs/Fair Trading in each State as well as the CEO's of supermarkets. This relatively simple change would allow consumers to make accurate price comparisons between different brands and sizes.

¹¹⁸ For more information on CHOICE's policy reform work in this area see <http://www.choice.com.au/viewArticle.aspx?id=105376&catId=100386&tid=100008&p=1&title=Complementary+medicines> (accessed June 2007).

Appendix A: Policy Development Case Study: National Finance Broker Regulation

Key points

- Intermediaries have played an increasingly important role in consumer financial services since deregulation of the financial system.
- Four states have some kind of regulation of finance brokers.
- Public disquiet about the activities of some brokers lead to calls for regulation including licensing and a complaints scheme, calls generally supported by the banking and mortgage broking industries as well as consumer organizations.
- In August 2003 the Ministerial Council on Consumer Affairs agreed to work towards nationally uniform legislation.
- Nearly four years later no consultation draft of the legislation has been produced.
- Allowing for the necessary adoption of uniform legislation, it will be no earlier than March 2009 before legislation is implemented, more than five and half years after action was agreed by Ministers.
- The primary causes of delay appear to be unrealistic or difficult to satisfy requirements imposed by the Commonwealth Office of Regulatory Review (now the Office of Best Practice Regulation, hereafter referred to as the OBPR) and difficulty in achieving agreement on the policy detail among the States.
- This is not the worst example of delay – some proposed reforms to the Uniform Credit Code have taken longer.

Introduction

Product complexity in financial services has generated a need for intermediaries to explain and sell products. Nowhere is this more apparent than with mortgages. Lenders are increasingly reliant on brokers to sell their loans and many consumers benefit from asking a mortgage broker to identify the most suitable product for their needs. Nationally it is estimated that mortgage brokers place up to 40 per cent of new loans and that they refinance about 30 per cent of existing loans.¹¹⁹

The 2003 report by the Consumer Credit Legal Centre (NSW), *a report to ASIC on the finance and mortgage broker industry*, identified many of the ways consumers can be adversely affected by brokers, particularly those at the fringe. These impacts include giving poor quality advice, excessive broker fees and commissions, cold calling and

¹¹⁹ John Collett 'Traps for Older Players' *Sydney Morning Herald* 23 January 2007.

pressure tactics, loan amounts higher than consumers can repay to maximize commission payments, and operating loan approval scams such as requiring the consumer to dial a premium telecommunications service or taking out a credit card to pay the broker fee through a cash advance.

While NSW, WA, Victoria and the ACT have legislation specifically regulating finance brokers, SA, Tasmania, Queensland and the NT do not. The legislation in NSW, Victoria and the ACT has a similar focus on disclosure for brokers dealing in consumer credit, although the regimes in Victoria and the ACT are less comprehensive than that in NSW. WA's legislation applies to commercial credit brokers as well as those who deal with consumer credit, so mortgage brokers are caught. There are key differences between the different regimes, meaning that businesses operating in different jurisdictions have to comply with different rules which put an unnecessary burden on business. Brokers who fall foul of the law in one jurisdiction can move their operations to another less regulated jurisdiction, to the detriment of the consumers who live in these areas.

For over five years mortgage brokers and consumer groups have been calling for a single set of minimum standards across Australia. The two key reforms required are a system to license brokers (and thus exclude those that do not comply with ethical standards) and a requirement to belong to an approved external dispute resolution scheme, as is the case for almost all other businesses supplying financial services.

Most industry organizations, including the Australian Bankers Association and representatives of mortgage brokers, have supported these calls. But the pace of change has been woefully slow.

We understand that the Commonwealth was reluctant to introduce national legislation because it believes credit laws, including the role of intermediaries, are a matter for the states and territories. As the problems with brokers became more obvious after several interest rate rises, the need to license and regulate brokers became urgent at a national level and saw the Federal Government and the States and territories agree to work towards uniform regulation by States and Territories in August 2003.

The road to uniform legislation

March 2003	<i>a report to ASIC on the finance and mortgage broker industry</i> by Consumer Credit Legal Centre (NSW) Inc released.
August 2003	Ministerial Council on Consumer Affairs (MCCA) meeting Communiqué: Ministers endorsed further work to develop consistent national regulation of finance brokers which builds on the <i>NSW Consumer Credit Administration Amendment (Finance Brokers) Act</i> .
August 2004	MCCA Meeting Communiqué: Ministers noted that a regulatory impact statement on model consistent national

regulation for finance brokers was currently being drafted. It proposed that the statement would be released for discussion in September 2004.

December 2004	Regulatory Impact Statement Discussion Paper detailing proposals for a national scheme to regulate the finance and broking industry released. 63 responses received, generally supportive of a comprehensive regulatory regime.
April 2005	Not referred to in Communiqué of MCCA meeting.
September 2005	Not referred to in Communiqué of MCCA meeting.
May 2006	Not referred to in Communiqué of MCCA meeting.
September 2006	MCCA Meeting Communiqué: Ministers today discussed issues related to the national regulation of finance and mortgage brokers. The proposals have been the subject of on-going consultation with industry and consumers. A decision on the scheme will be announced after further consideration out of session.
October 2006	Ministers agreed out of session to proceed to drafting of a consultation Bill.

Current status

NSW Parliamentary Counsel is currently drafting the consultation Bill and hope to have a Bill ready for a further round of public consultation by mid-year (however it is not possible to predict timeframes at this early stage...).

Following release of the consultation bill, an updated Regulatory Impact Statement will have to be submitted to OBPR for assessment, before a draft bill can go to the Ministerial Council for final approval. Even if the drafting is completed on schedule, on past experience, it will be well into 2008 before a legislative scheme is ready to be introduced into the state and territory Parliaments.

The uniform legislation would then have to be passed by each of the eight State and Territory governments. At the earliest implementation is still around 22 months away.

Factors inhibiting progress

The long path to implementation of these straightforward and widely supported measures highlights the difficulty of coordinating different jurisdictions to implement reform. We understand that, despite the years of work on this issue, the states continue to battle over what should be covered in a draft uniform code.¹²⁰

¹²⁰ Michelle Innis 'A Fine Balance' *Sydney Morning Herald* 29 September 2006.

Our understanding is that one person in NSW Office of Fair Trading has done nearly all the work on this project, including development of the discussion paper, analysis of submissions, ongoing consultation and liaison with stakeholders and preparation of final recommendations report. So the level of resourcing is one important issue.

The process has been considerably slowed by the need to get OBPR approval at each stage. There is considerable scepticism among parties involved in this policy process about whether the OBPR requirements have added value to the process. They argue that the OBPR's demands for data on costs of lack of regulation/ benefits of regulation have been hard to satisfy.

The focus of the OBPR appears to be on the impact of proposed legislation on competition policy and efficiency in general which, while important considerations, have appeared to derail the efficient and timely progress of this legislation.

Another factor that often impedes progress on law reform is a lack of agreement among the governments involved in multi-jurisdictional processes. In the case of mortgage brokers, this has been less significant – there is a fairly high degree of uniformity. However, there are some differences about the optimal approach, not all of which have yet been resolved.

Another contributing factor to the delay has been that some of the States have regulatory impact processes themselves, some requiring more detail than others, and creating their own delays. For instance, in NSW the mortgage brokers discussion paper had to be approved by the NSW Cabinet Office before release, delaying the process even further.

The worst example?

The slow path toward national mortgage brokers legislation is, regrettably, not the worst example. The process of getting holes in the uniform credit code plugged has been very slow and difficult. The problems with the ways fringe credit providers construct products to avoid the application of credit legislation were identified in the *Post Implementation Review of the Uniform Consumer Credit Code* conducted in the late 1990s. Seven years later, we are still dealing with problems, particularly in relation to solicitor lending and vendor terms contracts.

Even reasonably simple changes have taken far too long. For example, the low threshold for hardship variations in the credit code, originally set in 1996 at \$125 000, took many years to be adjusted despite the rapid increase in housing prices throughout Australia. It was not until the end of 2004 that the majority of States - mid 2005 for Tasmania - introduced a floating threshold linked to an Australian Bureau of Statistics index of the cost of new houses in Sydney. At the end of 2004 this rate was \$330 550. This meant that for eight years only consumers with mortgages or other consumer loans below \$125 000, well below average house prices, were eligible to apply for hardship relief or postponements of enforceable proceedings under the credit code.

These delays have been due in part to a lack of resources and energy, and in part due to flaws in a policy development process that is unable to respond quickly and efficiently on important consumer issues.

Appendix B: Switching rates

Professor Ian McAuley cautions that switching rates are not a reliable indicator of a healthy consumer market for services such as energy.

I'm aware of a naïve belief that switching is a reliable indicator of healthy consumer activism¹²¹. But I'm unconvinced.

Clearly, in a market which is competitive on the supply side, zero switching is indicative of possible trouble – an indication of stickiness, or perhaps even the Diamond Paradox. But is more better?

I don't know the relationship between switching levels and consumer benefit. I suspect that no-one knows it. For example, [in a paper presented at the OECD Consumer Policy Roundtable in 2005, White and Waddams show] that (a) consumers make more efficient switching in markets with fewer competitors and (b) many consumers switch to a higher cost source of supply¹²²

I'm particularly sceptical about the notion that because some consumers can find benefit in switching, then all can do likewise.

In such an assumption there is a fallacy of composition.

To an extent, in utilities, switching has to be a zero sum game, because these firms have high fixed costs and comparatively low variable costs (particularly low in the case of telecoms). Price discrimination is therefore inevitable. The theoretical maximum economic efficiency would be achieved with Ramsay pricing. In short, some consumers have to pay a high share of the fixed costs, while others, presumably the more active, with higher demand elasticity, will pay a lesser share. Not everyone can be priced at or near marginal cost.

Ramsay pricing¹²³, while being economically efficient, does not necessarily align with our norms of distributional justice. I suspect the beneficiaries of switching are people with a high degree of scepticism, a low opportunity cost of time, and the capacity to perform what can be reasonably complex spreadsheet calculations.

In time we will look back on this period and see the absurdity of introducing competition for fungible basic commodities (particularly gas, electricity and

¹²¹ McAuley notes “there has been (up to April 2007) quite a bit of media activity around switching in utilities – particularly the finding that Victoria has a very high level of consumer switching.”

¹²² Chris M Wilson and Catherine Waddams *Price Irrationality in Consumers' Switching Decisions: When More Firms May Mean Less Benefit* Paper presented to OECD Consumer Policy Roundtable 2005.

¹²³ Described for APEC as “The optimal set of average cost prices in a multi-product setting” (Charles J. Untiet ‘The Regulation of Natural Monopolies’ Antitrust Division US Department of Justice <http://www.apeccp.org.tw/doc/Workshop/w1997/a01.htm>) and by the National Competition Council as “those who are prepared to pay more do” <http://www.ncc.gov.au/pdf/DEAiViSu-024.pdf>.

water). We will wonder why we didn't recognise the technical economies in vertical integration, the low cost of capital in public corporations, the high transaction costs in retail competition and in structural separation, and the high costs of regulation – how a blind obsession with 'competition' overtook any notion of common sense in public policy.

Appendix C: The Revolving Door of Consumer Affairs Ministers in Australia from 1 January 2000 to 1 April 2007

From 1 Jan 2000 to date – less than 7 and a half years – there have been 37¹²⁴ different State and Territory Ministers for Consumer Affairs – on average 4 per jurisdiction. South Australia and NSW have had 6¹²⁵ Ministers and Victoria has had 4¹²⁶!! Of the Ministers appointed after 1 January 2000, the served *average* period of office is only 20 months. The current Ministers have an average of only 13 months experience in the job. Ministers who were in office at 1 January 2000 served an average of 45 months (3 years 9 months), a significantly longer period of time. This suggests that the problem of high turnover in consumer affairs ministers is of relatively recent origin.

Jurisdiction	Minister	Dates in office	Number months in office
Federal (4)	<i>Parliamentary Secretary to the Treasurer</i>		
	Chris Pearce	Oct 04 – current	30
	Ross Cameron	Oct 03 – Oct 04	12
	Ian Campbell	Nov 01 – Oct 03	23
	<i>Minister for Financial Services and Regulation</i>		
	Joe Hockey	Oct 98 – Nov 01	37
NSW (6)	<i>Minister for Fair Trading</i>		
	Linda Burney	Mar 07 – current	1
	Dianne Beamer	Aug 05 – Mar 07	19
	John Hatzistergos	Feb 05 – Aug 05	6
	Reba Meagher	Apr 03 – Feb 05	22
	Joseph Aquilina	Nov 01 – Apr 03	17
	John Watkins	Apr 99 – Nov 01	31
VIC (5)	<i>Minister for Consumer Affairs</i>		
	Daniel Andrews	Dec 06 – current	4
	Marsha Thomson	Jan 05 – Dec 06	23
	John Lenders	Dec 02 – Jan 05	25
	Christine Campbell	Feb 02 – Dec 02	10
	Marsha Thomson	Oct 99 – Feb 02	28
SA (7)	<i>Minister for Consumer Affairs</i>		
	Jennifer Rankine	Mar 06 – current	13
	Karlene Maywald	Jul 04 – Mar 06	20

¹²⁴ Two Ministers - Marsha Thompson in Victoria and Michael Atkinson in South Australia - have been in the position more than once.

¹²⁵ In South Australia Michael Atkinson has been Minister for Consumer Affairs twice in this period, so the portfolio has changed hands 7 times.

¹²⁶ In Victoria, Marsha Thompson has been Minister for Consumer Affairs twice in this period, so the portfolio has changed hands 5 times.

	Michael Atkinson	Aug 03 – Jul 04	11
	John Hill	June 03 – Aug 03	2
	Michael Atkinson	Mar 02 – June 03	15
	Robert Lawson	Dec 01 – Mar 02	3
	Trevor Griffin	* - 93 - Dec 2001	96
NT (3)	<i>Minister for Justice</i>		
	Sydney Stirling	Aug 06 – current	8
	Peter Toyne	Aug 01 – Aug 06	60
	Denis Burke	Feb 99 - Aug 01	30
QLD (3)	<i>Minister for Fair Trading</i>		
	Margaret Keech	Feb 2004 – current	38
	Merri Rose	Feb 2001 – Feb 2004	36
	Judy Spence	June 98 - Feb 2001	32
ACT (4)	<i>Attorney General</i>		
	Simon Corbell	Apr 06 – current	12
	John Stanhope	Nov 01 – Apr 06	53
	Bill Stephaniak	Dec 00 – Nov 01	11
	Gary Humphries	*- 95 – Dec 2000	60
TAS (3)	<i>Minister for Justice and Workplace Relations</i>		
	Steven Kons	April 06 – current	12
	Judy Jackson	June 02 - April 06	46
	Peter Patmore	Sept 98 - June 02	45
WA (4)	<i>Minister for Consumer Protection</i>		
	Sheila McHale	Dec 2006 – current	4
	Michelle Roberts	Feb 06 – Dec 06	10
	John Kobelke	Feb 2001 – Feb 06	60
	Doug Shave	Jan 97 –Feb 01	49

* exact month unknown



**Submission by CHOICE
to the Inquiry into unfair terms in consumer
contracts**

13 October 2006



CHOICE is a not-for-profit, non-government, non-party-political organisation established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and campaign for change when markets or regulation fails consumers.

CHOICE is fiercely independent: we do not receive ongoing funding or advertising revenue from any commercial, government or other organisation. With over 200,000 subscribers to our information products, we are the largest consumer organisation in Australia. We earn the money to buy all the products we test and support our campaigns through the sale of our own products and services.

Our policy voice is widely recognised. We campaign without fear or favour on key consumer issues based on research into consumers' experiences and opinions and the benefit or detriment they face. Our current campaigns cover food, health, financial services, product safety, communications and consumer protection law.

CHOICE conducts research, publishes policy reports and online information, gives presentations and keeps the media informed of our policy views. We provide representatives for many industry and government committees and independent bodies considering matters of concern to consumers.

To find out more about ACA's campaign work visit www.choice.com.au/campaigns and subscribe to CHOICE Campaigns Update at www.choice.com.au/ccu.



Introduction

CHOICE welcomes the decision of the NSW Legislative Council to establish the current inquiry into unfair terms in consumer contracts and the opportunity to provide a submission to the Inquiry.

Unfair terms in consumer contracts are prevalent. The pervasiveness of unfair terms is all the more evident in the modern digital age, with the increasing reliance of e-commerce and standard form agreements to enter into contracts.

Commerce works most effectively when consumers have confidence that they are treated fairly. The risk of unfairness is highlighted in the age of rising reliance on e-commerce and the use of online technology to contract for goods and services.

However, the market cannot, and will not fix many of the problems caused by unfair terms in contracts.

In this submission, CHOICE argues that in the absence of effective remedies, adequate regulation and market indifference to consumer detriment it is in consumers' interests that dedicated unfair terms regulation accompanied by appropriately resourced enforcement and proactive administrative guidance powers be introduced nationally. In the absence of a national regulatory framework, we would welcome the introduction of unfair terms legislation in NSW.

This submission has been prepared in a relatively short time. The submission identifies the nature and scope of unfair contract terms in selected industries. It is not an attempt to systematically identify all unfair terms. Attempting to identify all the unfair terms in the many thousands of consumer contracts that are currently in use in Australia would be a daunting prospect. The very fact that it is near impossible to know the size and scope of the problem faced by consumers is one of the most powerful arguments in favour of the need for a regulatory response.

The scope of the problem demonstrates that current regulation of unfair and unjust contracts is not operating as effectively as it could. The need for a regulatory response is all the more critical because of the increasing use of e-commerce in consumer transactions. The emergence of this model of contract making was not envisaged when existing regulation was developed.

Remedies available under the common law and statute have failed to protect consumers from detriment caused by unfair terms. They have only afforded consumers protection from unfairness or injustice that accompanies the conduct of parties making a contract, rather than the substantive unfairness of the terms themselves. Common law remedies have failed give consumers redress for unfair terms demonstrated by the reluctance of the courts to find unfairness in contracts terms. In particular, it will be argued the absence of effective statutory oversight means that the opportunity to more systematically address consumer detriment and poor industry practice has been lost. This cumulative lack of protection means that consumers effectively have no protection from harm caused by unfair terms in contracts.

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It will be argued that some unfair contract terms may be sorted out by the market. It is true that in some circumstances the relative fairness of a particular contract will be transparent to a reasonable percentage of consumers and provide alternative products an advantage such that astute consumers at least will have the choice of taking a similar product or service on fair terms.

But there are a wide range of circumstances where the market provides no incentive to avoid unfair contract terms. These include:

- where a supplier has a monopoly or is part of an oligopoly
- where the unfair term is not relevant to consumers' purchasing decisions and thus where there can be no competitive advantage in having a more fair term (for example terms that relate to default fees or the right to unilaterally change contract terms)
- where consumers are faced with a 'confusopoly' – that is where it is in supplier's interest to confuse consumers (typically where there are many suppliers with many products available over a period of time such as in telecommunications services, financial services, insurance)¹.

The incidence and detrimental impact of unfair terms in contracts on consumers is high. This submission will respond to each of the terms of reference by providing to the Inquiry examples of unfair terms and case studies that illustrate unfairness. Although the incidence of unfair terms is high and spread across many industries, we have limited our discussion to a variety of classes of unfair terms in particular industries, with a focus on consumer contracts in the telecommunications and consumer credit industry.

Recommendations

1. Legislation prohibiting unfair terms in consumer contracts should be introduced in NSW.
2. Unfair terms legislation should apply to all consumer contracts, including consumer credit contracts.
3. Any unfair terms legislation should be supported by a process whereby businesses and traders can be given advice from the Regulator as to whether terms in their contracts with consumers are fair or otherwise.
4. Individual consumers should have a right to bring an action in an appropriate tribunal or court to challenge unfair terms.
5. Unfair terms legislation should include mechanisms to designate qualified consumer bodies as empowered to make "super-complaints". Super-complaints would be made by designated consumer bodies when they have evidence that a

¹ A confusopoly was first applied to a group of companies with similar products who intentionally confuse customers instead of competing on price. It can now be used even where there is no evidence of deliberate confusions. See discussion of energy contracts below J Gans.

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- contract term, or class of such contracts, is unfair and is likely to cause significant harm to the interest of consumers.
6. Where a super-complaint is made, the Commissioner would be required to consider the complaint and the extent, if any, of the alleged problems. The Commissioner would be required to publish a response within 90 days setting out what action, if any, he or she proposes to take in response to the complaint.
 7. Any unfair contracts terms legislation should be accompanied by adequately resourced prosecution and enforcement mechanisms to enable the regulator to take action where there is non-compliance.
 8. An appropriate regulator should be adequately resourced to allow it to undertake continuous review/audit of unfair terms including reporting on the findings of any such review/audit.
 9. The regulator should provide and publish guidelines and provide other guidance to industry, for example, to review and provide guidance on individual trader's contracts.
 10. The regulator should be supported by adequate resources and infrastructure to enable it to undertake the responsibilities expressed and implied above.
 11. Consideration should be given to enable industry and companies to develop standard terms with guidance from the Commissioner and/or a specified Tribunal be empowered to declare particular terms acceptable or not acceptable with the principles in unfair terms legislation.

Consumer markets and the need for regulation

While a competitive market may deliver the best price and quality for consumers, competition does not guarantee fair contracts. In order for markets to work optimally, including finding the appropriate balance between suppliers and consumers' rights under a contract, consumers need to be able to rely on all contract terms (not just essential terms such as price and quality) to be fair.

Research on consumer behaviour also points to the misguided assumption held by many consumers that contracts are fair, and that in the context of effective market competition and consumer protection law, governments and regulators have some oversight of contracts, and would ensure that terms are fair and reasonable. It is also a misguided assumption that consumers have the time or expertise to assess, query or negotiate contract terms. Legislation and regulation needs to be based on what consumers really do, not what we think they should do².

² N Howell, An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts (Centre for Consumer and Credit Law, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 6.

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Unfair contract terms legislation is necessary to facilitate commerce in an electronic and digital age. It is not realistic to expect consumers to review anything other than the most essential contract terms (price and nature of service or goods) on for example, a mobile phone, or through interactive television, given the format, time or cost implications that they would face. For consumers to trust such transactions, and thus enable these forms of commerce to grow, they must have confidence that contract terms are fair. That fairness can be assured through a combination of unfair contracts legislation and the development of standard terms is described elsewhere in this submission.

While consumer advocates have welcomed the emergence of unfair terms in contracts regulation, industry and business response has been less enthusiastic. Opposition to regulating contracts is based on the theory that parties should be free to contract on their own terms, and that market competition and consumer choice adequately takes care of consumers, ensuring that businesses and traders do not include unfair terms in consumer contracts. Industry also argues that there is already sufficient regulation, that unfair terms regulation would impose further costs on businesses - which would be passed directly onto consumers, and that there is no evidence that the existing regulation is not working³.

In practice, however, consumers rarely read lengthy fine-print contracts - contemporary online 'click-wrap' contracts where consumers simply click "I agree" to form a contract militate against reading the terms and conditions. And in a market where, from the consumer perspective at least, competition is generally fought out on price rather than other terms and conditions, it is unlikely that negotiation on unfair terms is going favour consumers, if such terms ever come to consumers' attention at all⁴.

This submission will address the above industry reservations to unfair terms legislation by arguing that the existing regulation is not working and does not protect consumers, and that the costs of industry of unfair terms legislation will not impose costs on industry.

Incidence and impact of unfair contract terms

This section of the submission responds to the Inquiry's terms of reference. Parts (i) to (iv) discusses the incidence and impact of some kinds of contract by reference to (a) (i)-(iv) of the Inquiry's terms of reference. Part (v) gives examples of other classes of unfair terms. We also refer to the extensive research undertaken by the Communications Law Centre in unfair terms in telecommunications contracts, set out in their submission to this Inquiry.

(i) terms which allow the supplier to unilaterally vary terms

Some contracts have terms which allow providers, but not consumers to cancel contracts, limit the performance of contracts, or change terms or goods or services supplied under contracts.

³ There are some of the themes emerging from industry submissions to the 2004 Standing Committee of Officials of Consumer Affairs (SCOCA) discussion paper on unfair terms regulation.

⁴ N Howell, An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts (Centre for Consumer and Credit Law, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 6, referring to studies on behavioural economics and consumer decision-making, suggesting that consumers are likely to trade off the benefits of extra information for costs.



See, for example, the following term in a mortgage contract:

we can change the Credit Limit at any time...

...we may reduce the Credit Limit at any time, whether or not you have breached this Contract. If we do so and you are not in breach of the Contract, we will tell you in writing

And the following from clause from a major bank for their Term Deposit accounts.

2.3 In addition to the other changes [bank] may make to these terms and conditions which are detailed in these terms and conditions, [bank] may change any other terms and conditions (including by imposing new fees or charges, changing the amount, type, or method of calculation of fees and charges payable) [bank] will make any changes in accordance with any applicable legislation and industry codes.

Many mobile phone contracts allow the supplier to vary the rates and charges (for calls and SMS) at any time and regularly without notice to the consumer.

(ii) penalising the consumer

Terms that penalise consumers for late payment or early termination of contracts are common.

A late payment fee is usually taken to mean a charge for default, including a failure to pay on the due date. Sometimes referred to as “administration fees”, these fees may include both a fee plus an additional interest charge. Excessive and unreasonable fees contribute to a spiralling of debt for vulnerable and disadvantaged consumers.

Some contracts require consumers to pay a fee for early termination, on top of paying out the fees that remain for the term of their contract.

At common law, a term that requires a party to pay an amount of money upon their breach of an agreement that is not a genuine pre-estimation of the damages that the party who is not in breach will suffer is a penalty clause and is not enforceable.

Traders regularly attempt to contract out of this by using terms such as:

You agree to pay us interest on all outstanding charges at a rate of 9% per annum. You agree that such interest is genuine pre-estimate of our damages.

The legality or otherwise of penalties, however, sits uncomfortably with the reality that in many cases it would not be practical to challenge the enforcement of any penalty.

Some contracts provide for the supplier to recover damages on terms attempt to override the above common law prohibition. See for example, the contract term below which entitles the supplier, on the consumer’s payment default

(a) ...to recover liquidated damages on the overdue amount which you agree is a genuine pre-estimate of the actual loss that we will suffer as a result of you being late in any payment to us.

(b) for each failure to make a payment in full and on time, the amount of liquidated damages payable will be the greater of \$25 or 0.05% per day on the overdue amount until paid in full.

Other terms may deem a consumer in default of a contract where the consumer becomes bankrupt. This is arguably unfair, especially for a consumer who while bankrupt may well be able and willing to continue making payments under that contract.

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The clause below found in a vendor mortgage was recently litigated in the NSW CTTT, and found to be unjust under the *Uniform Consumer Credit Code* (the Code). Vendor terms, known as “wrapping” have been promoted to consumers struggling to buy a home.

The purchaser shall forfeit to the vendor and the vendor shall keep the deposit and all instalments paid under this contract, as liquidated damages for non – performance of the contract without necessity for the vendor to give notice or to do any other thing.

When the purchasers fell into arrears, and in reliance on the above clause, the vendor retained the purchaser’s payments of \$58,000. The CTTT re-opened the contract transaction pursuant to s70 of the Code, finding that the vendors had failed to inquire into the purchaser’s ability make the payments according to the contract’s terms. Ultimately, the CTTT found the contract unjust and by way of making compensation ordered the vendor remit \$28,000 to the purchasers. This was upheld on appeal in the Supreme Court.

It is likely that unfair terms legislation would have obviated the need for litigation in this matter.

A reverse mortgage that allows a lender the right to ask for immediate repayment of a loan for a minor issue which is then regarded as a default, allowing the lender to charge a penalty interest rate 2-3% higher than the normal rate until repayment is made.

Bank penalty fees

There is a strong case that the high fees imposed on consumers by banks and other lenders - such as direct debit fees and inward cheque dishonour fees – are an amount greater than the loss the lender suffers. Unfair terms legislation could address the imbalance in the rights and obligations of consumers and lenders that cause detriment to consumers arising under these kinds of terms.

Switching costs

Any unfair terms legislation should be sufficiently broad to protect consumers from excessive switching costs. The UK unfair terms legislation require that contract terms should be expressed fully, clearly, legibly and contain no concealed pitfalls or traps. Switching can be potentially unfair for consumers where a contract term creates excessive notice periods for cancellation or which require a consumer who terminates a contract early to pay high sums in compensation. It is likely that a term allowing high switching fees, that is, a fee that requires a consumer who fails to fill an obligation to pay a disproportionately high sum in compensation, would offend the UK legislation⁵.

(iii) supplier suspends services while continuing to charge the consumer

Some contracts contain terms that result in charges continuing in the event of a failure of provider to supply the goods or services contracted for.

Some supplier’s agreements give the supplier the right to suspend the service, for reasons including maintenance, security or where there is a direction or notice issued by a regulator body or court. This may be detrimental and unfair to the consumer if suspension lasts for an extended period, and the customer is still required to pay ongoing charges.

⁵ See Unfair Terms in Consumer Contracts Regulations 1999, Schedule 1, Cl 1(e)

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Some contracts may cause detriment to the consumer by failing to make reference to a consumer's right for a refund for services not yet provided, or any reduction in price for inconvenience caused by a failure or suspension of supply. Research undertaken by Communications Law Centre in 2003 into mobile phone contracts found that the consumer's right to a refund was not outlined in the majority of these contracts⁶.

Some contracts contain "unclaimed monies" clauses, which typically state:

In the event that your account is terminated and monies are owed to you by us, we will notify you of these amounts. In the event you do not claim those monies within three months of being notified we will retain the money and you agree that you will have no further claim in relation to those monies.

(iv) supplier but not the consumer permitted to terminate the contract

Some contract terms don't allow consumers to terminate the contract – or if they do, the penalty fees are so high, the consumer is better off staying with an unwanted contract. See the following two examples.

Ms A enrolled in a fashion school, agreeing to pay almost \$24,000 in monthly instalments over 3 years. After attending the course for the first semester, Ms P had to urgently move interstate to care for her ill parents. The contract included a "declaration" that

I acknowledge that by signing the [school] enrolment agreement I undertake to pay the prescribed fees by the specified dates as set out in the table of fees...whether I finish the course or not.

I understand that no deferrals are possible and that no refunds will be made for any reason whatsoever.

The school agreed to defer her course temporarily and to study by correspondence, but it would not allow her to cancel the contract. Ms P is being pursued by debt collectors for almost \$20,000.

Ms B signed a 12-month contract with a fitness centre. After 4 months Ms B moved house, and work pressures meant she was no longer able to attend the gym. She asked to cancel the contract, but the fitness centre refused, relying on a term in the contract that required her to pay the full amount of fees remaining for the 12-month term of the contract.

(v) other unfair terms

The following section outlines classes of terms, other than those identified above, which may be regarded as unfair. This list is drawn from various sources including classes of unfair terms set out in the Victorian and UK unfair terms legislation or schedules thereto, as well as examples of terms gathered in the ordinary course of CHOICE's research/work, and consultations with consumer advocates. Examples of these unfair terms and case studies are provided to illustrate unfairness – they are not intended to be an exhaustive list of the incidences of unfair terms, but exemplify the scope of unfair terms.

⁶ CLC *Fair Terms and Telecommunications Consumer Contracts* 2003 at <http://www.comslaw.org.au/currentprojects/CLCFairTermsReport.pdf>.

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Terms that exclude all liability, even though liability would arise at law in some circumstances

In the case of some suppliers, such as internet providers, this may involve excluding the supplier's liability for damage caused on installation of internet equipment, or even defective equipment. See, for example, the following clause obliges the consumer to continue to pay for goods:

... no matter what happens, even if the Equipment is lost, stolen, damaged or destroyed, if it is defective or if you can no longer use it...

Other terms are phrased in a way which may be interpreted by consumers to exclude all liability, often in terms that misrepresents consumers' legal rights. For example, the following example:

Subject to the Trade Practices Act and other laws [supplier] is not liable for any costs, loss, liability or damage, whether direct or consequential arising out of [supplier's] supply, delay or failure to supply service.

Other terms may be uncertain, and interpretation of these terms arguably misrepresents a supplier's liability under law – for example under trade practices or negligence law.

See also (iii) above, in relation to unfair unclaimed monies clauses.

Terms that limit consumers' rights and/or remedies

Some contracts seek to exclude liability and limit jurisdiction and thus available remedies. Exclusionary clauses may operate to:

- exclude rights or remedies otherwise available under common law or statute,
- restrict rights, for example, by imposing a limit on damages, or
- qualify rights, for example, imposing mandatory alternative conflict resolution processes.

The use of unfair exclusionary terms in some industries' standard form of agreements is pervasive. Where each industry supplier uses similarly offensive terms and conditions, the capacity for consumers to exercise choice and move to a business competitor is more apparent than real. In this environment of markets operating to the detriment of consumers, effective regulation is required. It appears that Victoria and UK experience of unfair terms legislation has led to better contracts working to the advantage of consumers, and a market advantage to suppliers using fairer contracts.

Riders such as "other than those implied by law" or "to the extent permitted by law" are common in contract terms which try to impose limits on consumers' rights of redress. These clauses are confusing, misleading or meaningless to consumers. The effect of these contradictory clauses may prevent consumers from pursuing, enforcing or defending their rights under a contract.

An example of a contract using one of the above riders while limiting the liability of the supplier to pay damages is illustrated by the following example:

...We limit our liability to the extent permitted by the Trade Practices Act. Our maximum liability under the Agreement (except for breach of a term implied by the Trade Practices

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Act) is limited to the total Charges paid by You during the 1 month period prior to Your claim.

Compulsory arbitration clauses may limit a consumer's rights to a limited set of laws thus excluding remedies that may be otherwise available in other jurisdictions. This may cause particular consumer detriment in inter-state services, for example freight services. See for example,

The Agreement is governed by the laws of New South Wales. Each of us agree to submit (and may not subsequently change our mind about doing so) to the exclusive jurisdiction of the courts of New South Wales.

Terms that permit a supplier to assign their rights to another supplier without notice or consent of consumer, or without permitting consumer to terminate

Examples of these kinds of terms which create unequal obligations, to the detriment of consumers include the following:

You acknowledge that we may, without giving you notice, sell, assign or otherwise dispose of or deal with our interest in the [goods] or [agreement].

You may not transfer any rights and obligations under this Agreement without us first agreeing in writing.

You may not transfer your rights or obligations under these terms without [supplier's] prior written consent.

Terms that permit the supplier to cancel or suspend the service for a breach by the consumer of another contract

A typical example of this class of unfair terms includes:

Related Accounts. If [supplier] terminates an Account, [supplier] may terminate any other Accounts that share the same member name, phone number, email address, postal address, Internet Protocol address, or credit card number with the terminated Account.

Acceptable use policies (AUPs)

AUPs are prevalent in internet service provider contracts, which often contractually oblige consumers to abide by the terms of an AUP as part of their contract. AUPs are often external to the contract making terms within them hidden from the consumer. Typically, standard form agreement will include a term stating:

You must comply with the [supplier's] Acceptable Use Policy

A breach of a term of the AUP may result in a consumer incurring additional usage charges or having services suspended or limited or their contract terminated. Some contracts make a breach of an AUP a breach of the contract, and may effectively deem *any* breach of an AUP to be serious breach, entitling the supplier to terminate a contract. See, for example:

You will be in serious breach of [the contract] if you breach the [AUP].

Terms which allow supplier to cancel or suspend for minor breaches

CHOICE's investigation into reverse mortgages has found default clauses which trigger default action for minor issues, like overlooking paperwork⁷. Terms which unreasonably

⁷ Uta Mihm 'Signing your home away?' *Money & Rights* CHOICE No 13 April/May 2006 pp 8-15.

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lead to action disproportionate with the breach should be considered unfair. Many lenders' 'No Negative Equity Guarantee' terms mean that the lender will not honour the guarantee if the borrower is in default at the time of the sale of the property, while one lender will not cover a loan shortfall if the borrower has been in default at *any time* during the loan term.

Another example is a reverse mortgage contract which contains many clauses similar to a home loan contract and includes many provisions that a borrower "must" do – for example, keep their password secure for an online or phone facility, and punctually pay all rates and taxes in connection with the mortgaged property. This contract states that the borrower will be in default if they "breach any other provision of [the] loan contract." Reverse mortgages are targeted at elderly people. It is unfair that these borrowers may risk serious consequences of default for mere failure to pay a council rate bill.

On-line contracts

Contracts formed on-line contracts are not conducive to negotiation. Various referred to as 'clickwrap' or 'click-on' agreements, the process of agreeing to contract terms generally involves scrolling through lengthy terms and conditions, and forming the contract by clicking "I agree". The risk to consumers in e-commerce transactions is that consumers will agree to terms that they have not had an opportunity to negotiate and that may be substantively unfair, or even agree to purchase goods that may be substantially different to those displayed on screen. For example, one online retailer's fine print contained the term "the actual products are often not the same as the images".

Some online traders bury essential terms and conditions on their websites – the consumer is simply directed to refer to the terms and conditions elsewhere on the site, or is informed that these terms are available "on request". These hidden terms and conditions often contain key obligations.

E-commerce now commonly makes consumers' use of suppliers' websites subject to unfair terms and conditions. See, for example:

It is a condition of use of this Site that you accept and agree to the following terms and conditions of The Company... The Company may vary these terms from time to time and the revised terms will be deemed to apply at the relevant time in respect of your application. By proceeding to enter the Site you agree to be bound by the following:

The Company reserves the right to alter or delete material from the Site at any time and may, at any time, revise these terms by updating this posting. You are bound by any such revision and should therefore periodically visit this page to review the then current terms.

While the Company uses reasonable efforts to include accurate and up to date information in the Site, the Company makes no warranties or representations as to its accuracy. The Company assumes no liability for any errors or omissions in the content of the Site.

Other examples or types or classes of unfair terms

- Irrevocable powers of attorney which apply beyond that which is necessary and reasonable.

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- Choice of law clauses, for example those that apply to interstate freight contracts, and don't allow consumer choice of applicable laws under which to lodge or resolve disputes
- Non revocable direct debit clauses, where a direct debit is set up with a finance institution to pay moneys to a third supplier – and where contract with third supplier terminates or is suspended and direct debit continues.

Prevalence of unfair terms in standard form agreements

Standard form contracts or agreements (SFOA) are used widely. SFOA drawn up by a supplier provide no or little opportunity for a consumer to negotiate or amend terms. These are prevalent in the form of on-line or “click-wrap” contracts referred to earlier. There is evidence that consumers’ problems with and complaints about contracts are heightened by the use of SFOAs, in particular in consumer telecommunications contracts, which consumers had no opportunity to review or change⁸. Indeed, according to Consumer Affairs Victoria, it was the emergence of standard form contracts that limit consumers’ ability to exercise real choice that was instrumental in introducing the unfair contracts legislation in Victoria⁹.

This part of the submission will look only briefly at the use of standard form agreements in particular the effect of SFOAs on industry practice.

The submission then considers the option for the establishment of a mechanism to enable industry and companies to develop standard terms with guidance from the Commissioner and/or a specified Tribunal.

Standard form agreements

The *Fair Trading Act 1999* (Vic) (FTA) defines a standard form contract as a “consumer contract that has been drawn up for general use in a particular industry, whether or not the contract differs from other contracts used in that industry”¹⁰. The onus is on the consumer, or on the regulator (under s 32Z) to show that the contract is a standard form contract¹¹.

⁸ Communications Law Centre *Unfair Practices and Telecommunications Consumers* 2001.

⁹ Communications with Consumer Affairs Victoria (CAV) October 2006, see also *CAV Annual Report 2005-2006* p 92.

¹⁰ section 32 U *Fair Trading Act 1999* (Vic)

¹¹ The definition of an unfair term in the UK includes the “a contractual term which has not been individually negotiated” and a test of “drafted in advance” and may be broader in application to the concept of standard form contract. See SCOCA Working Party Discussion Paper p 62.

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The FTA provides that the Commissioner can prescribe a term as unfair. Where a term is prescribed as unfair under the Act, once it has been shown that it is a standard form contract, the term is unfair 'per se'¹².

According to industry, SFOAs are a practical necessity in most consumer markets, for the following reasons:

- businesses cannot realistically negotiate with large numbers of customers,
- standard form contracts reduce transaction costs for both the supplier and the purchaser,
- standard form contracts ensure that legislative and other regulatory requirements are complied with.

Industry says that in the face of an unfair contract term, consumers are free to turn to an alternative trader with better contract terms. However, in practice most consumers have little time, expertise or other incentive to compare contracts' terms – and suppliers have no incentive to provide fairer terms than their competitors. The presumption that in the face of poor market practices, consumers will exercise choice and move to a business competitor is more apparent than real. As noted above, in the age of e-commerce, click-wrap agreements, and contracts that not uncommonly extend to over 100 pages of fine print, the use of SFOAs in many cases causes detriment to consumers who have no real opportunity to review, negotiate or change their terms.

In fact, in many ways it is more rational consumer behaviour to *not* read a contract, where reading terms or navigating services under a contract brings no benefit.

On this latter point, my own experience with choosing gas and electricity plans stands in sharp contrast. In preparing for a presentation at an ACCC conference last year, I decided to see how much competition amongst energy retailers had got us. I rang up all the main incumbents (including my own provider) and tried to compare the plans. The task was incredibly difficult. Some plans were based on monthly consumption, others bi-monthly. Some had the prices stated ex. GST and others including GST. And there was more. I put it into a spreadsheet and what did I find? They were all exactly the same! Hours of work for nothing. They were all the same and at their regulated cap¹³

SFOAs and industry practice

While the terms in some contracts may be technically compliant and within the letter of the law, their similarity to alternative suppliers' contracts and their complexity and length may have the effect that consumers are discouraged or hindered from seeking out or enforcing their rights. Consumers will simply not bother to navigate the complexity of the terms and find themselves committed to unwanted contracts, or contracts with onerous terms which may have detrimental consequences.

There is evidence that similar standard form contracts containing similar unfair terms are being used by product suppliers otherwise engaging in fierce pricing battles between their competitors (illustrated by the mobile phone market). There is evidence that this is particularly the case in some telecommunications contracts.

¹² Standing Committee of Officials of Consumer Affairs *Unfair Contract Terms: A Discussion Paper* (January 2004) p 62.

¹³ J Gans '[Confusion as a screening device](http://www.economics.com.au/?p=100)' <http://www.economics.com.au/?p=100>

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The incidence unfair terms in standard form contracts in some industries is such that consumers' capacity to exercise market choice and chose an alternative supplier with better contract terms is limited. By agreeing to some contracts which include unfair terms, consumers sometimes unwittingly lock themselves into contracts they don't want or need, and may cause detriment.

developing standard terms and guidance for industry

Consumers engaged in pre-paid contract formation where there is limited practical ability to review contract terms need confidence that contract terms are fair. With some adaption, the standard terms regime of the Insurance Contracts Act (ICA) offers a model for commerce in a digital age. The ICA provides for regulation to establish standard minimum contract terms, which insurers can amend but only by effectively bringing those variations to consumers attention prior to contract formation.

Having standard terms in regulation for a wide range of consumer industries would not be practical. A system where industries or companies are free to develop standard terms that comply with the principles set out in unfair contracts legislation combined with guidance issued by the Commissioner and the ability for the Commissioner and/or a specified Tribunal to declare particular terms not acceptable would lead to a similar result in a more efficient and practicable way. The advantage for business, consumers and overall economic efficiency is that business would compete for consumer's spending based on the virtues of their product and its pricing rather than the ingenuity of their lawyers and marketers.

Remedies for unfair contracts

A common argument against the introduction of unfair contract terms regulation is that there are a range of legislative and common law provisions that deal adequately with the concerns about consumer detriment. However, in all jurisdictions other than Victoria, consumers can effectively only challenge unfair processes in contract formation: that is, the procedures and conduct of parties accompanying the making of a contract – but not the substantive terms of the contract itself. Those protections that may have protected consumers from substantive unfairness have, in practice, not operated to consumers' benefit.

Recent consumer protection initiatives including as the *Financial Services Reform Act* and the *Consumer Credit Code* have focused on laws promoting competition between businesses and disclosure of information to consumers. However, these measures have failed to curb the detrimental impact of unfairness at a fine print level in consumer contracts.

Remedies (other than Part 2B of the Victorian unfair terms legislation discussed later in this submission) that may be available to consumers for unfair contracts include:

- Equitable remedies, including unconscionability, special disability, undue influence etc,
- *Trade Practices Act 1974 (Cth)*, *Australian Securities and Investment Commission Act 2001(Cth)* and State and Territory fair trading legislation prohibiting misrepresentation and deceptive conduct and unconscionability etc,

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- Uniform Consumer Credit Code protections against unjust transactions, and
- In NSW, the *Contracts Review Act 1980* (NSW) prohibiting unjust contracts.

There was historically some promise that s 70 of the Consumer Credit Code could provide a remedy for procedural and substantive injustice, based on factors similar s 9(2) of the *Contracts Review Act*¹⁴. However, an analysis of the case law shows that that without demonstrated procedural injustice at the time of the making of the contract, it will provide no relief for the consumer. It also appears that the courts have been reluctant to find unfairness solely on substantive grounds¹⁵.

Problems with pursuing current remedies

Apart from the obvious problem outlined above – that to get effective redress, consumers must demonstrate procedural unfairness in the making of the contract rather than substantive unfairness in contract – other problems with the current framework include:

At an individual level:

Challenging unfairness in consumer contracts commonly takes place in courts rather than lower cost tribunals. The problems for consumers litigating unfairness in contract in the courts are well-known and include:

- litigation is expensive, time consuming and often distressing,
- there are clear inequalities in litigants' resources and bargaining positions,
- case law on unconscionability, undue influence and special disability varies widely, making outcomes unpredictable,
- the rules of evidence can be intimidating for consumers,
- litigation relies heavily on evidence of facts and credibility which makes outcomes difficult to predict and costly to pursue,
- the variety of common law and statutory remedies means consumers often plead a number of alternative cases – thus prolonging already complex litigation,
- the above unpredictability, cost and complexity cumulatively act as disincentives for individuals to pursue their rights.

At an aggregate level:

- Under the current regimes unfairness is decided on a case-by-case basis giving no scope for systemic change. This means the opportunity to systemically improve industry practice is lost.

¹⁴ see Centre for Credit and Consumer Law, Griffith University *Submission to the Standing Committee of Officials of Consumer Affairs Unfair Contract Terms Working Party* citing *Unfair Contract Terms - A Discussion Paper* SCOCA Unfair Contract Terms Working Party January 2004.

¹⁵ *Unfair Contract Terms-A Discussion Paper*, SCOCA Unfair Contract Terms Working Party January 2004 p 39.

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- Removing unfair terms is competition enhancing, bringing overall societal benefits. Consumers, industry and government all lose when consumers abandon faith in industry and government to protect them from unfair or unjust practices¹⁶.

Effectiveness of Victorian and UK unfair terms legislation

In general, evidence from other jurisdictions strongly suggests that substantive unfairness caused by unfair terms can only be effectively addressed by dedicated legislation and well-resourced, proactive administrative guidance¹⁷.

This section of the submission looks briefly at the effectiveness of the Victorian and UK unfair terms in consumer contracts legislation, and supports these jurisdictions' approach of combining an expanded regulatory and enforcement jurisdiction with clear administrative guidance.

Fair Trading Act Victoria, Part 2B (FTA)

Part 2B of the FTA makes a term in a consumer contract unfair:

if, contrary to the requirements of good faith and in all the circumstances, it causes a significant imbalance in the rights and obligations arising under the contract to the detriment of the consumer.

This submission does not comment on the appropriateness or otherwise of the definition of an unfair term in a consumer contract, nor does it comment on how this definition was considered in the recent the Victorian Civil and Administrative Tribunal case¹⁸. Further consideration of an appropriate definition of an unfair term may well be required, and CHOICE would welcome the opportunity to contribute to any discussion in that regard¹⁹.

Where Part 2B is applied:

- unfair terms in consumer contracts are void,
- certain terms can be prescribed as unfair,
- it will be an offence to use a prescribed unfair term,
- the Director of Consumer Affairs Victoria (CAV) can apply to the Victorian Civil and Administrative Tribunal (VCAT) for a declaration that a term is unfair, and for injunctions to prevent the continued use of unfair terms, and
- individual consumers can also take civil action to void an unfair term.

¹⁶ C Britton 'The simple life – in a "low trust" society' *Consuming Interest* No 101 Spring 2004 p 10 cited in N Howell *An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts* (Centre for Consumer and Credit Law Research Paper, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 8.

¹⁷ For an analysis of how other overseas jurisdictions have addressed substantive unfairness, see J Davidson *Unfair Contract Terms and the Consumer: Regulating Substantive Unfairness* Centre for Credit and Consumer Law, Griffith University (September 2006).

¹⁸ *Director of Consumer Affairs Victoria v AAPT (Ltd) Civil Claims* [2006] VCAT 1943

¹⁹ Consideration of the SCOCA Working Party Discussion Paper will also be useful in this regard.

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One of the positive aspects of the operation of the new FTA unfair terms legislation is the regulator's proactive approach to engage industry and negotiate fair terms without the need for it, or consumers, to litigate unfair terms. CAV employs a compliance strategy based in the first instance on industry education and consultation, whereby individual companies' consumer contracts are reviewed and cooperation is sought by those companies to modify or remove unfair terms²⁰. CAV is also providing information and advice on the legislation, including advice to lawyers. CAV reports that in most cases, these negotiations result in amended contracts²¹.

There is some evidence that unfair contract terms in the Victorian FTA has led to an improvement, albeit incremental, in some consumer contracts to the benefit of consumers²². To date, the CAV has obtained undertakings from businesses to alter unfair contract terms related to loyalty cards, vouchers and gift cards and has secured revisions to terms in consumer contracts in the hire car, gymnasium, pay television and mobile phone industries, to the benefit of consumers. CAV has also successfully brought an action in the VCAT against unfair terms used by telecommunications company AAPT²³. In this case, the VCAT found that terms dealing with unilateral variation, suspension of service and immediate termination of the agreement were unfair.

While the introduction of unfair terms regulation within the FTA is welcomed, the effectiveness of the FTA could, however, be improved²⁴.

Firstly, the FTA legislation currently exempts consumer contracts to which the Victorian consumer credit legislation applies²⁵, unless consumer credit contracts are in a 'prescribed class of contract'²⁶. To date, no classes of contracts have been prescribed²⁷. The recent review of consumer credit in Victoria²⁸ has set out the option of extending the unfair contract terms provisions in Part 2B of the FTA to consumer credit contracts, and the Victorian government has supported this option²⁹. The UK Regulations also apply to consumer credit contracts. Evidence of a high proportion of unfair terms in credit contracts amended as a result of UK Office of Fair Trading oversight adds further support for their inclusion in any regulatory regimes.

²⁰ Consumer Affairs Victoria *Annual Report 2005-2006* p 92.

²¹ Consumer Affairs Victoria *Annual Report 2005-2006* p 93.

²² See Submission to this Inquiry by Communications Law Centre.

²³ *Director of Consumer Affairs Victoria v AAPT (Ltd) Civil Claims* [2006] VCAT 1943.

²⁴ Chris Field, *Fair's Fair*, CHOICE

[http://www.choice.com.au/viewArticle.aspx?id=104284&catId=100387&tid=100008&p=1&title=Fair's+fair+\(archived\)](http://www.choice.com.au/viewArticle.aspx?id=104284&catId=100387&tid=100008&p=1&title=Fair's+fair+(archived))

²⁵ Sections 32V and 163(2) FTA excludes the *Consumer Credit (Victoria) Act 1995*.

²⁶ See amendments to the FTA, s 3 *Fair Trading (Consumer Contracts) Act 2004*, amending s 32V(a) of the FTA. It appears that the exception was introduced to deal with concerns over the possible exploitation of the first homebuyer's grant and vendor terms in contracts by rogue financiers, rather than a general provision to override the credit contract exemption – see N Howell *An Update of Unfair Contracts Legislation – Examining the Need for Nationally Consistent Regulation of Unfair Terms in Consumer Contracts* (Centre for Consumer and Credit Law, Griffith University) available at <http://www.gu.edu.au/centre/cccl/pubs/clc0905.pdf> p 10.

²⁷ Communications with Consumer Affairs Victoria, October 2006.

²⁸ Merlino J *The Report of the Consumer Credit Review* Consumer Affairs Victoria (2006).

²⁹ see *Government Response to the Report of the Consumer Credit Review* Option 5.3 pp 12-13

[http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/\\$file/Credit%20Review%20-%20Government%20response%20\(web\).pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/$file/Credit%20Review%20-%20Government%20response%20(web).pdf)

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Secondly, unfair contracts legislation should explicitly include “penalty clauses” (that is, a term which allows for fees that are not a genuine pre-estimate of the loss that a business incurs as a result of a breach by a consumer). As noted above penalty clauses have potential to cause significant harm to consumers. Of note is the recent Victorian government response to the consumer credit review that gave in-principle support to making fees and charges reviewable on the grounds of unreasonableness³⁰. As noted below, in the UK one of the classes of terms most commonly found to be unfair are those applying unreasonably high penalties.

Thirdly, the remedies available under the FTA include rendering unfair terms void and unenforceable³¹, imposing injunctions to prevent the continued use of unfair terms³² and declarations³³ and advisory opinions.³⁴ The power to impose penalties for use of unfair terms are restricted to incidences where “prescribed” unfair terms are used, or where a person attempts to enforce such terms.³⁵ A “prescribed unfair term” is one which is prescribed by the regulations (by the Governor-in-Council) to be unfair or one of like effect. As noted above, no unfair terms, or classes of contracts containing unfair terms have been prescribed to date. It is also arguable that the civil penalty imposed on suppliers who continue to use a prescribed unfair term may be too low, and will not act as a sufficiently strong disincentive.

Fourthly, on its own, the legislation will not necessarily have the optimum benefit to consumers, as it may not affect the contracting practices of national industries or corporations. Ideally, a national, uniform approach is required.

To achieve optimum benefits of unfair terms legislation, any regulator must be empowered to take a proactive approach to monitoring, compliance and enforcement. This could include the introduction of a “super-complaints” jurisdiction, as is the case in the UK. This is discussed in the next section. It must also be appropriately resourced to enable it to provide valuable guidance to industry to systemically improve contracting practices.

Additionally, the UK unfair contract terms regulations annex a non-exhaustive ‘grey-list’ of terms, providing guidance on what *may* be considered unfair. The inclusion of such a list could also be considered in Australian unfair contracts legislation, or could be provided to industry as guidance by the appropriate regulator. CHOICE refers the Inquiry to such a list compiled by consumer advocates at http://tpareview.treasury.gov.au/content/subs/105_Attachment2_ACA.rtf.

Unfair Terms in Consumer Contracts Regulation 1999 (UK)

³⁰ see *Government Response to the Report of the Consumer Credit Review* Option 5.3 pp 7-8 at [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/\\$file/Credit%20Review%20-%20Government%20response%20\(web\).pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Consultations_Reviews/$file/Credit%20Review%20-%20Government%20response%20(web).pdf)

³¹ Section 32Y

³² Section 32ZA

³³ Section 32ZC

³⁴ Section 32ZD

³⁵ Section 32Z



The United Kingdom *Unfair Terms in Consumer Contracts Regulation 1999* was developed to implement a 1993 *European Union Directive on Unfair Terms in Consumer Contracts*.

The UK legislation uses the following definition:

A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer³⁶.

The effect an unfair term is that the consumer is not bound by the term.

The regulations enable the UK Office of Fair Trading (OFT) to take action to stop the use of unfair terms by applying for an injunction to prevent their use. However, the OFT has most commonly used its jurisdiction to enter into discussions with traders, and obtain undertakings from these to stop using unfair terms. As a result of OFT intervention, between 1000 and 1,500 unfair terms each year are revised or abandoned³⁷.

Over the last three years, the most commonly successfully challenged unfair terms under the legislation are those relating to:

- Exclusion or limitation of liability for breaches of contract, particularly liability for poor services, work or materials,
- Terms requiring consumers to pay financial penalties,
- Terms imposing unfair financial burdens, consumer declarations and unreasonable ancillary obligations and restrictions, and
- Failure to use plain and intelligible language³⁸.

The OFT has also been proactive in promoting the legislation by issuing regular bulletins on the changes that have been made to consumer contracts as a result of its negotiations with traders, and has issued guidelines on unfair terms in contracts for holiday caravans, package holidays, home improvements, health and fitness, and tenancy, among others³⁹. The OFT also regularly publishes updates on undertakings, detailing the company, the nature of the unfair term changed and the reasons why the term were considered unfair.

The UK unfair terms regulations attach a non-exhaustive list of unfair terms as a schedule to the regulations that may be regarded as unfair. The OFT publishes extensive guidance on the OFT's view of kinds of unfair terms on its website, by reference to the "grey list" schedule of unfair terms and also on terms commonly used by particular industry sectors. The OFT also publishes details of industry undertakings outlining why the term was considered unfair to consumers.

The OFT shares enforcement powers with other "qualifying bodies" which include fair trading bodies, and Which? an independent consumer organisation. The OFT does not have the power to take up consumers' individual cases, but protects consumers by seeking to prevent the continued use of unfair terms. The OFT, however, has a duty to

³⁶ Section 5(1) *Unfair Terms in Consumer Contracts Regulation 1999* (UK).

³⁷ See UK Office of Fair Trading Annual Reports (1000 in 2006).

³⁸ UK Office of Fair Trading, Annual Reports 2003-4, 2004-5, 2005-06.

³⁹ See, for example, guidelines at <http://www.oft.gov.uk/Business/Legal/UTCC/guidance.htm>

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consider any complaint made to it, unless one of the other qualifying bodies notifies the OFT that it will do so.

The OFT has a duty to consider any complaint made to it that a contract term drawn up for general use is unfair⁴⁰, unless one of the ‘qualifying bodies’ given jurisdiction with the OFT to enforce the regulations notifies the OFT that it will do so.

The OFT also has a “super-complaints” jurisdiction⁴¹, which allows designated consumer bodies to represent consumers to make complaints about a feature, or a combination of features of a market that is, or appears to be significantly harming the interests of consumers.

One notable distinction between the UK and Victorian unfair terms legislation is that the UK regulations apply to all consumer contracts including finance contracts. As noted above, terms within credit contracts feature amongst the highest proportion of terms found to be unfair by the OFT.

Other matters

Industry improvement

The Communications Law Centre (CLC) has undertaken extensive research in the area of telecommunications. Unfair terms has been a priority issue for CLC, and it has completed numerous reports on the area, including compliance reports for Consumer Affairs Victoria on unfair terms⁴². CLC notes in its Submission to the Inquiry there has been an appreciable improvement in consumer contracts used by industry. CLC’s view is that the reduction in unfair terms and conditions has been brought about as a consequence of the inclusion of unfair contracts terms provisions in the Victorian *Fair Trading Act 1999*⁴³.

Perhaps the most positive consequences of unfair terms regulatory regime is the capacity for the regulator to directly negotiate with industry to revise their contracts. While there have been no terms prescribed as unfair, and to date only one case prosecuted by CAV (AAPT), the regulator has already negotiated with companies in industries including telecommunications, car hire firms, fitness centres, pay television providers and has recently targeted store loyalty cards to revise hundreds of unfair contract terms.

Not only is this a positive step in encouraging better industry practice, this preventative approach to consumer protection translates into avoided costs to government which won’t have the bear the flow-on costs of supporting consumers who suffer detriment when unfair terms lead to harm and spiralling debt.

There are also benefits to industry by embracing good practice. A consumer detriment survey conducted by Consumer Affairs Victoria in 2005-6 found that in response to dissatisfaction with goods/service, the behaviour most commonly reported was telling

⁴⁰ Except those that are frivolous or vexatious: s10 *The Unfair Terms in Consumer Contracts Regulation 1999* (UK).

⁴¹ See <http://www.ofc.gov.uk/Business/Super-complaints/default.htm>.

⁴² set out in the Communications Law Centre’s submission to this Inquiry.

⁴³ CLC also attributes this industry improvement, although to a lesser extent, to the introduction of the Communications Industry Forum Consumer Contracts Code.

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others not to do business with the offending party (61%)⁴⁴. Dissatisfied customers also report doing less business themselves with offending traders (43%) or doing no future business with them at all (56%). Six per cent (6%) of those surveyed were involved in or contemplating formal action against traders.

Cost saving to industry

There is some argument that prescriptive regulatory reform creates added compliance costs – and a better regime is to have little regulation and assist consumers make informed choices about products.

Unfair contracts legislation, however, is not accompanied by increased or prescriptive disclosure obligations often blamed for increased industry costs. The costs to industry of excising unfair terms from contracts are not likely to cause substantial costs to industry.

The benefits of increased certainty in contracts outweigh any costs. Giving the regulator jurisdiction to determine whether contracts are unfair, and an additional advisory role in overseeing contract terms will lead to better and fairer contracts subject to less scrutiny or challenge. Measures that establish or build up consumers' faith in suppliers, and the terms under which they purchase their goods or services are likely to have widespread benefits for both industry and consumers.

Prescriptive regulation and contract terms

The benefits that flow from a regulatory approach to consumer protection in unfair contracts terms include:

- the capacity to influence industry behaviour, and contribute towards “responsibilising”⁴⁵ industry practice
- economic benefits/avoided costs:
 - consumers who don't have to suffer detriment before seeking redress
 - courts and tribunals will not have to hear matters where a contract terms is voided and dispute resolution costs avoided
 - businesses won't be bogged down complying with the minutiae of otherwise prescriptive legislative provisions
- protection from unfair contract terms legislation can be achieved prospectively, rather than retrospectively (after consumer detriment has occurred)⁴⁶.
- a properly empowered and resourced regulator can seek undertakings from businesses to remove or revise unfair terms, negating the need for individual consumers to engage in complex and time-consuming disputes with better-resourced service providers on matters of interpretation.

⁴⁴ See CAV Consumer Detriment Survey at [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Annual_Report_2006/\\$file/cav_annualreport_2006_cons_detr_survey.pdf#xml=http://search.justice.vic.gov.au/isysquery/irlcfc/1/hilite](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Annual_Report_2006/$file/cav_annualreport_2006_cons_detr_survey.pdf#xml=http://search.justice.vic.gov.au/isysquery/irlcfc/1/hilite)

⁴⁵ I Ramsay ‘Consumer Law, Regulatory Capitalism and the “New Learning” in Regulation’ (2006) 28 *Sydney Law Review* 12.

⁴⁶ E Lanyon *Consumer Credit Law: the End of an Enclave?* unpublished paper (2006).



- obviates the problems associated with pursuing common law remedies outlined above.

If you would like to discuss the matters raised in this submission please contact Gordon Renouf or Dr Nick Coates on 02 9577 3399.



19 June 2007

The Hon. Peter Costello, MP
Treasurer
Room MG47
Parliament House
CANBERRA ACT 2600

Email: peter.costello.mp@aph.gov.au

Dear Treasurer

Direct Debit Dishonour, Late Payment, Over-limit and other 'penalty' fees

We write regarding penalty fees charged by financial institutions. As you would be aware, these fees are of significant concern to many consumers and consumer advocacy organisations including CHOICE and Consumer Action Law Centre.

We regularly receive correspondence from consumers complaining about the fees. Our analysis suggests that the fees are largely arbitrary and impact unfairly on all consumers, and disproportionately on low income consumers and consumers in financial stress.

The fees of most concern are the following:

- periodic payment and direct debit dishonour,
- cheque dishonour,
- overdrawn account honour,
- deposited (inward) cheque dishonour,
- credit card late payment, and
- credit card over-the-limit.

We believe many of the current charging practices are unjust and likely to be legally unenforceable, and it is time they are reviewed with a view to significant change.

Consumer organisations have been concerned about these fees for some time. In 2004 the Consumer Law Centre Victoria's (now Consumer Action) report *Unfair Fees* presented a persuasive argument for why there may not be a legal basis for charging these fees. There remain significant questions about whether financial institutions have sufficient legal basis for charging each of these fees, due not to lack of disclosure of the fees but because the fees are likely to be excessive and unconscionable in comparison with the underlying costs they are purporting to recover.

CHOICE published its first review of bank penalty fees in 2005. Since that time the UK Office of Fair Trading has become involved in regulating the level of credit card

penalty fees in the UK believing charging practices were disproportionate to the costs incurred from defaults. This decision followed significant consumer action against major UK banks on these fees. More recently, the New Zealand Commerce Commission has announced that it is reviewing whether credit card late payment fees being charged in New Zealand are reasonable as required under their laws.

Currently in Australia, while these fees are probably not legally enforceable, financial institutions are able to debit them directly from consumers' accounts, meaning it is the individual consumer who must take legal action if they wish to recover the fees. This has left the fees unchallenged as it is risky, expensive and time consuming for an individual consumer to take legal action against a large financial institution.

There is also little competitive pressure on financial institutions to keep fees in check, as consumers do not expect to pay penalty fees at the time they open an account or take out a loan or credit card, thus they do not negotiate over these terms (even if they are aware of them). Nor, for similar reasons, do they choose one financial product over another based on the amount of penalty fees.

In the last couple of years a number of the major banks have significantly increased periodic payment and direct debit dishonour, credit card late payment and credit card over the limit fees (by up to as much as 40%). However, two, the ANZ and the NAB, have reduced penalty fees on their basic concession accounts. Those were decisions that we have publicly applauded.

Given these factors, improved disclosure of penalty fee amounts, as recently proposed by the Australian Bankers' Association – while important - is not sufficient to address the problem. Further, with obvious inter-commercial rivalries between major financial institutions, we believe a purely self-regulatory solution would succeed only in dragging out the problem of penalty fees over a longer period of time.

We believe the time has come for government to act to address the charging of these fees in Australia. CHOICE and Consumer Action recommend that government legislate to give the Australian Securities and Investments Commission (**ASIC**) the power to examine penalty fees to determine whether they are reasonable and fair, with reference to underlying cost.

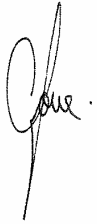
We do not propose that ASIC be able to set the amounts of different penalty fees that financial institutions may charge. However, the powers given to ASIC should enable it to investigate the fees and declare some fees invalid and/or set a maximum amount for fees, if considered appropriate. This would ensure some discipline on the fees which the market is unable to provide, while continuing to allow for flexibility in the structure and amounts of such fees. Any ASIC powers to review penalty fees would also need to allow ASIC to take an industry-wide approach and give it the power to examine the administrative costs incurred by financial institutions where consumer default occurs.

Penalty fees are commonly charged not only on deposit accounts but credit card, home and personal loan accounts as well. We therefore believe that any ASIC powers to review penalty fees should include penalty fees in relation to credit facilities, just as ASIC's general consumer protection powers under Division 2 of the *Australian Securities and Investments Commission Act 2001* cover conduct in relation to credit. More generally, this approach is consistent with both CHOICE and Consumer Action's support for a move to national regulation of consumer credit.

Due to community concerns about these fees, we have now established a website – www.fairfees.com.au – that Australian consumers can access for more information and for help in challenging their financial institution to repay penalty fees charged on their accounts.

If your Office wishes to discuss this matter, please contact Catriona Lowe, 03 9670 5088 or Peter Kell, 02 9577 3225. We have also written to your Parliamentary Secretary, Mr Pearce, about this issue.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'C. Lowe', with a stylized flourish at the end.

Catriona Lowe
Co-Chief Executive Officer
Consumer Action Law Centre

A handwritten signature in black ink, appearing to read 'Peter Kell', with a stylized flourish at the end.

Peter Kell
Chief Executive Officer
CHOICE