consumer action law centre

Addressing the Concept of Fairness: the new touchstone in the regulation of fees?

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1 Introduction

When considering the regulation of credit fees and charges, the finance industry generally strongly contest any use of the concept of fairness. However, the concept of fairness is not new to Australian or international consumer law. While in some respects the concept of fairness is developing, in others it is a well-understood and long standing notion that underpins consumers' rights in their dealings with corporations. This presentation examines the concept of fairness in consumer law in both Australia and internationally, and considers the potential application of the concept of fairness to the regulation of credit fees and charges. Importantly, I argue that the experience of the use of fairness in consumer law is one that not only benefits consumers individually but benefits the economy generally. This is because principles of fairness can actually promote competition, efficiency and economic activity.

2 The concept of fairness in Australian consumer law?

The concept of fairness already exists in a number of areas of Australian consumer law and 'quasi' law.[1] I will focus on four examples. Most prominently is the requirement of holders of an Australian Financial Services Licence (**AFSL**) to:

> Do all those things which are necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and *fairly* [my emphasis].[2]

It should be noted that credit providers are not required to hold an AFSL. Only those persons who provide advice on financial products, deal in financial products or make a market for them are required to obtain an AFSL. Credit related products are excluded from the definition of financial products and these products remain the responsibility of the various State and Territory agencies under the *Uniform Consumer Credit Code* (**UCCC**).[3] Nevertheless, many credit providers in Australia have an AFSL, and the obligations imposed upon them as licencees then also apply to their lending activities.[4]

[1] By 'quasi' law, I mean codes, policy statements and regulatory guidance that do not amount to black letter law.
[2] *Corporations Act 2001* (Cth) s 912A
[3] Note though that ASIC does have jurisdiction over credit under the *Australian Securities and Investments Commission Act 2001* (Cth) in relation to matters such as misleading and deceptive and unconscionable conduct.
[4] In the Federal Government's recent *Green Paper on Financial Services and Credit Reform,* it was proposed that the efficient, honest and fairness requirement should be extended to all credit providers.

The requirement to do all things necessary to ensure services are provided efficiently, honestly and fairly has existed in various forms since the 1970s. The Australian Securities and Investments Commission (**ASIC**) has provided a regulatory guidance on how AFSL holders should comply with their oblgiations.[5] In that guidance, ASIC states:

> The general obligations are principles-based and designed to apply in a flexible way. For this reason, we do not think we can or should give prescriptive guidance on what you need to do to comply with them. The Corporations Act places responsibility on you to decide how to comply.

However, later the guidance states:

> You need to do all things necessary to ensure your financial services are provided in a way that meets all of the elements of 'efficiently, honestly and fairly'. If you fail to comply with the other general obligations, it is unlikely that you will be complying with the 'efficiently, honestly and fairly' obligation.

And later:

> However, the 'efficiently, honestly and fairly' obligation is also a stand-alone obligation that operates separately from the other general obligations. For example, if you have contractual obligations to clients and breach them, this might not be a breach of the other general obligations, but it could amount to a failure to provide your financial services efficiently, honestly and fairly.

Thus, it would seem that fairness means compliance with all available laws – not only specific requirements of the Corporations Act such as disclosure, financial adequacy, training and education, and dispute resolution but also obligations such as the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* (Cth) and common law principles (such as misrepresentation, and unconscionability). This is supported by case law, which suggests that the words are intended to refer to the person who is not only dishonest, but also a person who is ethically sound.[6]

A second area in which consumer law requires fairness is in relation to obligations around internal and external dispute resolution of AFSL holders. ASIC has provided Regulatory Guide 165 (**RG 165**) about internal and external dispute resolution.[7] In relation to internal dispute resolution, RG 165 requires an AFSL holder's internal dispute mechanisms to satisfy the Essential Elements of Effective Complaints Handling in Section 2 of Australian Standard 4269–1995,[8] which provides a number of essential elements of an effective complaints handling system, including fairness.[9] In this context, the fairness requirement necessitates that the procedures allow adequate opportunity for both parties to make their case, with

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[5] Australian Securities & Investments Commission, *Regulatory Guide 104 – Licensing: meeting the general obligations*, October 2007.
[6] *Story v National Companies and Securities Commission* (1988) ACLR 225.
[7] ASIC has recently released a consultation paper reviewing RG 165 as well as RG 135: ASIC, *Consultation Paper 102: Dispute resolution – review of RG 139 and RG 165*, 8 September 2008.
[8] Note there is a newer version of the Australian Standard.
[9] Other elements are commitment, resources, visibility, access, assistance, responsiveness, charges and remedies. This Australian Standard has been superseded, however, by AS ISO 10002.

investigations to be carried out by staff who are not involved in the subject matter of the complaint where possible.

ASIC assesses external dispute resolution (**EDR**) schemes for users by financial services in terms of six principles:

- Accessibility;
- Independence;
- *Fairness;*
- Accountability;
- Efficiency; and
- Effectiveness.[10]

These six benchmarks originate from the 1997 benchmarks for industry-based EDR schemes.[11] Those benchmarks provide more detail about the principle of fairness:

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

While this explanation primarily considers procedural fairness, the principle is also applied In a substantive way. For example, in relation to determinations, the benchmarks state that EDR schemes should base determinations on what is fair and reasonable, having regard to good industry practice, relevant industry codes of practice and the law.

When it comes to applying fairness considerations to decisions regarding the imposition of credit fees and charges, the schemes have taken different approaches, primarily due to how each interprets exclusions to its jurisdiction. For example, the Banking and Financial Services Ombudsman (**BFSO**) (now the Financial Ombudsman Service (**FOS**)) states that it is unable to deal with disputes as to the level of default fees:

> The BFSO considers complaints made about banks and other financial services providers that are members of the scheme. Where a complaint relates to a fee the Ombudsman will consider whether the fee was properly disclosed to the customer, whether the fee was correctly charged in accordance with the customer's contract with the financial services provider and whether it was correctly applied in accordance with any scale of fees used by the financial services provider.
>
> Under our Terms of Reference, we cannot consider the amount of a fee so far as it relates to a policy or practice of a bank, unless that policy or practice is in breach of a specific obligation or duty to the customer. The level of any disclosed default fee is a matter of bank policy that this office is unable to review.
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> In the BFSO's view, the question of whether the level of a default fees charged by banks is unenforceable at law is a matter that would be best dealt with by the appropriate regulator or determined by a court.[12]

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[10] Corporations Regulations 2001 (Cth), reg 7.6.02(3). ASIC can also take into account any other matter ASIC considers relevant.
[11] Department of Industry Science and Tourism, *Benchmarks for Industry-Based Customer Dispute Resolution Schemes*, August 1997.

Conversely, the Credit Ombudsman Service Limited (**COSL**) and the Financial Co-operative Dispute Resolution Service (**FCDRS**) have both stated that they can consider disputes about the level of fees, where the fee has been applied in an unconscionable manner or amounts to a penalty at law.[13]

A third area in which consumer law uses the concept of fairness is in relation to unfair contract terms. In Victoria, unfair contract terms are prohibited by Part 2B of the *Fair Trading Act 1999* (Vic) (**FTA**) (see below for discussion of the current proposal for national unfair contract term laws). Section 32W provides for a general test of whether a term in a consumer contract is unfair, that is, where:

> Contrary to the requirements of good faith and in all the circumtstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer.

This is supplemented by section 32X which provides for several matters to be taken into account in determining whether the general test applies to a term. Currently, Part 2B of the FTA does not apply to contracts regulated by the UCCC, but the Victorian Government has now stated that it will extend the application of Part 2B to credit contracts.[14]

It has been argued that unfair contract term laws create regulatory and business costs that outweigh any benefits to consumers.[15] However, in one cost benefit analysis of unfair contract terms, Dr Rhonda Smith has shown that regulatory intervention to address unfair terms in consumer contracts corrects overwillingness to buy, leading to more efficient market results.[16] She contests the assumption that there is a current efficient market equilibrium, showing that the use of unfair contract terms commonly means that consumers have an over-willingness to enter into transactions as they are unaware of the full cost of contracting including the cost of unfair terms. She concludes that the cost of intervention must be assessed against correct market outcomes, not simply the current inefficient market.

In relation to credit contracts, fairness can be considered in the provision of the UCCC that allows contracts to be reopened, where a court is satisfied that they are 'unjust'.[17] Section 70(2) of the UCCC sets out matters that a court can take into account in determining whether a particular term of a credit contract is unjust, including 'whether the credit provider exerted unfair pressure, undue influence or unfair tactics on the debtor'.[18] It has been held that injustice in this context can either encompass injustice in the terms of the document itself or injustice in the party's conduct at the time the document was entered into, which in

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[12] Banking and Financial Services Ombudsman, *BFSO approach to default fees*, available at: http://www.bfso.org.au/ABIOWeb/abiowebsite.nsf.
[13] COSL, *Guidelines to the Rules of the Credit Ombudsman Service*, 3rd edition, 28 May 2007; FCDRS, *Letter from FCDRS to Choice and Consumer Action law Centre*, 28 April 2008.
[14] Government response to the consumer credit review.
[15] Professor Chris Field, Transcript of evidence to the Productivity Commission's Review of Australia's Consumer Policy Framework, 23 March 2007.
[16] Dr Rhonda Smith, *Unfair contract terms: costs and benefits of intervention in relation to unfair contract terms*, Appendix in Consumer Action Law Centre, *The consumer protection provisions of the* Trade Practices Act*: Keeping Australia up to date*, May 2008.
[17] UCCC, s 70.
[18] UCCC, s 70(2)(j).

fact makes the terms of the contract unjust.[19] While the section does appear to have been used mostly in a procedural way, it clearly has a broader meaning than unconscionability, and might be applied to substantive aspects of the contract, including the imposition of fees and charges.

3 The concept of fairness in international consumer law?

Internationally, a general duty to trade fairly exists in many jurisdictions. The leading example comes from the US. The US *Federal Trade Commission Act* (**FTC Act**) provides the basic market-wide consumer protection obligation in the US, together with one of the main provisions of the US antitrust/competition laws. This is achieved in one main provision which states:

> Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hearby unlawful.[20]

While this prohibition is similar to Australia's prohibition on misleading and deceptive conduct in prohibiting 'deceptive' acts or practices, it goes further by also prohibiting 'unfair' acts or practices. The FTC has clarified that conduct will be in breach of this section where it can distort consumer behaviour (leading to individual detriment but also harming competitive markets). For example, the FTC has said the main concern of the prohibition of unfair acts and practices is with 'unjustified' consumer injury.[21] 'Unjustified' consumer injury is said to be caused by conduct that has an unreasonable effect on the exercise of consumer choice.[22] As such, this prohibition on unfair acts or practices accords with the economic rationale for consumer protection laws as well as with fairness motives.

A more recent international adoption of fairness principles has been the European Union's Unfair Commercial Practices Directive (**UCPD**), adopted by the European Council and European Parliament in May 2005. Such directives are binding on member states of the EU and require them to implement the directive's provisions in their own jurisdictions, with each member state determining the method according to their national legal framework.

The UK has now implemented the EU's UCPD into its domestic laws by introducing a general duty not to trade unfairly. The structure of the UK law is very similar to the UCPD provisions, with a general prohibition on unfair commercial practices, provisions setting out that misleading actions, misleading omissions and aggressive practices are unfair, and a list of unfair practices contained in a schedule.

In relation to financial services, the UK Financial Services Authority (**FSA**) has a robust framework of regulation and guidance using principles of fairness. The FSA has established

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[19] *Masiano v Car and Home Finance Pty Ltd* [2005] VCAT 1755 (12 August 2005).
[20] *Federal Trade Commission Act* (United States Code Title 15 Chapter 2 Subchapter 1), section 5(a).
[21] FTC, *Policy Statement on Unfairness*, December 17 1980.
[22] Consumer Action Law Centre, *The consumer protection provisions of the* Trade Practices Act 1974: *Keeping Australia up to date*, May 2008.

high level principles, being the fundamental obligations of all firms under regulation.[23] Principle 6 provides that:

> A firm must pay due regard to the interests of its customers and treat them fairly.

To give substance to this principle, the FSA examined judicial pronouncements, statutory interpretations, the contents of fiduciary duties, and interpretations by other regulators including the UK Office of Fair Trading (**OFT**) and the Financial Ombudsman Service to conclude that 'fairness' is not a definitive concept, and may be summarised as including:

- Honesty, openness and transparency;
- Disclosure, as necessary on an on-going basis, to the customer of material information;
- Honouring of representations, assurances, and guarantees where this leads to a legitimate expectation in the mind of the customer;
- Treating like situations alike and differentiating appropriately between different situations;
- Acting impartially and reasonably, having regard only to relevant issues and not taking into account irrelevant issues;
- Acting with integrity and in good faith;
- Acting with reasonable competence and due diligence;
- Refraining from exploiting a customer and acting capriciously;
- Being reasonable about putting right things for which one is responsible and that have gone wrong.[24]

After concerns that some firms were treating customers unfairly despite the regulatory obligation, the FSA implemented the 'Treating Customers Fairly' initiative (**TCF**). This is an initiative which requires senior management of regulated firms to give consideration to what Principle 6 of the high level principles means in the context of their businesses and to implement strategies to ensure that this is complied with.

The UK has also adopted unfair contract term laws through its *Unfair Terms in Consumer Contracts Regulations 1999* (UK) (**UTCCRs**). Similar to the Victorian FTA, the UTCCRs state that:

> A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.[25]

The OFT, the regulator responsible for the UTCCRs, has undertaken some analysis as to how the UTCCRs apply to credit fees and charges. In 2006, the OFT undertook an investigation into credit card default fees, which resulted in the OFT making a statement setting out its views on the application of the UTCCRs to contract terms imposing credit card

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[23] *Financial Services and Markets Act 2000* (UK), Handbook principles.
[24] UK FSA, *Treating Customers Fairly after the Point of Sale*, 2001.
[25] Unfair Terms in Consumer Contracts Regulations 1999 (UK) reg.5(1).

default charges.[26] The OFT's statement included a monetary threshold of £12 above which it considered that such charges would almost certainly be unfair. Credit card issuers subsequently amended their default charges so that they did not exceed the OFT's threshold.

The OFT subsequently undertook a similar investigation in relation to transaction account default charges. Rather than issuing a statement, the OFT commenced proceedings in the High Court for a declaration on the application of the UTCCRs to terms imposing such charges against seven banks and one building society in August 2007.[27] These institutions have over 90 per cent of the transaction account market in the UK and all agreed to participate in the proceeding as a test case.

On 24 April 2008, judgment in stage one of the OFT test case was handed down.[28] Stage one considered whether the test of unfairness under the UTCCRs applies to the default charges imposed by the banks' current account contracts and whether the common law of penalties applies (the finding was that the UTCCRs do apply). A follow-up judgment, yet to be made, will determine whether default charges imposed by the banks' basic and historical personal account contracts can be also assessed for fairness under the UTCCRs and whether they are capable of being penalties at law.[29] Stage two of the test case will deal with whether the default charges are actually unfair.[30]

3 Applying fairness to regulation of credit fees and charges

As outlined above, the concept of fairness has many applications in consumer law. In relation to the regulation of fees and charges, arguably the most relevant application is via unfair contract term laws.

Fairness has, however, also been proposed as a test to apply to credit fees and charges in proposed amendments to the UCCC. In a consultation document released by the UCCC Management Committee in early 2008, amendments were proposed to section 72 of the UCCC to replace the term 'unconscionable' with 'unfair'.[31] Section 72 currently provides that:

> (1) The Court may, if satisfied on the application of a debtor or guarantor that--
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> …
>
> (b) an establishment fee or charge; or
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> (c) a fee or charge payable on early termination of a credit contract; or
>
> (d) a fee or charge for a prepayment of an amount under a credit contract;

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[26] OFT, *Calculating fair default charges in credit card contracts – a statement of OFT's position*, April 2006.

[27] OFT, *Press release – OFT files details of case against unauthorised overdraft charges*, 31 August 2007.

[28] *OFT v Abbey Bank & Ors* [2008] EWHC 875 (Comm).

[29] OFT Press Release, *OFT statement on Case Management Conference*, 23 May 2008, available at: http://www.oft.gov.uk/news/press/2008/66-08.

[30] For more information about the OFT test case processes, see OFT, *Questions and answers for OFT personal current account work*, available at: http://www.oft.gov.uk/advice_and_resources/resource_base/market-studies/personal/personal-test-case/personal2.

[31] Uniform Consumer Credit Code Management Committee, *Discussion Paper – Consumer Credit Code Amendment Bill: Proposed changes following written submissions on consultation package*, February 2008.

is unconscionable, annul or reduce the change or fee or charge and may make ancillary or consequential orders.

It is important to note that in relation to establishment fees, early termination and prepayment fees, and default fees, the consultation document proposed to define 'fairness' in the UCCC. It did this by proposing a provision stating that a fee would only be unfair if it is more than the credit provider's average reasonable costs.[32] The paper did, however, propose a catch-all clause which stated that other fees and charges could also be challenged for unfairness, with such unfairness not further defined. The paper stated that it was the intention that this provision would enable a court to review both procedural and substantive unfairness.

Even more recently, the Ministerial Council on Consumer Affairs (**MCCA**) has accepted a recommendation from the Productivity Commission to introduce national unfair contract term laws.[33] MCCA has proposed an arguably more limited unfair contract term law compared with the Victorian FTA, stating that the provisions should have the following features:

- a term is unfair when it causes a significant imbalance in the parties' rights and obligations arising under the contract and it is not reasonably necessary to protect the legitimate interests of the supplier;
- a remedy could only be applied where the claimant shows detriment, or a substantial likelihood of detriment, to the consumer (individually or as a class). Detriment is not limited to financial detriment;
- it would relate only to standard form (ie non-negotiated) contracts. Should a supplier allege that the contract at issue is not a standard form contract, then the onus will be on the supplier to prove that it is not;
- it would exclude the upfront price of the good or service, using the approach currently adopted in regulation 6(2) of the UK's UTCCRs; and
- it would require all of the circumstances of the contract to be considered, taking into account the broader interests of consumers, as well as the particular consumers affected.

Where these criteria are met, the unfair term would be voided only for the contracts of those consumers or class of consumers subject to detriment (or the substantial likelihood thereof), with suppliers also potentially liable for damages for that detriment, along with other remedies available under the *Trade Practices Act 1974* (Cth).

It is worth considering how these proposals might apply to specific credit fees and charges. I will consider mortgage early termination fees and credit default fees (for example, for late payment of a credit card) as common examples.

Deferred establishment fees and other payments that are contingent upon early termination or prepayment have received significant attention during 2008 and ASIC has undertaken a review of the levels of such fees.[34] Early termination fees can come as a considerable

[32] Proposed section 72(3), (4) and (5).
[33] Ministerial Council on Consumer Affairs, *Joint Communiqué*, Friday 15 August 2008.
[34] ASIC, *Repot 125: Review of mortgage exit and entry fees*, April 2008.

surprise to a consumer (despite their disclosure in the detailed terms of the contract), can mislead consumers regarding the true cost of the loan, and can serve as a "trap" to prevent consumers from refinancing a loan when the terms have changed substantially. For example, some credit providers have raised interest rates considerably higher than others in response to the global "credit crunch", and consumers may be prevented from switching due to high exit fees. Such fees are not only unfair to the individual consumer but they have a flow-on effect of dampening competition in the market more broadly. If the UCCC amendment proceeded, such fees could be challenged on the basis that they are in excess of the loss suffered by the credit provider due to the consumer's early termination. In an unfair contract term circumstance, a fee might be challenged on a range of bases, considering all the circumstances of the matter. For example, it could be challenged on procedural (i.e., if it is not expressed clearly or given sufficient prominence) or substantive (i.e. the nature or level of the fee or charge) grounds. A court might also consider whether the fee has substantially distorted the cost of the loan, in addition to whether the fee unreasonably exceeds a credit provider's costs.

Default fees are also an example of commonly imposed credit fees and charges. One example of such a fee is a credit card late payment fee. Default fees are particularly problematic because they rarely figure in a consumer's contemplation when entering a loan or continuing credit contract, and they have a particularly harsh impact on consumers in hardship. While default fees can be challenged under the common law of penalties, such a process is difficult to access for consumers. There is a further question about providers' ability to re-draft terms which impose such fees so that they may be seen as imposing a fee for service rather than fee upon default (this was a successful argument in the UK test case on default fees). As outlined above, the difficulty of challenging default fees is exacerbated by the fact that the BFSO (now FOS) will not consider disputes in relation to the level of such fees. If the UCCC amendment proceeded, such fees could be challenged as unfair on the basis that the fee is in excess of a lender's costs. Given that credit providers are already being compensated for late payments or because credit card limits are exceeded through the imposition of interest, any default fee should be limited to the administrative costs of processing a default of that type. If the unfair contract term proposal proceeded, it would allow for a regulator-led action to ensure default fees are fair in all the circumstances.

As suggested above, the imposition of mortgage exit fees and credit card default fees prevent competitive forces coming to bear on credit markets. In relation to mortgage exit fees, consumers can be 'locked in' to products that are not competitive. Recent market conduct provides a good example of such an outcome. The current "credit crunch" is purportedly increasing the cost of wholesale credit for financial service providers. Consequently some lenders have increased interest rates directly to consumers on a number of occasions (in addition to rate increases passed on from rate rises by the Reserve Bank of Australia). Given high termination fees, consumers have no ability to switch to cheaper products or challenge such interest rate rises and are subject to the vagaries of the market. Where switching costs are significant, firms can discriminate between new and old customers. This is not a good, competitive outcome in the market.

In relation to credit card default fees, the level of a penalty fee is not a relevant factor in most consumer decisions to choose or stay with a particular financial product. Consumers simply

put little weight on penalty fees – they discount the possibility of the fee applying to them and, as such, the market does not work to put pressure to limit such fees.

Taking the FTC approach to determining unfairness, the impact on competition and consumer choice is a relevant factor. As such, if these fees can be considered unfair under the proposed changes to the UCCC or through national unfair contract term laws, not only will consumers benefit but a more competitive market will be facilitated, bringing about improved welfare across the economy.