Consumer issues in the implementation of a national consumer credit law

Briefing paper: Ensuring access to justice

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

1. Executive summary

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

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

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

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

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

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

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

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

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

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

2. Access to justice in consumer credit matters

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

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

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

3. The need for a low cost judicial forum

For low-value consumer disputes, the traditional court system is an inappropriate venue for resolving disputes. In the majority of cases, the costs of litigation would outweigh any potential benefit from a successful claim; in fact, in many cases the court filing fees alone

may be prohibitively high in comparison with the amount claimed.[1] In addition, there is the risk of an adverse costs order if a claim is unsuccessful. Without alternative mechanisms for resolving disputes, many consumer disputes would simply go unchallenged.

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

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

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

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

- lower filing fees;
- much lower, if any, risk of an adverse costs order being made;
- cases are heard by a member with expertise in consumer credit legislation;
- proceedings are more flexible and informal;
- formal evidence rules are relaxed;
- alternative dispute resolution mechanisms are used;
- legal representation is limited or excluded, and self-representation a right;
- matters can proceed in a more timely manner.[2]

These benefits are, of course, often found in EDR schemes. However, an accessible judicial forum is needed to complement EDR. In jurisdictions that do not have a specialist consumer tribunal, proceedings under the Consumer Credit Code are heard by a court (for example, the Magistrates Court in Queensland for disputes under $50,000). Consumers in these jurisdictions have been noticeably disadvantaged by the lack of access to a low or no

[1] The current fee for filing a document commencing a general proceeding in the Federal Court is $785 for natural persons (although some people are exempt from paying fees, such as if they hold a pensioner or health care card, and the Registrar can waive the filing fee if satisfied that payment of the fee would cause the person financial hardship). The equivalent filing fee in the Federal Magistrates' Court is currently $374, with similar exemption and fee waiver provisions. By contrast, for example, the current filing fee for consumer credit applications by debtors at the Victorian Civil and Administrative Tribunal is $35.20 (this fee may also be waived if it would cause financial hardship). Note that the filing fee for a human rights application with the Federal Court or Federal Magistrates' Court is only $50.

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

cost jurisdiction. While the numbers of consumers who take legal action in relation to consumer credit matters is relatively low, the number of such legal actions in jurisdictions without a specialist low cost jurisdiction is negligible. Further, the majority of the important legal precedents in the consumer credit area, which are relied upon by EDR schemes in resolving consumer credit disputes, arise from Victorian or New South Welsh cases that were commenced in the low cost tribunals.

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

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

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

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

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

1. EDR schemes cannot determine the law or create precedent

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

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

    - In the consumer credit arena, important recent decisions of the State Tribunals include *Director of Consumer Affairs v City Finance Loans (Credit)* [2005] VCAT 1989 (30 September 2005); and *Lewis v Ormes (Commercial)* [2005] NSWCTTT 481 (18 July 2005). These and other cases can provide useful statements on the interpretation of the law, and can then be used by the EDR schemes in their

resolution of disputes. Litigated cases can also highlight inadequacies with the law, which can then be used to agitate for law reform. Unlike many areas of law, consumer disputes are subject to alternative dispute resolution processes to such an extent that there is often inadequate guidance for the Courts and the EDR schemes.

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

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

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

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

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

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

    - Some EDR schemes (including FOS and the Credit Ombudsman Service Limited) have determined that they have no powers to order a hardship variation under s 68 of the Consumer Credit Code. Thus, if a credit provider refuses a variation request under s 66 of the Code, but has followed an appropriate *process*

in considering the request, some EDR schemes will not be able to resolve the matter.

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

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

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

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

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

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

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

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

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

4. EDR schemes cannot make determinations involving non-members

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

5. EDR processes are not always quick

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

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

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

- As noted above, EDR schemes cannot determine the law and must rely on legal precedents set in the court system for the resolution of disputes. If only an expensive court forum is available as an alternative, consumers are unable to take the sorts of legal actions that can assist in determining and developing the law.

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

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

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

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

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

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

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

6. What is needed in the Commonwealth consumer credit law

To ensure access to justice for consumers, viable and realistic access to the court system must be maintained under Commonwealth consumer credit regulation. For this to occur, there must be access to a judicial venue that is low-cost, flexible, informal, specialist and not overly legalistic. In addition, consumers need to have protection from the risk of adverse costs orders – these have a chilling effect on the initiation of legal action by consumers.

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

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

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

> **Principle 1:** Consumers should have access to a low-cost jurisdiction that can hear and determine claims under the consumer credit legislation. This must be achieved by developing a no-cost division in the Federal Magistrates Court or Federal Court for consumer credit claims.[3]
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> The benefits from the consumer credit matters determined in the judicial system flow far beyond the small number of individual consumers directly affected by those cases. In particular, they play a critical role in setting precedents which guide both industry practice and EDR scheme decisions. This is especially important in the consumer credit area, in which there are relatively few legal precedents, particularly around issues of what is reasonable conduct in given factual situations.
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> Access to a low-cost jurisdiction would not prevent the majority of consumer disputes from continuing to be determined by the EDR schemes. Even in those states that currently have specialist low-cost tribunals the vast majority of consumer credit disputes are taken to EDR schemes where this option is available. However, where it is appropriate for a matter to be determined in the court system, this can only occur if the consumer has a practical option for accessing that system.
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> Low filing fees are a crucial element of an accessible court forum. High court filing fees are not necessary to discourage consumers from taking court action inappropriately, given that almost all consumers with consumer disputes approach the free EDR schemes. Instead, high court fees discourage the small number of complaints that might more appropriately go through the court system. Further they tend to discourage only those complaints from low-income or vulnerable consumers who cannot afford the fees.
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> A low, if any, risk of an adverse costs order is also a critical element of an accessible court forum. It is difficult to overstate the effect that a risk of an adverse costs order has on a consumer's willingness to take a consumer dispute to court. Particularly in the consumer credit field, where people are often already in financial difficulties and at risk of costs such as interest accruing, the risk of further costs being incurred through an unsuccessful action is a major deterrent to challenging lender conduct. If a home is at risk, the deterrent effect of potential costs orders is even greater.
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> Consumers tend to be reluctant to challenge a lender's negative response to their requests, for example to vary repayment arrangements due to hardship or to limit an excessive fee. Without court oversight of such conduct there is likely to be a negative impact on industry practices.

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

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

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

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

In Victoria this is already the case. Recent legislative amendments have given the regulator the authority to institute and defend proceedings on behalf of consumers in all matters under the Consumer Credit Code.[4] The Victorian Government has also supported a recommendation that the regulator should have the ability to bring proceedings in its own right involving multiple or a class of contracts under sections 70 and 72 of the Code, and the Victorian Government is committed to progressing this issue nationally.[5]

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

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