



**A submission from the Victorian Government
to the
Productivity Commission's Inquiry into
Australia's consumer policy framework**

June 2007

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Executive Summary

Consumer policy is the framework of strategies and programs that protects and promotes the interests of consumers¹ and redresses problems in their relationships with those supplying goods and services to consumers. It is well recognised that effective consumer policy is essential to maintaining consumer confidence and, therefore, their willingness to engage in trade. Consumer confidence is quickly undermined in markets where there is a widespread risk of deception or exploitation by business. Consumer policy also addresses other issues that arise when consumer markets are not delivering outcomes consistent with the community's economic efficiency and social policy objectives.

The economic and social costs of consumer detriment are wide-ranging and substantial. A survey commissioned by Consumer Affairs Victoria estimated that, for the 12 months to March 2006, 63 per cent of Victorians aged 16 or over experienced one or more incidents of consumer detriment. The costs of repairs and replacements and the time and cost of dealing with problems, was estimated to be \$3.15 billion. Emotional costs, annoyance, frustration, stress and disappointment were also significant, ranked as high or very high for more than half of consumers suffering detriment in most industries. These estimates did not take into account the cost to business of dealing with customer complaints or the cost to taxpayers when issues are brought to the regulator.

The Victorian Government, therefore, supports this national review to consider the potential to improve the effectiveness of consumer policy. Such a review is also timely in that it follows a focus on competition policy over recent years.

Although the focus on competition policy has significantly increased competition in many Australian markets and improved the potential for competition to drive greater economic efficiency and benefit consumers, supply side reform will be ineffective, if the demand side of the market is not working well. Unless consumers are discerning and send clear signals to business about the goods and services they value most, businesses will not produce the products that maximise benefits to consumers. While there is still potential to pursue additional competition policy reforms, it is now timely to consider whether consumer policy can be improved to empower consumers to activate competition and drive productivity and growth. (Attachment 1 discusses links between competition and consumer policy.)

The policy framework

The design and implementation of a well balanced and effective consumer policy framework is not an easy task.

1 As noted in the Victorian Government's preliminary submission, to the extent that small business policy and regulatory bodies seek to promote and protect the interests of small business as consumers, they also form part of the consumer policy framework.

First, consumer policy must be developed with the foundation of a sound understanding of the policy objectives. This can be complex with consumer policy often targeting both economic efficiency and social equity outcomes. While policies that target economic efficiency objectives will often improve social outcomes, this is not always the case. Sometimes, social objectives require consideration of issues beyond economic efficiency. Good consumer policy needs to recognise both economic and social policy issues and be effectively targeted at the real causes of consumer problems.

Second, Governments must select the appropriate policy instrument that can deliver the required outcomes. To minimise regulation the policy framework needs to promote, and not undermine, incentives for industry to develop solutions that would address information deficiencies and protect consumers with minimal government intervention. Sometimes individual businesses can obtain a commercial advantage from informing consumers and developing a reputation for ethical and honest trading. These market responses reduce, but often do not eliminate, the need for government intervention.

When voluntary action by individual businesses is insufficient, self-regulation, through codes of practice for example, may overcome some consumer problems while minimising the compliance costs on business. However, due care is needed to ensure self-regulation is effective and appropriate; many consumer issues cannot be suitably addressed by self-regulation.

Third, effective consumer policy should be based on available evidence and take into account complex consumer behaviour; Government should be mindful of how consumers react to risk and uncertainty, and how they respond to different government policies and initiatives. For example, many information problems extend beyond the availability or accessibility of information, and hinge on the ability of consumers to comprehend and use available information in their decision making processes. In such cases, it is important to look more closely at what information consumers take into account and how they use that information so that policies are effectively designed to overcome such information problems. Where improving access to information is not sufficient to overcome information problems, more comprehensive behavioural change strategies may be necessary.

Fourth, the development of effective consumer policy depends on public participation in the development of policy and effective consumer advocacy. Consumer policy tends to be more effective and appropriate when consumer organisations, outside of government, are able to undertake research and analysis, and present their views on behalf of consumers more widely.

Current regulatory instruments

Victoria's experience shows that ensuring the scope of general fair trading legislation is sufficiently broad to cover key consumer problems, and improving available compliance and enforcement tools, can greatly enhance the general

consumer law's effectiveness and improve outcomes for consumers. Victoria's unfair contract terms legislation is a clear example of how extending the scope of the general law can bring considerable benefits to consumers in Victoria and flow-on benefits to consumers in other jurisdictions.

An effective Fair Trading Act reduces the need for industry-specific regulation, which in turn minimises the risk of regulatory gaps or duplication arising from the interaction between industry specific-law and the general consumer law. General consumer law, however, cannot deal with all consumer problems. In some industries, consumer detriment may be sufficiently large and the causes sufficiently distinctive to warrant industry-specific regulation. This is the case in industries such as consumer credit and utilities. When such industry-specific regulation is being considered, a structured, objective and rigorous approach should be applied to assess the need for, and design of, the regulation.

In addition, the design of effective consumer policy must also include the implementation of suitable tools to encourage compliance and enable enforcement. A range of compliance and enforcement tools are required, many of which will be non-regulatory, such as using information, education or other strategies to encourage voluntary compliance. It may also be useful to consider whether Australia's compliance and enforcement framework could be improved if consumer organisations were given a greater role in assisting consumers to resolve disputes and obtain redress.

Alternative dispute resolution also plays an important role in encouraging compliance with the law and in facilitating redress for consumers when things go wrong. Note that whilst many alternative dispute resolution schemes are managed by industry there is still a role of government in ensuring the relevance, suitability and performance of providers of such schemes. Overall, a credible enforcement capability is still important as a last resort, and the tools available to give substance to that capability need to be proportionate and appropriate to the range of potential breaches of the law.

National approaches

The consumer policy framework in Australia needs to take into account the national nature of many consumer markets and subsequently balance nationally consistent approaches with the need for policies that can engage directly with individual consumers and respond quickly and flexibly with innovative solutions when new problems emerge. Any approach to harmonisation should be based on a realistic understanding of how consumer markets operate and the importance of flexibly combining good regulation with effective information for consumers and traders and targeted enforcement, when necessary.

At present, there are mechanisms to facilitate greater national cooperation and consistency in consumer policy. Most of these are managed through the Ministerial Council and the Standing Committee of Officials of Consumer Affairs,

which play an integral role in national policy development and enforcement coordination.

In some circumstances, greater national cooperation and uniformity in regulation may be appropriate. A good example is the issues associated with e-commerce and m-commerce, which are national (and global) in nature. The consumer issues arising from the increasing proportion of purchases on line requires national consideration and leadership.

The role of the Commonwealth and its commitment to taking leadership and championing effective consumer regulation are critical to the success of addressing such issues, and other efforts for national coordination and cooperation. However, harmonisation should not undermine the effectiveness and efficiency of consumer regulation, the ability to improve approaches by learning across jurisdictions, or the immediacy and responsiveness of current policy development to consumers. Given States' constitutional responsibility for many aspects of consumer policy, harmonisation needs to be accompanied by a commitment to maintain effective regulation.

The Victorian Government's submission

This is the Victorian Government's second submission to the Productivity Commission's Inquiry into Australia's consumer policy framework. The first submission provided factual information on the institutions and regulatory and non-regulatory initiatives that make up the consumer policy framework. This submission analyses the strengths and weaknesses of the existing consumer policy framework and strategies that could improve its performance.

The submission also includes attachments on electronic and mobile commerce transactions (attachment 2) and the Consumer Credit Code (attachment 3) to help inform the Inquiry, given the Commission's indication at the National Consumer Congress in March, that it would be looking at these areas.

Victoria has considerable experience analysing policy issues in these two areas due to its roles as chair of the Uniform Consumer Credit Code Management Committee and the E-commerce Working Party (established by the Ministerial Council on Consumer Affairs) and provides the information in the attachments to assist the Commission grapple with these difficult issues.

The Victorian Government's key messages to the Productivity Commission

- In some circumstances, markets will develop mechanisms to address information problems reducing (but not eliminating) the need for Government intervention.
- Self-regulation through the introduction of codes of practice can reduce compliance costs for business, but may not be an effective tool for addressing consumer problems, in particular where there is a serious market failure or important social objective to be achieved.
- There is a need for further research into behavioural economics and the implications for consumer policy.
- Behavioural change strategies, such as social marketing techniques, should be considered in the policy development process alongside more traditional responses such as information campaigns and regulation.
- Unfair contract terms legislation has been successful in achieving change for the benefit of consumers. It should be introduced nationally.
- Although industry-specific regulation will still be appropriate in some areas, such as utilities and credit, consumer policy strategies should place greater reliance on the fair trading Acts.
- The scope and adequacy of the general law should be examined to ensure the regulatory framework is as effective as possible. There is a case for adopting a broader unfairness test for business conduct.
- A structured, objective and rigorous approach should be applied to determine when licensing schemes should be used and what form these schemes should take.
- Effective consumer policy requires input from consumers as well as business and government and needs to be based on evidence.
- Ensuring enforcement powers and remedies are appropriate can increase the effectiveness of general regulation and create scope to reduce the reliance on more prescriptive rules based regulation.
- Whilst alternative dispute resolution (ADR) provides opportunities for consumers and suppliers, Government must play a role in the relevance, suitability and performance of ADR schemes.
- Enforcement of the regulatory framework may be improved if consumer organisations had a greater role in assisting consumers resolve disputes and obtain redress. Mechanisms such as the super complaints system in the

United Kingdom and representative actions, also being considered in the United Kingdom, should be examined.

- In its recommendations, the Commission should retain the federalist nature of current arrangements and adhere to the principle of subsidiarity.
- There is constructive inter-jurisdictional comparison in the area of consumer policy. Throughout its review, the Commission should promote inter-jurisdictional learning and improvement in the development and implementation of consumer policy.
- The federal system of governance does not lead to significant inefficiency within the consumer policy framework. However, nationally uniform regulation and cooperation may be appropriate in some circumstances, when assessed on a case by case basis.
- The Ministerial Council and the Standing Committee of Officials play an integral role in coordinating policy development and enforcement within Australia's consumer policy framework. There are a number of impediments and challenges to achieving best practice in relation to these national processes but significant improvements have been made in recent years.

1 Consumer markets

Consumer policy needs to respond to economic and social changes. Economic changes mean that previous approaches to dealing with market failure may be inappropriate because new industries or problems have emerged or old problems have diminished. Changes in social expectations affect community views on how governments should respond to the problems consumers can face, particularly the attitude to social policy concerns and how they should be dealt with.

Further, our understanding of the impacts of government intervention (regulatory and non-regulatory) is becoming more sophisticated so there are likely to be opportunities to improve the effectiveness of government responses to consumer problems.

To assess the effectiveness of existing consumer regulation and how it could be improved, this submission considers:

1. the economic and social problems consumer policy is trying to reduce and when government intervention is necessary to resolve these problems;
2. what regulatory and non-regulatory tools can address those problems;
3. how effective compliance and enforcement can be achieved; and
4. the institutional structures that would generate incentives for ongoing improvements in regulation.

But first, to put these issues in context, this section discusses how consumer markets and the demographics of consumers are changing and the challenges these changes generate for consumer policy.

The trends discussed below do not necessarily have adverse consequences for consumers; some are clearly favourable. Others, however, are likely to cause consumers difficulty and some warrant changing consumer protection measures. New information and communications technology, for example, is likely to generate a complex, long term mix of positive and negative outcomes for consumers.

Many of the significant changes in the economy that affect consumers are not simply a function of what happens in the market or in the socio-economic circumstances of consumers, but an interaction of the two. An example is the growth in house prices and household indebtedness over the last decade. Increases in the capital value of assets have increased wealth. At the same time, indebtedness has increased because people have sought larger loans to finance higher housing costs and people's additional asset wealth has made banks willing to lend them more. While the higher asset values mean consumers can sell assets if they get into financial difficulty, this asset is the family home and the personal cost of such action would be high.

Overall, a good understanding of both economic and social trends is important to understanding consumer markets, consumer behaviour and the best approach to consumer policy.

1.1 Broad economic trends

A starting point for understanding the circumstances of consumers is an assessment of the macro-economic context in which Australians consume, particularly the goods and services available and their incomes, which gives them power to buy. Private consumption expenditure is an important driver in the Australian economy accounting for 60 per cent of Australia's gross domestic product².

Many trends in Australia's economy indicate that consumer's capacity to spend is strong and increasing. The Australian economy has experienced 15 years of continuous growth, including growth in gross domestic product per capita³. At the same time employment has been growing and unemployment is historically low. The number of employed people has increased steadily since 2003, with the number of unemployed people falling. Participation in the labour force has also increased⁴ — while the unemployment rate is at 4.4 per cent, the lowest in more than 20 years.⁵

The pattern of expenditure is also changing. There is:

- greater accessibility and diversity of financial products following deregulation of the Australian banking sector and competition among credit providers;
- a long term shift in production away from goods to services (which have more inherently problematic characteristics for consumers⁶) illustrated by 22 per cent growth in value added by service industries from 1997-98 to 2002-03 compared with 12 per cent for goods-producing industries;⁷
- technological innovation, which over the last two decades has intensified and broadened, increasing consumer choice through new products, new markets and lowering the cost of some existing products.

Greater access to and interest in international goods is expanding consumer choice and also the challenges associated with ensuring that products are safe

2 ABS 2006, *Australian System of National Accounts, 2005-06*, Cat no. 5204.0, p. 26.

3 Ibid, p. 4.

4 ABS 2006, *Labour Force Australia, March 2007*, Cat no. 6202.0, p. 5.

5 ABS 2007, *2007 Year Book Australia*, Cat no. 1302.0, p. 169 and ABS 2007, 6202.0 — Labour Force, Australia, Apr 2007, <http://www.abs.gov.au/ausstats/abs%40.nsf/mf/6202.0>, accessed 15 May 2007.

6 Services are more likely to involve asymmetric information, experience and credence characteristics and reduced capacity for redress for unsatisfactory purchases.

7 ABS 2005, *Year Book Australia 2005*, Cat. No. 1301.0.

and consumers can exercise their rights. Greater links to international markets have been driven by market trends and government policy. Information and communications technology has a major influence, increasing the ease with which international suppliers can contact and market to Australians. Australian consumers can more easily compare overseas products with those sourced in Australia and products can be ordered overseas, paid for electronically, and delivered to Australia. Greater penetration of telecommunications services has facilitated much of this change. Fixed phone lines and mobile phones have increased from 52 per 100 Australians in 1993 to 118 in 2002, and the price of telecommunications fell from 1994–95 to 2002–03. Household computer ownership and Internet access have also risen steadily from 16 per cent of households in 1998 to 53 per cent in 2003.⁸

Government policy has reinforced these trends, reducing the price of overseas products by reducing the protection offered to Australian industry, and increasing the ease with which products can enter Australia by negotiating 'free trade agreements'.

1.2 Retail market trends

Much of consumers' spending occurs through retail transactions. Sales through retail businesses are about half of total household consumption expenditure (excluding rents and imputed rents for owner-occupiers). Sales by supermarkets and grocery stores alone account for 26 per cent of total retail sales.⁹ Clearly structural, technological and other developments in retail markets can have large scale, positive and negative, impacts on consumers. Some retail trade trends with possible consumer policy implications include:

- longer retail trading hours that allow consumers to shop more often and buy less per shopping trip. Retailers are responding with more sophisticated marketing to maintain customer loyalty, 'as more shopping trips means more opportunity to be disloyal';¹⁰
- access to the internet. Although retailers have not fully embraced on line shopping¹¹, ¾ of Australians over 16 years old have used the Internet, and Australia has one of the world's highest incidence of consumer purchases online, with 87 per cent of Australian Internet users having made a

8 In 2002, 61 per cent of households had a computer and 46 per cent of households had Internet access. By 2003, 66 per cent of households had a computer and 53 per cent had Internet access. Australian Institute of Health and Welfare (AIHW) 2005, *Australia's Welfare*, p. 37.

9 ABS 2002, 'Services Industries Retailing in the '90s' in *Year Book Australia 2002*, Cat. No. 1301.0.

10 ACNielsen, *Industries and Issues: Consumer Packaged Goods* at www.acnielsen.com.au, accessed 13 December 2005.

11 ACNielsen, *Industries and Issues: Retailing*, at www.acnielsen.com.au, accessed 13 December 2005.

purchase over the Internet¹² and 30 per cent *regularly* using online shopping services;¹³

- retail industry concentration is increasing and is among the highest in the world¹⁴ and the location of shops is moving away from street shopping strips to more malls and shopping centres.
- technological change has brought in-store innovations such as bar code/scanner systems, just-in-time delivery in supply chain management, electronic funds transfer at point-of-sale (EFTPOS), interactive consumer information kiosks and computer-based customer loyalty programs;¹⁵
- consumers have faster access to money for retail transactions and to financial products through automated teller machines, EFTPOS terminals and online banking;
- advertising is changing and increasing its penetration into daily life, with strategies targeting young people to influence household discretionary spending, subtle product placements in television programs and films, telemarketing, and unsolicited e-mails and 'pop-up boxes' on the Internet;
- Deregulation of financial markets, electricity gas and water utilities and telecommunications means consumers have new choice and face new challenges in exercising that choice;
- Ongoing service contracts (phone, internet) are increasing in importance. For many consumers they may be their biggest ongoing expenditure, apart from accommodation (rent or mortgage). The potential for such contracts to generate consumer detriment has, therefore, increased proportionately, with services (power, water, gas and telephone) ranking second, behind building and renovating, among the sectors that generate the highest level of detriment for Victorian consumers;¹⁶ and
- The number and types of market intermediaries are growing. In addition to groups such as real estate, investment and travel agents, new intermediaries are emerging, including buyers' advocates (real estate) and loan consolidators. While intermediaries and agents can assist time and

12 Behind New Zealand, Iceland, Sweden, Hong Kong, Denmark and the US, but ahead of Japan, UK and Germany. The most common Internet purchases in Australia were airline tickets, videos, DVDs or games and books. ACNielsen, *Online Consumer Opinion Survey*, media release 24 October 2005.

13 Nielsen//Net Ratings, *The Australian Internet and Technology Report 2005-06*, Edition 8, November 2005, p. 111 at www.nielsen-netratings.com.au.

14 ACNielsen, *Industries and Issues: Retailing* at www.acnielsen.com.au accessed 13 December 2005.

15 Office of Consumer Affairs 2004, *Industry Canada: The Consumer Trends Report*, p. 47-8.

16 CAV 2006, *Consumer detriment in Victoria: a survey of its nature, costs and implications*, Research paper No. 10, p. 3.

knowledge poor consumers, in some markets consumers may have similar difficulties selecting an agent as they currently have purchasing the product or service.

1.3 Household trends

The wants and needs of individual consumers are directly related to their age, gender and stage of their life. Their ability to participate in the market depends on their skills and resources. Although income is an important indicator of such resources, it is not the only one. Wealth (or 'net worth') also provides insight into people's financial capacity. People's level of education, familiarity and comfort with technology, literacy and English skills also affect their ability to access and absorb information and identify and avoid potential problems. Similarly, the constraints on people's time and their level of time flexibility affect their ability to obtain and use information and seek redress if problems occur. Between 1985 and 2005 the number of people working part-time increased from 7 per cent to 15 per cent of men and 37 per cent to 46 per cent of women. At the same time the hours worked by those employed full time increased from 40.2 to 41.9 hours each week. The number of people working more than 50 hours each week also increased significantly.¹⁷

Consumers' spending patterns can vary as society's expectations and standards change. Accordingly, trends in spending patterns can also provide useful insights into how social trends are affecting consumer preferences. The following discussion, therefore, covers four themes: demographic patterns, income, net worth (reflecting household assets and debt) and spending.

There are always risks if consumers are treated as a homogenous group. Demographic factors alone point to wide variations in consumers' circumstances, fundamentally affecting their decisions and behaviours — for example, consider the likely spending behaviour of a single female in her mid-20s compared with a male in his 70s. The picture is further complicated when the diversity in income and wealth is added. Cultural diversity also needs to be recognised. Fifteen per cent of people in Australia speak a language other than English at home. Of these, 21 per cent do not speak English well or not at all. Of those over 65, 40 per cent are not proficient in English.¹⁸

Overall, systematic changes in the demographics of Australia's population will have systematic effects on consumption patterns. Consumption in Australia is being affected by the ageing of the population, where the proportion of people over 65 is projected to rise from 12 per cent in 2001 to around 25 per cent by 2040 (it was 4 per cent in 1901). Such changes affect health and aged care services, for example, as people over 65 spend four times more on such services

17 ABS 2006, *Trends in hours worked*, <http://www.abs.gov.au/AUSSTATS/abs@.nsf/7d12b0f6763c78caca257061001cc588/0f152d0eab2c88bdca2571b000153da2!OpenDocument>, accessed 30 April 2007.

18 ABS 2007, *2007 Year Book Australia*, pp. 385-386.

than people under 65.¹⁹ Often age also affects people's capacity to change and adapt to new technology, which can make them less able to access information and more vulnerable in some markets.

There are also significant changes in the composition of families and households.

- Average household size declined from 3.6 people in 1961 to 2.6 in 2001.
- One-person households grew from 18 per cent of households in 1981 to 25 per cent in 2001. There are projected to be around 3 million Australians living alone by 2026.
- 'Couple only' families are expected to grow from 29 per cent of families in 1981 to 42 per cent by 2021 (to become the dominant family type).
- The probability of people having children in their twenties halved between 1976 and 2001, from 41 per cent to 20 per cent.
- One parent families are expected to grow from 9 per cent of all families in 1981 to 16 per cent in 2021.²⁰

Such changes affect the demand for housing, leisure goods, the sources and types of food purchased and the number and types of people that could potentially find themselves vulnerable or disadvantaged in consumer markets.

Consumer income and wealth has a significant effect on the areas where consumer problems are likely to emerge. This is linked to what consumers buy, how they pay for their purchases, where and when they shop and their resilience to unexpected problems. Consumer income and wealth also affects the financial buffer they have if current levels of economic, employment or asset growth are not maintained in the long run or interest rates change.

Some of the key indicators of household financial status and trends are:

- 'average household net worth', increased on average by about 7 per cent per annum between 1993-94 and 2004-05 (at current prices)²¹ with strong growth in house and superannuation assets offsetting significant increases in mortgage debt;

19 OECD, 'Economic Survey of Australia, 2004' in *OECD Observer*, January 2005, p. 4 and ABS *Australian Social Trends 2002* at <http://www.abs.gov.au/Ausstats/abs@.nsf>.

20 ABS 2004, *Australian Social Trends 2004*, Cat. No. 4102.0, <http://www.abs.gov.au/Ausstats> and Australian Institute of Family Studies, *Family Facts & Figures* at <http://aifs.gov.au/info> accessed 19 December 2005.

21 ABS, *Experimental Estimates of the Distribution of Household Wealth, 1994-2000*, *Australian System of National Accounts 2004-05*, Cat. No. 5204.0 and Cat. No. 1351.0 and *Australian Demographic Statistics* Cat. No. 3101.0.

- household debt growth is outpacing income growth, mainly due to mortgages. Household debt as a proportion of household disposable income rose from 49 per cent in 1990-91 to 143 per cent in 2004²². Overall, debt growth is also outstripping the growth in the value of assets;²³
- more of household income is required to *service* debt than previously (up from 6.5 per cent of household disposable income at the end of 1996 to 11.5 per cent by the end of 2006);²⁴ and
- households are saving less, as net saving as a ratio to gross domestic product fell from a peak of 11 per cent in 1974-75 to -2 per cent in 2004-05.²⁵

Consumers' expenditure on goods and services is growing in real terms, between 1998-99 and 2003-04 average weekly household expenditure on goods and services increased by 26 per cent. Prices increased by 18 per cent over the same period. Expenditure increased most on:

- housing costs (up 39 per cent), partly due to mortgage interest payments (up 47 per cent) and rent payments (up 23 per cent);
- food and non-alcoholic beverages (up 20 per cent);
- recreation (up 27 per cent); and
- miscellaneous goods and services (up 37 per cent), partly due to interest payments on consumer credit (excludes housing loans) (up 79 per cent).

For individual items, over the same period, all of the largest spending increases (with the exception of petrol) were on consumer services:

- mobile phone charges (up 183 per cent);
- interest payments on mortgages (up 47 per cent);
- health practitioners' fees (up 44 per cent);
- education fees (up 41 per cent);
- child care (up 34 per cent);

22 Reserve Bank of Australia (RBA) 2005, *Statement on Monetary Policy*, p. 26 and Australian Institute of Health and Welfare 2005, *Australia's Welfare 2005*, p. 272.

23 Reserve Bank of Australia 2007, *Household Finances Selected Ratios*, <http://www.rba.gov.au/Statistics/Bulletin/B21hist.xls>, accessed 17 April 2007.

24 Ibid.

25 ABS 2005, Australian System of National Accounts 2004-05, Cat. No. 5204.0, p. 6.

- health and accident insurance (up 34 per cent);
- domestic fuel and power (up 32 per cent); and
- petrol (up 26 per cent).²⁶

Overall, robust consumers that are able to thrive in a changing marketplace will need to be discerning, cope with increasingly rapid change and complexity in consumer products, and distinguish between persuasive advertising and information when the two are delivered in similar ways. Consumers will also need to use debt prudently even if it is relatively easy to access, avoiding overstretching themselves under an assumption that the good times will not end.

Governments recognise that consumer protection priorities are changing. The main groups of potentially vulnerable and disadvantaged people are shifting, with greater numbers of people from culturally and linguistically diverse backgrounds, older people and single parent families. However, as outlined in *Consumer Affairs Victoria's Discussion Paper What do we mean by 'vulnerable' and 'disadvantaged' consumers?* (included at attachment 4), the notion of consumer vulnerability and disadvantage extends beyond the personal capacity and characteristics of the consumer to the nature of consumption and the characteristics of the market. For example, when considering vulnerability and disadvantage in a policy context, it is necessary to have regard to the characteristics of markets which impact on decision making, such as the availability of information or the complexity of the goods or services.

Consumer agency priorities reflect new patterns in demand. Areas like mobile phones and credit have a history of consumer problems and the increasing importance of these sectors makes it even more important for agencies to focus compliance and enforcement on these products. Finally, the strategies agencies use to communicate with consumers and businesses are changing, recognising that more businesses are not located locally and that consumers are using different ways to shop and research their purchases.

²⁶ ABS 2006, *Household Expenditure Survey, 2003-04*, Cat. No. 6530.0, p. 6.

2 Consumer problems

Problems in consumer markets can cause economic inefficiency, injustice and undermine the freedoms and protections Australia expects for its citizens. While it is important that all markets are underpinned by minimum standards to support contracts and prohibit deceptive practices, some markets have characteristics, which increase the risk and consequences of consumer problems, and therefore warrant further government action.

Consumer detriment

The detriment caused by problems in consumer markets can be large. This is clearly demonstrated in the results of Victoria's consumer detriment survey (Box 1).

Box 1: Victoria's consumer detriment survey²⁷

In 2006 Victoria commissioned its first survey on consumer detriment. The objectives of the survey were to measure the financial and emotional costs Victorian consumers experience from problems that arise from their purchase of goods and services. This included losses associated with goods whose characteristics are hard to identify (such as their environmental impact), unfair trading and impulse purchases, and how consumers respond to detriment.

The survey demonstrated that the cost of consumer problems is significant. The total cost of consumer detriment in Victoria in the 12 months to March 2006 was estimated at \$3.15 billion (about 1.5 per cent of gross state product) and 63 per cent of Victorians experienced one or more incidents of detriment.

The detriment was distributed roughly evenly between repairing and replacing goods and services, financial costs of following up and resolving problems and the cost of time spent on following up and resolving problems. Five categories of products and services accounted for 72 per cent of detriment — building, renovating and home repairs (22.4 per cent), utilities (17.9 per cent), public and private transport (13.3 per cent), banking, finance and insurance (9.8 per cent) and electronics and electrical goods (8.7 per cent).

The average cost to consumers of a problem was \$406, ranging from an average of \$38 for incidents in the food and drink sector to \$1600 in building and renovating.

The survey also indicated that the emotional cost of detriment, while often overlooked, can be significant. Emotional costs, such as annoyance, frustration, stress and disappointment were rated high or very high by 50 per cent or more of consumers for most types of goods and services. These costs were highest

²⁷ Source: IPSOS Australia 2006, *Consumer detriment survey*, Melbourne and CAV 2006, *Consumer detriment in Victoria: a survey of its nature, costs and implications*, Research paper No. 10, Melbourne.

(around 70 per cent of those experiencing detriment) in sectors like building and renovating and buying, selling or letting a home.

In order to design and implement effective consumer policy it is important to understand the causes and nature of problems in consumer markets. Such an analysis can ensure that consumer policy is more effective, targeted at the real problems consumers face and based on an understanding of how those problems arise and affect consumers.

To inform the discussion on policy approaches later in the submission, this section looks at the causes of economic and social problems in consumer markets that may warrant government action.

2.1 Economic efficiency objectives

The underlying objective of economics is to maximise community welfare. This requires producing the right things as efficiently as possible and getting them to the right people. For this to be achieved businesses need to face incentives to reduce their costs, innovate and continually strive to improve their performance (supply-side efficiency). It also requires that consumers are able to signal to producers what products and services they want to ensure the right products and services get to the right people (demand-side efficiency). A breakdown in either of these processes results in inefficient markets.

Demand has two roles in delivering efficient markets. The first is to drive competition, the second is to generate the right mix of goods and services. Competition among suppliers is stimulated by consumers shopping around for the best deal. As noted in Schwartz and Wilde²⁸ it is not necessary for all consumers to search for there to be effective competition that benefits all consumers.

The presence of at least some consumer search in a market creates the possibility of a 'pecuniary externality': persons who search sometimes protect nonsearchers from overreaching firms. This result can be obtained because in mass transactions it is usually too expensive for firms to distinguish among extensive, moderate, and nonsearchers. Also, it would often be too expensive to draft different contracts from each of these groups even if they could conveniently be identified. Thus, if enough searchers exist, firms have incentives both to compete for their business and to offer the same terms to nonsearchers²⁹.

This will stimulate traders to produce the products and services they demand efficiently and offer them at the lowest possible price to all consumers, as long as traders cannot discriminate between searchers and nonsearchers.

28 Schwartz and Wilde 1979, 'Intervening in Markets on the Basis of Imperfect Information: A legal and economic analysis', *University of Pennsylvania Law Review*, vol. 127.

29 *Ibid*, p. 638.

The Business Council of Australia paper *New Concepts in Innovation: The keys to a growing Australia*³⁰ stressed that delivering the products and services customers want is a key driver of innovation, particularly in professional services and manufacturing. Obviously, for this innovation to be effective, demand signals need to be clear so that traders can identify what consumers want and are rewarded for responding to those demands.

But there is a second dimension to market efficiency: resource allocation. A proportion of well informed searchers will not necessarily overcome the problems where poorly informed consumers systematically choose the wrong type of product or service (for example, a high priced high quality option when a lower priced lower quality alternative would match their underlying preferences better). In that case traders are inefficiently encouraged to provide the service being demanded.

These problems can be exacerbated by the losses caused by consumers correcting past mistakes. This has an income effect, reducing consumers' ability to buy other products and services that would have improved their welfare. It also disadvantages sellers of the other products and results in the production of a mix of goods and services that does not reflect consumers' preferences. This is an inefficient outcome.

*... producers respond to market signals in the form of consumer expenditures. When consumers make poor consumption choices or fail to receive the value that they expect for the money they expend, productive resources are diverted towards products and services which generate low consumer satisfaction and are denied to products and services which would generate higher levels of consumer welfare*³¹.

Market failure can affect either the demand or supply side of markets. The most common market failures that cause problems for consumers and are targeted through consumer policy are:

1. Information problems — consumers make poor choices because of a lack of information or because they ignore or fail to act on information. Information problems include asymmetric information, in which one party to a transaction (either the buyer or the seller) has more information than the other³².

30 BCA 2006, *New Concepts in Innovation: The keys to a growing Australia*, p. 2.

31 Department of Fair Trading (NSW) 2002, *Fair Trading Act 1987 and Door to Door Sales Act 1967, National Competition Policy Review*, Final report. p. 48.

32 Asymmetric information has been a major area of study in economics because of an increasing realisation that it can be strategically manipulated, and that even the potential for this to occur can impact fundamentally on the efficient operation of markets.

2. Market power — where competition is limited, consumer choice is restricted and consumers usually face higher prices.³³
3. Externalities — where the effects of a transaction go beyond those directly involved, there may be a positive or negative impact on others not connected with the transaction. This can be an issue in product safety, for example, where the costs of the harm caused by unsafe products can affect the community, not just those involved. Equally, some traders' actions may affect other traders, for example by increasing or decreasing consumer confidence in that market.

These areas of market failure are discussed below.

2.1.1 Addressing information problems

Information problems are the most significant barriers to activating consumer demand that drives competition and economic efficiency. Consumers often need to make complex decisions under uncertainty and there are many examples where consumers do not make effective decisions because of barriers to obtaining or using information.

Economic theory has evolved since the current legal and regulatory consumer protection regimes were developed in the 1960s and 1970s. The theoretical developments most relevant to consumer affairs are in the economics of information and strategic behaviour. First, the seminal work by George Stigler proposed that information is an economic good that consumers and firms pursue until its marginal benefits and marginal costs are equal, just like other goods and services. Consumers, as part of the decision to purchase something, make decisions about how much to spend on 'search costs' — time spent researching prices and qualities etc. Second, theories on consumers' approaches to obtaining and using information have been developed by the work of behavioural economists, who have combined understanding of psychology, sociology and economics to look at other factors that affect consumers' use of information, such as the influence of habit and social norms, how people develop shortcuts when facing large amounts of complex information, and how their use of information can be biased by their beliefs and assumptions.

There are five broad categories of problems related to obtaining, understanding and acting on information.

1. lack of affordable or accessible information;
2. poor consumer skills or inability to understand or use information (information may be inherently complex);

33 Governments have a range of competition policies to address market power, which have benefits for consumers. The links between competition policy and consumer policy are discussed in Attachment 1.

3. situations where consumers ignore or use information inaccurately;
4. barriers to consumers changing their behaviour even when information is accessible, understood and accepted; and
5. unethical traders deliberately trying to deceive consumers.

Lack of affordable or accessible information

In some cases, consumers have difficulty obtaining the information needed to make decisions because it is not readily available or it is costly to access or collect. This problem is well recognised and many government strategies make information more accessible and cheaper, such as requiring traders to provide information or making information available through consumer agencies.

In other cases, private companies develop commercial solutions to assist consumers to obtain the information they need, such as:

- classified ads, publications and internet sites that help people wishing to buy products and services identify those willing to sell; and
- directories, such as accommodation guides that help those looking to book accommodation in an unfamiliar area.

Skills and ability to use information

Some information problems arise because consumers do not have the skills or knowledge to use technical or complex information effectively, even if it is provided.³⁴ Again private and government sector responses have evolved to reduce these problems. The government usually assists consumers by simplifying information to make it more accessible (such as requiring consumer credit contracts to make information on key loan conditions easier to understand) and building consumers skills (for example through education programs). The private sector may also implement strategies to simplify information and assist consumers (for example rating schemes that indicate the quality of tourist accommodation).

Consumers failing to use information

There is a considerable amount of research which demonstrates that, even when understandable information is available, consumers often ignore or misuse that

34 For example, research commissioned by Radio for the Print Handicapped in 2002 estimated that over 17 per cent of Australians had a print disability (an inability to access standard printed information, which includes vision impairment or blindness, physical dexterity problems such as multiple sclerosis, Parkinson's disease, arthritis or paralysis, learning disability, brain injury or cognitive impairment, English as a second language, literacy difficulties, and early dementia). *Secondary Research to Determine the Size of the National Print Disabled Audience* commissioned by Radio for the Print Handicapped and conducted by Market Equity, May 2002, www.rph.org.au, accessed 8 May 2007).

information. This research has been highlighted by the OECD's Committee on Consumer Policy, which held a roundtable meeting in October 2005 and subsequently released the report *Roundtable on demand-side economics for consumer policy: summary report*.³⁵

From a consumer agency's perspective the most important question is—does this matter? Sometimes it doesn't matter as consumers still make choices that are consistent with their underlying preferences. In these situations, government intervention is not necessary on efficiency grounds as consumer demand still signals to businesses the goods and services consumers want and traders still respond to those signals.

In other cases it does matter, because consumers make poor choices that are inconsistent with them buying the goods and services that would maximise their welfare. Such problems can arise for a range of reasons. For example, people often use proxies or shortcuts to deal with inadequate or complex information. They rely on a simplified set of principles in making judgements that involve complex probabilities, and the shortcut chosen could result in consumers choosing the wrong products or services.³⁶ Also, shortcuts in decision making may be so ingrained that consumers do not realise they are choosing in a way that does not identify the right product for them. As a result, while these shortcuts may assist in decision making they can also result in systematic errors in the decisions. A few examples of such biases are set out in Box 2.

Box 2. Bias in decision making under uncertainty³⁷

Attribute substitution occurs when someone, faced with a difficult question, looks for an easier alternative to approximate the original question:

Thus, a person who is asked 'What proportion of long-distance relationships break up within a year?' may answer as if she has been asked 'Do instances of swift breakups of long-distance relationships come readily to mind?' This would be an application of the availability heuristic.³⁸

Substituting known information to answer more difficult questions can result in systematic bias in choices because, for example, people may:

35 Organisation for Economic Co-operation and Development 2006, *Roundtable on demand-side economics for consumer policy: summary report*, OECD, Paris, <http://www.oecd.org/dataoecd/31/46/36581073.pdf>, accessed 11 September 2006.

36 As noted in the preceding paragraph, the use of proxies or shortcuts will not always lead to consumers making choices that do not match their underlying preferences. In some circumstances, proxies are an effective tool in dealing with complex choices and reduce search costs for consumers.

37 Source: Cope 2006, 'Information and education strategies for modern consumer policy' presented to *Third National Consumer Congress, Melbourne*, pp. 4-5.

38 Kahneman D 2002, *Maps of bounded rationality: a perspective on intuitive judgment and choice*, p. 466.

- overestimate the reliability of a short sequence of observations and use this information to predict longer term or broader issues. 'For example, the excess sensitivity of stock prices may be a result of investors overreacting to short strings of good news',³⁹
- judge the likelihood of an event by how easy it is to think of relevant examples, so undue weight is given to easy-to-remember information, such as information with a high media profile; or
- find it easier to assess average characteristics of a group, rather than extending the analysis to the specific probabilities of a particular case. This may result in decisions based on stereotype.

In addition, putting more weight on information from friends than from other, perhaps more informed, sources reinforces popular misconceptions and underestimating the risks of familiar products and overestimating the risk of unfamiliar products makes people reluctant to change and less cautious than they should be in some situations.

An area of consumer policy that illustrates consumers' failure to use information and the potential for detriment to result is retirement villages. Contracts for retirement villages are often complex, cover a wide range of issues and performance of the contract is carried out over many years. Consumers entering these contracts may overlook, discount or not understand important terms of the contract, such as their ability to undertake future renovations or their liability for future maintenance of roads and footpaths.

Unethical traders deliberately trying to deceive consumers

A further information problem consumers face is an inability, at the time a transaction is entered into, to distinguish between 'good' and 'bad' traders. As a result, consumers are susceptible to misleading, deceptive and fraudulent conduct. While market participants may develop mechanisms to send signals to consumers and help them distinguish between traders (discussed further in section 3.1), regulatory tools such as disqualifying provisions and entry restrictions as part of licensing schemes are commonly used where the potential detriment of fraud is high.

The motivation of traders that do not comply with consumer regulation ranges from those that are unaware of the law and inadvertently breach their obligations, through others that periodically behave inappropriately due to circumstances such as financial pressure, to those that deliberately engage in ongoing activities to exploit consumers. It is clear that the detriment caused by the worst of these traders, "rogue traders," is significant. While relatively small in number, they can:

39 Royal Swedish Academy of Sciences 2002, *Foundations of behavioural and experimental economics: Daniel Kahneman and Vernon Smith*, 2002 Nobel Prize Advanced Information Paper 17, p. 14.

- have large financial and emotional impacts on consumers;
- disadvantage ethical competitors;
- owe large amounts of money to suppliers and government agencies (which have little chance of recovering that money); and
- divert the resources of regulators to pursuing their detection and prosecution.

Given rogue traders' tendency to target consumers when they are vulnerable, the damage they cause individuals is often severe.

2.1.2 Addressing market power

Market power arises when a firm can profit from unilateral action to increase prices, reduce quality, or restrict choice for a significant period. It may be exercised by a single firm (a monopoly) or co-ordinated among firms (collusion).

Many consumer markets are sufficiently competitive to encourage providers to keep their prices low, maintain service levels and continue to develop new innovative products. In some markets, however, there is concern about market power. Water and public transport, for instance, are examples of markets where the scope for competition is limited. In such cases, there are often benefits from government policy that:

- introduces initiatives to increase competitive pressure on firms; and/or
- puts controls on prices or service quality to ensure that outcomes reflect more closely those that would be expected in a competitive market.

2.1.3 Addressing externalities

Where external costs (for example, passive smoking) are not reflected in a product's price, these costs will not be considered when consumers decide how much of the product they will buy and too much of the product is sold. Similarly, where external benefits (for example, immunisation against infectious disease) are not reflected in a product's price, again consumers do not always take these broader benefits into account and not enough of the product is used.

Externalities are sometimes used as a justification for government intervening, through regulation, in consumer markets. In some cases, however, it may be possible to use information based strategies to reduce the extent of externalities. In many cases consumers are not only concerned about the benefits and costs they directly face as a result of consuming particular goods and services, they are also concerned about the social and environmental consequences of their

choices and their overall fairness⁴⁰. They may choose a product that is more expensive because they recognise the benefits to others or the environment.

In considering the response to externalities, therefore, governments may find it valuable to look not only at traditional policy responses, such as pricing and regulation, but also consider empowering consumers to make well-informed choices that decreases the need for government intervention.⁴¹ A comprehensive understanding of the information issues discussed in the earlier section, could also assist in developing policy that more effectively addresses other economic problems such as externalities and, in some situations, may reduce the scope for businesses to exploit their market power.

2.2 Social objectives

Consumer policy has always been intended to achieve social objectives, ensuring people have a level of basic rights and those rights are maintained and enforced. In 1985 the UN Assembly adopted eight basic consumer rights.

1. The right to safety — To be protected against products, production processes and services which are hazardous to health or life.
2. The right to be informed — To be given facts needed to make an informed choice, and to be protected against dishonest or misleading advertising and labelling.
3. The right to choose — To be able to select from a range of products and services, offered at competitive prices with an assurance of satisfactory quality.
4. The right to be heard — To have consumer interests represented in the making and execution of government policy, and in the development of products and services.
5. The right to satisfaction of basic needs — To have access to basic essential goods and services, adequate food, clothing, shelter, health care, education and sanitation.
6. The right to redress — To receive a fair settlement of just claims, including compensation for misrepresentation, shoddy goods or unsatisfactory services.

40 Rabin, M 2002 *A Perspective on Psychology and Economics Paper EO2'313*, Institute of Business and Economic Research Department of Economics, University of California, pp. 13-15.

41 For example, Consumer Affairs Victoria's resource, *Consuming Planet Earth*, which forms part of the Consumer Education in Schools project, aims to provide young people with the knowledge and skills to contribute towards a more sustainable future by understanding that every decision we make as consumers has an impact on the environment.

7. The right to consumer education — To acquire knowledge and skills needed to make informed, confident choices about goods and services while being aware of basic consumer rights and responsibilities and how to act on them.
8. The right to a healthy environment — To live and work in an environment which is non-threatening to the well-being of present and future generations.^{42 43}

While several of these rights can be interpreted in an economic context they also focus on access to justice, fairness and prohibiting levels of harm or disadvantage that the Australian community believes are unacceptable. In Australia, however, the social objectives of consumer policy have not been clearly articulated and the benchmarks for what is acceptable and unacceptable are not well defined. While it is recognised that social standards change over time, it is difficult to assess policy approaches if the social standards we want consumer policy to achieve have not been clearly explained.

Victoria has assisted in clarifying these expectations in its *A Fairer Victoria* strategy, which is a comprehensive, whole-of-government framework for addressing disadvantage in Victoria from 2005 to 2007. *A Fairer Victoria* outlines actions ‘to improve access to vital services, reduce barriers to opportunity, strengthen assistance for disadvantaged groups and places and ensure that people get the help they need at critical times in their lives.’⁴⁴

The UN consumer rights can be divided into three categories.

1. Access to justice in consumer transactions
2. Freedom of choice, to participate in economic and political processes, to be represented and to have the knowledge and skills to exercise that choice.
3. Protection from undue harm or disadvantage.

In Australia all these are accepted as social objectives. The debate is about the acceptable standard in each case and the extent to which consumer policy, rather than other policies (such as the welfare system) has a role in delivering these objectives.

42 ACA (Australian Consumers Association) 2005, *The Eight Basic Consumer Rights*, www.choice.com.au, accessed 24 April 2007, p. 1.

43 Among the UN rights, the right to have basic needs met and the right to a safe environment are often dealt with in Australia outside the consumer affairs portfolio, though there may be overlap in areas like availability of basic banking products.

44 Victorian Government 2005, *A Fairer Victoria: Creating Opportunity and Addressing Disadvantage*, p. 1. The Victorian Government has also released updates to the framework in 2006 (*A Fairer Victoria: Progress and Next Steps*) and 2007 (*A Fairer Victoria: Building on Our Commitment*).

In other cases, Australia has regulated consumer markets to achieve broader social objectives, such as restricting the availability of alcohol, controlling when people shop etc. These will not necessarily marry with consumer objectives.

2.2.1 Access to justice

From society's perspective, access to justice, through effective dispute resolution, for example, is fundamental to establishing the foundations for social cohesion and reducing inequity⁴⁵. It generates confidence in the justice system as people have a greater understanding of their rights and responsibilities and confidence that the system is capable of upholding their rights. Ignoring small claims could undermine the effectiveness of the justice system.

For many citizens these [relatively small claims] are the only kinds of claims that they are likely to seek redress from the legal system, so that for the legal system to take the view, either wittingly or unwittingly, that because the claims are small they are trivial or unimportant risks undermining the confidence of the general body of citizenry in the accessibility, even-handedness, and responsiveness of the legal system. Thus, it is likely to be socially costly, in the long run, to leave this challenge unaddressed even if addressing it requires imaginative consideration of unconventional options that may be unsettling to traditional habits of legal thought and practice⁴⁶.

While most consumer transactions are completed without problems, as illustrated by Consumer Affairs Victoria's consumer detriment survey there are still many instances where consumers are not satisfied with the product or service they have purchased and end up in dispute with the business that supplied that product or service. Access to justice in such circumstances is critical to retaining consumer confidence in markets, maintaining pressure on business to improve their service to consumers and achieving the underlying objectives of consumer protection regulation.

If consumer rights are to have a real and practical value, consumers need confidence and reassurance that if something goes wrong they can and will get access to justice. This remains a big challenge⁴⁷.

Such rights can be particularly important in relation to vulnerable and disadvantaged consumers (attachment 4), who are often not able or willing to negotiate directly with business or have the skills or resources to pursue issues through the courts. This has been a Victorian priority. The 2004 Attorney

45 Department of Justice 2004, *New directions for the Victorian justice system 2004-2014*, Attorney General's justice statement, p. 35.

46 Trebilcock, M. 2001, *Rethinking consumer protection policy*, presented at the Eighth international consumer law conference, 9-11 April, p. 40.

47 Kyprianou M. 2005, *Speech at the OECD Workshop on Consumer Dispute Resolution and redress in the Global Marketplace*, OECD Workshop on Consumer Dispute Resolution and redress in the Global Marketplace, 19 April, p. 4.

General's justice statement stated that one of the essential values in alternative dispute resolution in Victoria is accessibility, which means that:

*The justice system should be flexible enough to provide appropriate access for those who are unable to otherwise afford it, and a range of processes appropriate to the issue to be resolved.*⁴⁸

2.2.2 Freedom to participate in economic processes

People have a fundamental right to be able to participate in economic processes. In Australia, this right is linked to having access to the information and assistance necessary to make good choices in consumer markets. The right to participate in economic processes is also closely linked to the previous discussion on information failure in markets. Reducing such market failure boosts consumers' ability to make informed decisions and buy goods and services with confidence, and reduces the risk of them being exploited or deceived.

In some cases, however, the freedom to participate may go beyond correcting market failure. This can occur when there are groups of vulnerable or disadvantaged consumers who face specific difficulties. The experience of low income people in the credit market, indigenous people in the housing market and people from culturally and linguistically diverse backgrounds in markets where goods are highly technical and involve complex contracts, are all examples of where such problems can occur. In markets where there are only a small number of such consumers, the information and exclusion problems may not be sufficiently widespread to affect the performance of the market or economic efficiency. The costs to individuals that experience such exclusion can, however, be high. In such cases, social policy objectives may warrant government intervention to assist this group, even if there are not efficiency grounds for broader government action.

2.2.3 Protection from unacceptable levels of harm or disadvantage

Society also considers it unacceptable for people to be subject to certain levels of harm or risk, even if they freely accept those risks. Governments ban some drugs, restrict minors' access to alcohol and regulate some forms of sport because the risks are considered too great. Similarly, judgements about what are acceptable risks and levels of potential harm are also made in relation to consumer policy. Economic efficiency says that, depending on the costs and benefits of government action, it may be appropriate for the government to intervene if risks are not fully accounted for in decisions to buy or sell goods or services. In a few cases, however, governments judge that a risk is unacceptable, even if consumers and businesses freely choose to take that risk.

In addition, consumer policy is designed to help protect the interests of vulnerable and disadvantaged consumers. It does not explicitly try to neutralise

⁴⁸ Department of Justice 2004, *New directions for the Victorian justice system 2004-2014*, p. 22.

all the disadvantages vulnerable people face, rather it focuses on people's access to consumer markets, capacity to exercise their rights and rights to redress, and tries to reduce the impediments disadvantaged people face in participating in such processes on the same bases as the general community. It recognises those groups that are either more susceptible to problems or more affected by the consequences of problems and looks for ways to ensure such people are not victimised, discriminated against or exploited.

2.3 Need for government intervention

The preceding discussion outlined a range of economic and social problems that can arise in consumer markets. It is important that consumer policy focus equally on its economic and social policy objectives. Often policies that work to achieve one type of objective will automatically enhance other objectives. For example, initiatives to improve competition in markets, by empowering consumers to make better, more informed, decisions are also likely to support consumers' rights to be informed, educated and have a choice of products and services. However, there are risks in some markets and it is not always the case that achieving one objective will enhance other objectives. For example, increased competition could result in highly complex products or services that are difficult for consumers to understand and may put some groups of consumers at a considerable disadvantage. In such cases, the implementation of economic policy needs to consider and accommodate social policy outcomes.

Similarly, approaches with a purely social policy focus risk undermining economic incentives for business to produce the types of goods and services consumers want at the lowest possible price and, therefore, could be detrimental to consumers in the long run (for example, regulation of residential tenancy issues could reduce the availability of low cost housing). A balance is needed to maximise simultaneously achieving economic and social goals.

Even if problems are identified in consumer markets this does not automatically mean that government intervention is warranted. The appropriateness of government action depends on several factors:

1. Will the market voluntarily, and in a timely manner, develop mechanisms to reduce the problems or its impact on consumers (discussed further in section 3.1)?
2. Could government action effectively reduce the costs of the problem?
3. Is the problem large enough that the benefits of intervention would outweigh the costs?

Such an analysis applies to regulatory and non-regulatory interventions. In many cases non-regulatory strategies may be equally or more effective at simultaneously achieving economic and social objectives. As noted in the previous discussion, much of the detriment in consumer markets is the result of

information based problems. In many cases, information problems lend themselves to non-regulatory solutions, particularly if a sophisticated approach is taken to understanding the real drivers of consumer behaviour and how consumers access and use information, so that effective behavioural change strategies can be developed and implemented.

In addition, it is often possible to address new problems without adding to the stock of regulation by improving the effectiveness and enforcement of the existing law. Where general laws are used; their outcome focus makes them particularly adaptable to new markets and products.

Finally, while government intervention may be necessary to overcome economic and social policy problems in consumer markets, poor regulation can undermine economic and social policy objectives. For example, for consumer demand to drive innovation effectively the regulatory framework must be sufficiently flexible to allow that innovation to occur. This is potentially an issue in industries like the food industry, where regulation of food standards may not be flexible enough to allow businesses to respond to emerging consumer demand.

These issues are discussed further in the following sections on the consumer policy framework. That discussion recognises that while explicit regulation is sometimes necessary there is also likely to be scope to improve the effectiveness of existing laws and non-regulatory strategies.

3 The policy framework

Having established the social and economic objectives of consumer policy, the achievement of these goals must be balanced against the costs of any intervention. While government regulation is sometimes necessary to achieve these goals, excessive or poorly developed regulation can impose costs on society that outweigh the benefits of this regulation. These costs can have negative implications for overall economic performance, including employment and investment opportunities.

Through rigorous assessment of proposed regulation, the Victorian Government seeks to ensure that proposed policy responses are appropriate, all options for government action (non-regulatory and regulatory) are considered, and that any regulation does not impose an undue burden on business or the community. Further, the Government has committed to a reform agenda whereby the administrative burden of state regulation on business will be reduced by 15 per cent by 2009 and 25 per cent by 2011. The Reducing the Regulatory Burden initiative has two other components: offsetting simplifications for new regulations that increase administrative burden and a program of priority reviews to reduce compliance burdens.

The Victorian Government will not resort to explicit regulation unless it has clear, continuing evidence that:

- a problem exists;
- government action is justified; and
- it is not possible to deal with the problem using non-regulatory approaches, so that regulation (i.e. in the form of primary or subordinate legislation) is the best option available.

To achieve the Victorian Government's vision of well-targeted, effective and appropriate regulation, best practice principles have been established to assist with the design of government policy responses. A central principle is that the Government will not take action, particularly imposing regulation on businesses, markets or consumers, without establishing that the benefits outweigh the costs.

Best practice consumer policy must recognise that consumer detriment may not be distributed evenly across all consumers, with some consumers more able than others to protect their interests without government intervention. Therefore, where consumer detriment is concentrated in particular groups of consumers, and these groups can be identified, it may be preferable to implement policies that can protect these vulnerable and disadvantaged consumers without imposing costs on other consumers. For example, default policies may be an effective means of addressing information asymmetry for vulnerable and disadvantaged consumers, without imposing costs on those consumers who are able to make decisions that reflect their preferences and are in their best

interests.⁴⁹ However, in some cases, it may not be practicable to target policies in this manner and the costs of any intervention will be borne by all consumers. In such cases, an analysis of the costs and benefits of regulation may indicate that intervention is not appropriate on balance.

To achieve 'good' regulation, it is important to consider a number of policy responses, including regulatory and non-regulatory alternatives, to ensure any intervention is the minimum necessary to achieve the desired objectives. Consultation with businesses and the community in developing and evaluating the alternative policy responses is also necessary to enhance the accountability, transparency and effectiveness of regulatory proposals.

In addition, it is important that government policy responses are evaluated regularly to ensure that they meet their specified objectives. In relation to consumer regulation, this includes ensuring that regulation keeps pace with market changes (outlined in section 1 above), and adapts to changing economic and social conditions.

To assist with policy development and evaluation, the Victorian Department of Treasury and Finance has published the *Victorian Guide to Regulation*, which outlines the characteristics of a good regulatory system (listed in Box 3).

Box 3: Characteristics of a good regulatory system⁵⁰

Effectiveness — Regulation, in combination with other government initiatives, must be focused on the problem and achieve its intended policy objectives with minimal side-effects. The regulatory system should also encourage innovation and complement the efficiency of markets.

Proportionality — Regulatory measures should be proportional to the problem that they seek to address. This principle is particularly applicable in terms of any compliance burden or penalty framework which may apply. This characteristic also includes the effective targeting of regulation at those firms/individuals where the regulation will generate the highest net benefits.

Flexibility — Government departments and agencies are encouraged to pursue a culture of continuous improvement, and regularly review legislative and regulatory restrictions. Where necessary, regulatory measures should be modified or eliminated to take account of changing social and business environments, and technological advances.

49 For further examples and a more detailed discussion of what the authors term 'asymmetric paternalism', see Camerer et al 2003, Regulation for Conservatives: Behavioural economics and the case for "Asymmetric Paternalism", University of Pennsylvania Law Review, vol. 151.

50 Source: Department of Treasury and Finance 2005, *Victorian Guide to Regulation*, pp. 3.1-3.2.

Transparency — The development and enforcement of government regulation should be transparent to the community and the business sector. Transparency can promote learning and information-sharing within the regulatory system, and can also help to build public trust in the quality of regulation and the integrity of the process.

Consistent and predictable — Regulation should be consistent with other policies, laws and agreements affecting regulated parties to avoid confusion. It should also be predictable in order to create a stable regulatory environment and foster business confidence. The regulatory approach should be applied consistently across regulated parties with like circumstances.

Cooperation — When appropriate, regulation must be developed with the participation of the community and business and in coordination with other jurisdictions, both within Australia and internationally, to ensure that it reflects the interest of Victorians and takes into account Victoria's major trading relationships. Regulators should also seek to build a cooperative compliance culture.

Accountability — The Government must explain its decisions on regulation and be subject to public scrutiny. The same is true of its enforcement agencies. As such, the development and enforcement of regulation in Victoria should be monitored, with the results being reported to the public on a systematic basis.

Subject to appeal — There should be transparent and robust mechanisms to appeal against decisions made by a regulatory body that may have significant impacts on individuals and/or businesses.

In light of recent market trends and an improved understanding of consumer and trader behaviour, there may be scope to improve Australia's consumer policy framework, in line with best practice criteria. In particular, the Victorian Government considers the following aspects of the framework may warrant further investigation during the Productivity Commission's Inquiry:

- the extent to which market mechanisms and self-regulatory approaches may be relied upon to adequately address information problems and reduce the need for government intervention;
- whether the use of behavioural change strategies could improve the effectiveness and proportionality of policy responses given developments in behavioural economics theories and their ability to explain why traditional policy responses have not always been fully effective;
- the benefits that could be realised from national adoption of the unfair contract terms provisions that were introduced to the Victorian Fair Trading Act in 2003;

- the ability to reduce regulatory duplication and compliance costs through greater reliance on general fair trading legislation, such as the state and territory Fair Trading Acts and the Trade Practices Act;
- whether there is potential to improve the effectiveness of occupational licensing schemes and reduce the associated regulatory burden; and
- the role of consumer organisations in the policy development and regulatory processes and the potential to improve the transparency, accountability and effectiveness of policy interventions by enhancing this role.

These issues are discussed further in the sub-sections below.

3.1 *Market incentives to address asymmetric information*

In some circumstances, markets will develop mechanisms to address information problems reducing (but not eliminating) the need for Government intervention.

As noted in section 2.1.1, consumers can face different types of information problems, which restrict their ability to activate the demand side of markets and lead to inefficient market outcomes. In some circumstances, where the benefits of intervention outweigh the costs, governments will intervene through regulatory and non-regulatory activities to address these problems.

However, in some circumstances, market participants may develop mechanisms to address information problems, particularly against a backdrop of the general consumer protections in the FTA, which may reduce or remove the need for government intervention, or change the nature of the intervention required.

Market participants may develop such mechanisms without government intervention if there is benefit in them doing so.

Two market mechanisms that have developed to partially address consumer information problems in markets are discussed below. These are market signalling and market intermediaries.

3.1.1 Signalling

Consumers often face problems in assessing the credibility of traders' claims about their goods or services because they lack the necessary tools, skills or information to independently verify them. In some markets, these problems are more exacerbated than in others. Goods or services with '*credence*' attributes are

good examples because the qualities of such goods or services are hard to verify before and after purchase.⁵¹

As consumers are unable to verify traders' claims, fraud is a potential problem. It is also a serious matter because consumers who are defrauded suffer welfare losses whether the fraud is discovered or not. In addition there is a second type of welfare loss — that to the economy when markets are 'thin' or missing altogether because consumers simply decide not to purchase goods they are not confident about — 'dishonest dealings tend to drive honest dealings out of the market'⁵².

Because of the potential for traders with fraudulent claims to drive honest traders out of the market, or for the market to become homogenised, market participants may have incentives to develop mechanisms to help consumers distinguish between products and services offered and give them confidence in the claims being made.

There is now a wide recognition, from studies over the past thirty years that many 'commonplace' features of markets exist to counteract the potential for strategic behaviour (adverse selection and moral hazard behaviour) due to asymmetric information. These include warranties, money-back guarantees, insurance excesses, product standardisation, investments in branding, advertising, sunk costs, third-party certification and brokering. The body of literature is often referred to as 'signalling literature'.

Due to the growing demand for goods with credence attributes, many markets for credence goods are developing signalling mechanisms, such as certification schemes, to provide consumers with confidence of the claims being made. One example is in the egg market, which is outlined in Box 4.

Box 4. Signalling in the market for eggs

51 Goods with credence attributes include goods that are pesticide free, healthy or low fat, meet environmental standards, produced locally, meet religious requirements, produced according to desirable social or cultural standards and produced with high standards of animal welfare.

Many services also have credence attributes. Dulleck and Kerschbamer (2005) (*Experts vs Discounters: Competition and Market Unravelling When Consumers Do Not Know What they Need*, CEPR Discussion Papers 5242) review international literature on the behaviour of expert sellers of credence services who "identify the quality that fits a customer's need best by performing a diagnosis", including mechanics, financial advisers, taxi-drivers and physicians. Consumer concerns about being defrauded by experts are not unfounded, they conclude, quoting studies showing high percentages of unnecessary auto repairs and some types of medical treatments (eg caesareans) are correlated with variables related to the knowledge and/or finances of recipients. In Australia recently, a report by the Federal Government's Professional Services Review found a growing number of skin cancer clinics are performing unnecessary procedures to boost their profits (The Age, 15 January 2007).

52 Akerlof, G. 1970, The market for "lemons": quality uncertainty and the market mechanism, *Quarterly Journal of Economics*, vol. 89, pp. 488-500.

In farming, as elsewhere, the right to do business requires minimum levels of socially acceptable practices be observed, and these change over time as definitions of 'acceptable' change. In the layer hen industry, adjustment is currently occurring towards a new legal requirement for minimum cage sizes of 550 sq cm per bird (floor space) by 1 January 2008. Sixty five per cent of Australia's egg producers are licensed under the Australian Egg Corporations' Quality Assurance program covering all production systems. This involves third-party auditing of requirements related to animal welfare; biosecurity; food safety and labelling from receipt of birds to dispatch of eggs and transfer to consumer.

Some egg consumers are prepared to pay for 'extra' qualities above the minimum legal cage-size requirements and there are a range to choose from including 'barn laid' (approximately 20 to 30 per cent price premium) and 'free-range' (40 to 50 per cent) backed up by private certifiers with significant reputations such as the RSPCA.

Producers of these types of eggs also recognise the value of science, and information about science, in strengthening the market by making cheating more difficult. For example, the poultry industry is conducting research through the CSIRO to find a method of identifying the housing system used to produce a given batch of eggs, using ultraviolet light to show up wire patterns on caged hen eggs.

Thus, in the markets for non-cage laid eggs, market solutions have developed because consumers are prepared to pay for reputable third-party certification; and investments in scientific research and communication.

The development of signalling mechanisms by market participants does not mean that all information problems will be addressed or that there is no longer a need for government intervention. In fact, over-arching general regulation, such as the misleading and deceptive conduct and false advertising provisions of the FTA are necessary to deal with rogue traders and other fraudulent claims.

In addition, signalling mechanisms will not be effective in all markets and industry specific intervention in the form of regulatory and/or non-regulatory strategies may still be required. The market conditions that are most likely to lead to the development of effective signalling mechanisms are discussed below.

Spence (1973)⁵³ investigated *signals* between buyers and sellers and established that, and under certain conditions, signals will be an effective means of solving adverse selection problems due to asymmetric information, so that all producers, regardless of the quality of their products, do not make dishonest

53 Spence, A. 1973, Job market signalling, *Quarterly Journal of Economics*, August, vol. 87, no. 3, pp. 355-374.

claims about their separate types of goods in a free market situation. If this occurs, it is termed a 'separating equilibrium'.

Whether or not signalling will lead to a separating equilibrium in a particular market situation depends on:

- the feasibility and costs of signalling;
- the additional cost of producing high versus low quality products; and
- the marginal benefit to consumers (the amount they are prepared to pay for high quality).⁵⁴

For each particular product, service or industry, there will be a different combination of the above variables and for some, the combination will be such that the information asymmetry cannot be resolved via private sector signalling. In such cases, there may be a role for government to identify the most cost-effective mechanisms to address the information problems consumers face. The egg market (outlined in Box 4 above) is an example of a market where the conditions do generally exist for a separating equilibrium.

Previous attempts at identifying potentially problematic markets (where a market-based solution is unlikely to emerge) have generally focused on *lists* of characteristics such as Hadfield, Howse and Trebilcock (1998).⁵⁵

- Repeat transactions are rare, and consequently the performance incentives created by the possibility of repeat business from satisfied customers are blunted.
- Entry and exit costs in the industry are low, leading to the possibility of a large number of fly-by-night operators with few sunk costs and only moderate investments in reputational capital.
- Many sellers or producers are extra jurisdictional, making redress through private law more difficult for consumers.
- Sellers characteristically have few assets against which a judgement may be enforced.
- The costs to consumers of a 'bad' transaction are delayed or potentially catastrophic, making ex post relief an inadequate or unsatisfactory solution.

54 Macho-Stadler, I. And Perez-Castrillo, J. 1997, *An Introduction to the Economics Of Information*, Oxford University Press.

55 Hadfield, G.K., Howse, R. and Trebilcock, M.J. 1998, Information-based principles for rethinking consumer protection policy, *Journal of Consumer Policy*, vol. 21, pp. 131-169.

- The small size of a typical transaction creates a disincentive to seek ex post relief through the courts.

It would be useful to conduct national research to develop a more detailed model capable of predicting industries where calls for government intervention may be more likely, to understand the reasons why, and determine whether and in what form intervention should proceed.

3.1.2 Intermediaries

Consumers can have problems identifying the goods or services that best meet their needs. Purchase decisions may be complicated by the complexity, volume or variation of the goods or services on offer and the need to filter this information to match the attributes of the goods or services to their own requirements.

In some markets, intermediaries have emerged to act as a conduit for goods or services offered by a trader to a consumer. Intermediaries are now common in many markets including finance, motor car trading, telecommunications and real estate. Brokers within these markets can offer a variety of services ranging from simply collecting and collating information on product or service choices to providing advice on the best products/services to meet their needs and acting as an agent for the consumer in transactions.

Consumers may be prepared to pay for an intermediary to collect and collate information for them because it may reduce their search costs. Because more people are working longer hours, there may be a growing number of time-poor consumers seeking assistance from brokers. This trend was noted during consultations conducted in 2004 by Mr Noel Pullen MP on the operation of the *Motor Car Traders Act 1986*. In his report to the Minister of Consumer Affairs, Mr Pullen commented:

*Traders said that brokers were a big growth area in the industry, particularly in Melbourne. This growth may reflect a change in the market and an increase in demand for brokers' services from time-poor or non-mechanically minded consumers.*⁵⁶

However, although using an intermediary may be beneficial for consumers dealing with complex decisions, it may also create risk and possible detriment because the quality of an intermediary can be as difficult for a consumer to assess as the quality of the product or service itself. Further, due to the variation in services provided by brokers, consumers may make incorrect assumptions regarding the level of service the broker will provide. For example, a consumer may expect a finance broker to:

56 Pullen N 2004, *A Report to the Minister of Consumer Affairs on the Motor Car Traders Act consultations*, prepared by Noel Pullen MP with the assistance of Consumer Affairs Victoria, p. 49.

- make an accurate assessment of their financial needs;
- independently assess all, or at least a wide selection of, available products or services on the market against the consumers' needs;
- advise them of the suitability of the products or services on offer to meet their needs;
- be accountable for the eventual suitability of any recommended product or service.

However, the broker may only be offering to facilitate a loan with a particular credit provider, in which case the consumer may not get the loan product that is most suited to their needs. The consumer may also be unaware of any commission arrangements or the fee charged by the broker. There is a role for government in providing information and advice to consumers to alert them to these issues and to encourage them to consider the nature of the service offered by the intermediary.

There is also a need for governments to closely monitor markets where intermediaries are emerging and assess any need for regulatory intervention. This is particularly important where they operate in connection with licensed industries because consumers and traders may be confused about the application of the existing law and in some circumstances, brokers may undermine existing consumer protections.

3.2 Appropriate use of codes of practice

Self-regulation through the introduction of codes of practice can reduce compliance costs for business, but may not be an effective tool for addressing consumer problems, in particular where there is a serious market failure or important social objective to be achieved.

The promotion of industry self-regulation, especially through the development of voluntary codes of conduct, has had a long history in Australia. However, despite such promotion, there has been mixed success in the use of, and reliance on, self-regulation to address consumer problems. Over the past couple of decades, there have been a number of government reviews of the strengths and weaknesses of self-regulation. These reviews, combined with practical experience from the use of codes in the United Kingdom and in Australia, have led to a greater understanding of the circumstances under which self-regulation is suitable and likely to be effective.

3.2.1 The focus on self-regulation in the 1980s and 1990s

One of the earliest reports into the strengths and weaknesses of self-regulation, the conditions necessary for effective self-regulation and the circumstances under which it may be desirable to promote self-regulation was produced by the

then Victorian Ministry of Consumer Affairs in 1984.⁵⁷ This report based its findings on the experience within the UK where codes had been actively pursued in several sectors and on examples of self-regulatory schemes then in operation in Australia, for example advertising self-regulation.

In 1994, the then Office of Fair Trading and Business Affairs (Victoria) (OFTBA), in an attempt to promote the adoption of voluntary codes released *Guidelines for Establishing Self-Regulatory Schemes*. The objective of this guide was to provide clear guidance on the key elements of an effective self-regulatory scheme, for example that there should be a well-established trade association covering a substantial portion of the industry and that the association must have the willingness and resources to monitor, enforce and publicise the code. Where there was compliance with the criteria, OFTBA was prepared to endorse the code, which included advising consumers to deal with members of an endorsed association.

In the mid-1990s, the Ministerial Council on Consumer Affairs also commissioned a national guideline to industry and professional codes of conduct.⁵⁸ The guide assisted industries and professional associations develop effective codes. It was updated regularly by agreement among agencies, until 2000 when it was abandoned.

During the early to mid-1990s, voluntary codes were considered as a substitute or replacement for legislation. Thus, in March 1998, when the Commonwealth released its policy framework for codes of conduct⁵⁹, the principles underlying the policy included:

- the general presumption that competitive market forces deliver greater choice and benefits to consumers;
- the Government will consider intervention where there is market failure or a demonstrated need to achieve a particular social objective;
- effective voluntary codes of conduct are the preferred method of intervention; and
- where a code of conduct is not effective the Government may assist to regulate effectively.

In August 1999, the then Federal Minister for Financial Services and Regulation established a Taskforce on Industry Self-regulation to examine self-regulation in

57 Ministry of Consumer Affairs Self-regulation Working Party 1984, *Industry Self-regulation: Its Role in Consumer Policy*.

58 *Fair Trading Codes of Conduct Why have them, How to prepare them*, a guide prepared by Commonwealth, State and Territory Consumer Affairs Agencies, October 1996.

59 Codes of Conduct Policy Framework, Industry, Science, Tourism, Consumer Affairs, March 1998.

national consumer markets. The Taskforce released an Issues Paper and a Final Report in August 2000. The Taskforce did not evaluate the effectiveness or otherwise of any particular self-regulatory schemes focusing instead on the features that it observed in existing schemes. The conclusions reached by the Taskforce included the following:

- there is a broad range of self-regulation at the national level (state and territory self-regulatory models were not considered);
- there is no single model for industry self-regulation;
- self-regulation is likely to be effective where problems are neither widespread nor serious;
- self-regulation is likely to be less effective where there is a broad spread of smaller businesses that do not communicate with each other;
- a self-regulatory scheme is likely to be more effective if it has broad industry coverage and a high level of consumer awareness;
- clarity in a scheme's documentation can help consumers understand their rights;
- industry may promote self-regulation as an alternative to government regulation where there is a serious market failure or important social objective;
- Government involvement in self-regulation is justified when there is a public policy objective that would otherwise call for a regulatory response; and
- the degree of government involvement will depend on the significance of the market failure or social policy objective and consequences of self-regulation proving ineffective.

The Taskforce did not make recommendations but encouraged the Australian Government to consider updating its guidelines on how to assess options for addressing market failures. This work was not carried forward.

In October 2003, the Australian Competition and Consumer Commission (ACCC) announced new Guidelines for developing and endorsing voluntary industry codes. A two-stage approach was proposed, similar to that adopted in the United Kingdom. In 1998, a report by the UK Office of Fair Trading (OFT) questioned the continued reliance on codes as a policy instrument in the UK suggesting that codes were held in low regard, that compliance with codes was patchy and that

there was widespread ignorance of codes among both consumers and traders.⁶⁰ However, rather than abandon the policy, it developed a revised two-stage approach. Under stage one, the code's sponsor promises that its code meets the OFT's core code criteria, for example the codes must contain measures to address consumer concerns and undesirable trading practices. Under stage two, the code sponsor must demonstrate effective code implementation. Where the sponsor can prove effective operation of the code, the OFT will 'approve' the code. There has been no further public promotion of this approach by the ACCC since 2003 and the ACCC's *Guidelines for developing effective voluntary industry codes of conduct*⁶¹ released in 2005 follow the approach set in the earlier Guide commissioned by the Ministerial Council on Consumer Affairs rather than promoting the UK style approach..

3.2.2 Self-regulation implementation

Considerable effort has gone into identifying in a general sense, the strengths and weaknesses of industry self-regulation and the features that might make for an effective scheme. Benefits have been said to include flexibility, sensitivity to market circumstances necessary for product innovation and development, the capacity to address industry specific problems and greater industry buy-in to the regulation. Weaknesses have been said to include lack of adequate coverage and inadequate enforcement of rules.

Voluntary codes have been developed in many national and state based industries with mixed success. For example, a review in 2001 by Consumer Affairs Victoria⁶² after a decade of promoting the adoption of voluntary codes, including a policy of endorsing codes, found that only one self-regulatory scheme had been endorsed and in a compliance review of that scheme, compliance was found to be patchy at best with little action taken to enforce the Code or sanction non-compliance. At a general level, the costs of developing a self-regulatory scheme were an impediment for smaller state based associations which were often focused on other responsibilities, such as industrial relations, or relied on volunteers to run the self-regulatory scheme. For small trade associations, the potential long-term benefits of belonging to a self-regulatory scheme — attracting increased patronage through promotion of higher trading standards — was at best a theoretical argument. The reality as these associations saw it was that consumers were driven by price considerations and self-regulation increased prices vis-a vis their competitors.

Given these findings, codes of conduct may be more effective where there is a regulatory hook. For example compliance with codes such as the Code of

60 *Raising Standards of Consumer Care: Progressing beyond codes of practice*, A report by the Office of Fair Trading, February 1998.

61 ACCC 2005, <http://www.accc.gov.au/content/index.phtml/itemId/658186>, accessed 16 May 2007.

62 Consumer and Business Affairs Victoria 2001, *Review of Industry Self-regulation, Voluntary and Mandatory Codes of Practice*, unpublished.

Conduct for Marketing Retail Energy in Victoria is a requirement of retail gas and electricity licences.

A threshold issue for voluntary codes is their place in the regulatory spectrum and the circumstances in which they should be used. It was noted above that the Commonwealth's policy framework suggested a preference for intervention by voluntary codes, which implied that intervention should be, at least initially, by means of voluntary codes.

In contrast, the Victorian Guide to Regulation, although stating that regulatory measures must be the minimum necessary to achieve the desired objectives⁶³, does not indicate a preferred means of intervention. Instead, it advocates a full and proper assessment of all viable options (regulatory and non-regulatory) to select the most effective tool to achieve the desired outcome.⁶⁴

The fundamental rule is that government should not intervene unless it has evidence that a problem exists. If intervention is justified then the policy option chosen to address the problem should deliver the greatest net public benefit. In many cases, voluntary codes will not deliver the greatest net benefit and so, their use should not be elevated above alternative policy instruments. Even within the context of industry self-regulation, there are options beside codes, for example, service charters, the development of standards and the establishment of internal complaints handling processes.

Voluntary codes or self-regulation more generally, may not be an appropriate policy choice where there are serious market failures that undermine adherence to accepted necessary minimum standards by all market participants. Voluntary codes are thus unlikely to be an acceptable alternative to government regulation where there is a serious market failure or important social objective to be achieved.

Voluntary codes may be appropriate to lift standards above the minimum prescribed by legislation — to set best practice benchmarks. If it is accepted that the purpose of a voluntary code is to set best practice standards then some of the earlier criteria which were seen as essential criteria for effective codes, for example substantial industry coverage, may not be required.

In the last decade, perhaps in recognition of some of the short-comings of voluntary codes, moves have been made to amend the *Trade Practices Act 1974* and the *Fair Trading Act 1999* to enable the introduction of mandatory codes. For example, sections 51AD and 51 AE of the TPA which came into effect on 1 July 1998 allow the Government to prescribe industry codes of conduct as either mandatory, which are binding on all industry members, or voluntary which are binding on just the members of the industry which have formally subscribed to

63 Department of Treasury and Finance 2007, *Victorian Guide to Regulation*, p. 3-3.

64 Ibid. p. 3-5.

the code. Examples of the former include the Franchising Code, Oilcode and Horticulture Code. There are no prescribed voluntary codes.

Mandatory codes, which are binding on all industry participants and can be enforced, are a form of quasi-regulation, rather than industry self-regulation. However, to the extent that they are developed in close consultation or involvement from industry and fall under the general fair trading law, they can be distinguished from industry-specific regulation.

3.3 Responding to insights from behavioural economics

There is a need for further research into behavioural economics and the implications for consumer policy.

As outlined in section 2.1.1 above, there is a considerable amount of research, which demonstrates that, even when understandable information is available, consumers often ignore or misuse that information.

The increasing interest in behavioural economics — which draws on other disciplines such as psychology and sociology — is because research is suggesting departures of actual behaviour from the traditional model may be systematic and non-trivial, with implications for policy. As discussed above, consumers' failure to use information properly can lead them to make poor choices that are inconsistent with them buying the goods and services that would maximise their welfare. This can reduce the efficiency of the markets concerned.

Behavioural economics has uncovered numerous types of idiosyncratic behaviour (often termed 'biases') including:

- Overconfidence — people are prone to overconfidence in their judgements (for example, thinking they are a better driver than the average person).
- Confirmation — once an opinion is formed, people are receptive to further information that confirms it but unreceptive to that which might challenge or contradict it.
- Ease of recall — people disproportionately weight memorable or vivid evidence when making judgements.
- Framing — people often change their minds between identical options depending on how information is 'framed' (for example, 'two for one' instead of 'half price').
- Context — adding a new option to a menu of choices increases the proportion of consumers choosing an existing option.

- Desire for immediate gratification — even though people have plans, wanting satisfaction in the present often overrides these (for example, ‘impulse spending’).
- Reference-based satisfaction — people care a lot about changes in wealth, consumption, ownership, health etc and not solely about their absolute levels.
- Loss aversion — people are more averse to losses than they are attracted to same sized gains (losing \$100 hurts more than winning \$100 gives pleasure).
- Reciprocity — people punish ‘bad’ behaviour and reward ‘good’ behaviour even at some cost or inconvenience to themselves.

For a more detailed discussion of these biases, see appendix 4 of Consumer Affairs Victoria’s Consumer Detriment Research Paper.⁶⁵

In terms of consumer policy, behavioural economics has important implications for some of the tools governments use to ensure consumers are protected and empowered in markets. For example, are laws requiring the disclosure of certain information effective if people don’t respond to the information in the way the traditional model predicts? Can we help consumers identify the ways marketers are ‘playing on’ their idiosyncrasies?

Behavioural economics principles can also help governments and policy makers understand what makes people vulnerable.

There are also lessons for traders — for example, one behavioural economics proposition tested in the Consumer Detriment Survey was that people will ‘punish’ unfair treatment and ‘reward’ good treatment far more than traditional models would predict. The survey found 65 per cent of people would ‘probably’ or ‘definitely’ inconvenience themselves to avoid a business that had treated them unfairly and 97 per cent would discuss unfair treatment with people they know (occasionally, sometimes, usually or always – 33 per cent said always).

A recognition of behavioural factors helps increase the sophistication of government’s policy approaches. Policy development that is cognisant of traditional sources of economic market failure, social policy concerns and behavioural factors would be based on a more realistic understanding of the way consumers respond to risk and uncertainty, the detriment they may suffer from

65 CAV 2006, *Consumer detriment in Victoria: a survey of its nature, costs and implications*, Research paper No. 10.

making poor decisions and how they respond to government initiatives to overcome such problems.⁶⁶

In many cases, behavioural biases and short cuts in decision making mean that the nature of information failure in consumer markets will be more complex than simply a lack of access to easily understandable information and, therefore, more sophisticated approaches to addressing information problems are needed. Such approaches could involve:

- Changing the environment in which decisions are made so that consumers are not as prone to the biases that are causing problems;
- Changing the way information strategies are designed and implemented to make them more effective and targeted to the real sources of information problems; and
- Relying more on more holistic behavioural change strategies rather than information provision alone (discussed in the following section).

A key insight from behavioural economics is that people's preferences are not fixed but influenced by the environment in which decisions are made. Policies that influence that environment can, therefore, change the pressures consumers face and the risk that they inadvertently make poor decisions. The use of defaults is a good example. A range of factors give people a strong incentive to choose not to choose and accept the default outcome. Defaults, therefore, have a significant impact on policy outcomes. In two neighbouring states in the United States, New Jersey and Pennsylvania, motorists have an option to take cheaper insurance that limits their rights to sue. In New Jersey, where the limited right to sue is the default, only 20 per cent of motorists pay extra to gain a full right to sue. In Pennsylvania, where a full right to sue is the default, 75 per cent of motorists have retained the full right to sue.⁶⁷

Similarly, cooling-off periods are another way that the decision making environment can be changed, without restricting people's freedom to choose.⁶⁸

66 The OECD's Committee on Consumer Policy held a roundtable meeting in October 2005 to outline and discuss developments in economic research, particularly behavioural economics, with a view to exploring possible implications for public policy. The report *Roundtable on demand-side economics for consumer policy: summary report*, is available at <http://www.oecd.org/dataoecd/31/46/36581073.pdf>. New Zealand has also published a discussion paper on the implications of behavioural economics for policy: Ministry of Economic Development 2006, *Behavioural analysis for policy: New lessons from economics, philosophy, psychology, cognitive science, and sociology*, available at <https://psi.govt.nz/pdtoolkit/default.aspx>.

67 Camerer et al 2003, *Regulation for Conservatives: Behavioural economics and the case for "Asymmetric Paternalism"*, University of Pennsylvania Law Review, vol. 151, pp. 1226-1227.

68 Ibid, p. 1239.

Overall, policies such as setting defaults and cooling-off periods can often create an environment where the risk of poor choices is diminished without imposing significant costs on rational consumers.⁶⁹

A second insight from behavioural economics is that, because of the complexity in consumers' approaches to decision making, policy responses need to recognise this complexity and be well founded on a sound understanding of the problems in the market. It means that effective information strategies need to:

- account for how people make decisions and use information — they may need to convince consumers of the need to obtain new information or change their approach before new information is provided and information may also need to be made more salient and responsive to the short cuts people use in decision making;
- recognise the importance of long term skills development; and
- recognise that consumers are not a homogenous group and different approaches may be needed to target different groups.⁷⁰

Finally, a more holistic approach to behavioural change is often needed. For example, concerns about escalating credit have tended to lead governments to focus on interventions focused on the supply side of the market, such as disclosure statements requiring specified information to be provided to consumers. Little attention has been paid to policy instruments focussed on the demand side. Yet authors such as Gans⁷¹ are beginning to suggest that the desire for immediate gratification, combined with self-control problems, is the most important behaviour affecting credit card debt. Behavioural change strategies, in combination with regulatory responses, may better target the root causes of problems without imposing unnecessary costs and regulatory burden on others. These strategies are discussed in the following section.

3.4 Facilitating behavioural change

Behavioural change strategies, such as social marketing techniques, should be considered in the policy development process alongside more traditional responses such as information campaigns and regulation.

As noted above, one of the consequences of developing a more sophisticated understanding of what drives consumer behaviour is the ability to develop policies that more effectively address both economic efficiency and social policy concerns in consumer markets. For many years, government agencies have assumed that the more knowledgeable their constituents are, the more

69 Ibid, p. 1219.

70 CAV 2006, *Information Provision and Education Strategies*, Research Paper No. 3, pp. 18-19.

71 Gans, J. 2005, 'Protecting consumers by protecting competition': Does behavioural economics support this contention?, *Competition and Consumer Law Journal*.

empowered and motivated they are to exercise informed choices. However, there is now greater recognition that merely providing information to people will not necessarily change their behaviour.

Food labelling, for example, is being used to address public health issues related to nutrition and obesity. Experience shows, however, that a more comprehensive policy framework is needed to encourage consumers to move to a "healthier" eating lifestyle, which benefits consumers and society generally. Such a framework needs to be planned and coordinated across government.

While some will benefit from an information guide, many require alternative and multi-dimensional information or marketing approaches. The barriers to achieving behavioural change are outlined in Box 5.

Box 5. Barriers to behavioural change

Even if consumers have access to information, read and understood that information and accepted that they need to change, they may still not make those changes because there are other internal and external barriers to shifting behaviour. There are many theories about the stages people move through before they adopt a sustained change in their behaviour. The model developed by Robinson, for example, describes seven obstacles, or preconditions, to behavioural change:

- *Knowledge* — the person is aware of the problem and that there is a practical solution. They know the personal costs of inaction and the benefits of action;
- *Desire* — the person wants to change;
- *Skills* — the person can easily visualise the steps required to achieve their goal;
- *Optimism* — people will not act if they believe their efforts are futile, so the person needs to believe that they are likely to achieve the benefits of change;
- *Facilitation* — the barriers to change need to be reduced so achieving change is as simple, quick and low cost as possible;
- *Stimulation* — something needs to initiate action to break the inertia of habit; and
- *Reinforcement* — *feedback and recognition are needed to maintain action and build on success*⁷².

Seven steps to social change

72 Robinson, L 1998, 'A 7 step social marketing approach', Paper presented at the *Waste Educate 98 Conference*, pp. 5-7.



Source: Robinson, L 1998, 'A 7 step social marketing approach', Paper presented at *the Waste Educate 98 Conference*, p. 4.

Robinson argued that policy makers need to clear the obstacles to behavioural change, rather than pass on wisdom about the right course of action and that policies to achieve behaviour change will be ineffective unless these obstacles have been addressed.

Agencies' traditional approaches to information campaigns have been shown to influence the impact and retention of the information, but not necessarily the behaviour of the consumer. Social constraints and ingrained behaviour continually temper individual choice. For example, peer pressure, inherent trust in others, or even a disinclination to become educated can influence consumers' behaviour. It is useful, therefore, to consider whether alternative strategies to those used in the past could achieve more effective behavioural change. Social marketing is such a strategy that is currently being applied in health and environmental fields.

3.4.1 Social Marketing⁷³

In essence, social marketing aims to change individuals' behaviour to achieve a socially desirable goal. An organisation must understand those behaviours it wants to change, and tackle the barriers that prevent people from changing those behaviours.

A typical social marketing project would first assess the 'barriers' that the campaign is trying to overcome, using extensive research to guide the development of the campaign or policy.

73 For a more detailed discussion of social marketing, see McKenzie-Mohr, D. 2005, *Quick Reference: Community based social marketing* at www.cbsm.com/Reports/CBSM.pdf, (accessed 9 May 2007) and Consumer Affairs Victoria 2006, *Social Marketing and Consumer Policy*, Research Paper No.6.

Traditional information campaigns are limited in their ability to achieve behavioural change for a number of reasons including:

- the public rarely seeks out information from governments proactively before making purchasing decisions;
- the Government conducts a large number of programs, and with major budget constraints;
- many Government initiatives have relatively low brand awareness. This is commonly attributed to differences in the penetration of marketing — the government may put out a warning about excessive use of credit, for example, only to be 'drowned out' by blanket advertising from lenders encouraging its use;
- Australians are from a range of cultural and socio-economic backgrounds so that different communications approaches are required to avoid missing sections of the community;
- many people object to the time and inconvenience of resolving problems themselves. There is no incentive to become familiar with their rights unless there is a problem;
- information is insufficient in many cases, as the target audiences of any government agency are not typically a homogenous group. They consider different factors when making crucial decisions, and respond to different kinds of information strategies. Information campaigns therefore need to be multifaceted; and
- consumer agencies often do not have ongoing relationships with their customers, as most consumers move in to and out of the market. Therefore, there is a short time frame to educate consumers when they are in the market, for example buying a car or home or building a house.

Social marketing campaigns use tools that encourage behavioural change and break down barriers to change, often relying on a multifaceted approach that simultaneously informs, persuades and uses incentives and deterrents. The tools used in community based social marketing strategies are often non-regulatory and lend themselves to testing through pilots. This helps avoid costly mistakes. Progress and performance is continually monitored so that the strategies can be improved and refined.

The final stage of a social marketing campaign is an evaluation ,which examines the strategy's effectiveness in changing behaviour, not just raising awareness or changing attitudes. This is a critical component of the process, because it is necessary to test the effectiveness of existing programs and improve the effectiveness of future programs.

3.4.2 Social marketing in practice

Social marketing campaigns do face challenges, as the product being 'sold' is difficult to define, often intangible and has benefits that could be delayed or difficult to detect (for example, avoiding potential harm). Despite the challenges, social marketing has been used successfully to encourage the adoption of environmentally friendly behaviours such as composting, recycling and conserving energy, and to implement health strategies such as immunisation programs.

Consumer Affairs Victoria is examining the use of social marketing as part of the Victorian Government's response to the Consumer Credit Review. One of the review options (10.1) suggested that Consumer Affairs Victoria "...develop targeted information and education activities, using social marketing principles where appropriate".⁷⁴ In the Government Response to the Review, this option was supported, with the emphasis on older Victorians and those from disadvantaged households. The Government Response also emphasised the importance of research as a first stage of any such campaign, which is a hallmark of the social marketing approach.

Consumer Affairs Victoria has also initiated the research phase of the social marketing model across a number of consumer policy areas, including building, real estate and owners corporations.

3.5 Unfair contract term provisions

Unfair contract terms legislation has been successful in achieving change for the benefit of consumers. It should be introduced nationally.

Market developments, such as the increased use of standard form contracts and the greater complexity of goods and services, have created an environment conducive to the inclusion of unfair terms in consumer contracts.⁷⁵ In response, the Victorian Government introduced unfair contract terms provisions into its Fair Trading Act (FTA) in 2003. Since the introduction of these provisions, Consumer Affairs Victoria has identified and successfully negotiated the modification or removal of many terms it considered unfair, improving both the economic efficiency and social equity of consumer contracts.

74 Consumer Affairs Victoria 2006, *Government Response to the Report of the Consumer Credit Review*, p. 13.

75 This is not to say that consumers have not benefited from the introduction of standard form contracts (through reduced transaction costs) or the availability of an increased range of goods and services. However, as noted in section 4, Governments must continually assess market developments and ensure that existing interventions are appropriate or the need for further intervention is examined.

3.5.1 The existence of unfair terms in consumer contracts

Unfair contract terms typically arise where there are insufficient incentives for suppliers to make their terms fair, owing to the characteristics of the market, good or service, or the consumer.

There may be insufficient incentives because of substantial asymmetry in the relative bargaining power of consumers and suppliers. For example, suppliers may be more able to dictate terms because there is a lack of competition between suppliers in the industry, or because demand for the goods or services is inelastic, or through accepted use of standard form contracts, which severely restrict consumers' ability to negotiate terms.

Suppliers may also have insufficient incentives to make their terms fair where product or consumer characteristics constrain consumers' ability to understand or effectively pursue their best interests when deciding to sign a contract. Unless consumers are influenced by the fairness of the terms at the time they sign the contract, suppliers will have little incentive to make their terms fair, because there will be no commercial advantage in doing so. There are three reasons why consumers may not alter their purchasing decisions in accordance with the fairness of the terms:

- they may focus on principal contractual terms such as the price and quality of the product or service; or
- they ignore or ascribe limited importance to unfair terms, even though they are aware of their presence in the contract. They may, for example, underestimate the risk the term would apply to them; or
- they are not aware of unfair terms in the contract (because they cannot or do not read the contract or if they can and do, they cannot or do not understand the meaning and effect of the various terms and so recognise that a term is or could be unfair).

Consumers may focus on principal contractual terms owing to the complexity of the contract or the product or service being purchased. Further, unfair contract terms may not be easily identifiable to a consumer at the time of entering the contract, particularly if they are not given sufficient time to review the contract, are already emotionally committed to the purchase or are under pressure to sign.

In the case of standard form contracts, consumers may focus on the price and product features under an incorrect assumption that the contract terms are fair because any problems would have already been identified and fixed by others.

Certain behavioural patterns of consumers may lead them to ignore or ascribe limited importance to unfair terms, even though they are aware of their presence in the contract. For example, where an unfair term relates to a future uncertain event, such as a dispute arising with the supplier, the consumer may ascribe a

very low probability to that event occurring and, therefore, give a very low weight to the presence of the unfair term. They would focus on other aspects of the contract, such as the price and product features, and suppliers will compete on these aspects, rather than on the fairness of the contractual terms.

Traditionally, under contract law, the parties are assumed to have the ability to look after their own interests and to contract only on terms that are mutually beneficial. Although these assumptions may still hold in a commercial context, the above factors indicate that consumers are not necessarily able to ensure favourable contractual terms or to look after their best interests. Therefore, it may no longer be appropriate to follow the traditional model, which holds that a person is bound by the contract they enter into whether or not they have read or understood it unless some sort of vitiating conduct has been engaged in (for example, misleading, deceptive or unconscionable conduct).

3.5.2 The social and economic effects of unfair contract terms

Since the introduction of unfair contract terms legislation (Part 2B of the FTA) in Victoria in 2003, Consumer Affairs Victoria's Unfair Contract Terms Taskforce has examined consumer contracts in a wide range of industries. A description of the unfair contract terms provisions and Consumer Affairs Victoria's approach to enforcing them, was outlined in Boxes 4 and 11 in the Victorian Government's preliminary submission. In summary, Part 2B has the effect that an unfair term in a consumer contract is void and the Director of Consumer Affairs can apply to the Victorian Civil and Administrative Tribunal for a declaration that a term is unfair and for injunctions to prevent the continued use of unfair terms. Consumer Affairs Victoria's strategy for encouraging compliance with unfair contract terms provisions is based, in the first instance, on industry education and consultation, whereby individual companies' co-operation is sought in modifying or removing terms Consumer Affairs Victoria considers are unfair.

Pursuant to s. 32W of the FTA:

A term in a consumer contract is to be regarded as 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 has been interpreted by Justice Morris in *Director of Consumer Affairs Victoria v AAPT Ltd*⁷⁶, to mean that there are two types of unfair terms:

- terms that cause such an imbalance that they are unfair even if they were individually negotiated or brought to the consumer's attention;

76 [2006] VCAT 1493.

- other terms that cause less (but still significant) imbalance, which will not be unfair if they were individually negotiated or brought to the consumer's attention.

The unfair terms identified by the Taskforce typically fall within three categories:

- lock-in-terms (unilateral change terms) — which allow the supplier to vary important terms of the contract, or to perform his or her obligations under the contract in a different way than was agreed with, or is expected by, the consumer, particularly without giving the consumer the option to terminate the contract, without penalty;
- terms restricting the liability of the supplier, its servants or agents for breach of the contract or for negligence; and
- penalty clauses — which unfairly penalise the consumer for a breach of the contract for example by requiring the consumer to pay an amount on early termination which goes beyond compensating the supplier for the actual costs.

The social inequity of unfair contract terms

The social inequity of unfair contract terms is evident in the terms themselves as they are, by definition, unfair. Fairness is a basic tenet of our society and many aspects of our law. In this context, fairness requires a balance in the rights and obligations of the contracting parties and no significant imbalance to the consumer's detriment. Of course, what is 'fair' or 'not fair' must be determined with respect to the particular circumstances and context.

Table 1 provides examples of terms found in consumer contracts that Consumer Affairs Victoria considers are unfair. These terms illustrate the social inequity that can result from the use of unfair contract terms. Through its compliance activities, the Taskforce has improved the fairness of consumer contracts by requiring the modification or removal of each of these terms, as well as many others.

| Table 1. Unfair terms in consumer contracts identified by Consumer Affairs Victoria | |
|--|--|
| <i>Actual term</i> | <i>Effect of term/unfairness</i> |
| [In a mobile phone contract] We may vary any term of this Agreement at any time in writing. To the extent required by any applicable laws or determinations made by the | Under this term, the supplier can vary the terms of the contract at any time, which may involve changes that adversely affect the consumer. However, the consumer does not |

| | |
|---|--|
| <p>Australian Communications Authority (ACA), we will notify you of any such variation.</p> | <p>have the opportunity to exit the contract in response.</p> |
| <p>[In a car hire contract] The customer acknowledges having received the vehicle in a clean condition and in sound working order, in accordance with the vehicle condition report, and with a full fuel tank and a bottle of gas.</p> | <p>The unfairness being that where the vehicle was not, in fact, in sound working order — and most consumers would not be in a position to know one way or another — these ‘deeming’ terms can only operate to facilitate an attempt to prove what is not true or to prevent evidence being led to prove what is true.</p> |
| <p>[In a mobile phone contract] If we have agreed to provide a Service to you for a particular term and you terminate before the end of the term, then you will be liable to us (a) [for] the whole contract amount quoted to you at the commencement of the term in respect of the provision of the Services throughout the Term; (b) an early termination fee; and (c) any outstanding charges, constitute a debt owing to us at the time of the early termination of this Agreement.</p> | <p>The unfairness being that the costs the consumer must pay if they exit a contract before the end of the term do not bear any connection to the costs the supplier would incur. In fact, because the consumer must pay the entire amount of the contract and an additional termination fee, they would end up paying more than if they had continued under the contract.</p> |
| <p>[In a health/fitness centre Membership Agreement] The Company has sole discretion to terminate this agreement as a result of breach by [the consumer] of any terms contained in this agreement or of any membership conditions or rules and regulations overleaf.</p> | <p>The unfairness being that the consumer has no reciprocal right to terminate the contract. There is no provision for notice to be given to the consumer, no allowance for the consumer to rectify a breach and no distinction between serious and minor breaches.</p> |

The economic inefficiency of unfair contract terms

The revisions to consumer contracts as a result of the Taskforce’s compliance activities should also improve the economic efficiency in the markets involved. Unfair contract terms can detract from efficient market outcomes⁷⁷ by:

77 In an economically efficient market, consumers purchase the mix of goods and services that best suits their preferences and maximises their welfare and suppliers use the resources to produce and offer this welfare-maximising mix of goods and services.

- creating an inefficient allocation of risk;
- adversely affecting consumer confidence; and
- creating information asymmetry between the supplier and consumer.

Unfair contract terms may inefficiently allocate risk between the parties to the contract. In an efficient market, where a risk can be avoided or reduced, it should be allocated to the party who is best able to control the actualisation of the risk or mitigate the damage.⁷⁸ The party who bears the risk then has an incentive to reduce the risk or the damage that might result, and is able to do so at less cost than the other party.

Many unfair terms shift risk from the supplier to the consumer, when in fact the consumer has no ability to reduce the likelihood of the risk occurring or mitigate the damage that might occur, or the supplier could do so at less cost. If the risk is allocated to the consumer, but is controlled by the supplier, the supplier has no incentive to reduce the risk. Table 2 provides examples of terms identified by the Taskforce that inefficiently shift risk to the consumer.

| Table 2. Contract terms demonstrating inefficient allocation of risk | |
|--|---|
| <i>Actual term</i> | <i>Effect of term</i> |
| [In a mobile phone contract] To the extent permitted by law, we may change a Supplier or its products, or vary our charges from time to time without notice to you. Otherwise, we may vary these terms on 30 days written notice to you. | With such a term in its contracts, the provider would have no incentive to improve productivity or keep its costs low because any cost increases could be passed on because the consumer is 'locked-in' to a fixed term contract. |
| [Carpet/curtain retailer terms and conditions] We will make every effort to complete the work on time but we cannot be held responsible for delays due to circumstances beyond our control. In this case, we will complete the work as soon as reasonably possible. | This term effectively allows the supplier to complete the contract in its own time without having to compensate the consumer. The consumer therefore bears the burden of any delays, and the supplier has a reduced incentive to complete the work on time. |
| [Pay TV agreement] We may vary the Service including part of the service by: | In this example, the consumer bears the risk of the supplier varying the characteristics of the service |

78 Ahtonen R. 2004, *Unconscionability and adjustment of unfair contract terms*, p. 56. www.joensuu.fi/taloustieteet/ott/tutkimus/opinnaytteet/gradut/ahtonen.pdf (accessed 21 September 2006).

| | |
|---|--|
| <p>changing the content or broadcast times of your Programming Package; changing or withdrawing a Channel, Box Office Programme or Main Event Programme ...</p> | <p>provided. An alternative that places some responsibility on the supplier to mitigate any detriment to the consumer from service changes, would be to commit the supplier to either reducing the fee for the service, or replacing the removed channel with a similar genre channel; or allowing penalty free termination of the contract by the consumer.</p> |
|---|--|

Unfair contract terms may also be inefficient because they can adversely affect consumer confidence. Consumer confidence may be affected if consumers have suffered detriment in the past due to unfair terms, the industry has developed a poor reputation with regard to unfair terms, or consumers distrust suppliers or their own ability to judge contract terms. A downturn in consumer confidence would lead to less growth in the market and industry. Further, the processes available to consumers to signal their dissatisfaction to suppliers are blunt. Standard form contracts present consumers with a take it or leave it option and in such complex markets it is often difficult for individual suppliers to profitably distinguish their product by the fairness of their contract. If consumers abstain from purchasing goods they value due to the presence of unfair terms in contracts, they send incorrect signals to the market regarding their preferences and, therefore, suppliers do not produce a welfare maximising mix of goods and services.

In addition, some unfair contract terms create an information asymmetry between the supplier and consumer — for example, terms that bind the consumer to hidden terms or conditions. In such cases, the supplier has information relevant to the contract that is not available to the consumer. As with all forms of information asymmetry, the consumer is less likely to make an efficient choice because they do not have all the relevant information. There is also no incentive for traders to compete for customers by improving efficiency in these areas.

3.5.3 The case for greater coverage of unfair contract terms legislation

Victoria's FTA has been significantly enhanced by the introduction of Part 2B. It has enabled Consumer Affairs Victoria to address issues of substantive as well as procedural unfairness and provided a mechanism to effectively deal with systemic issues arising from some industries' widespread use of unfair terms.

The general law equitable action of unconscionable conduct recognises there may be unequal bargaining power between contracting parties and provides some protection to consumers where the supplier has taken advantage of a special (that is, physiological, mental or emotional) disability of the consumer.

However, this action is concerned only with the circumstances surrounding the formation of the contract rather than the substance of the contract itself (although the unconscionable conduct will normally be reflected in an unfair contract).

There are also slightly broader statutory counterparts of this equitable action contained in s. 51AB of the TPA and mirror provisions in state and territory fair trading Acts, such as s. 8 of the FTA in Victoria. The main difference is that the statutory provisions do not require the existence of a special disability. These provisions prohibit unconscionable conduct in certain situations, including where a business takes advantage of its stronger bargaining position to force terms on a consumer that are not reasonably necessary for the protection of its legitimate interests.

However, in interpreting these provisions, the Full Federal Court has stated that there must be some circumstance, other than the mere terms of the contract itself, that makes reliance on those terms unconscionable.⁷⁹ Further, the fact that a contract contains unfair terms does not of itself mean that it was unconscionable for the supplier to obtain the consumer's consent to the contract.⁸⁰ This means that unless it can be shown, in a particular set of circumstances, that the supplier has engaged in unconscionable conduct to obtain consent to an unfair contract, or used a term in a way that is unconscionable (not merely in a way that is unfair), the courts will not interfere.

Victoria is currently the only jurisdiction in Australia to have unfair contract terms legislation. Therefore, other jurisdictions must still rely on unconscionable, misleading or deceptive conduct provisions, and are restricted to taking retrospective action in individual cases or passing industry specific legislation to deal with problems as they arise. The Victorian Government considers that the economic and social benefits of unfair contract terms legislation are clear and justify their introduction in other jurisdictions.

Having uniform coverage of unfair contract terms across Australia would benefit Victorians as economies of scale could be realised in compliance activities. Consumer Affairs Victoria has assessed and effected amendments to many contracts that are used by companies that operate nationally or are replicated by companies operating in other jurisdictions. Since 2004, Consumer Affairs Victoria has examined around 40 contracts relating to companies and organisations that trade only in Victoria and 30 contracts relating to companies and organisations that also trade in other jurisdictions. A full list of these companies and organisations can be provided to the Productivity Commission if required. These contracts also cover a range of industries including mobile phones, health and fitness, car hire, online auctions, domestic building, pay tv, airline frequent flyer programs and major events such as the 2006 Commonwealth Games and the Formula 1 Foster's Australian Grand Prix. Therefore, if consumer agencies in the

79 *Hurley v McDonalds Australia Ltd* [1999] FCA 1728.

80 *ACCC v Dataline.net.au Pty Ltd* [2006] FCA 1427.

other jurisdictions assessed contracts and negotiated the modification or removal of unfair terms in an industry, there would be flow on benefits to the industry in Victoria.

The Victorian Government has recognised the benefits of the unfair contract terms legislation and announced in its Government Response to the Report of the Consumer Credit Review⁸¹ that it would be extending the coverage of Part 2B to vendor finance contracts. Currently, credit contracts (including vendor finance contracts) are exempted from the operation of Part 2B of the FTA. Vendor financing, especially 'wrap' finance⁸², has caused extensive consumer detriment, particularly during the recent property boom. Vendor finance contracts are consistently weighted in favour of the vendor, such that minor infractions or temporary repayment difficulties have often resulted in the consumer losing the house.

These changes will be aligned, as much as possible, with forthcoming amendments to the Consumer Credit Code that will confirm the application of the Code to vendor finance arrangements.

The Victorian Government also announced in the Response to the Report of the Consumer Credit Review that it would commence a dialogue with industry and stakeholders as a prelude to removing the credit exemption altogether from Part 2B. An issues paper will soon be released, followed by publication of guidelines, after which industry will have time to amend their contracts (where necessary) before the removal of the exemption takes effect. This whole process is expected to be completed by mid-2008.

Overall, Consumer Affairs Victoria has taken a proactive approach to unfair terms and modifying terms across industries. It has discussed terms with companies directly, with a view of achieving consensus on appropriate changes, rather than relying on enforcement action — though it has taken enforcement action where this proved necessary. In many instances, Consumer Affairs Victoria has used the unfair contract terms provisions to address systemic issues, which, in the past, have often been dealt with by the introduction of industry-specific prescriptive legislation. There are a number of Victorian Acts, such as the *Consumer Credit (Victoria) Act 1995* (currently exempt from Part 2B), the *Domestic Building Contracts Act 1995*, the *Retirement Villages Act 1986*, the *Residential Tenancies Act 1997* and the *Introduction Agents Act 1997* that include provisions relating to contracts.

81 Consumer Affairs Victoria 2006, *Government Response to the Report of the Consumer Credit Review*, p. 13.

82 In a 'wrap' contract, the property being sold is already subject to a mortgage. The instalments paid by the consumer to the vendor under the vendor finance arrangement are (at least in theory) used by the vendor to repay the vendor's own credit contract with the third party credit provider. In an 'ordinary' vendor finance arrangement, the vendor owns the property outright, and the credit comprises the vendor's agreement to accept the sale price in a series of instalments payable by the consumer.

Victoria has also been able to address recent issues in relation to car hire and fitness centre contracts without resorting to legislation or mandatory codes of conduct, which have been advocated or introduced in other jurisdictions. Greater reliance on general unfair contract terms provisions has the potential to reduce the need for industry specific legislation to deal with similar issues in the future.

3.6 Greater reliance on the FTA

Although industry-specific regulation will still be appropriate in some areas, such as utilities and credit, consumer policy strategies should place greater reliance on the fair trading Acts.

The Victorian Government's preliminary submission highlighted that the consumer regulatory framework in Victoria is comprised of a mix of general and industry-specific regulation. As noted in that submission, the FTA is the primary legislation with general application across a range of industries.

Both general and industry-specific regulation is required for the consumer regulatory framework to be effective. General regulation provides overall consumer protection, while industry specific regulation addresses particular problems that cannot be addressed through the general law. However, incremental development of these laws over time has led to overlap in their coverage and operation.

As noted in the preliminary submission, in some instances, this overlap involves mirroring provisions of the FTA in industry specific regulation, while in others, more prescriptive and specific rules are included in industry specific regulation, which regulate conduct that could be covered by general standards in the FTA.⁸³

Given the recent focus in Australia on reducing red-tape and regulatory burdens on business, the extent to which general and industry-specific regulation overlap, causing unnecessary regulatory burden, is an area that the Productivity Commission may wish to consider.

3.6.1 Advantages of greater reliance on the FTA

There are a number of reasons why greater reliance on the FTA and scaling-back industry-specific regulation may be desirable.

The FTA is already in place. Therefore, it may be possible to solve a problem with little or no change in regulatory provisions. If the FTA can be relied on to address a problem, it avoids the duplication, increased complexity and higher regulatory costs that can arise if specific regulation is enacted where it is not needed.

83 For a detailed discussion of the differences between general and industry-specific regulation and an examination of the strengths and weaknesses of each approach, see Consumer Affairs Victoria 2006, *Choosing between general and industry specific regulation*, Research Paper No. 8.

The strengths of the FTA include:

- universal and consistent coverage;
- lower business administration and compliance costs; and
- reduced risk of regulatory capture.

Universal coverage and consistency

The FTA applies broadly to conduct in trade and commerce and because it is triggered by generic behaviours or problems it can accommodate changing industries and emerging problems more easily. Prohibitions on misleading conduct, for example, automatically protect consumers against misleading claims about products in new industries. This is especially important as rates of technological development and innovation increase.

Relying on the FTA would also:

- avoid boundary problems between Acts and the complexity of deciding which activities should be (or are) defined into or out of an industry-specific Act. The FTA reduces the risks of gaps, overlap or inconsistencies, particularly in industries that are still emerging, are constantly changing or are difficult to define. This also avoids confusion among different regulators over enforcement responsibilities.
- deal with issues in industries in which the problems are too small to warrant a separate regulatory regime but significant enough to justify low cost government intervention.
- apply regulation consistently across all industries, which has fairness, efficacy and efficiency benefits (see Box 6).

Box 6: The benefits of consistent regulation

From a fairness perspective, consistent regulation means that consumers who face the same risks receive the same protection, and traders that engage in the same types of behaviour suffer the same consequences.

The efficacy of the regulation is improved by reducing gaps and overlap. Gaps allow behaviours that the legislation is trying to redress to continue in some sectors. Consumers in these sectors are disadvantaged. Overlap occurs when an industry is covered by two or more Acts that address similar issues. This can increase compliance costs, add complexity and cause confusion. It increases the risk of conflict among the various regulatory requirements.

From an economic efficiency perspective, consistent regulation prevents one industry from being unfairly advantaged simply because it is subject to more

lenient regulation. This is not an argument for no regulation; it simply means that similar problems should be regulated in a similar way.

Lower costs of administration and compliance

Regulation can impose costs on taxpayers, compliance costs on industry and costs on consumers through higher prices and reduced choice. In the case of industry, compliance costs are imposed on all industry participants — both good and bad industry performers. Therefore, any regulation introduced to address problems caused by a minority of traders will impact on all. Under general regulation, such as the FTA, there is no need to develop and manage multiple regulatory regimes or multiple industry-specific regulators. Relying on the FTA reduces the complexity of regulation and the administrative burden for government, which reduces the cost to taxpayers. Consumer Affairs Victoria can focus on developing skills, expertise and a body of case law related to the general regulation rather than having to spread resources across a multitude of specific regulations.

From an industry perspective, because the FTA is less prescriptive than industry-specific regulation it gives traders more flexibility in how they comply with the law. They can choose methods that suit their operations. This reduces compliance costs and increases flexibility and innovation. However, if what constitutes compliance is unclear, general regulation may increase uncertainty, at least temporarily, which could raise the cost of compliance. One way of addressing this and clarifying the application of the FTA is the development of guidelines on the operation of specific provisions. For example, Consumer Affairs Victoria's guide *Preventing unfair terms in consumer contracts – Preliminary guidelines for suppliers*, assists traders understand their responsibilities under Part 2B of the FTA. In addition, the publication *Unfair terms in vehicle rental agreements for cars, 4WDs, motor homes and vans* goes further and outlines the application of the same provisions to a specific industry — the car hire industry.

Prescriptive rules can lead traders to focus on meeting the letter of the law rather than delivering on its intent to avoid consumer detriment. In addition, if traders must comply with multiple Acts there is more risk of confusion among traders and that the combined effects of these Acts could have unanticipated costs.

The compliance costs of both general and industry-specific regulation can flow to consumers as higher prices. To the extent that industry-specific regulation is more prescriptive, and hence has higher compliance costs, it may result in larger price increases. Unlike a number of industry specific Acts, the FTA does not constrain which traders can enter an industry and which products they can sell (with the exception of the product safety provisions). It is thus less likely to restrict the range of service providers, products and services available to consumers.

Regulatory capture

Regulatory capture involves a group of stakeholders gaining undue influence over the development of the regulations or the activities of the regulator. While it is essential to consult all stakeholders in the regulatory process, the views of interest groups should be balanced with the public interest when making decisions.

3.6.2 Realising the advantages of relying on the FTA

The Victorian Government recognises that the realisation of the above advantages of relying on the FTA will depend, in part, on:

- the adequacy of the scope or coverage of the FTA;
- having appropriate enforcement powers, penalties and deterrents in the FTA; and
- effective enforcement of the FTA.

In light of this, to improve the effectiveness of the FTA, the Victorian Government has taken steps to enhance its coverage, most notably through the introduction of the unfair contract terms provisions in 2003. It has also enhanced the enforcement powers available to Consumer Affairs Victoria and increased the range of enforcement tools available, allowing flexibility to take action that is appropriate in the circumstances. The recent improvements to the enforcement powers and remedies under the FTA are outlined in section 4.1 below.

Although effective enforcement will be partly determined by the availability of resources to pursue priority issues and actively monitor compliance, improving communications with traders and promoting the outcomes of successful prosecutions can increase awareness of the FTA and improve compliance. Each action taken under the FTA has a flow-on benefit to future enforcement activities, by expanding the body of information and legal precedent surrounding it, which improves its certainty and clarity across all industries, and makes it easier to enforce in the future.

3.6.3 Reliance on the FTA will not always be appropriate

In some circumstances, industry specific regulation is appropriate. The strengths of industry-specific regulation are that it:

- provides targeted solutions;
- is easier to enforce; and
- addresses problems before they occur.

Targeted solutions

Industry-specific regulation targets particular problems in particular industries, reducing the risk of overregulation — for example, it may be desirable to extend consumer protection to activities that do not involve trade and commerce (as covered by the FTA), such as the collection of donations for charities. Specific regulation can address such issues without risking extending general regulation to areas it is not intended to cover.

Specific requirements in industry regulation may be easier for traders to understand. This may be particularly so in the case of codes of practice where industry has been actively involved in the development of the standards in the code. Some traders may prefer the clarity of prescriptive rules that tell them exactly what they need to do to comply. However, as noted above, it is possible under the FTA to develop guidelines for traders to clarify their obligations.

Industry-specific regulation can also address highly technical issues. Sometimes, it is necessary to define technical standards precisely; for example, the risk to health and safety if the electrical work in people's homes does not meet a minimum standard is very high, justifying more detailed industry-specific regulation.

In addition, industry specific regulation can also be used to achieve consumer policy and other objectives. Under the motor car traders licensing scheme, for example:

- the State Revenue Office has arrangements for the transmission of duty collected by licensed motor car traders;
- financiers rely on licensed motor car traders to streamline finance applications approvals and facilitate payments;
- the link between licensing and the statutory compensation scheme creates an effective dispute resolution alternative; and
- there are provisions that recognise that dealing in motor cars can be linked with criminal activity.

Easier enforcement

Some commentators argue that industry-based regulation is easier to enforce than the FTA, particularly when it is more specific or sets technical rules or preconditions for entering an industry. It is easier to demonstrate that prescriptive rules have been broken and prosecution is less dependent on proving that the intention or the outcome of the breach would damage consumers. This has advantages for consumers seeking to resolve disputes themselves through legal action or other dispute resolution processes. The regulator is also more likely to

be able to use its own testing to obtain evidence and is less reliant on the participation of consumers.

Regulators managing industry specific regulation may also be able to use intelligence they gain through regulatory and complaints processes to compile a picture of consumer and trader behaviour and identify systemic market problems, and effective mechanisms for tackling those problems.

It is also easier for regulators to detect and prove that a business has breached a rule if the industry is subject to ongoing monitoring or testing — particularly if traders are required to report regularly against compliance. This is a common feature of many industry specific regulatory regimes. However, it may be possible to increase the range of remedies and the speed with which general regulators can activate those remedies, so that the enforcement advantages of industry-specific regulation are less.

Addresses problems before they occur

Some industry-specific regulation proactively addresses problems before they arise. It sends a clear signal to traders about what is expected from them. Product standards, for example, set minimum requirements and prohibit the sale of products that are likely to harm consumers. Where substandard products or services can cause severe injury or death, eliminating these risks can be important. Eliminating such risks may also be important if it is difficult to detect poor quality after it has occurred; for example, when there are long time lags between the use of the product and its detrimental impact.

3.6.4 Industry specific regulation in Victoria

There are many examples in Victoria where industry-specific regulation is considered appropriate. For example:

- In the electricity and gas industries, it is recognised that energy is an essential service and that some consumers may not be sufficiently informed, experienced or motivated to ensure that the market contracts offered to them contain fair and reasonable terms. Therefore the Government provides a level of protection through its “safety net” arrangements. Industry-specific regulation of the retail electricity and gas markets is discussed further in Box 7.
- In the consumer credit sector, the difficulty consumers have understanding complex consumer contracts is recognised as a justification for specific regulation to assist consumers choose between credit products and protect themselves against overly harsh terms in credit contracts.

| |
|--|
| Box 7. Industry specific regulation in the gas and electricity industries |
|--|

The essential nature of energy necessitates that industry-specific measures for consumer protection be adopted to ensure access and affordability to all members of the community, particularly consumers who are vulnerable and/or experiencing hardship. In Victoria, there are both price and non-price protections for energy consumers. Price protections exist under the Government's 'safety net' agreement negotiated with first tier energy retailers; AGL, TRUenergy and Origin Energy. In addition, the Government has a reserve power to regulate 'safety net' tariffs if it believes that competition is ineffective and energy retailers are exercising market power.

In the future, it is conceivable that effective competition will be able to provide fair and reasonable prices that would no longer necessitate "safety net" regulation — though non-price protections would need to be considered carefully, especially where these protect customers who are vulnerable or experiencing hardship. The Australian Energy Market Commission (AEMC) assessment of the effectiveness of competition, to be completed by the end of 2007 in Victoria, provides impetus for revisiting appropriate energy consumer protections.

Victoria's framework for mitigating energy consumer hardship was strengthened in 2006 with the development and implementation of recommendations from the Committee of Inquiry into Financial Hardship of Energy Consumers. These recommendations require gas and electricity retailers to develop 'best practice' hardship policies to: assist energy consumers in financial difficulty and genuinely unable to pay their bills on time; and prohibit their disconnection, when a disconnection would be based solely on incapacity to pay.

Additional consumer protections are provided for in energy Codes and Guidelines regulated by the Essential Services Commission. These include:

- An obligation to offer, which is reflected in energy retailers licences and recognises the essential nature of energy supply by requiring retailers to offer to supply and sell electricity and gas to domestic and small business customers.
- An obligation to connect, which requires retailers to connect a customer at their supply address as soon as practicable after a customer applies. Customers also have a right to disconnection on request.
- An obligation on the retailer to develop and implement an approved hardship policy for domestic customers experiencing financial hardship; and
- A prohibition on energy retailers disconnecting a customer who is complying with an approved hardship policy.

The arrangements to adopt a national framework for energy regulation are progressing, with a second tranche of legislation to allow the non-economic regulation of distribution and retailing to move to the Australian Energy Regulator

(AER) due to be introduced in 2008 (tranche one is the transfer of economic regulation of distribution network charges from jurisdictional regulators to the AER). An inter-jurisdictional working group is developing recommendations to the Ministerial Council on Energy on the energy distribution and retail regulation functions to be transferred to the AER. This work is part of the Council of Australian Governments' (COAG) energy market reform program.

Industry specific regulation will usually operate in conjunction with the general law. This makes co-ordination and co-operation between agencies critical. In the area of food regulation, for example, problems have occurred when industry specific codes are developed that do not accord with interpretation under the general law. An example is the ACCC interpretation of the word "free" as in "sugar free" meaning zero. An international trading standard exists for use of the claim "sugar free" which allows some presence of sugar (nutritionally insignificant).

The policy framework needs to have clear parameters to ensure that there is a consistent approach so that where general consumer legislation is applied existing national or international standards are recognised. This can be achieved through mechanisms such as memoranda of understanding, interdepartmental committees and agreed policy frameworks. In Victoria, draft recommendations by the Victorian Competition and Efficiency Commission have proposed:

*That the Ministers for Health and Agriculture agree to implement a food safety framework for Victoria, and that the Food Safety Unit develop a statewide strategic plan in collaboration with Dairy Food Safety Victoria, the Municipal Association of Victoria, PrimeSafe and Consumer Affairs Victoria, whose own strategic plans and operation should be consistent.*⁸⁴

3.6.5 Conclusion

As discussed above, the main benefits of relying on the FTA are consistency across industries and reduced risk of regulatory duplication and complexity. It is also likely to be less costly for industry, consumers and the government. Although additional enforcement expenditure may be necessary, it automatically addresses problems from new industries, products or types of behaviour as they arise, and reduces the risk of regulatory capture.

The way regulation is implemented and the mechanisms used to encourage compliance affect whether its potential benefits are realised. To encourage compliance, and reduce the risk of consumer detriment, general regulation relies on traders choosing not to engage in behaviour that could breach the regulation. This is more likely when traders are aware of their responsibilities and there is an expectation that those that engage in inappropriate behaviour will get caught.

84 Victorian Competition and Efficiency Commission 2007, *Simplifying the menu: food regulation in Victoria*, draft report, April.

Industry-specific regulation works best for industries that can be clearly defined and are relatively static, where the industry is unusual or there are specific or technical problems that cannot be dealt with through general regulation and the consequences for consumers if problems occur are large and widespread across many traders. In these cases, industry-specific regulation may be a proactive way to reduce the risk of significant consumer detriment. Product standards in industries such as pharmaceuticals, for example, can reduce the risk of consumers purchasing products that might be detrimental to their health, or of dangerous drugs being misused or abused.

Similarly, for industry-specific regulation to be effective, the structure of the industry would have to be conducive to industry-specific approaches. It is hard to develop robust long term industry-specific solutions if the industry is difficult to define or is constantly changing.

In summary, the Victorian Government considers industry-specific regulation is most appropriate when:

- general regulation is not working;
- the general regulation cannot be improved to address the problem;
- the problem is big enough (in terms of the size of potential detriment and how widespread it is) to warrant further action;
- specific regulation can effectively target the problem and the industry involved; and
- the problem and the industry are stable enough to make detailed action effective over time.

In some markets, the suitability, appropriateness or need for industry-specific regulation will change over time, for example if the nature of the problem changes, or if the coverage or scope of the general law changes.

3.7 The adequacy of the general law

The scope and adequacy of the general law should be examined to ensure the regulatory framework is as effective as possible. There is a case for adopting a broader unfairness test for business conduct.

It will only be possible to avoid the proliferation of unnecessary industry specific regulation if the community has confidence in the general fair trading law.

Australia's general consumer law relies on prohibitions on misleading and deceptive conduct, unconscionable conduct, harassment and coercion and, in Victoria only, unfair contract terms, to control business behaviour that causes

considerable consumer detriment. This definition is somewhat narrower than that used and being considered in some other major countries.

In the United States, section 5 of the Federal Trade Commission Act makes unfair and deceptive acts and practices in or affecting commerce unlawful. Unfair practices are defined as practices that:

...cause or are likely to cause substantial injury to consumers which is not reasonably avoided by consumers themselves and not outweighed by countervailing benefits to consumers or competition.

The United States has successfully used the unfairness provision to address internet practices such as spoofing and mouse-trapping.

- Spoofing is the practice of making it appear that spam is coming from a third party who in fact is not connected with the transaction. The third party's mailbox is flooded with undeliverable emails and responses from those being spammed. Because the instigator has not deceived the third party, prohibitions on deceptive practices cannot be used to provide relief. Unfairness, however, was used to obtain redress for the economic cost of damage to the email system caused by the influx of emails, time spent deleting emails and damage to the victim's reputation from being associated with spamming, often in connection with adult websites.
- An individual involved in mouse-trapping registered 6,000 domain names that were misspellings of popular websites. When the consumer visited one of these sites the program took over their internet browser, opening dozens of advertising windows. The consumer had to spend up to 20 minutes manually closing the windows or turn off their computer and risk losing previous work.

More recently, the focus on unfair practices has been extended to the European Community (EU). In 2005, the EU adopted the Unfair Commercial Practices Directive, which includes a general prohibition on unfair trading, identifies specific categories of misleading and aggressive commercial practices, and lists 31 practices, which are considered unfair per se. The EU directive covers all businesses and all aspects of their dealings with consumers.

The UK, as a member of the EU, is amending its legislation in response to the EU directive and will introduce a general duty on all businesses not to trade unfairly.

A broad unfairness test has the capacity to address inappropriate advertising and marketing practices, poor quality services and products (currently the subject of a proposal to introduce lemon laws in Victoria) and exploitative pricing (particularly targeted at vulnerable consumers). Victoria encourages the Productivity

Commission to consider the benefits and costs of including a prohibition on unfair practices in Australian consumer legislation, similar to that adopted overseas.

3.8 Occupational licensing schemes

A structured, objective and rigorous approach should be applied to determine when licensing schemes should be used and what form these schemes should take.

As discussed in the Victorian Government’s preliminary submission, industry-specific regulation, is a common method of regulating markets where there is a high level of consumer risk.

The types of industry-specific regulation within the consumer regulatory framework include licensing schemes, negative licensing schemes, registration schemes, conduct standards, codes of conduct, and accreditation schemes. Each of these different approaches has its own advantages and drawbacks and is best suited to address a particular set of consumer protection issues. The Victorian Government utilises each of these approaches to regulate different industries when the market conditions fit the particulars of the licensing scheme. For example, Victoria administers licensing schemes (estate agents and motor car traders), negative licensing schemes (finance brokers) and registration schemes (fundraising).

As part of its strategy to assess the administrative burden of its regulations and meet the Victorian Government’s targets for reducing the burden on business, Consumer Affairs Victoria has recently developed a framework to determine when to use occupational licensing⁸⁵.

3.8.1 Victoria’s Licensing Framework

There always exists the potential for the costs of licensing schemes, such as higher prices, reduced competition and poorer consumer choice, to outweigh the benefits of the schemes in protecting consumers and addressing market failures. Therefore, the Victorian Government’s preference when it comes to consumer protection is to rely initially on general consumer law and to use occupational licensing only when less onerous approaches are not applicable due to the specific characteristics of the consumer protection issue being addressed.

The Victorian Government also recognises that licensing has its limits as a tool for consumer protection. Licensing seeks to exclude those who may potentially cause detriment to consumers but the fact that an individual or business is

⁸⁵ In this section, a distinction is not drawn between ‘occupational licensing’ and ‘business licensing’. Although a distinction is sometimes made — with occupational licensing referring to licensing of individuals (often with entry qualifications) and business licensing referring to licensing of corporate entities — this distinction is not clear cut as some of the licensing schemes administered by Consumer Affairs Victoria provide for individuals or corporate entities to obtain licences.

granted a licence today does not guarantee that the licensee will not act inappropriately in the future or that rogue traders will still operate even if they do not have a licence.

This is not to suggest that licensing should never be used, is important for addressing cases of market failure or a high level of consumer risk. Rather, as the Victorian Guide to Regulation states, the “regulation of specific activities, industries and professional groups is a last-resort option.” Thus, specific industry law should not duplicate the general law and a structured, objective and rigorous approach should be applied to determine when licensing schemes should be used and what form these schemes should take. A key component of any approach to determining this is to ensure that the industry specific regulatory approach chosen fits the objectives of consumer protection in the industry in question.

The consumer protection objectives flow from the particular consumer problems that exist in the market segment in question. As described in section 2.1 above, consumer problems can be classified as types of market failures and include the following:

- Market power — where consumer choice is restricted by limited competition
- Information asymmetries — where consumers have insufficient information relative to the trader, including in relation to the competence of the trader
- Redress — where consumers lack access to mechanisms whereby they can obtain redress from a trader
- Probity — where preventing or prohibiting certain types of behaviour is necessary for consumer protection

These consumer problems translate into certain objectives and therefore different types of Government interventions. For the Victorian Government, the latter three problems — information asymmetries, redress and probity — are the main focus as market power is generally handled at the Commonwealth level through agencies such as the ACCC. The relationships between problems, objectives and interventions at the Victorian level are outlined in Box 8.

Box 8. The link between consumer protection objectives and components of occupational regulation

| <i>Problem type</i> | <i>Objective</i> | <i>Intervention examples</i> |
|-------------------------|---|---|
| Information asymmetries | Promote information provision | <ul style="list-style-type: none"> – Public register – Disclosure requirements – Quality certification – Annual reporting |
| | Address consequences of uninformed choice | <ul style="list-style-type: none"> – Cooling off periods – Money back guarantee |
| | Competence | <ul style="list-style-type: none"> – Qualification requirements – Experience requirements – Service standards – Indemnity insurance |
| Redress | Minimise risk of loss | <ul style="list-style-type: none"> – Disclosure requirements – Limit conduct of licensees – Limit up front fees – Solvency requirements – Contract terms |
| | Remedy losses suffered | <ul style="list-style-type: none"> – Dispute resolution processes – Compensation fund – Statutory warranty |
| Probity | Promote probity | <ul style="list-style-type: none"> – Character requirements – Trust fund requirements – Limit conduct of licensees – Record keeping – Contract terms |
| | Address lack of probity | <ul style="list-style-type: none"> – Disciplinary procedures – Penalties – Compensation fund – Complaints handling |

Box 8 is not intended to cover all possible consumer policy objectives or to provide an exhaustive account and categorisation of government interventions. Rather, the point of Box 8 is to highlight the link between consumer problems, the consumer policy objective and the type of government interventions in the marketplace.

As noted above, and in the preliminary submission, different regulatory schemes include both positive and negative licensing schemes, registration schemes and the imposition of general conduct standards. The intervention examples shown in Box 8 do not necessarily have to form part of an occupational licensing scheme.

Rather, the combination of the interventions required will determine the type of scheme that is appropriate.

It should also be noted when considering this issue that licensing schemes can be responding to more than one type of consumer problem and interventions can serve more than one objective. In addition, licensing schemes may combine interventions to achieve consumer policy objectives with interventions to achieve other government policy objectives. For example, the licensing scheme for motor car traders provides protection for consumers and assists the police investigate and enforce regulation relating to vehicle theft and other crimes.

3.8.2 Improving occupational licensing

The Victorian Government recognises that existing licensing schemes, which have often been in place for decades, need to be assessed as to the administrative and compliance burden they impose on business. It also recognises that not all schemes are fully aligned in terms of the objectives and interventions as per the framework described above.

Under the Victorian Government's Reducing Regulatory Burden initiative, a comprehensive review of all existing licensing schemes administered by Consumer Affairs Victoria has commenced to ensure the consumer problems, regulation objectives and government interventions are consistent and appropriate. Based on this review, the goal is to develop reforms that would streamline the interaction between business and the regulator.

3.9 Consumer input into the policy development process

Effective consumer policy requires input from consumers as well as business and government and needs to be based on evidence.

It is well recognised that effective consumer policies require input from all stakeholders — including consumers. For example, the European Union's Consumer Policy Strategy 2002-2006 notes:

*In order for consumer protection policies to be effective, consumers themselves must have an opportunity to provide input into the development of policies that affect them.*⁸⁶

Consumers have a fundamental stake in the development and operation of the consumer policy framework. Therefore, consumers play an important role in counteracting any anti-competitive pro-regulation input from industry. This was noted by the Productivity Commission during its review of National Competition Policy:

⁸⁶ Commission of the European Communities, Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions 2002, *Consumer Policy Strategy 2002-2006*, p. 21.

*In a reform-specific context, it is the role of consumer advocates in providing a counterbalance to producer groups seeking to maintain anti-competitive arrangements that lead to higher prices, reduced service quality or less market innovation, that is most relevant.*⁸⁷

Consumer input into the policy development process can also:

- explain how consumers are likely to view a situation or problem, and how these views differ from other stakeholders;
- identify consumers' views on the priorities in a particular situation;
- help anticipate how consumers might respond to various policy options; and
- identify options that will meet the needs of consumers.

Without direct input from consumers, policy makers may lack a sound understanding of the magnitude of consumer problems and fail to develop policy responses where they are most needed.

There are a number of formal and informal mechanisms open to consumers and consumer organisations to participate in policy development and review processes of the Victorian Government. Informally, consumers lobby relevant agencies and departments, Members of Parliament and Ministers and use media outlets to voice concerns. Formally, consumers are able to participate in consultation processes relating to Regulatory Impact Statements and other public policy and legislative reviews. However, very few individual consumers or organisations have the capacity or resources to exploit these mechanisms in a sustained or organised fashion.

3.9.1 Deficiencies in consumer representation and input

Despite the existence of the numerous Victorian based consumer and community advocacy bodies, and the presence of the two national bodies, consumer views are still consistently under-represented in policy discussions. An example of disproportionate representation can be seen in policies regarding mandatory country-of-origin labelling. For example, the horticultural industry in Australia lobbies strongly for mandatory country-of-origin labelling (to protect themselves from imports) without an opposing voice from consumers. Despite analysis showing there is limited market failure, and benefit-cost analysis coming out against it, mandatory country-of-origin labelling has been introduced.

Similar issues can arise in licensing schemes where industry may lobby for additional 'licensing tests', purportedly to protect the public from rogue traders or

⁸⁷ Productivity Commission 2004, *Review of National Competition Policy Reforms – Discussion Draft*, p. 301.

social problems, but which also clearly protect incumbents from increased competition. Often there is no dedicated consumer voice to argue the case for reducing requirements, increasing competition, and generating the price and service quality benefits competition can bring.

There are a number of reasons why the existing consumer voice may not be effective. The main influences on the effectiveness of consumer organisations are resources, funding and fragmentation of consumer interests among many and varied interest groups.

For example, Field (2006) found that:

consumer advocacy organisations, in general, focus their advocacy activities on the interests of low income and vulnerable consumers. It follows that consumer advocacy organisations are much more effective at advocating for these consumers than consumers at large.

It is also clear that consumer advocacy organisations, in general, are more effective at serving segments of markets, as opposed to markets generally. In particular, credit, financial services, utilities, tenancy and telecommunications markets are more effectively served by consumer advocacy organisations. Of course, there are many good reasons for this, including the essential nature of many of these goods and services for consumers. However, this practice results in whole market areas either receiving only minor attention or being wholly ignored. The lack of a countervailing voice to producer interests in these markets is of serious concern. Market segments where consumer advocacy is either less effective or wholly ineffective include insurance, superannuation, building and motor vehicle market segments (the latter two are the most significant and expensive markets in which consumers participate and, arguably, markets with poor reputations in terms of, at least, retailing behaviour).⁸⁸

The majority of the existing organisations are involved in service delivery and many only undertake policy advocacy as a peripheral activity. In some cases, this service delivery role is re-enforced by a widespread Commonwealth, State and Territory government funding model that ties funding to service delivery, leaving little resources available for general policy research or advocacy. While many of these organisations, nonetheless, seek to participate in policy research and advocacy, they often experience frustration at the level of expectation of their involvement compared with their resources.

Even where advocacy bodies are able to participate in policy discussions, their effectiveness may be hampered by their inability to fund research to support their policy positions. This lack of consumer oriented research has been recognised by the Victorian Government, which, through Consumer Affairs Victoria, funds the

88 Field, C. 2006, *Consumer Advocacy in Victoria*, Research Paper No. 7, p. 33.

Consumer Action Law Centre to undertake policy and research work to advance the interests of consumers. Similarly, the Western Australian Government, through the Department of Consumer and Employment Protection, supported the creation of the Centre for Advanced Consumer Research in partnership with the University of Western Australia.

The Victorian Government encourages the Productivity Commission to examine whether further benefits could be obtained from the establishment of a national body to undertake consumer policy and research work. Such a model has existed in the United Kingdom since 1975, after a White Paper on a “National Consumer Agency noted the need for an:

*...independent national consumer body sufficiently representative and influential to ensure that those who take decisions which will affect the consumer can have a balanced and authoritative view before them.*⁸⁹

The National Consumer Council (NCC) is a non-departmental government body. The board of the NCC is appointed by the Secretary of State for Trade and Industry and around 75 per cent of the NCC’s funding comes from the UK Department of Trade and Industry. The remainder of the funding comes from a variety of sources for specific projects.

*The National Consumer Council (NCC) makes a practical difference to the lives of consumers around the UK, using its insight into consumer needs to advocate change. We work with public service providers, businesses and regulators, and our relationship with the Department of Trade and Industry — our main funder — gives us a strong connection within government. We conduct rigorous research and policy analysis to investigate key consumer issues, and use this to influence organisations and people that make change happen.*⁹⁰

In concluding that the establishment of an Australian National Consumer Council warranted close examination, Field (2006) argued such a body:

...would conduct rigorous research into consumer issues, developing policy solutions for consumers flowing from this research and undertake coherent, well reasoned and high level advocacy. Such a Council could also advocate in markets where consumer advocacy is currently less effective as well as concentrating on economy-wide behaviour of significance to all consumers. An Australian National Consumer Council would be more effective than suggested alternative models for undertaking consumer research, such as competitively tendered research projects from governments.

89 Quoted in UK National Consumer Council 2005, *Future Arrangements for Consumer Advocacy*, available at http://www.ncc.org.uk/about/board-papers_January05.htm, p. 8.

90 NCC website at www.ncc.org.uk.

4 Compliance and enforcement

To be effective and efficient, the consumer regulatory framework must be backed by appropriate compliance and enforcement mechanisms. As outlined previously, CAV is proactive in encouraging traders' compliance with consumer laws in Victoria but has a range of enforcement tools available to address non-compliance when it occurs.

The large volume of consumer transactions that occur daily, combined with the necessarily limited resources of regulatory bodies, means that consumers, businesses and government must share responsibility for good consumer outcomes. The consumer policy framework should facilitate this shared responsibility by:

- encouraging and educating traders to comply with the law;
- empowering consumers to look out for breaches of the law and to take remedial action if a breach has occurred; and
- ensuring effective regulation is in place to enable the government to take appropriate regulatory action where necessary.

However, care must be taken to share responsibility appropriately and not rely too heavily on any one sector of the market for good compliance and enforcement outcomes.

The vast majority of traders want to comply with the law. Therefore, for these traders, compliance hinges on their understanding and awareness of relevant consumer laws. As outlined previously, providing traders with information about good trading practices as well as specific consumer laws, combined with a proactive program of compliance monitoring, is an integral aspect of the consumer policy framework in Victoria. Involving traders in the regulatory process and consulting them when drafting regulation will also improve compliance, particularly in relation to industry-specific regulation.

In competitive markets, informed consumers have an important role in driving traders to comply with the law and adopt good trading practices. Providing consumers with basic information, either through mandatory disclosure requirements or general education campaigns will help create consumers who are more alert to itinerant traders and responsive to breaches of consumer laws.

Not all consumer transactions will go smoothly and the consumer policy framework must provide for mechanisms to resolve disputes. As outlined above, there are numerous dispute resolution mechanisms within the Victorian framework – some internal to a business or industry and others of a more general nature. To be effective, these mechanisms must have the appropriate support or regulatory backing from the Government. For example, Consumer Affairs Victoria facilitates and encourages traders to develop internal complaint handling and

dispute resolution processes; and provides regulatory backing for some industry ombudsmen schemes by requiring membership of a scheme as a licence condition.

For consumers, there must be easily accessible dispute resolution mechanisms either through dispute resolution service providers like Consumer Affairs Victoria and industry Ombudsmen schemes or through accessible tribunal and court systems like the Victorian Civil and Administrative Tribunal. However, pursuing a legal remedy through these mechanisms will not be accessible to all consumers and there must be programs and mechanisms to support such consumers, for example through advocacy bodies and community legal centres.

In some circumstances, trader misconduct is so consistent, harmful or serious that enforcement is warranted and maintaining a credible threat that enforcement is an option is essential to discouraging and redressing such conduct. An effective regulatory framework depends on the capacity to take enforcement action that is meaningful, proportionate to the detriment or seriousness of the breach that has occurred, and sufficient to deter future breaches. This means having a range of redress mechanisms available so the most effective strategy can be matched to the problem at hand.

Given the above aspects of an efficient compliance and enforcement approach, the Victorian Government invites the Commission to consider the following issues:

- the appropriate balance between administrative, civil and criminal actions, recognising that civil remedies can provide regulators greater flexibility in enforcement actions, ensuring that responses are proportionate to the seriousness of the breach and the resultant detriment;
- the benefits of effective alternative dispute resolution schemes and the appropriate role for governments in relation to such schemes; and
- whether consumer policy outcomes could be improved by establishing more formal mechanisms for consumer organisations to encourage compliance with, and assist in the enforcement of, consumer regulation.

These issues are discussed further in the sub-sections below.

4.1 Victoria's model compliance and enforcement toolkit

Ensuring enforcement powers and remedies are appropriate can increase the effectiveness of general regulation and create scope to reduce the reliance on more prescriptive rules based regulation.

Effective inspection and enforcement powers in fair trading legislation are essential to support a fair competitive playing field for traders and effective protection of consumers. When traders know they face serious sanctions for

contravening general fair trading controls, there is less need for industry-specific legislation, so the overall regulatory burden can be reduced. A comprehensive and flexible compliance and enforcement toolkit, backed up by skills and resources, is therefore recommended for fair trading legislation in all jurisdictions.

Victoria's *Fair Trading Act 1999* has an advanced compliance and enforcement toolkit (which was outlined in the Victorian Government's preliminary submission). The Act was comprehensively revised in 1999 and has been subject to an ongoing reform program to protect consumers and promote fair markets. New enforcement tools including adverse publicity orders and cease trading injunctions have been added to the toolkit.

This range of enforcement options allows Consumer Affairs Victoria and the courts to tailor responses to a wide range of unfair market conduct. Culpable rogue trader conduct aimed at hurting individual consumers can be addressed by a combination of administrative, civil and criminal actions which can involve removing an offender from the marketplace. Market conduct aimed at consumers generally can be addressed by administrative and civil sanctions that are not only remedial but serve to educate both traders and consumers about unfair practices and dangerous goods.

4.1.1 Proposed Civil Pecuniary Penalties

Victoria has proposed to SCOCA that all Australian jurisdictions consider introducing civil monetary penalties linked to the benefit derived by the offender. Proceedings for such a penalty would be an alternative to criminal proceedings for fair trading contraventions in particular cases. This proposal is being considered by a national SCOCA working party and a final report is expected to be released in 2007.

Civil penalties are available in Part IV of the *Trade Practices Act 1974* (restrictive trade practices) and in various laws in New Zealand, the UK and the European Union. The general formula in those jurisdictions is:

1. estimate the offender's turnover resulting from the breach of the Act and decide on a percentage (10-30 per cent) of that figure to use as a base;
2. multiply the base figure by the duration of the breach (in years);
3. adjust for mitigating or aggravating factors (various rules apply);
4. apply a maximum limit,
 - o in the UK, penalties are capped at 10 per cent of a corporate offender's worldwide turnover,

- in NZ, it is the greater of three times the unlawful gain, \$10 million or 10 per cent of the offender's total turnover (for individuals, these maximum ranges would be slightly lower), and
- the option of substituting a penalty of 10 per cent would normally only be taken where it was difficult to estimate an offender's unlawful gain.

Civil penalties would be consistent with the protective nature of fair trading legislation. They would be appropriate for breaches that are part of marketplace strategies yet not regarded as 'criminal' conduct. These penalties could be sought in the same proceedings as those for other civil remedies, such as the various kinds of injunctions mentioned above. Under the current system, proceedings for criminal fines and civil remedies must be conducted through separate applications in separate courts.

Criminal punishment would still be available as an alternative to deal with matters that were sufficiently serious.

4.2 Alternative dispute resolution processes

Whilst alternative dispute resolution (ADR) provides opportunities for consumers and suppliers, Government must play a role in the relevance, suitability and performance of ADR schemes.

The Victorian Government has explicitly recognised the importance of effective dispute resolution processes. The Attorney-General's Justice Statement acknowledges that all Victorians are entitled to reasonable access to assistance in resolving disputes, regardless of the type of dispute, and that improving alternative dispute resolution (ADR) services will assist the Government's aim of building cohesive communities and reducing inequality⁹¹. In 2006, the Victorian Government made an election commitment to "making legal processes for civil disputes simpler, cheaper and more effective by:

- simplifying court processes for civil disputes following the outcomes of the Victorian Law Reform Commission's civil procedure review;
- improving the co-ordination and integration of ADR across the justice system; and
- modernising the office of Supreme Court Master, enabling this position to become one of Associate Judge to whom matters may be referred for mediation."⁹²

91 Attorney-General (Victoria) 2004, *Attorney-General's Justice Statement*, Department of Justice, Melbourne.

92 Australian Labor Party (Victorian Branch) 2006, *Access to Justice*, Policy for the 2006 Victorian Election, http://www.vic.alp.org.au/index.php?option=com_content&task=view&id=173&Itemid=9#Justice (accessed 30 April 2007).

Consumer ADR services are available through a variety of mechanisms. Courts and tribunals use ADR to reduce the need for every issue to be resolved through a complete court hearing and decision, for example pre-hearing processes often involve ADR. A range of services also attempt to resolve disputes before they enter formal legal processes. Non-court processes, with dispute resolution as their primary function, include:

- state and national industry ombudsman schemes, which may be mandatory or voluntary and apply to private or publicly provided goods and services;
- Commissioner schemes, which may also be established by either state or Commonwealth legislation; and
- government ombudsmen.

Consumer regulatory agencies also have a dispute resolution function.

The Victorian Department of Justice is overseeing the *Contemporary Justice Service Delivery — ADR project*. The project has completed a report on the supply of ADR in Victoria, based on qualitative and quantitative research conducted on key ADR service providers — *Alternative Dispute Resolution in Victoria: Supply Side Research Project*⁹³. This research comprised interviews with stakeholders, including courts and tribunals, industry ombudsmen, commissioners, government agencies and academics.

In reviewing and refining its ADR processes Victoria recognises the need to balance providing services that reflect the needs of consumers with different types of disputes and different capacities to address those disputes without assistance, being accessible to consumers, and avoiding confusion about the role and scope of different dispute resolution options. Governments play an important role in ensuring that consumers can move smoothly between different levels of dispute resolution (usually comprising direct discussions with a trader, informal advice from a regulator, formal complaint mediation or arbitration and legal redress) and that the system is inclusive so consumers, particularly vulnerable and disadvantaged consumers, are not prevented from accessing suitable processes.

4.2.1 Issues

The use of ADR has increased dramatically in the last two decades. As a result, there has been a somewhat ad hoc proliferation of dispute resolution schemes and ombudsman bodies, leading to inconsistency in:

93 Field 2007, *Alternative Dispute Resolution in Victoria: Supply-Side Research Project*, Research Report, February, <http://www.justice.vic.gov.au/wps/wcm/connect/DOJ+Internet/Home/About+Us/Our+Goals/JUSTICE+-+Alternative+Dispute+Resolution+in+Victoria+Supply+Side+Research+Report>.

- whether an industry ombudsman scheme is available in a particular sector;
- whether the regulator also acts as the dispute resolution body or these functions are separated;
- the dispute resolution body's powers (does it merely mediate or have determinative powers);
- the qualifications of ADR practitioners; and
- the cost of accessing the dispute resolution body.

A recent report, *Alternative Dispute Resolution in Victoria: Supply Side Research Project* initiated by Consumer Affairs Victoria for the Department of Justice as a whole, considered these issues and made the following observations.

A central access point for ADR services

Whilst it would be difficult to create a central access point for ADR that “covers the field”, the greater use of centralised access points for ADR services should be considered for efficiency and effectiveness reasons.

Achieving critical mass in ADR service providers

Critical mass issues should be considered in establishing new agencies — for example, it may be sensible to expand existing schemes to meet new needs.

Problems caused by variable qualifications, training and accreditation of ADR practitioners

Government should take a lead in developing training, qualification and accreditation standards for ADR practitioners and ADR service standards. The National Alternative Dispute Resolution Advisory Council has recognised this issue and the National Mediation Conference is developing accreditation standards. Additional and complementary measures may also provide immediate benefits to consumers.

Variation in quality of ADR

There appears to be a case for developing comprehensive Key Performance Indicators (KPIs) for ADR services. KPIs would enhance comparison, funding efficiency and performance improvement.

The role of government and the private sector in funding ADR services

Government has an important role in funding ADR services, particularly where ADR generates broader community benefits or facilitates low-income or vulnerable consumers' access to affordable dispute resolution processes. It is also sensible to consider whether some industries should provide greater support

for ADR. At the moment, some industries do not contribute directly to ADR services, while others with comparable levels of disputes, which are subject to recognised industry-based dispute resolution schemes, are required to fund dispute resolution processes.

The relationship between the regulator and dispute resolution bodies

There are both advantages and disadvantages in splitting the roles of regulator and dispute resolution body. What is critical is a properly integrated interface between member businesses and the regulatory agency. Ombudsman schemes face the challenge of balancing working with businesses to resolve disputes and bringing systemic breaches of the law to the regulator's attention. If the former is over-emphasised the complainant may obtain a favourable outcome but systemic problems may not be addressed and unlawful behaviour by business may remain unchecked.

Criteria for determining the need for an industry ombudsman scheme

Consideration should be given to whether consumer complaints are heard by a general ombudsman scheme or an industry-specific scheme. In determining this question, a number of tests could be applied. An industry-specific scheme may be justified if the disputes in the industry are different to disputes that arise elsewhere, such as in the finance industry, telecommunications or the utilities sector. In contrast, in the fitness industry, for example, consumer issues are likely to be similar to those in other industries such as travel, so that relying on a general complaints scheme may be more appropriate.

What services should dispute resolution schemes offer?

There is significant variation in the services offered by different dispute resolution schemes. Most industry ombudsman schemes have a determinative role. That is, their decisions on a dispute are binding on the member company, but the complainant is not bound by the outcome (though few consumers would take action beyond the ombudsman's consideration of their complaint). Other ADR providers do not have a determinative function. Consumer Affairs Victoria cannot compel a party to a dispute to attend mediation or conciliation and its conciliators play a strictly facilitative role.

Schemes' approaches to resolving disputes also vary. For example, in 2005-06 the Energy and Water Ombudsman Victoria conciliated 4,728 matters, out of 17,763 contacts (26.6 per cent). The Financial Industry Complaints Service received 14,369 contacts, but only 616 matters were mediated or arbitrated or adjudicated in some manner (4.3 per cent). Each scheme will have its unique features, which may leave consumers unable to anticipate how their disputes will be handled by any given ADR scheme.

What standards should dispute resolution bodies aspire to?

Most, if not all, industry ombudsman schemes recognise and adopt the *Benchmarks for Industry-Based Customer Dispute Resolution Schemes*, originally developed in 1997 by the Commonwealth Department of Industry, Science and Tourism and adopted by the Australian Securities and Investments Commission to assess finance industry dispute resolution regimes. While any dispute resolution scheme should be assessed against these criteria, it should also be assessed against other criteria such as proportionality, choice and timeliness.

The Benchmarks recognise the differences among industries and allow for differing governance arrangements. They state that a dispute resolution scheme should have:

Accessibility — the scheme makes itself readily available to customers by promoting knowledge of its existence, being easy to use and having no cost barriers.

Independence — the decision-making process and administration of the scheme are independent from scheme members.

Fairness — the scheme produces decisions that are fair and seen to be fair, by observing the principles of procedural fairness, making decisions on the information before it and having specific criteria upon which its decisions are based.

Accountability — the scheme publicly accounts for its operations by publishing its determinations and information about complaints and highlighting any systemic industry problems.

Efficiency — the scheme operates efficiently by keeping track of complaints, ensuring complaints are dealt with by the appropriate process or forum and regularly reviewing its performance.

Effectiveness — the scheme is effective by having appropriate and comprehensive terms of reference and periodic independent reviews of its performance.

Whilst many ADR issues could be considered, the Productivity Commission may like to look at the fragmentation of ADR schemes in the financial services sector and whether there would be advantages of moving to a comprehensive national statutory scheme, similar to that in the United Kingdom.

4.3 Greater role for consumer organisations

Enforcement of the regulatory framework may be improved if consumer organisations had a greater role in assisting consumers resolve disputes and obtain redress. Mechanisms such as the super complaints system in

the United Kingdom and representative actions, also being considered in the United Kingdom, should be examined.

As noted in section 3.9, consumer organisations have an important role in advocating for consumers and providing input into policy and legislative review processes, and there may be potential for this role to be improved through the establishment of a national consumer organisation. In addition to their role in policy development, the Victorian Government considers that consumer organisations play important roles in assisting regulators:

- monitor compliance with regulations and industry self-regulatory tools;
- identify areas where significant consumer detriment is arising from gaps in the regulatory framework; and
- obtain redress for consumers.

There is a variety of formal and informal ways in which consumer organisations can fulfil this role. Some, such as legal and financial counselling services, are funded to assist consumers obtain redress. Such organisations can also be involved in ad hoc and ongoing consultation processes. Consumer Affairs Victoria, for example, regularly brings together representatives of Victorian community and consumer organisations in the 'Working Together Forum'. This forum is an avenue for consumer organisations to raise concerns about gaps in compliance and enforcement. Consumer organisations can also, at their own initiative, raise issues with the regulator or the Minister. Many of these mechanisms have dual roles enabling organisations to raise and discuss policy issues as well as concerns about compliance and enforcement.

In the United Kingdom, consumer organisation's role in identifying areas of systemic consumer detriment has been formally enhanced by the introduction of a super-complaints mechanism to bring matters to the attention of the regulators. The United Kingdom has also proposed enabling consumer organisations to bring representative actions on behalf of consumers.

Both of these proposals are outlined in the sections below. Compared with the UK, Australia may be underutilising consumer organisations and not capitalising on the market intelligence and perspective these organisations could contribute. The UK approach reveals that policies that empower consumers through devolving authority to selected consumer organisations can improve consumers' access to justice and deter rogue traders.

The Victorian Government encourages the Productivity Commission to examine the role of consumer organisations in encouraging compliance with and enforcement of consumer regulation, mechanisms that facilitate this role being used and considered overseas, and the potential of such mechanisms to enhance the Australian consumer regulatory framework.

4.3.1 Super-complaints

The 'super-complaint' process has been in operation in the UK since June 2003. The initiative offers a fast-track system for designated consumer bodies to bring market features, which appear to be significantly harming the interests of consumers, to the attention of the UK Office of Fair Trading (OFT) and other relevant regulators.

At the centre of the process is the Secretary of State's selection of consumer advocate organisations to become designated bodies. Designated bodies gather evidence and present a reasonable case as to why a UK market appears to be significantly harming the interests of consumers and should therefore be investigated. The designated bodies act as a front line access point for individual consumers and assist consumers build cases for the OFT to review.

Presenting the case in the super-complaints format assists the receiving authority in undertaking a full appraisal of market features that may be significantly harming consumer interests and what action, if any, should be taken. The guidelines for making a super-complaint recognise that they are not expected to provide all the evidence necessary for a regulator to decide that immediate action is appropriate, rather, they are a 'stepping stone' to a full investigation. They are, therefore, an accessible mechanism for designated organisations to put forward complaints and, as the consumer protection agency must respond to super-complaints in a designated timeframe, they increase the transparency of decisions about whether or not issues will be pursued.

The super-complaint process does not affect other processes that individual consumers or bodies can use to raise specific instances of anti-competitive behaviour or infringements of consumer protection legislation. Super-complaints operate in parallel to other complaint handling processes. Similarly, procedural safeguards that ensure fairness for those who may be the subject of enforcement action are unaffected by super-complaints.

On the face of it, 'super-complaints' may provide Victorian consumer organisations with a formalised, more accessible and better resourced system in which to raise compliance and enforcement issues. They may also provide another avenue for consumer organisations to influence policy processes by identifying areas where there are major gaps in the regulation's ability to deliver fair and effective outcomes for consumers. The system also takes pressure off consumer protection agencies to cover all the emerging market issues, placing more reliance on the advice and intelligence of consumer organisations. However, at the same time, the regulator must have the capability and resources to give appropriate consideration to complaints when raised.

Whilst the super-complaints process appears to have been successful in the UK, as evidenced by a range of case studies⁹⁴, a recent New Zealand Ministry of Consumer Affairs review (part of its review of redress and enforcement provisions of New Zealand consumer law) concluded that:

Although the super-complaints system is regarded as a success in the United Kingdom, it is not proposed that the Fair Trading Act (FTA) be amended to provide for such a system in this country. This is because the benefits that have accrued in the United Kingdom since the introduction of the super-complaints system would be unlikely to occur in New Zealand. In the United Kingdom complaints received about consumer protection issues are directed to Trading Standards Authorities (TSA).

The review went on to say that:

Before a super-complaint system could be proposed, there would need to be significant information that indicates that the current system would be greatly improved by the introduction of such a provision in the FTA. Currently, there are informal arrangements between consumer groups and the Commission to discuss where consumer groups see priorities and how the Commission's priorities compare. Some of the recent Fair Trading Act court cases taken by the Commerce Commission have originated from information supplied to the Commerce Commission by consumer organisations.

As Victoria, like New Zealand, already has less formal processes for input by consumer organisations, it would be useful for the Productivity Commission to consider the benefits, if any, of a more formal mechanism for consumer organisations to raise issues with government consumer agencies. The broad principle involved is giving significant consumer organisations greater status and recognition in the consumer policy framework.

4.3.2 Representative actions

Due to perceptions that the process is too complex, or the potential costs outweigh the possible gains, many consumers are reluctant to bring cases of breaches of consumer protection on their own.

In Australia, individual consumers may join with others to commence a class action. However, class actions are likely to be limited, due to the cost and the risks of an unsuccessful action. There are also circumstances in which a class action is not viable because consumers cannot be identified or losses, while large in total, are small to individual consumers. In these cases, unless a government

94 *Citizens Advice delighted by OFT response to its super-complaint on payment protection insurance*, http://www.citizensadvice.org.uk/index/pressoffice/press_index/press-051207.htm and *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.

organisation takes action, representative action by a consumer organisation may be the only way to achieve redress and representative actions may assist consumers by increasing access to justice and overcoming barriers presented by class actions.

In the UK, where the legal system does not encourage class actions, the concept of a statutory right for non-government consumer organisations to bring a representative action has been developed to provide better access to consumer redress.⁹⁵ The program proposed for discussion in the UK allows bodies to represent groups of consumers in court to help them recover damages for similar detriment caused by the same company. Safeguards would prevent inappropriate or spurious cases by including requirements that cases could only be brought by bodies designated by the Secretary of State, be on behalf of named consumers and possibly subject to pre-trial court approval. These ideas were recently the subject of a consultation paper that called for submissions on representative actions and the proposed model. At this stage, it is unclear what role the OFT would have in presenting, coordinating or guiding representative actions and there are differing opinions in the organisation's level of involvement.

As part of the consultation process the OFT has identified a number of considerations that need to be incorporated in the process. These include:

- the procedure for opting out of the action and the consumers' awareness of the litigation relating to them — some consumers may have no desire to litigate;
- the level of costs incurred by consumers in obtaining financial recompense if damages are awarded by the court;
- how the group would be defined and limitation periods;
- which organisation would have the authority to act for the group;
- if the individual harm cannot be identified this raises evidential issues; and
- where the overall loss is greater than that amount of loss that can be allocated to identified individuals and whether the court should have the discretion to award any damages paid to a consumer education fund.⁹⁶

In Australia, while several jurisdictions (including Victoria) have given the consumer regulator the power to bring or fund actions on behalf of consumers,

95 UK Department of Trade and Industry 2006, *Representative Actions in Consumer Protection Legislation*, p. 4.

96 Office of Fair Trading (UK) 2006, *Representative actions in consumer protection legislation: A consultation response by the Office of Fair Trading*.

there is no statutory right for non-government consumer organisations to take such action.⁹⁷

A policy that promotes representative actions might benefit Australian consumers by providing a broader scope for access to redress. The barriers to class action would be diminished and consumer organisations could potentially be delegated authority to act on behalf of millions of consumers. Furthermore, representative actions could deter rogue traders from breaching consumer regulation by raising the cost of such breaches, without government resorting to further regulation. While representative actions punish rogue traders for bad behaviour, and offer consumers financial redress, they avoid the distortion caused by regulation that potentially affects all business. Any Australian initiative to introduce and encourage representative action would need to consider the points raised by the OFT.

97 See for example, s.105 Fair Trading Act 1999 (Vic); s.18 Consumer Affairs Act 1971 (WA); and s.12 Fair trading Act 1987 (NSW).

5 Harmonisation and national approaches

As the Victorian Government's preliminary submission identified, consumer policy in Australia operates within a large and complex framework. As a result of Australia's federal system of government, a key determinant of the efficiency and effectiveness of Australia's consumer policy framework is the allocation of roles and responsibilities among the different levels of government. The preliminary submission outlined the various roles and functions that make up the framework including policy development; making, administering and enforcing regulations; dispute resolution; and other non-regulatory activities such as education and community engagement.

Within the current framework, these functions are split between the levels of government resulting in a mix of Commonwealth and state or territory based regulations and institutions to administer and enforce them.

Consumer policy in Australia should be based on a logical and consistent framework, which identifies the appropriate allocation of roles and responsibilities between various jurisdictions to maximise consumer welfare.

This section of Victoria's submission will discuss and propose various principles that should guide the Commission in recommending any improvements to the allocation of roles and responsibilities for consumer policy in Australia. In particular, the following issues are discussed:

- the benefits of applying the subsidiarity principle in determining an appropriate allocation of roles and responsibilities between the levels of government;
- the factors to consider in determining when a departure from the subsidiarity principle is justified to improve the effectiveness and efficiency of the allocation of roles and responsibilities between levels of government
- the approaches that could be adopted to improve harmonisation and the effectiveness and efficiency of the current allocation of roles and responsibilities;
- cooperative arrangements between the jurisdictions, including the SCOCA and MCCA processes, significantly enhance the effectiveness and efficiency of functions residing with the states and territories.

5.1 The subsidiarity principle for institutional arrangements in consumer policy

In its recommendations, the Commission should retain the federalist nature of current arrangements and adhere to the principle of subsidiarity.

There is constructive inter-jurisdictional comparison in the area of consumer policy. Throughout its review, the Commission should promote inter-jurisdictional learning and improvement in the development and implementation of consumer policy.

The complexity of the current institutional arrangements supporting consumer policy is a direct result of the Australian federal system of governance; Australia has the distinction of being one of the oldest continuing federations in the world.⁹⁸

There is no 'best' model for assigning functions between levels of government however the subsidiarity principle provides the strongest guidance; the subsidiarity principle states that the responsibility for a particular function should, where practicable, reside with the lowest level of government.⁹⁹

The principle of subsidiarity stems from the idea that a central authority should have a subsidiary function, performing only those tasks which cannot be performed effectively at a more immediate or local level (whether that is done individually or through a harmonised approach). It assumes that where lower level governments are both efficient and effective at delivering a function of government, then no other level of government will be better placed to deliver that function or service. The subsidiarity principle is presently best known as a fundamental principle of European Union law. The principle was established in the 1992 Treaty of Maastricht and accordingly, the EU may only act (that is, make laws) where member states agree that action of individual countries is insufficient.

In the area of consumer policy, as in any other area of government policy, there are four main reasons in support of firstly, the structure of a federalist nation, and secondly and more specifically, the subsidiarity principle of government:

1. **Knowledge, capability and responsiveness:** Although Australia has a relatively homogenous society, there are still distinct differences in the wants or needs of communities.¹⁰⁰ Sub-national governments are likely to have greater knowledge about the needs of the citizens and businesses affected by their policies¹⁰¹, and have the necessary capability to explore, customise and implement appropriate and diverse policy solutions in a timely manner.
2. **Accountability:** Decentralisation of responsibility and dispersion of decision making powers makes it easier to constrain the ability of elected

98 Productivity Commission (PC) 2005, Productive reform in a federal system, *Annual Report 2004-05*, Annual Report Series, pp. 1–27, Productivity Commission, Canberra.

99 Ibid.

100 Twomey and Withers 2007, *Federalist Paper 1; Australia's Federal Future*, A Report for the Council for the Australian Federation, April.

101 PC 2005, op cit.

representatives to pursue their own agendas to the disadvantage of citizens they represent.¹⁰²

3. **Competition, innovation and learning:** Intra-national mobility of individuals and businesses exposes sub-national governments to a reasonable degree of intergovernmental competition¹⁰³ and consequently increases the incentives to improve effectiveness and responsiveness through innovation and adopting best practice¹⁰⁴. The development of alternative models allows for comparison, and learning.

In Australia, competition may take place between states (horizontal competition) or between the three levels of government (vertical competition).

4. **Testing of ideas:** Initial emphasis on the lowest level of government encourages careful consideration or testing of the case for allocating a function to a higher or national government and thereby guards against excessive centralisation and also allows the testing of regulatory approaches before introduction in other states and territories.¹⁰⁵

Box 9 provides examples that demonstrate the benefits of the subsidiarity principle within the existing framework. A comparative report on consumer policy regimes in the OECD, where many countries have decentralised regulatory and institutional arrangements, also found there to be many benefits of decentralised frameworks.¹⁰⁶

Box 9: The benefits of the subsidiarity principle in operation

Inter-jurisdictional learning and improvement

In a recent paper by Twomey & Withers (2007) written for the Council of Australian Federation, inter-jurisdictional comparison was emphasised as an important benefit of Australia's federalist structure.

The paper notes that:

State and Territory policies are constantly compared against each other. These comparisons are more meaningful than those between different counties, because they are made from a common base. The States and Territories are periodically placed under real political pressure to improve

102 Ibid.

103 Ibid.

104 Twomey and Withers 2007, op cit.

105 Ibid and PC 2005, op cit.

106 Department of Trade and Industry (DTI) 2003, *Comparative Report on Consumer Policy Regimes*, DTI, United Kingdom.

their performance, through innovation or through learning from successes and failures of other jurisdictions.

*Without this interaction, comparison and competition, there would be little incentive for a centralised government to take the risk of implementing new ideas, especially when the consequences of failure are more widespread for national reforms. The likely result would be a bloated, complacent and sedentary bureaucracy.*¹⁰⁷

A federalist structure operating on the principle of subsidiarity creates significant opportunities such as this for inter-jurisdictional learning and improvement.

An example of inter-jurisdictional learning and improvement: Unfair contract terms legislation

The development of unfair contract terms legislation is an example of Victoria's innovation in consumer policy. The United Kingdom introduced unfair contract terms regulation in 1999. However, given the recent approach of the Australian Government, such regulation was unlikely to be adopted nationally in Australia. Recognising the potential benefits, Victoria was the first Australian jurisdiction to adopt unfair contract terms legislation, incorporating provisions into its FTA in 2003. This has allowed the testing of the legislation in one jurisdiction. Subsequently the experience and lessons from this pilot have been examined by other states and territories. For example, in 2006 a Report by the NSW Legislative Council's Standing Committee on Law and Justice recommended that unfair contract terms regulation be introduced in NSW.¹⁰⁸

Responsiveness to jurisdictional differences

The paper by Twomey & Withers (2007) also notes that:

*Federalism accommodates the vast differences across Australia by allowing policies that affect local communities to be tailored to meet the needs of those communities, by people who live there and understand those needs. Different policies may be appropriate in different States or Territories because of difference in climate, geography, demographics, culture, resources and industry.*¹⁰⁹

An example of responsiveness to jurisdictional differences: Product safety

In early 2007, Consumer Affairs Victoria became aware that faulty valves had been fitted to automotive liquefied petroleum gas tanks, creating a risk of the

107 Twomey and Withers 2007, op cit, p. 12.

108 NSW Parliament Legislative Council Standing Committee on Law and Justice 2006, *Unfair terms in consumer contracts*, Report 32, November.

109 Ibid, p. 10.

tanks rupturing and causing major explosions. In December 2006, the ACCC had issued a warning notice and did not consider further action was warranted.

Consumer Affairs Victoria discovered that over 59 per cent of the faulty valves (28,000) were distributed in Victoria and considered that, due to the greater risk in Victoria, further action was required. Subsequently, a Public Warning Notice, Media Release and Consumer Alert were issued and in conjunction with VicRoads, letters were sent to owners of LPG vehicles advising them of the potential risk.

This example highlights how different responses may be considered appropriate for different jurisdictions.

It is important that the above advantages of the subsidiarity principle form the underlying framework for consumer policy in Australia. Indeed, much of the existing framework is based on the subsidiarity principle, with the vast majority of consumer laws and non-regulatory activity being administered and undertaken at the state or territory level. However, the Commonwealth does have some areas of responsibility. For example, the Council of Australian Governments recently agreed to transfer its trade measurement functions to the Commonwealth, which has had Constitutional responsibility for the area since Federation.

The broad scope of consumer policy and the extent of the regulatory and institutional framework, mean there are also many areas of overlap between the Commonwealth and the states and territories, and duplication among the states and territories. Therefore, in practice, the application of the subsidiarity principle in consumer policy is not simple, with shared responsibility for many areas.

The need for the State, Territory and Commonwealth Governments to work together is recognised in a commitment by all Australian Governments to a new National Reform Agenda (NRA), which covers issues of both social and economic importance. Among the focuses of the NRA are competition reform and regulation reform (reducing red tape burden on business). In implementing the NRA, COAG has identified 'hot spot' areas, including trade measurement and product safety, as priority areas of reform.

The Victorian Government's preliminary submission provided an overview of the many roles and functions that make up the policy framework, including policy development and administration, compliance and enforcement, dispute resolution and other non-regulatory activities. Within a given subject or policy area, it may be appropriate for some functions to rest with the states and territories while others rested with the Commonwealth, and in other policy areas, it may be best to adopt a shared and cooperative approach.

The appropriateness of this existing framework is examined in the next section.

5.2 The appropriateness of the current allocation of responsibilities between the Commonwealth, states and territories

The federal system of governance does not lead to significant inefficiency within the consumer policy framework. However, nationally uniform regulation and cooperation may be appropriate in some circumstances, when assessed on a case by case basis.

The Victorian Government recognises that concerns over the cost to business of the lack of uniformity across the jurisdictions was one of the drivers for the Commission's inquiry. In recommending a review of consumer policy in its *Review of National Competition Policy Reforms*, the Productivity Commission noted that inconsistencies in consumer policy increased compliance costs and impeded the development of national markets. Similarly, the report of the Australian Government's Taskforce on Reducing Regulatory Burdens on Business also commented that the lack of uniformity led to "greater compliance costs and burdens for companies that operate nationally, such as food franchises and banks"¹¹⁰.

The Victorian Government agrees that differences in regulation can create costs for businesses. However, these costs may not be significant and will vary depending on the circumstances.

Although there are a number of different approaches that could be adopted to reduce the costs of regulatory differences, the adoption of these approaches must involve a careful consideration of their costs, particularly if they involve a departure from the subsidiarity principle. These issues are discussed further below.

5.2.1 The type and extent of costs from differences in regulatory approaches

The costs of regulatory differences between the jurisdictions include:

- Confusion among businesses and consumers about their rights¹¹¹, and responsibilities and the administrative arrangements in place to uphold their rights;

110 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, p. 51.

111 Consumers may also assume they have rights when they do not. For example, in Victoria, there is a 3-day cooling off period for most used car purchases, but not for new car purchases; whereas in NSW, both new and used car purchases are entitled to a cooling off period, but only where a credit agreement from a linked credit provider is entered into as part of the sale.

- Increased costs for government associated with administering regulations and conducting education programs, because economics of scale and scope cannot be fully realised;
- Reduced potential for competition among operators in different states and territories, thus decreasing the benefits that competition can bring to consumers through lower prices and more innovative services;
- Higher costs for businesses wishing to move between jurisdictions, or operate in more than one jurisdiction, resulting from the need to learn and comply with different standards;
- Increased costs, or a reduced potential, for national stakeholder groups to participate in legislative development and review processes; and
- Reduced potential for the development of a body of case law that can support general law provisions in multiple jurisdictions.

However, the magnitude and significance of these costs will depend on a number of factors including:

- The nature of the market and market participants — differences in regulations create few costs for traders that operate only within one jurisdiction. Only those traders who operate in more than one jurisdiction, or would do if there were no differences in regulatory arrangements, will incur costs from regulatory differences. Similarly, the vast majority of consumer transactions are completed within a single jurisdiction and are unlikely to be affected by regulatory differences. Only in some markets where there is significant interstate trade or cross-border migration will the costs of confusion to consumers be significant. However, if traders are mobile across borders, rogue traders may take advantage of regulatory differences and ‘jurisdiction shop’, increasing overall costs to the community.
- The type of regulation imposed — for those traders who do operate in more than one jurisdiction, differences between regulations affecting matters of process (such as the type of premises a trader can operate from) will result in fewer compliance costs than differences between regulations affecting outputs (such as the nature of products that can be sold). Traders are more likely to be able to accommodate the former of these types of differences, and, if they only have a physical premises in one jurisdiction, they will not be affected at all by the different regulations.
- The extent of the differences between the various regulations — where regulations are merely different, but compatible, a trader may be able to comply with both by adopting the highest standard. If this standard was in-line with normal business practice, there would be no cost resulting from

the different regulations. Traders would incur higher costs where regulations differed to such an extent that they were incompatible and both could not be complied with simultaneously. However, incompatible regulations are uncommon.

Although the growth in interstate trade and development of national markets has undoubtedly increased the costs of regulatory differences over the last decade, there is little empirical evidence to indicate just how significant the impact of lack of complete harmonisation of consumer laws across the country is.

5.2.2 The potential to increase efficiency through greater harmonisation

Increasing harmonisation and moving to more uniform regulatory models may reduce the differences in regulations between jurisdictions, and the associated costs. 'Harmonisation' aligns laws, rules and processes to promote consistency in their application and outcomes, and to remove inconsistent or contradictory requirements.

In addition to reducing business and consumers' costs by creating economies of scale and reducing duplication of activity, greater harmonisation may also reduce the costs of government developing, administering, monitoring and enforcing the regulatory schemes.

The different models that can be used to improve harmonisation and reduce costs of regulatory differences are outlined in Box 10.

Box 10. Models for achieving greater harmonisation

A single national law

This approach requires a departure from the subsidiarity principle and the introduction of Commonwealth legislation. The Commonwealth Constitution restricts the areas in which the Commonwealth can legislate. Therefore, the Commonwealth would either have to have power, or the states and territories would, pursuant to s. 51(xxxvii) of the Constitution, have to refer their constitutional powers in this area to the Commonwealth. An example of such a system was the enactment of the *Corporations Act 2001* (Cth), following the referral by each of the states of the necessary constitutional powers.

'Template' legislation

This approach requires one jurisdiction to enact a 'template' Act with other jurisdictions enacting legislation that refers to the first jurisdiction's legislation. Any change to the original jurisdiction's template Act automatically becomes law in the other jurisdictions. Template legislation is currently used to regulate credit in Australia. Under the *Australian Uniform Credit Laws Agreement 1993*, initial legislation was enacted in Queensland and enabling legislation was then enacted

in the other states and territories¹¹². As a result, any changes to the Uniform Consumer Credit Code (which are decided by the Ministerial Council) only need to be made in Queensland, as they apply automatically¹¹³ in the other jurisdictions.

Model legislation

This approach involves each state and territory adopting separate but uniform legislation. This approach underpinned the state and territory Fair Trading Acts, which mirrored parts of the Trade Practices Act. However, amendments to the state and territory Fair Trading Acts, since their introduction, mean that they are no longer uniform.

The Uniform Trade Measurement Legislation Scheme is an example of an attempt to address the problem of divergence following the initial agreement. Under the scheme, the states and territories¹¹⁴ each enacted model legislation and a ministerial advisory council was established to oversee the maintenance of the legislation and its administration. Under the agreement, any amendments to the legislation must be first agreed by the Ministerial Council. Problems exist, however, as there is a lack of uniformity in the administration Acts and Regulations, and lack of synchronisation in amending the legislation in each jurisdiction.

Uniform legislative provisions

This approach requires each jurisdiction to agree on uniform provisions that they then reflect in legislation. The national travel agents scheme is an example of such an approach. Each of the states and territories, except the Northern Territory, has enacted travel agents legislation with uniform core provisions pursuant to the Travel Agents Participation Agreement.

Uniform principles

This approach involves jurisdictions agreeing on a set of principles for regulation, rather than legislative provisions. Such an approach gives jurisdictions more flexibility in how they give effect to the agreement and is common in international agreements such as Directives within the European Union and Model Laws of the United Nations.

Mutual recognition

112 Except Western Australia, although it has subsequently passed enabling legislation.

113 In both Tasmania and Western Australia, however, there is a system whereby amendments to the Code or Regulations must be ratified by their respective parliaments before coming in to force.

114 Except Western Australia.

Mutual recognition makes it easier for goods and people to move between jurisdictions by providing that goods, or a person engaged in a particular occupation, that have met the regulatory requirement in one jurisdiction can be lawfully sold, or practice, in all other jurisdictions without being reassessed against different regulatory standards. Mutual recognition in Australia currently applies to goods and over 200 registered occupations.¹¹⁵

National cooperative approaches to policy development and enforcement

This approach involves cooperative processes, through bodies such as Ministerial Councils and national working parties, to develop policy. Through these processes, jurisdictions retain their autonomy but work to develop consistent policy proposals. Much of the existing consumer regulatory framework has been developed through such processes, including MCCA and SCOCA, which has resulted in significant commonality across the jurisdictions. These processes are discussed further in section 5.3 below.

Each of the approaches outlined in Box 10 has different advantages and disadvantages and their suitability will depend on the circumstances of the industry or area to be regulated. Regardless of the approach, however, many factors must be considered when assessing the desirability of greater harmonisation, including:

- the appropriate level of regulation (this may require increases in regulation in some jurisdictions and reductions in others),
- the appropriate institutional arrangements for administering and enforcing the scheme (for example, a single national regulator or multiple jurisdiction-based regulators; establishment of new agencies or an expansion of the functions of existing regulators),
- how any future amendments can and will be made,
- who will be responsible for educating consumers and traders about the scheme, and
- how policy decisions, including the prioritisation of issues and the allocation of resources will be made.

To date, most discussion of jurisdictional responsibilities and institutional arrangements has been on particular regulatory areas, such as product safety or trade measurement. Because of the close interaction between many consumer policy areas, it is considered desirable that a more holistic view of future

115 Productivity Commission, 2003, *Evaluation of the mutual recognition schemes, Research Report*, p. xv.

arrangements be taken. The current inquiry provides the Commission with an opportunity to do this.

5.2.3 The costs of greater harmonisation

Moving to a more harmonised regulatory environment would impose initial costs on business and government. Both businesses and consumers may be required to become aware of, and adhere to, new rights and responsibilities; and businesses (particularly small business) and governments may incur large costs from adopting new administrative systems and processes.

These costs must be balanced against the costs of existing regulatory differences and the benefits from greater harmonisation. In many cases, only those transacting across borders will benefit, but all consumers and businesses will be affected by the costs of change, because there is no way of limiting the costs to the beneficiaries.

Further, there are a number of different approaches that could be adopted to increase harmonisation and reaching agreement on an appropriate model across nine jurisdictions can be extremely difficult and time consuming. The transactions costs involved in seeking harmonisation may outweigh the benefits in some cases.

In addition, there are potential costs associated with harmonisation that could go beyond the costs of change and strike at the heart of the federal system and the sovereignty and separation of the Australian jurisdictions. As noted in the above section, there are benefits from the subsidiarity principle in terms of fostering interstate comparison, learning and improvement and in the responsiveness of policies to local and regional issues, which may be lost under some of the harmonisation models outlined in Box 10.

Depending on the approach adopted, moves to increase harmonisation may:

- require jurisdictions to relinquish some, or all, regulatory control. For example, where template legislation is adopted, amendments may be determined by a majority of jurisdictions, in which case a jurisdiction may have to adopt legislation it is not in favour of;
- prevent a jurisdiction from making legislation that would benefit it, or that is tailored and responsive to any particular and unique needs of that jurisdiction;
- make the regulatory scheme less responsive to emerging issues and create delays in enforcement activities or introducing legislative amendment;
- reduce the resources available, including for enforcement activity if a single regulator model is adopted; and

- remove the potential to benefit from competitive federalism, where each jurisdiction has incentives to introduce the most efficient regulatory structure to attract traders and investors to their jurisdiction.

Given these considerations, the costs of change, and the benefits of the subsidiarity principle, moves to more uniform or harmonised approaches should be considered carefully. The following factors may indicate that a function or policy responsibility may be more appropriately addressed at a national level (by the Commonwealth or through harmonised approaches):

- whether national standards are required as a measure of equity;
- whether significant spillovers into other jurisdictions are involved;
- whether there are readily identifiable areas of shared or common interest or significant economies of scale or scope could be achieved; and
- whether the harmonisation of policy is needed to increase efficiency and/or effectiveness.¹¹⁶

Based on an application of these factors, one area of consumer policy where the Victorian Government considers it may be appropriate to adopt an appropriate national approach is e-commerce and m-commerce. These issues are national (and global) in nature and the associated consumer problems are not unique to any one jurisdiction. The high proportion of inter-jurisdictional transactions means there are significant spillovers among jurisdictions and differences in regulation between jurisdictions can hamper the ability to enforce and therefore the effectiveness of state or territory based laws. These issues are discussed further in Attachment 2.

A further issue that is being approached on a national level is the framework for distribution and retail energy regulation. The national regime for regulating electricity and gas distribution and retail services is being developed consistent with a commitment in the Council of Australian Government's (CoAG) Australian Energy Market Agreement (AEMA) that the initial rules will reduce overlap between energy specific and generic regulation, and that the rules will be administered under statutory criteria to promote efficient investment in, and efficient operation and use of, energy services, for the long term interest of consumers with respect to price, quality, safety, reliability and security of supply.

Section 14.5 of the Australian Energy Market Agreement sets out that in order to achieve national consistency the initial rules under the national framework for distribution and retail energy regulation will (to the extent possible and where effective regulation is not impeded):

116 Twomey and Withers 2007, *Federalist Paper 1; Australia's Federal Future*, A Report for the Council for the Australian Federation, April, p. 46.,

- (a) provide common regulatory arrangements for the electricity and natural gas sectors;
- (b) improve the transparency of regulatory arrangements;
- (c) provide an appropriate level of regulatory certainty;
- (d) reduce overlap between energy specific and generic regulation; and
- (e) minimise the regulatory compliance burden and associated cost.

Ministerial Councils also have an essential role in the harmonisation process, especially when they have the authority and support of their respective Governments. The reforms initiated by the Ministerial Council on Energy to develop a national framework for energy regulation is an example; this is a cross-jurisdictional review of consumer protection regimes that has the potential to identify improvements to the mix of industry-specific and general consumer law.

Below is a discussion on the roles of the Ministerial Council on Consumer Affairs and the Standing Committee of Officials.

5.3 The roles of MCCA and SCOCA

The Ministerial Council and the Standing Committee of Officials play an integral role in coordinating policy development and enforcement within Australia's consumer policy framework. There are a number of impediments and challenges to achieving best practice in relation to these national processes but significant improvements have been made in recent years.

As noted in section 5.2.2 above, the development of national cooperative approaches to policy development and enforcement can reduce the costs associated with different regulatory arrangements among the jurisdictions.

Within the Australian consumer policy framework, the key co-ordinating body is the Ministerial Council on Consumer Affairs (MCCA). The Council is supported by the Standing Committee of Officials of Consumer Affairs (SCOCA) and its Advisory Committees, which were discussed in the Victorian Government's preliminary submission. These mechanisms have had substantial success in achieving commonality among the various regulatory arrangements. However, there are also a number of impediments to their success, which are outlined in this section.

5.3.1 Ministerial Council on Consumer Affairs

MCCA's procedures and Strategic Agenda were reviewed by Ministers during 2006 with the aim of expediting decision making and achieving tangible outcomes for Australian consumers. Ministers confirmed the benefit of consensus decision making in relation to adding or removing items to and from the Strategic Agenda but agreed to a new streamlined project management approach. Rather than rely on multi-jurisdictional project teams to advance work, Ministers agreed that individual jurisdictions should advance projects to the point of final report to

the Standing Committee of Officials of Consumer Affairs (SCOCA) and MCCA. This would follow agreement on the Terms of Reference for the project and key milestones. This approach would better enable jurisdictions to accord priority to national projects within their individual agency business plans.

Several areas of COAG's National Reform Agenda relate to consumer affairs issues. However, it might be noted that only two matters are being actively managed by MCCA. These matters are the Consumer Product Safety System and Trade Measurement. MCCA is integrally involved in a third hot spot area, Personal Property Securities reform through work it has done in relation the development of a national register of encumbered vehicles, however this work is being managed by the Standing Committee of Attorneys General (SCAG). Victoria has representation on the SCAG working group and its representation includes an officer from Consumer Affairs Victoria. A fourth area, business registration which is managed by and is an integral operational area of all consumer affairs or fair trading areas is within the auspices of the Small Business Ministerial Council. MCCA is yet to be formally consulted on this issue, which has significant consumer protection implications.

While MCCA has sought to improve its own procedures and renew its Strategic Agenda, there are currently some factors that hamper MCCA's effectiveness. A significant impediment relates to a disconnection between the Commonwealth representation on MCCA and actual decision-making responsibility within the Commonwealth Government. The Commonwealth Government is represented on the Council by the Parliamentary Secretary to the Treasurer, however for some significant issues currently being considered by MCCA, the Parliamentary Secretary does not have policy carriage or decision making responsibility. For example, in relation to national trade measurement regulation – a current COAG hot-spot issue, decision making for the Commonwealth rests with the Minister for Industry, Tourism and Resources who is not a member of MCCA. Similarly, in relation to significant consumer issues emerging from the telecommunications sector, like telemarketing and the Do Not Call Register, policy carriage rests with the Commonwealth Minister for Communications, who is also not a member of MCCA.

Even where MCCA has policy carriage for an issue, for example consumer product safety, its line of responsibility can be artificially drawn, for example, MCCA is not responsible for consumer product safety relating to electrical products, notwithstanding that individual members of the Council carry this responsibility.

MCCA is also constrained by the fact that the Commonwealth's representative is a Parliamentary Secretary, rather than a Minister.

5.3.2 Standing Committee of Officials of Consumer Affairs

As outlined in the preliminary submission, MCCA is supported by the Standing Committee of Officials of Consumer Affairs (SCOCA). SCOCA's Agenda and

work program supports MCCA but in addition it can consider a broader range of operational issues. In recent times, SCOCA has made it a practice to meet with representatives of Choice and the Consumers Federation of Australia at least annually.

There are significant challenges to the effective operation of SCOCA. These reflect those evident in the Ministerial Council and include:

- The consensus decision making model can constrain innovative approaches to issues resulting in acceptance of lowest common denominator answers.
- Where there are firmly held different approaches to policy matters, there are no clear mechanisms to resolve policy conflicts. Measurers such as Regulatory Impact Statements, which aim to assess the costs and benefits of options are not impermeable to manipulation and can appear to be applied in a differential manner.
- Issues can take a long time to reach a conclusion especially where new regulation is proposed as the remedy to an identified market failure. Reasons for time delay include the difficulty in obtaining adequate quantifiable data to indicate the costs of a problem or the costs and benefits of particular policy options.

Attachment 1 — Links between competition and consumer policy

Over recent years Australia has undergone a major reform program, National Competition Policy, designed to break down market power and increase competition. The benefits for consumers have been a driving force in the rationale for that reform. There are, however, two significant issues to recognise in considering whether those benefits to consumers are realised:

1. competition is not possible in all markets and in these markets there can be incentives for business to increase prices, constrain supply or reduce product quality; and
2. having sufficient competitors in a market is not sufficient to guarantee competitive outcomes. Effective demand is also necessary to stimulate that competition and direct it to the right products and services.

The overall objective of both competition and consumer policy is to improve the welfare of consumers. Competition policy focuses on the suppliers of goods and services, improving the incentives for business to reduce their costs, lower their prices, improve the quality of their products, innovate and provide the goods and services that consumers want. It does this by removing restrictions on businesses or products entering markets, stopping businesses combining through mergers or takeovers if this would reduce competition or prohibiting firms engaging in behaviour, such as collusion and price fixing, that undermines competition.

Consumer policy focuses on the demand side and reduces consumer detriment by changing trader behaviour or the processes for selling goods and services, improving their quality, or reducing their price

In most cases consumer policy and competition policy will be complementary, reinforcing each other and improving outcomes for consumers. In some cases, however, they diverge and it is important to identify and be aware of these cases.

Complementarities between consumer and competition policy

It is well recognised that competition and competition policy can benefit consumers, as noted by the UK Director General of Fair Trading:

Competition is good for consumers for the simple reason that it impels producers to offer better deals — lower prices, better quality, new products, and more choice¹¹⁷.

Mergers regulation, for instance, stops firms amalgamating if this would reduce competition and disadvantage consumers by allowing price increases or service

117 Vickers, J 2002, *Competition is for Consumers: A speech to the Social Market Foundation*, Office of Fair Trading, p. 4.

quality reductions. In opposing the acquisition of the Wattyl paint company by Barloworld the Australian Competition and Consumer Commission (ACCC) concluded that:

Market inquiries demonstrated that Barloworld and Wattyl vigorously compete for second position in the market and are each other's main competitors, but are also clearly competing with the market leader, Orica. The proposed acquisition is likely to remove this competition and lead to increased prices for consumers¹¹⁸.

One of the primary objectives of recent national competition policy reforms was to identify areas in which restrictions on competition could be removed to improve the incentives for businesses to operate efficiently and provide consumers with value for money goods and services.

Vickers also noted that 'demand conditions can be a major influence on the nature of competitive interaction between suppliers'¹¹⁹. Therefore, consumer policy, which helps consumers shop around to identify the right goods and services for them, and to change suppliers if a better offer is available elsewhere — will also ensure there are strong incentives for business to compete and competition is directed to the goods and services consumers want.

Consumer and competition policy reinforce each other. They address different parts of the market and an effectively competitive market cannot arise unless both policies work properly.

The potential for tension between consumer and competition policy

Nevertheless, as noted by the Deputy Chair of the ACCC¹²⁰, consumer policy and competition policy do not always reinforce each other. Freeing markets to expand competition may not automatically benefit all consumers if:

- The market structure is such that even with deregulation or other attempts to increase competition there will tend to be too few firms to make competition effective.
- There are other barriers to consumers exercising effective choice or avoiding the risks associated with some products. For example, the product range is so complex or technical that consumers find it too difficult to compare products and choose effectively. This problem arises in markets such as mobile phone plans, financial investment products and

118 ACCC (Australian Competition and Consumer Commission) 2006, *ACCC to oppose paint acquisition*, Release MR 150/06, 6 July, p. 1.

119 Vickers, loc cit, p. 9.

120 Sylvan, L 2004, *Activating Competition: The Consumer Protection — Competition Interface*, University of South Australia, Trade Practices Workshop.

retirement village units. Other products may have health and safety risks that consumers have difficulty identifying.

If there are problems in getting the benefits of competition to flow through to consumers, often the best approach is to change consumer policy to help consumers to take advantage of the range of goods and services on offer. Sometimes, this could be done by educating consumers or using other strategies to change their behaviour. In a few markets, however, managing the risk of consumer detriment might require reductions on competition — for example, product standards that limit the types of goods that can be sold or control the types of businesses that can enter a market.

Policies that reduce competition to protect consumers usually involve trade-offs among consumer benefits, for example trading-off higher prices or less choice for improved safety standards or less risk of buying the wrong product.

Overall, the greatest gains arise when competition and consumer policy tools reinforce each other so that the approach to competition benefits consumers and consumer protection does not undermine competition unless consumers are truly better off, taking account of both the benefits from the consumer policy and effects of less competition.

Attachment 2 — E-commerce and M-commerce

Introduction and Summary

E-commerce provides economic benefits, such as low-cost entry into new markets, and increased choice for consumers. However, it also presents consumers with risks that are not apparent in the traditional retail environment.

Although consumer protection legislation applies equally to online and mobile commerce as it does to traditional commerce, it can be argued that consumers are exposed to greater risks when they shop online or transact using their mobile phone.

Some of these risks are similar to those present in other forms of distance selling, for example, uncertainty about the location and identity of the seller, an inability to inspect goods prior to purchase, and uncertainty about delivery. Victoria has provisions in its FTA that offer protections from these kinds of risks associated with distance selling.

Other risks are particular to or exacerbated by the online environment. For example, whereas it is possible to pay for a mail order with a personal or bank cheque or cash on delivery, with online sales, goods need to be paid for in advance usually by releasing credit card and other personal information.

A National E-Commerce Working Party led by Victoria looked at these issues, but jurisdictions were unable to come to agreement on a national consumer protection regime. The Victorian Government considers e-commerce and m-commerce consumer protection a national (and global) issue that requires Commonwealth acquiescence to preferred options.

Coverage of existing regulation

The general consumer protection provisions contained in the state and territory Fair Trading Acts and the Commonwealth *Trade Practices Act 1974* (Cth) apply to consumer transactions completed over the Internet or via mobile phone networks in the same way as they apply to transactions entered into at a bricks-and-mortar store.

In Victoria, in addition to general provisions covering all transactions, there are also specific provisions in the FTA related to non-contact sales agreements that also apply to e-commerce and m-commerce.

These provisions, which are contained in Part 4, Division 3 of the FTA, require the trader to provide certain information to the consumer before a non-contact sales agreement is entered into. A supplier cannot enforce a non-contact sales

agreement if the supplier has failed to comply with s. 69.¹²¹ Pursuant to s. 69, the trader must provide the purchaser with the following information:

- the total cost;
- any postal or delivery charges;
- any rights the purchaser has under the agreement to cancel the agreement and how those rights may be exercised; and
- the full name of the supplier and either¹²² the full business address of the supplier or their telephone number.

Under s. 71 of the FTA, where a non-contact sales agreement provides for a cooling-off period, this must be a minimum period of 10 days. The 10 days commences when the consumer has received the goods, or when the agreement is entered into in the case of services.

These provisions governing non-contact sales in the Victorian FTA go beyond requirements in the Trade Practices Act and other state and territory Fair Trading Acts. However, they are less prescriptive than requirements in some overseas jurisdictions. For example, in the United Kingdom, the Consumer Protection (Distance Selling) Regulations 2000, which implement the EU Distance Selling Directive, require traders to disclose:

- their identity and street address, and their 'commercial purpose';
- the main characteristics of the product;
- the (tax inclusive) price and any delivery costs;
- the payment, delivery and performance arrangements;
- the statutory cooling-off right and process, and any contractual right to cancel;

121 Non-compliance with s. 69 requirements is an offence with a penalty of not more than 120 penalty units in the case of a natural person or 240 penalty units in the case of a body corporate.

122 Section 29 of the FTA requires a person who publishes a document, statement or advertisement that is intended or likely to promote the supply of goods or services in trade or commerce and contains a reference to a means of contacting that person, to provide the full address of the place of business or residence of the person, or a licence or registration number or a registered business number. Where a person is required to comply with both sections 29 and 60, the requirement in section 29 to provide a full address takes precedence over the requirement in section 69, which provides the option of providing either an address or telephone number.

- the period the offer remains valid, and any minimum duration of a contract for services;
- any substitute for unavailable product; any after-sales service; any guarantees; and
- any inability to cancel after the commencement of services.

Although the above provisions of the FTA cover e-commerce and m-commerce, the Victorian Government recognises that these markets are still developing and evolving. Therefore, there is a continuing need to ensure that the existing provisions provide an appropriate level of protection for consumer transacting in these environments.

In 2006, Consumer Affairs Victoria completed a major market investigation of online auctions. The investigation examined complaints trends, existing protections in consumer protection legislation, information asymmetries, and raised issues about compliance and enforcement. In particular, the study found:

- Internet auctions offer efficient market transactions, and are becoming a new channel for small and micro businesses. Some of these businesses may be unaware of their legal obligations under consumer protection legislation.
- Complaints have risen significantly, reflecting the growth in transactions being facilitated by online auction services.
- The most common complaints to Consumer Affairs Victoria involved clear breaches of contract: non-delivery; unreasonable delays in delivery; goods not matching the description provided by the seller; and goods that were faulty or of unsatisfactory quality.
- Generally, Victorian consumers buying products auctioned by Australian companies acting in trade or commerce have the same legal protections and ability to obtain redress as those buying online from other Australian e-tailers.¹²³ However, where the seller is a private individual or the company is based overseas, the consumer's ability to obtain redress is considerably reduced and fraudulent transactions are particularly difficult to investigate.
- Consumers are engaging in risky online auction transactions transferring funds direct in advance to overseas sellers, yet many still lack knowledge of how to minimise their risk in an online environment where fraud is particularly evident.

123 It should be noted that consumers in some Australian jurisdictions do not have all of the protections usually available under the Fair Trading Acts and TPA, because sales by auction are exempted from certain statutory warranties and implied conditions in these jurisdictions.

As a result of this study, Consumer Affairs Victoria has undertaken a range of actions to improve consumer awareness of the risks of online auctions, and improve traders' awareness of their obligations when selling through online auction websites. The trader education exercise investigated compliance with Victorian legislation among the operators of stores on online auction websites. Consumer awareness activities included publicising safe online trading messages through the media and in fact sheets. Consumer Affairs Victoria has also met with the operators of major online auction websites.

National E-Commerce Working Party

In August 2002, e-commerce and m-commerce were added to MCCA's strategic agenda, which led to the establishment of the E-commerce Working Party. The Working Party, which was chaired by Victoria, examined and reported to MCCA on four issues:

1. Online shopping and consumer protection
2. A uniform extra-territorial regime for the state and territory Fair Trading Acts
3. Web Seals of Approval
4. M-commerce

Each of these projects is outlined below.

Online Shopping and Consumer Protection

In May 2004, the E-Commerce Working Party published a discussion paper¹²⁴, which identified issues that impact on consumers who buy goods or services online. The paper considered whether consumer issues are being adequately addressed within the existing regulatory framework and whether there is a need for statutory intervention.

Proposals for intervention that were outlined in the paper centred on disclosure obligations, and included requiring:

- disclosure of the name, address, telephone number and e-mail address of the e-trader;
- disclosure of the total costs of the product in the applicable currency;
- disclosure of the e-trader's policies on collection, storage, use and trade of personal information; and

124 Standing Committee of Officials of Consumer Affairs E-commerce Working Party 2004, *Online Shopping and Consumer Protection discussion paper*
[http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Reports_and_Guidelines/\\$file/onlineshopping.pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Reports_and_Guidelines/$file/onlineshopping.pdf).

- Australian e-traders to stipulate the governing law/forum for the transaction.

As noted above, the Victorian FTA already contains disclosure requirements in relation to non-contact sales that are similar to the first two of these proposals. However, the TPA and other state and territory Fair Trading Acts do not contain these protections.

Submissions received in response to the discussion paper indicated mixed support for these proposals and the Working Party was unable to reach consensus on whether further statutory intervention was required.

Uniform extra-territorial provisions in state and territory fair trading legislation

The advent of online and mobile transactions has increased the number of transactions entered into where the parties are located in different jurisdictions. To be effective, the regulatory framework must ensure that consumers are adequately protected regardless of where the trader is located.

The Working Party examined whether common extra-territoriality provisions in the state and territory Fair Trading Acts would improve the regulatory framework. Although the extra-territoriality provisions contained in the Victorian FTA are already very broad in reach, very narrow provisions apply in some jurisdictions, causing problems for consumers wishing to obtain redress and regulators wishing to enforce their laws.

The Working Party circulated its report to MCCA in December 2003, but was unable to secure agreement on the desired form of a common extra-territorial regime. However, there was general agreement that there was a need to ensure that effective protocols are in place between States and Territories to enable consumer complaints about interstate traders to be appropriately handled. Accordingly, the Working Party recommended that SCOCA review existing principles and protocols relating to handling cross-jurisdictional complaints and prosecutions to ensure that those principles and protocols remain relevant and effective.

Web Seals of Approval

Web seals of approval (sometimes referred to as trustmarks), are accreditation schemes established to promote good online practices and/or to target specific problems perceived to hinder consumer confidence in engaging in online transactions. Web seals are a self-regulatory mechanism designed to enhance consumer confidence in the online world.

In January 2002, prior to the establishment of the Working Party, Consumer Affairs Victoria released a Discussion Paper¹²⁵ on web seals of approval. Following the circulation of this paper to SCOCA, the Working Party was asked to give further consideration to whether web seals of approval were an effective means of enhancing consumer confidence in e-commerce. The Terms of reference given to the Working Party asked it to report to MCCA on the following:

1. Whether there [had] been recent market developments, which affect the contention in [Victoria's] Discussion Paper that there [were] too many web seal programs.
2. Whether there [had] been other market developments aimed at boosting consumer confidence in e-commerce, which may challenge the role of web seals.
3. The extent to which the Discussion Paper [had] adequately identified the consumer issues relating to seals.
4. Whether there [were] further options for government action beside those identified in the paper.
5. Having regard to the costs and benefits of the options, whether there [was] a consensus among the jurisdictions about future government action.

The Working Party developed an Options Paper¹²⁶, which was released for consultation in September 2003, and released a final report¹²⁷ in January 2005.

In its final report, the Working Party found that potentially web seals can play a role in enhancing consumer confidence in e-commerce by raising awareness of, and encouraging compliance with, consumer protection laws and best practice principles. However, it noted that evidence at the time suggested web seals were not a particularly effective means of enhancing consumer confidence in e-commerce. Consumers were generally unaware of such trustmarks and the evidence about whether they would find such schemes useful was contradictory.

The Working Party highlighted that web seals were just one tool in a complex mix of measures needed to enhance consumer confidence in e-commerce. Notwithstanding the current small role that web seals play, the Working Party

125 Consumer Affairs Victoria 2002, *Web Seals of Approval*, [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Reports_and_Guidelines/\\$file/webseals_of_approval.pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Reports_and_Guidelines/$file/webseals_of_approval.pdf).

126 *Options Paper – Web Seals Of Approval*, Standing Committee of Officials of Consumer Affairs E-commerce Working Party, August 2003, http://www.consumer.gov.au/html/Web_options/downloads/webseals.pdf.

127 *Web Seals of Approval - Final Report*, Standing Committee of Officials of Consumer Affairs E-commerce Working Party, January 2005, [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Computer_s_Internet_Discussion_Papers/\\$file/WebSealsFinalReport.pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Computer_s_Internet_Discussion_Papers/$file/WebSealsFinalReport.pdf).

considered it important to develop awareness material to help educate consumers and business about web seals. In response, Consumer Affairs Victoria has developed a number of fact sheets and placed consumer information on its website to assist consumers understand these market tools better.

M-commerce

The final topic examined by the Working Party was mobile commerce, or m-commerce. The Working Party released an Issues paper in August 2004, which covered the following issues:

1. The anticipated availability and uptake of m-commerce services in the Australian marketplace in the short to medium term;
2. The types of applications and services that are currently being developed for the Australian consumer market, and the emerging industry structure;
3. The potential consumer issues that are likely to arise and industry approaches to providing consumers with adequate protection and support; and
4. International approaches to regulating m-commerce services.

Submissions in response to the discussion paper took a wide range of stances on the issues raised, with industry tending to favour greater self-regulation and other bodies such as consumer advocacy groups preferring external monitoring. The Working Party found that m-commerce was still a developing market and it was not clear that a policy response was needed at the time. It was agreed that SCOCA would continue to monitor this marketplace for emerging consumer issues.

National Consumer Protection Policy

E-commerce and m-commerce are national (and global) in nature and the reports of the Working Party have highlighted that consumer issues emerging from the online and mobile markets are not unique to any one jurisdiction. However, measures currently in place to address these issues differ between the Australian jurisdictions. These differences may have a significant impact on the effectiveness and efficiency of the policy framework and, in particular, the ability to enforce regulation and obtain consumer redress.

While Consumer Affairs Victoria can enforce the FTA in regard to Victorian traders using the Internet to offer goods or services, the costs and practical difficulties of enforcing the FTA and obtaining redress where a consumer has entered a transaction with an interstate trader are often prohibitive and make it difficult for Consumer Affairs Victoria to protect consumers in such situations.

Consumers who have entered transactions with traders in jurisdictions that don't have similar consumer protection provisions will find it even harder to protect themselves or get redress.

E-commerce growth has also seen an increase in the number of online transactions between private buyers and sellers. In particular, private sales are a large proportion of sales on online auction sites. Consumers do not understand that they do not have the same protections when they purchase from a private seller, as compared to a trader which must operate in compliance with the *Fair Trading Act (Vic) 1999*.

The growth in interstate and private-to-private transactions has increased the importance of the Victorian Government's role in educating consumers about how to transact safely online, where to get help, and minimise the risks associated with online shopping.

As outlined above, the E-Commerce Working Party examined issues arising from e-commerce and m-commerce transactions. Although the papers prepared by the Working Party identified a number of options for improving the existing policy and regulatory framework, a failure to reach consensus among the jurisdictions has halted progress on resolving these issues.

However, the Victorian Government considers that, due to the inter-jurisdictional nature of many online and mobile transactions, national consistency and enforcement frameworks are still required to ensure consumers across Australia receive an appropriate level of protection. Because of the national (and global) nature of these transactions, the consumer protection issues that emerge from the increasing proportion of purchases made online require national consideration and leadership.

An appropriate Commonwealth framework for dealing with e-commerce and m-commerce would bring consistency to traders and consumers and assist consumers obtain redress where transactions cross jurisdictional borders. In addition, there are substantial economies of scale in consumer and trader education and information activities that could be realised if a level of consistency was introduced and applied at the Commonwealth level.

The Commonwealth Government has jurisdiction under the Australian Constitution with regard to telecommunications, broadcasting and interstate trade and commerce.

The Victorian Government notes that the Commonwealth has introduced some national consumer protections in telecommunications and broadcasting legislation. For example, the *Spam Act 2003*, Ministerial service provider determinations under the *Telecommunications Act* and legislation dealing with online gambling and adult content. However, this action is generally reactive and

focuses on particular issues like online predators and adult content rather than fair trading in the online environment.

To date, the Commonwealth's approach to e-commerce and m-commerce consumer protection has been through a combination of reliance on the provisions of the TPA and through the development of best practice guidelines for industry self-regulation.

In 1999, the Commonwealth Government released *Building Consumer Sovereignty in Electronic Commerce - A Best Practice Model for Business* (the BPM), which was based on the OECD's *Guidelines for Consumer Protection in the Context of Electronic Commerce*. The BPM was reviewed in 2003 and subsequently replaced in 2006 by the *Australian Guidelines for Electronic Commerce*.

The Victorian Government considers that neither the BPM nor Guidelines are effective self-regulation. As guidelines rather than codes, neither are effective in influencing online business practices because compliance is entirely voluntary and not supported by any enforcement or monitoring of industry uptake. At the time the BPM was reviewed, Consumer Affairs Victoria argued the guidelines had not been effective, should be more robust, and the Commonwealth should work with industry to review and promote the code of practice to Australian businesses.

The Victorian Government considers that the Productivity Commission should examine whether the Australian consumer protection framework could be improved through the pursuit of a more effective national approach to e-commerce consumer protection matters.

Attachment 3 — The Consumer Credit Code

Introduction

This attachment provides the Productivity Commission with background information on the operation of the Uniform Consumer Credit Code. This is a template uniform national regulatory scheme operated by the States and Territories. It is a major example of industry-specific regulation, which has had a long history and was subject to major change in 1995.

The Consumer Credit Code 1994, underpinned by the Uniform Credit Laws Agreement 1993, is an important example of state-territory co-operative federalism in modern consumer protection regulation. The Victorian Government is aware that the Productivity Commission intends to examine the Code as part of its inquiry and provides the information in this appendix to assist in this process.

This attachment is in two parts. Part One examines the Code's policy framework. Part Two looks at the governance behind the Code.

1. The Code's policy framework¹²⁸

Objectives and scope

The Explanatory Notes to the *Consumer Credit (Queensland) Act* 1994 set out the objectives of the legislation as follows:¹²⁹

... to provide laws which apply equally to all forms of consumer lending and to all credit providers, and which are uniform in all jurisdictions in Australia...based on the principle of truth-in-lending which will allow borrowers to make informed choices when purchasing credit.

The Bill...would regulate the credit provider's conduct throughout the life of a loan, but without restricting product flexibility and consumer choice. The policy...is to rely generally on competitive forces to provide price restraint but to provide significant redress mechanisms for borrowers in the event that credit providers fail to comply with the legislation.

The Bill is designed to...provide standards...which will not be overtaken by changes in the financial marketplace.

The Code covers the 'traditional' credit products such as standard home mortgages, car loans and credit cards as well as newer products like reverse mortgages and lo-doc loans. Disclosure obligations apply to all these loans plus point-of-sale credit (eg MyerCard purchase of flatscreen TV) and consumer leases (eg lease of laptop computer). The Code not only sets out disclosure obligations but substantively regulates interest charging, securities and

128 This discussion draws extensively on a keynote paper presented by Dr Elizabeth Lanyon to the 2nd National Consumer Credit Conference in November 2004.

129 *Consumer Credit (Queensland) Bill* 1994 Explanatory Notes.

guarantees, termination charges, and aspects of insurance, related sales contracts and enforcement. It also contains hardship and re-opening of unconscionable transaction provisions. The Code set a benchmark in consumer credit protection in 1996 when it commenced.

The Code does not prescribe types of fees and charges permitted, nor with two exceptions, the basis on which fees and charges are to be struck. The Code does not place any limits on interest rates, though the method for charging interest is regulated.¹³⁰ Disclosure requirements are central to the consumer protection mechanisms in the Code, both in relation to contract formation and during the contractual relationship (statements of account). Failure to properly disclose key requirements attracts the civil penalty provisions which result in substantial monetary penalties.¹³¹

Consumer redress mechanisms are principally focussed on breach of disclosure requirements through the civil penalty process. The debtor has a right to compensation for breach of any section which does not carry its own civil penalty¹³². Debtors, mortgagors and guarantors may seek reopening of unconscionable transactions. Debtors are entitled to apply to the credit provider, and if the application is unsuccessful, to the court for variation of their credit contracts where they are temporarily unable to pay because of hardship.

Policy tensions

The Code objectives imply that that the policies expressed are compatible. It is important to recognise, however, that while a great deal of policy consensus and consistency was achieved, the enactment of the Code in 1994 did not resolve all the debates on foot in the lead-up to the Code's enactment. One point of contention was the solution that the Code arrived at to promote product and pricing flexibility. The light touch approach to pricing relies heavily on market forces for balance, aided by full disclosure ('truth in lending') so consumers know what credit costs and how it compares. But because the Code separates disclosure of interest from that of credit fees and charges, and permits unilateral variation of interest rates and fees and charges, there were concerns that debtors would find it difficult to use disclosure to shop around. As a fallback mechanism, there is a power to prohibit particular types of fee or charge, but it has never been exercised. In mid 2003 the scheme of mandatory comparison rates (MCR) was introduced for a 3-year period. MCR are designed to help consumers understand the cost of credit and to shop around, by requiring lenders to meld interest and fees and charges into a single cost indicator – the "comparison rate".

130 See Part 2, Division 3 of the Code.

131 Civil penalties are payable where the credit provider has failed to meet the comprehensive disclosure requirements in the Code. Where initiated by the regulator, the penalty is assessed against the level of infringement nationwide, and is payable into a trust fund or to the regulator. See Part 6 of the Code.

132 Section 114 of the Code.

The inclusion of high value long term credit contracts under the Code (like home loans) meant that industry needed flexibility and consumers needed safety net protection. As a result, lenders can charge an establishment fee, but it is reviewable where underlying costs are exceeded. Consumers were granted a right to terminate a credit contract early, but lenders can charge a fee to compensate. While interest rate settings are not regulated in the Code, consumers can challenge “excessive interest charges” in the context of a broad action based on an alleged unjust contract.¹³³ Concerns about the transacting process, and in particular with over-commitment, were addressed by including a right for the court to review a credit contract where the lender overlooked the consumer’s capacity to pay.¹³⁴

A third issue that was hotly contended when the Code commenced was the abandonment of a stringent civil penalty procedure under which credit providers were obliged to seek reinstatement of credit fees and charges rendered invalid because of breach of disclosure requirements. Ten years on, there has not been any clamour for a return to the previous system.

Post Implementation Code Review

In December 1999, the Ministerial Council on Consumer Affairs ("MCCA") released the *Final Report* of the Post Implementation Review (PIR). The Terms of Reference for the PIR, agreed by MCCA in August 1997, concerned the operation and impact of the Code in the current market. Three broad areas were identified: the impact of the Code's truth in lending provisions for borrowers, the relevance of the law to the current marketplace and the impact of the Code's administrative structure on the achievement of uniformity between jurisdictions.

The PIR therefore concerned most, if not all of the Code's objectives. A number of specific recommendations, principally for amendments rather than for monitoring or research, were made. The PIR concluded¹³⁵

While a number of recommendations for change have been made in this report, stakeholders generally believe that the Code is operating well and is a positive regulatory scheme. There will always be scope for improvement and change and the Code's ability to adjust to keep pace with change in the consumer credit market will be the ultimate test of its value.

At the same time, a major inquiry was being conducted by the Wallis Committee into Australia's financial system. The Wallis Committee reported before the Post

133 Section 70 of the Code.

134 The Senate Economics Committee’s report on its “Inquiry into Links Between Australia’s Current Account Deficit, the Demand for Imported Goods and Household Debt” recommended that credit providers be required to make appropriate checks of consumers’ capacity to repay before issuing a credit card or increasing a credit card limit: see Recommendation 7.

135 Page 8.

Implementation Review *Final Report* was issued. In its Final Report, the Wallis Committee said:

Recommendation 6. States and Territories should retain and review consumer credit laws.

*The States and Territories should retain responsibility for the Uniform Consumer Credit Code (UCCC) and related laws and focus efforts on improving its cost effectiveness and nationwide uniformity. After it has operated for two years, the UCCC should be subject to a comprehensive and independent review to consider what improvements are necessary and whether a transfer to the Commonwealth would be appropriate.*¹³⁶

The PIR was not prompted by the Wallis Inquiry. It was initiated by the Standing Committee of Officials of Consumer Affairs (SCOCA). The terms of reference, and the fact that the PIR followed so shortly after the Code's commencement reflected the debates referred to above. The Uniform Consumer Credit Code Management Committee (UCCCMC), a committee of State and Territory consumer affairs officials formed to monitor implementation of the Code, was asked to steer the PIR. MCCA, in approving the Terms of Reference, decided to link the PIR with the National Competition Review of the Code that was required by the National Competition Agreement before 2000. The process of reviewing and amending the Code therefore became a protracted two stage process that lost some momentum after the National Competition Policy (NCP) stage.

Unlike the process envisaged by the Wallis Report, the Commonwealth did not conduct or formally participate in the PIR. The PIR was not independent in the sense of being conducted by a reviewer independent of government, although UCCCMC drafted an Issues Paper, encouraged informal consultation, and constituted technical reference panels. External research into the truth in lending term of reference was also commissioned.

The PIR Final Report contains a series of recommendations ranging across many facets of the Code. It did not address in detail the policy tensions underpinning the Code and the different views of those making submissions, which tended to repeat the debates which preceded the Code. Progress on implementing the recommendations was held up pending completion of the NCP review. Some of the recommendations have been implemented, some are in the process of being implemented, some have been superseded and some remain untouched.

Market change

In the last ten years, the consumer credit market in Australia has changed dramatically. There are several facets to this. A truly national market is now occupied by major banks which have centralised processing and training

136 Commonwealth of Australia 1997, *Financial System Inquiry, Final Report*, p. 33

functions. GE Money, a non bank lender providing a range of credit card, lending and leasing products, has grown its business in Australia exponentially, in part by taking over smaller finance providers. As a result, a national and international administrative structure has replaced what were once State or even branch structures.

At the same time, there has been an increase in the availability of credit through the mechanism of so called "sub-prime lending". The company with the largest share of the market, Liberty Financial, was only established in 1997. Liberty operates nationally, as do other lenders in this sector of the market, such as Bluestone Mortgages. Some mainstream lenders, such as GE and NAB, also lend in the sub-prime area. There have always been mechanisms for the supply of credit to people in lower socio-economic brackets. However, the sub prime lending market, based on pricing for risk, has marked a shift from rationing to retailing of credit through a broad range of financial institutions, not just local pawnbrokers, individual stores or moneylenders to a larger number of Australian consumers.

More and more second tier finance companies (sometimes called "fringe lenders") have been appearing on the scene. These often look to obtain market share by financing door to door or catalogue/internet sales of products without an established reputation for quality or value for money.¹³⁷ The smaller scale of many of these operators may be conducive to lack of training, lack of compliance and poor dispute handling. Then again, this industry is also attracting significant amounts of investment and some of these credit providers have floated recently or are looking to do so, such as *Amazing Loans*, *City Finance & Cash Solutions* and *Flexirent*.

One especial area of concern in the fringe market is small amount cash lending, sometimes known as payday lending. While ten years ago this form of lending was in its infancy, it has burgeoned, with state by state estimates ranging from an annual turnover of \$25 million (Victoria) to \$80 million (QLD). These figures may not be as accurate as the Reserve Bank of Australia (RBA) figures for mainstream lending, but they represent tens of thousands of individual credit contracts every year. While a considerable proportion of consumers using fringe lenders do so in response to an episode of financial stress, there are also many from the disadvantaged sectors of the community.

Against expectations, the convergence of financial services providers and other service providers that was anticipated has not eventuated, but there has been a proliferation of intermediaries, particularly finance brokers. Securitisation, in its infancy in 1994 is an established part of the market and all types of consumer credit receivables are being securitised, not just home mortgages. This has also driven the growth of mortgage originators, such as Aussie, RAMS and Virgin.

137 These entities finance things like interactive mathematics programs, water coolers, alarm systems and so on.

There has been a spectacular growth in the prevalence of "plastic money": credit card and charge card schemes. Banks have driven the usage of credit cards for small scale personal borrowing. Multinational corporations, Visa and MasterCard, now occupy a far more prominent position in that market and their contracts set obligations for Australian acquirers and merchants. Regulation of credit card products has become complicated by the use of the card as both a payment mechanism regulated by the RBA and as a means for the provision of credit. Credit cards also are an example of bundled products, including features such as rewards (loyalty) schemes and travel insurance.¹³⁸

Technology has driven increases in consumer choice and access.¹³⁹ The pace of innovation itself is increasing. Product development and deployment cycles have shortened. Other advances have allowed niche markets to be identified and products targeted to those markets to be created. The consumer attitude to credit has also radically changed from a focus on "debt" as a last resort to regarding credit as part of a suite of financial services to be routinely utilised.

More areas of the retail market reflect the bundling of primary and secondary purchases, if not in one contract at least at the same point of sale. Once the case with motor vehicles, there is a much more prevalent selling of credit in retail stores of all kinds, particularly to pay for white goods, furniture and electronic equipment. Interest free products and other special promotions are common.

The number of different home loan products has increased exponentially – there are thousands of home loans on the market and more than two hundred credit cards to choose from. Increasingly, home loans combine debit and credit features. One example is the mortgage offset account or the combination of an overdraft or redraw facility with a savings account. Products combine many different pricing features and confer on the consumer much more choice to set rate types. In a significant development, many Australians are using home equity to fund loans for personal purposes, such as holidays, furniture, renovations and repairs, or to repay accumulated debts.

As more Australians live longer, the pressure to use equity in homes is increasing so that it is reasonable to expect more equity loans to appear in the market.¹⁴⁰ The latest figures reveal that older Australians have taken out in excess of \$1 billion worth of reverse mortgages. It is reasonable to expect more products and more advertising targeted at that sector. Informational problems may be greater with that age group.

138 Recent announcements from the Reserve Bank relating to debit cards may see the use of the credit card as a purely payment mechanism diminishing.

139 Some of these changes are outlined in the *Post Implementation Review Final Report* (December, 1999) page 7. Since then there has been a considerable increase in product innovation and variety, home mortgage redraw facilities and payment holidays, bundling with insurance, fee free cheque accounts etc. Credit cards, loyalty schemes

140 Usually an equity loan enables principal, and in some cases interest, to be paid in a lump sum when the property is sold on the death of the surviving proprietor.

More ordinary Australians are now accessing credit for investment purposes. Investment has not just been confined to a second real estate property but also to products such as margin loans (to facilitate share trading).

Lastly, the last few years have been ones of general prosperity. There is a growing concern about the effect of any adverse change in the economy on a large number of Australian consumers. That change could involve increased interest rates, lower property prices or increased unemployment. One concern is that existing home mortgages could become unaffordable leading to straitened circumstances or at worst enforced sale.¹⁴¹ Another is that consumers with high levels of credit card debt may not have adequate income to pay living expenses and manage the debt or at worst be forced into bankruptcy. A welfare perspective emphasises that people with lower economic resources are least able to weather adverse changes and are therefore likely to suffer disproportionately as a result.

Financial Services Reform – a recognisable but different approach

This section reflects on the reforms applicable to financial services under the *Corporations Act* to see what insights that paradigm shift in regulatory approach can afford.

Financial services reform in some respects reflects the same objectives that underpinned the Code: the importance of competition to deliver consumer protection, the centrality of disclosure and product flexibility. Section 760A sets out the main objective of Chapter 7 of the *Corporations Act* (which contains the financial services provisions) as follows:

The main object of this Chapter is to promote:

- (a) confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services; and*
- (b) fairness, honesty and professionalism by those who provide financial services; and*
- (c) fair, orderly and transparent markets for financial products; and*
- (d) the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.*

Crucial differences from the Code however, are objectives (b) and (c) set out above. The *Corporations Act* achieves these objectives by licensing financial services providers and requiring of them compliance practices and procedures and conferring on ASIC the role of active compliance monitor. A financial services licensee must "do all things necessary to ensure that the financial

141 As at May 2007, bankruptcies are on the rise, as are default rates on mortgages.

products covered by the licence are provided efficiently, honestly and fairly." They must also comply with licence conditions, take reasonable steps to ensure that its representatives comply with the financial services laws, are adequately trained to do so and have an internal dispute resolution procedure and be a member of an ASIC approved dispute resolution scheme.

The scheme under which ASIC grants Australian Financial Service Licences places positive obligations on the licensee to develop appropriate practices and procedures which can be measured against a standard ("honestly, efficiently and fairly"). Licensees must not only adopt compliance and training policies and procedures but must demonstrate capacity to the regulator, who has a present obligation to vet them. Licensees must initiate an internal and an external dispute resolution process. Licensees are required to notify ASIC in writing of any significant breaches or likely breaches. ASIC is able to undertake targeted audits of licensees.

The new regulatory structure also comprehends disclosure requirements:

One of the central aims of FSR disclosure is to ensure consumers have sufficient information to help them make informed choices when considering the purchase of financial products and services. As such, ASIC discourages licensees from providing their clients with documents that are overly long, and contain unnecessary information.¹⁴²

In contrast to the Code, broad principles and standards are set out in the *Corporations Act* which are amplified in regulations, ASIC policy statements and ASIC guidelines. The regulatory framework itself is a flexible one, which can produce swift responses to individual complaints and broad responses to emerging issues. The extent to which the consumer credit policy framework might benefit from elements of the financial services model is certainly worth exploring.

Broad directions

Recent overseas developments and the Federal financial services reform in Australia reinforce the importance of dealing with the credit provider-customer relationship in its entirety, from selling practices and advertising to contract entry, contract terms and the relationship of the parties during the contract. The financial services reforms signal the value of processes such as training, dispute resolution and internal compliance monitoring which are documented, measurable and can be externally verified. The regulatory framework needs to be both 'consumer sided' (such as information, contract formation, redress

142 ASIC's policy in relation to Product Disclosure Statements is explained in ASIC Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* and its policy in relation to Financial Services Guides and Statements of Advice in Policy Statement 175 *Licensing: Financial product advisers — conduct and disclosure*.

mechanisms) and 'credit provider sided' (conduct standards and compliance, training and alternative dispute obligations).¹⁴³

The commoditisation and bundling of credit products suggests that conceptualising credit regulation purely in terms of the Code is no longer sustainable, and that broad legislative strategies like Victoria's unfair contract terms protections could equally apply to the provision of credit. For example, the Victorian Government has agreed to commence a process of analysis and consultation that will lead to the application of unfair contract terms legislation to consumer credit. General fair trading conduct provisions around the country already apply to credit.¹⁴⁴ In assessing the effectiveness, efficiency and fairness of credit regulation, it is necessary to recognise that there are protections and powers beyond the confines of the Code itself, and that Government Consumer Agencies do recognise and employ these.¹⁴⁵

There is room for regulatory agencies to expand their reach in relation to credit, but this would require new tools. The rapidity of change itself in the development of credit products, the targeting of niche markets and the growth of credit providers suggest that it may be desirable to legislate broad principles and standards and allow more latitude to regulatory authorities to respond to particular cases and emerging problems through 'soft law' instruments such as statements and guidelines.

One consequence of the present system where policy making is a shared responsibility across SCOCA and MCCA is that policy anchors are tacit not explicit. When working towards implementation of the PIR recommendations or responding to more recent market developments, the tendency is to cling to the principles enshrined in the Code (one law for all credit products, truth-in-lending etc.). The state of the market and the effectiveness of the regulatory settings in the early 1990s when the development of the Code was underway are very different from now. Contemporary policy needs to take account of current and emerging market developments as well as developments in regulation and regulatory policy. These include the insights available from behavioural economics and government commitments to reduce the regulatory burden on business across the board.

Responses to consumer concerns and problems in connection with credit can only benefit from a broad approach. This approach should take into account not

143 Some jurisdictions do have broad behavioural standards - eg the Tribunal in Victoria can look at whether a credit provider has been "carrying on business efficiently, honestly and fairly" - s.30(3)(c) Consumer Credit (Victoria) Act 1995. In NSW the objects of the disciplinary provisions in the Credit Administration Act 1995 include ensuring that credit providers comply with "appropriate standards of honesty, fairness, competence and diligence" - s.11(1).

144 For example, misleading and deceptive conduct prohibitions.

145 For example, Consumer Affairs Victoria took successful action against a vendor finance entrepreneur under the unconscionable conduct provisions of the *Fair Trading Act*. Other jurisdictions report success with fair trading legislation in a credit context.

just questions about the continued effectiveness of regulation, but also the efficiency of markets, the central role of credit in the Australian economy, the relationship of rising debt to consumer demand and the prosperity of the economy, the long term risks of high borrowing levels and the extent to which government welfare and industry corporate social responsibility can make a contribution. The States and Territories *and* the Commonwealth Government need to participate in the process, irrespective of where the formal allocation of regulatory responsibility resides.

Observations on how “broad directions” might affect the Code’s fundamental principles.

(a) Scope of the Code

The Code objective is to provide laws which apply equally to all forms of consumer lending. However, Code exemptions are being exploited to deny consumers appropriate protection. For example, moves are now underway to stop consumers being exploited by small amount cash lenders who use *promissory notes* as the loan ‘vehicle’. *Tiny terms* ‘loans’ where credit charges are buried in the sale price are due to be brought within the scope of the Code this year, and the Code will be amended to clarify that *vendor terms contracts* are explicitly covered. While all these developments are promising, the more that specific inclusions are introduced, the more scope there is to find other loopholes not explicitly brought within the Code and the more incentive there is for disreputable lenders to seek out these loopholes.

Does this mean that the Code’s conceptualisation of credit is too narrow? Should the focus instead be a broad one of financial accommodation provided to individuals? At the very least, should the current demarcation between “personal, household or domestic purpose” and business or investment credit be abandoned, as is the case with the forthcoming national scheme of regulation of finance brokers? If government is concerned about consumers becoming over-committed, should the Code also apply to money situations where the credit is extended without any cost, such as a mobile phone plan? At present, telephone ‘credit’ issues are addressed through industry codes of conduct and agencies like the Telecommunications Industry Ombudsman.

An open examination of the framework underlying the Code might also ask whether the constellation of issues facing consumers obtaining credit from fringe credit providers might warrant separation from the rest of the Code. The Code itself contains precedent for this, in that consumer leases are treated differently from credit contracts.¹⁴⁶

(b) Consistent application

146 See Part 10 of the Code.

The Code tries to treat all credit in the same way. It applies to all credit providers¹⁴⁷, including banks, non-bank financial institutions, credit unions, building societies and small amount cash lenders (such as payday lenders). Nevertheless, in a highly diverse credit marketplace, it could be argued that all credit should not be treated alike. Right from the start, the treatment of credit cards has been different. Differentiation in the regulation of other product types (or products) may be necessary to avoid forcing a square peg into a round hole (eg in the case of reverse mortgages or shared appreciation mortgages).

With a few notable exceptions, the Code's focus is on the credit contract, not on the credit provider's conduct. In those jurisdictions that have registration or licensing schemes, the credit provider may - in theory - be disciplined for not acting "honestly, efficiently and fairly", but this almost never happens in practice. In Federal financial services regulation, there are positive standards of conduct imposed on licensees, which must be continuously substantiated. Enlarging the ambit of the Code to include performance and compliance standards which could actively be vetted by Government Consumer Agencies (or whomever is the regulator) might be a more effective strategy for coping with deliberate evasion of the Code. Consideration of this sort of approach, as with any other, would need to take account of the desire across governments to reduce the regulatory and administrative burden on industry.

Intermediaries (such as mortgage brokers and mortgage managers) minimise the obligation on credit providers to ensure that the Code is being applied where appropriate. Since credit providers are in a better position to ensure the training and compliance of intermediaries and to protect themselves financially against the consequences, the risk of non-compliance should potentially attach to the credit provider even where the conduct arose prima facie from the intermediary's conduct. Extensive improvements in the regulation of finance and mortgage brokers are in the pipeline, with a draft exposure Bill for the national regulation of broking being fine-tuned as at May 2007.

(c) *Truth in lending*

Disclosure has a central role in effecting consumer protection in the credit market. Due to the important role that credit fees and charges have assumed in pricing, mandatory comparison rates were introduced in mid-2003 to aid consumer choice. A major review of comparison rates has been completed, which was unable to marshal sufficient evidence to demonstrate a substantial net public benefit. Efforts continue to determine if there is a way of refining the scheme of comparison rates to make them more relevant and effective.

In the meantime, research into the effectiveness of a proposed new model for other elements of the scheme of pre-contractual disclosure has commenced. This research is taking place at a time when there is a consensus that disclosure

147 Only a handful of exemptions have been granted.

is less effective in assisting consumer choice than was thought at the time the Code was enacted.

More broadly, the reliance on disclosure as a key tool of consumer protection is being re-evaluated, both as a matter of theory and in terms of practical outcomes. For example, behavioural economics offers insights into the factors influencing consumers. It suggests consumers act in ways which suit their prejudices irrespective of the signals sent by information disclosure.¹⁴⁸ This also questions consumer rationality as a premise for mandatory warnings and disclosure.¹⁴⁹ Information overload can compromise consumer choice, while an orthodox cost/benefit analysis might argue that the cost to credit providers of presenting the mandated information is not outweighed by the economic advantages to the consumer in choosing products either cheaper or better suited to them.

A further argument is that consumers in lower socio-economic groups are not able to make use of the information given to them in connection with consumer credit.¹⁵⁰ One reason may be lack of financial literacy, a condition that could be improved by education initiatives. Another may however be lack of choice because risk factors prevent access to cheaper products. Shopping around for those consumers is largely illusory.

(d) *Competition and price restraint*

Relying on competition to bring about pricing restraint has not been entirely successful. On the other hand interest rate caps have not worked either, and it is too early to tell whether capping the combined cost of interest and fees and charges will be more effective.¹⁵¹

This comes back to the policy tension surrounding how to deal with the cost of credit. If competition combined with a degree of safety net does not work, what other options are there? Is it unrealistic to expect consumers to determine the best and most competitively priced product for them when the pricing is spread across a whole range of product features? Is the problem more about the size of contingent fees? Should certain types of fee be prohibited or restricted, as Canada is examining in relation to rollover fees? What about the fact that a consumer decision to obtain a particular credit card can be unravelled, even

148 Sunstein 2000, 'Thus information which supports their desired decision will be favourably received, whereas unwelcome information that might cause them to change approaches will sometimes be ignored or downplayed', *Behavioural Law and Economics*, Cambridge UP at p. 381.

149 See Donald C Langevoort 2002, 'Investor Psychology and Securities Regulation: Lessons for the Online world', paper given at the *12th Annual Corporate Law Teachers Association Conference*, Melbourne 10-12 February 2002.

150 See G Howells and T Wilhelmsson 2003, 'EC Consumer Law: Has it Come of Age?' 2003 *European Law Review* 370., pp. 380-381, the improvement of usage of information occur in higher income groups.

151 This is the model that NSW and the ACT have pursued. Victoria continues with interest rate caps only.

shortly afterwards, if the credit provider exercises an entitlement to unilaterally increase the interest rate and/or the fees and charges? There is also the issue of switching costs and the extent to which they prevent consumers from migrating to the most appropriate and best value credit product.

(e) *Significant redress mechanisms for borrowers*

The Code does contain redress mechanisms, including contract re-opening provisions (section 70), annulment of certain “unconscionable” fees (section 72) and civil penalty provisions relating to breach of disclosure key requirements (section 100). It enables consumers to seek variation of their contract where they are suffering hardship (section 66). But actions by consumers under these sections are rare. It is not clear why this should be. A class action proceeding in specialist tribunals and lower courts could assist. Victoria has indicated it will do this, in its *Government Response to the Report of the Consumer Credit Review*. Amendments to the Code being drafted as at May 2007 aim to give Government Consumer Agencies ‘standing’ to bring test cases where credit provider conduct in contravention of the unjust contract terms or unconscionable fees provisions is causing systemic harm to consumers.

The primary concentration of the Code on civil penalties for a failure to properly disclose does not afford consumers effective mechanisms to enforce ‘downstream’ obligations meant to protect consumers during the life of the loan. In this respect, MCCA’s decision in 2006 to explore the feasibility of requiring credit providers to offer external dispute resolution is a welcome development.

(f) *Standards for the provision of credit which will not be overtaken by changes in the financial marketplace.*

The last objective in the Second Reading speech quoted at the beginning of this paper refers to “standards for the provision of credit”. Consumer advocates point to the aggressive selling practices of brokers and lenders proffering dubious debt reduction or debt consolidation schemes, using simplistic fixes like a *line of credit* or misleading consumers by refinancing packages the transaction costs for which outweigh any longer term benefits. The Code does not deal with these abuses, nor do current licensing regimes (where they exist) except by challenge on a case by case basis. This illustrates how a broad standard (“honestly, efficiently, and fairly”, for example), elaborated administratively (such as ASIC guidelines on various issues), could deal with emerging practices.¹⁵²

2. Governance

Uniformity

152 In Victoria, although registered credit providers can be challenged in VCAT if they do not carry on business “efficiently, honestly and fairly”: section 30(3)(c) of the *Consumer Credit (Victoria) Act* 1995. No credit provider has been disciplined on this basis in the decade that it has been in force.

A major Code objective is to regulate consumer credit by laws "*which are uniform in all jurisdictions in Australia*". The Code is the product of the Uniform Credit Laws Agreement (the Uniformity Agreement) between all States and Territories, signed in 1993. The Code is 'template' legislation, enacted in Queensland¹⁵³ pursuant to the Uniformity Agreement and adopted in the other jurisdictions.

The Uniformity Agreement permits non-uniformity in the following areas:

- Interest rate caps
- Licensing schemes for credit providers.
- Vesting of jurisdiction in specialist tribunals.
- Establishment of consumer credit trust funds to receive civil penalty payments.

Three States have interest rate caps – VIC, NSW and ACT – the latter two of which have defined interest for this purpose as inclusive of fees and charges.

Licensing (or registration) schemes differ between jurisdictions. Where there is some form of registration or licensing, it takes one of three forms: positive licensing (WA), negative licensing (NSW, Qld, SA), or registration (Vic, ACT).¹⁵⁴ Despite the disparities of form, however, the substance of the obligations placed on credit providers and the powers of the agencies are similar.

The vesting of jurisdiction in specialist tribunals is not, of itself, a cause of any significant lack of uniformity. The major consequence is that in some instances, like Victoria and NSW, the Code is handled by a tribunal with express jurisdiction, whereas in other States or Territories, Code cases are handled by the courts. Reposing jurisdiction in a mixture of tribunals and courts has seriously impeded the development of 'cross vesting' arrangements. This has disadvantaged consumers and credit providers, but is an issue too esoteric and technical to have attracted any real attention.¹⁵⁵

Separate consumer funds in each jurisdiction may be impeding the establishment of national or large scale programmes or research projects. The amount of money in any State or Territory fund reflects the size of civil penalty awards and in turn the number of credit contracts affected by a breach in that jurisdiction. The establishment of different arrangements in each state means granting

153 *Consumer Credit (Queensland) Act 1994*

154 A detailed account of supervision and administration can be found in Duggan and Lanyon, chapter 13.

155 See P McAlister and E Lanyon 2000, 'Cross Vesting Arrangements under the Consumer Credit Code' *Journal of Banking and Finance Law and Practice*.

programs are not co-ordinated and each fund has its own priorities.¹⁵⁶ This also points up the lack of a national body to commission or encourage and resource consumer credit research: Queensland has used its civil penalty funds to help auspice the Centre for Credit and Consumer Law, with Western Australia planning a similar approach.

On the other hand, the existence of separate funds in different jurisdictions contributing to different programs and projects also has benefits. It may lead to better public policy by fostering innovation and diversity.

Uniformity can be subverted by disparities in the timing of commencement of legislation amending the Code. In the early days of the Code, Western Australia was unable to synchronise with the rest of Australia, as it did not adopt the Code template (but passed mirror legislation instead). This has caused delays ranging from months to years in one instance. A typical example is the payday lending amendments that entered into force in December 2001, but took until June 2002 in Western Australia. Even though Western Australia has since adopted the template model, timing problems remain because like Tasmania,¹⁵⁷ the amendments are tabled in both Houses of Parliament, with the possibility of disallowance. Western Australia must also refer amendments to a Parliamentary Standing Committee. Although this might seem a minor hurdle, these exercises involve Executive Council and rely on Parliament being in session. If Parliament is on a break, or has been prorogued, there is nothing that can be done but to wait. This either means a nationwide delay or a temporary period of non-uniformity. Delays also occur whenever an election has been called, because this prevents continuation of policy work and prevents Ministers from acting on projects for which their State has the lead role.

The Uniformity Agreement has been challenged at various times during the last decade. Examples include the tabling in the New South Wales Parliament of an exposure draft Bill on mandatory comparison rates¹⁵⁸ and credit card over-commitment legislation in the ACT.¹⁵⁹ The main impetus for departures from uniformity has been impatience with the lack of responsiveness of the uniformity framework to address emerging issues and abuses. The (Victorian) Government Response to the Report of the Consumer Credit Review endorses a proposal that Victoria's unfair contract terms provisions should apply to credit contracts (following a period of consultation with industry), in view of the lack of progress with a nationally consistent scheme of unfair contract terms regulation. While comparison rates in NSW alone never went ahead - and instead were introduced

156 Some funds are formally established with express statutory purposes but others are informal.

157 Complications caused by the Tasmanian system of adopting Code amendments were experienced recently in connection with the extension of the sunseting of the scheme of mandatory comparison rates and with the commencement of the new e-commerce provisions.

158 Consumer Credit (NSW) (Amendment (Comparison Rates) Bill 2000.

159 *Fair Trading Amendment Act* (2002).

nationally - the ACT's responsible lending provisions on credit cards stand alone in Australia and have been in force for almost four years, creating an island of disparity. That said, it is possible that the current national policy development on credit cards and responsible lending will lead to the ACT scheme being superseded by a nationally consistent scheme. Victoria has announced an intention in the Government Response to require credit providers to offer external dispute resolution (EDR) to consumers. While mandatory EDR is being explored by UCCMC as a requirement under the Code, it is likely that credit contracts entered into in Victoria will trigger an EDR requirement before any such obligation exists in other parts of the country.

As mentioned already, New South Wales and the Australian Capital Territory have chosen to place a ceiling on the overall cost of a credit product, taking account of fees and charges rather than simply capping the annual percentage rate of interest. Victoria retains its dual interest rate ceiling – one for secured credit and a higher ceiling for unsecured credit. No other jurisdictions have caps of any sort, though South Australia and Queensland have released Discussion Papers in October 2006 and November 2006 respectively and Western Australia has committed to exploring the feasibility of capping the cost of credit. The Uniformity Agreement permits States and Territories to go their own way on interest rate ceilings, although there are commentators who see the NSW and ACT methods of capping interest (by incorporating known fees and charges) as consistent with the Uniformity Agreement.

Administration, enforcement and policy development

Ministerial Council on Consumer Affairs

The Code is administered by the Ministerial Council for Uniform Credit Laws, which is for all intents and purposes the same as MCCA.¹⁶⁰ Credit matters are therefore only one part of the MCCA agenda. The Uniformity Agreement depends on substantial consensus between State and Territory governments, that can be of different political persuasions or if of the same political persuasion, can have different priorities. While the Uniformity Agreement states that amendments to the Code will be carried with a 2/3 majority (that is, six members in favour), in practice there has been full consensus for all Code amendments made to date.

MCCA meets once or twice a year, so “out of session” papers are the main way in which Code issues are handled by MCCA.¹⁶¹ The standard turnaround time

160 Under the Uniformity Agreement, the Ministerial Council for Uniform Credit Laws does not include Commonwealth or New Zealand representatives, though these do participate in MCCA.

161 Apart from agreeing to Code amendments, MCCA considers Code exemption recommendations and authorises the release of discussion papers and exposure draft Bills. MCCA also considers requests and suggestions for policy development projects, such as when it agreed in 2003 to the development of finance broker legislation or in 2006 when MCCA confirmed an intention to explore mandating external dispute resolution.

required for responding to MCCA papers is 4 weeks (the same as for SCOCA out of session papers). Sign-off protocols (eg Cabinet approval) differ from jurisdiction to jurisdiction. At present, the Victorian Minister for Consumer Affairs seeks Cabinet approval for Code amendments, as does the Queensland Minister. In New South Wales, the approval of either the Premier or the Cabinet is required for new policy initiatives.

Standing Committee of Officials of Consumer Affairs

MCCA receives advice from SCOCA. SCOCA too has a broader portfolio than credit. In terms of the ability to allocate resources, brief ministers, drive stakeholder agreement, it is SCOCA which has the natural role in setting the policy agenda, identifying emerging issues and driving reform. For the past several years credit has had to take its place among all the other consumer issues for which SCOCA is responsible, making it difficult for SCOCA to drive the agenda on broad credit reform. This has not stopped SCOCA from responding positively to proposals for UCCCMC to be assisted by a national project officer (funded since mid-2004) and a national credit legislation officer (funded since April 2006). Evidence of a renewed vigour and willingness in SCOCA to grapple with consumer credit issues can be seen in its agreement to fund significant consumer credit research, and the holding of a major SCOCA 'roundtable' on selected credit policy issues in February 2007. SCOCA's April 2007 meeting included a number of credit related items that were actively discussed.

Uniform Consumer Credit Code Management Committee

MCCA and SCOCA have strategic policy roles, whereas the work program for credit reform, review and refinement has resided with UCCCMC, a committee of officials from each jurisdiction whose responsibilities within their own agencies is usually much wider than credit.¹⁶² UCCCMC's role was originally an administrative one. To facilitate the Uniform Credit Laws Agreement's stated objective of consistency of administration, a management committee was established in 1996 for a one year period, comprising officers from each State and Territory. Initially UCCCMC's function was envisaged to relate to consistency of administration and enforcement practice.

UCCCMC was, however, allocated the responsibility of co-ordinating the PIR in 1998 and its tenure was extended until its completion. The PIR involved extensive consultation, the compilation of submissions, the establishment of technical reference groups and the development of an Issues Paper. At the time of the PIR, SCOCA (informally) delegated the policy advisory function to UCCCMC. As a result, UCCCMC officials drafted the Final Report of the PIR, including the recommendations. Since then, UCCCMC has remained in existence, being often perceived from outside government as the de facto organ

162 Victoria and New South Wales are the exceptions.

for the development of consumer credit reform. UCCCMC remains in place and is currently chaired by Victoria.¹⁶³

The governance arrangements for the Code have in the past not been conducive to proactive policy formulation. UCCCMC has had extremely limited resources to commission empirical research, employ consultants, or to spend time identifying policy issues and developing responses. The necessary allocation of projects back to individual jurisdictions can cause a fragmentation of overall evaluation and policy development. A lot of UCCCMC's energy has been directed to carrying out the agenda set out in the Final Report of the PIR, especially those aspects endorsed in the National Competition Review of the Code, interspersed with activity to respond to initiatives taken by individual states seeking to drive a national response.

Individual jurisdictions may play an important role in administering credit regulation (both the Code and the regulation of credit providers). Substantial policy and legislative development work is assumed by individual jurisdictions on behalf of UCCCMC. At present, New South Wales, Queensland, Victoria and Western Australia all have projects they are leading on behalf of UCCCMC. In this work they are assisted by the (full time) National Project Officer and the (part time) Credit Legislation Officer. The Chair of UCCCMC presently is responsible for the overall program of UCCCMC's work, in which he (or she) reports formally to SCOCA on an annual basis, as well as providing rolling reports to SCOCA's quarterly in-session meetings. The SCOCA Secretariat in The Treasury in Canberra attend UCCCMC meetings, compile minutes and act as a clearinghouse for the circulation of UCCCMC papers and occasional materials. The Secretariat also handles monies voted for UCCCMC projects and for the project and legislation officer monies.

UCCCMC still has no formal status. It is one of four SCOCA sub-committees. The PIR recommendation that UCCCMC be given statutory recognition was rejected.

Process insights

Amendments to the Code must go through a lengthy process of approvals. Generally this will mean UCCCMC, SCOCA and MCCA approval for each stage of policy development, drafting, consultation and implementation. In addition, the *COAG Guidelines* for regulation making must be met to the satisfaction of the Office of Best Practice Regulation. The process of obtaining OBPR approval can be lengthy.

Amendments to the Code are drafted by a single nominated jurisdiction but then settled by the (national) Parliamentary Counsels Committee (PCC). UCCCMC has always had the enthusiastic co-operation of Parliamentary Counsel no matter which jurisdiction has been responsible for drafting. There are nevertheless a

163 New South Wales and Tasmania have also had considerable terms as chair of UCCCMC.

few areas of concern. UCCCMC has experienced delays not ordinarily incurred in the legislative process of any State or Territory, as a result of competing priorities - that is, where Counsel responsible for the drafting has had to give local Bills priority over a Code Bill. The fact that MCCA has agreed to the drafting in question and that the PCC has agreed to allocate it to the drafting jurisdiction does not appear to assist. The other issue that has arisen is where a Code-related Bill or regulation has been addressed at a meeting of the PCC but there is no protocol for reporting the official decision of the PCC meeting back to UCCCMC.

A complicating factor to this already lengthy process is that where MCCA has approved the policy development and then the resulting amendment has been prepared by another jurisdiction and signed off by PCC (on which QLD Chief Parliamentary Counsel is represented), the Queensland Minister for Fair Trading must still go through all the usual Queensland Cabinet procedures as if the issues were being canvassed for the very first time. In the past, Queensland officials have done what they can, within formal constraints, to recognise that in a very real sense, MCCA acts as de facto national Cabinet insofar as the Code is concerned. It is worth noting that Victoria and New South Wales also need Cabinet authority before their respective Ministers can participate in a MCCA decision on the Code, while for other MCCA Ministers, obtaining Cabinet approval would appear to be a matter of discretion. The four week turnaround for decisions by MCCA on out of session agenda papers is not realistic if Cabinet authority is required.

The net result of the various processes that need to be navigated and hurdles that need to be jumped is that on average, Code legislation projects tend to take between 3-5 years to come to fruition. For example, work began in earnest on the e-commerce amendments to the Code in 2002, and the amendments eventually came into force in 2006. The comparison rate amendments were conceived in 2000 and became law in 2003. The finance broking amendments (which do not amend the Code itself but rely on the same sort of 'machinery' for their development and implementation) began development in 2003 but will not come into force before 2008. The 'fringe lending' project led to a discussion paper in 2003 – the exposure draft of the Bill will be released in the second half of 2007. In a rapidly changing credit environment, this is an inordinately drawn out process.

Market monitoring and policy development tools

A research project called *Taking Credit* was conducted as part of the PIR in 1998 in relation to disclosure and consumer behaviour. There followed a lengthy period during which little detailed analysis was undertaken of the effect of the Code on market conditions or outcomes for consumers. No resources were allocated to literature surveys, consideration of international developments or empirical studies, though discussion papers were released on payday lending (2000) 'fringe lending' (2003) and comparison rates (2006), with more modest treatment of instalment lending, disclosure issues and e-commerce in the last few

years. The comparison rate paper was informed by a larger scale research project that examined international practices and surveyed Australian consumers.¹⁶⁴

That said, Victoria undertook a significant review of national credit regulation and credit markets in 2005-2006 and part of the role of the National Project Officer has been to monitor market developments here and overseas and to monitor regulatory initiatives overseas. Two national consumer credit conferences have been convened and two research papers came out of Victoria's Consumer Credit Review.¹⁶⁵

In summary, while things are improving, responsiveness and policy development have in the past been impeded by a lack of adequate resources and sufficient ongoing expertise and momentum to effectively identify issues, consult with stakeholders on a national basis, consider alignment with federal financial services approaches and independently test existing policy settings. Further, the new credit marketplace arguably calls for a proactive approach to compliance and enforcement with committed resources and national consistency.

Credit is an important financial service regulated by the States and Territories

Some stakeholders have over the past several years talked about the potential feasibility, efficiency and effectiveness of transferring the regulation of consumer credit to the Commonwealth. To date, however, there has been no serious examination or cost-benefit analysis of this proposal. One critical part of the consideration would be whether this would properly entail transferring the responsibility for the Code over to the Commonwealth or whether it simply means ensuring that credit is redefined as a financial service regulated by Chapter 7 of the Corporations Act. The latter approach would mean jettisoning the many and various special protections in the Code, both major and minor, such as the right to have a hardship request considered and the right to request the credit provider to calculate a payout figure on demand.

In 1993 when the Uniformity Agreement was signed, the regulation of banking and finance in Australia was very different. It was widely accepted that the Commonwealth did not have constitutional power to regulate all credit providers, a significant number of which were building societies and credit unions. This meant that coverage of all main types of credit providers was impossible. There was no instrumentality able to take an active enforcement or policy development role in relation to consumer credit and Treasury was perceived to be focussed on macro economic settings. Now, in contrast, the Commonwealth, and in this context particularly ASIC, has a predominant and central role in the regulation of financial products. These developments are summarised below.

164 Auspiced by the Victorian Consumer Credit Fund.

165 One on regulating the cost of credit, and one on small amount cash lending.

Changes in regulatory structure so major they were impossible to imagine in 1994 were effected as a result of the 1997 Financial System Inquiry¹⁶⁶ ("Wallis Report"). In 1998, the responsibilities of APRA were reallocated so that while it retained prudential regulation, it no longer had responsibility for licensing or consumer protection. The *Banking Act* was amended to encompass all deposit taking institutions, not just banks. The *Payment Systems (Regulation) Act* strengthened the Reserve Bank's powers to promote safety of the payments system and to make directions in relation to competition. The Payments System Board was created. Subsequently the Reserve Bank has conducted inquiries into interchange fees and has regulated credit card interchange fees.

As part of this reform, jurisdictions have referred powers to the Commonwealth to enable it to legislate for credit unions and building societies. Even although not authorised deposit institutions, non-bank credit card issuers like GE Money are now regulated by the Reserve Bank as Specialist Credit Card Institutions. ASIC took over responsibility for market conduct and consumer protection in credit products and services from the ACCC in 2002, when the relevant provisions were excised from the *Trade Practices Act* and introduced into the ASIC Act.¹⁶⁷

In 2003, as noted above, extensive financial services reform was implemented through Chapter 7 of the *Corporations Act*. Those provisions do not apply to credit. However, they do apply to the management of financial risk and to non cash payment systems. Credit card loyalty schemes fall within the definition of non cash payments, although interim relief has been granted in this respect.¹⁶⁸

The FSR reforms are administered by ASIC. ASIC has an infrastructure which supports licensing, audit and compliance, and enforcement. It also has a successful track record in conducting effective national stakeholder consultation and in developing policy guidelines. ASIC also has broad regulatory power over conduct that is misleading or deceptive – or is likely to mislead or deceive – in relation to credit products and services (as well as other financial services). It also prohibits other forms of market misconduct. In terms of prioritisation, ASIC generally focuses on issues that are national in scope and/or have a clear systemic aspect.

Grassroots education, advice and assistance to individual consumers, including initiation or intervention in proceedings, may be lost if a Commonwealth agency assumes responsibility for credit. Would abuses committed by small scale local credit providers be taken seriously by a Federal regulator? Would particular State concerns be relegated or ignored, such as the proliferation of small amount

166 S Wallis (chair) 1997, *Financial Services Inquiry Final Report*

167 Credit is specifically included in the definition of financial product in the *Australian Securities and Investment Commission Act* s12BAA, but excluded from the definition in the *Corporations Act*. reg 2B(1)

168 ASIC Interim Relief 04-06 ASIC guidelines for interim relief for loyalty schemes non cash payment facility.

cash lenders in SE Queensland or the surge of promissory note lending in Western Australia?¹⁶⁹

169 In fact, South Australia and Northern Territory have worked with ASIC recently to tackle abuses in remote Aboriginal communities.

**Attachment 4 — Discussion Paper, What do we mean by
'vulnerable and 'disadvantaged' consumers?**