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By email: christian.mikula [at] treasury.gov.au

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Dear Mr Mikula

Discussion Paper: Early Termination Fees under Consumer Leases

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on Treasury's discussion paper on early termination fees under consumer leases (**the discussion paper**).

Briefly:

- we welcome attempts to improve transparency and fairness in consumer lease termination fees, however these fees are symptom of larger, systemic problems with the regulatory structure of consumer leases. The only real solution will be to address those systemic problems;
- we could support option one (the introduction of a formula to prescribe a maximum consumer lease termination fee) however the formula would be complex to design and would come with significant drawbacks;
- we do not support option two, which would allow lessors to determine their own termination fee as long as it was a reasonable estimate of their loss;
- we could support option three, which would deem a consumer lease to be a sale by instalments if the termination fee exceeded a certain percentage of the total cost of the contract. However, we believe the percentage would need be very low, perhaps around 10 per cent; and
- if Government chooses to regulate the amount that can be charged in early termination fees, the regulation needs to explicitly state that the law relating to penalties and unfair contract terms is not displaced by that regulation.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research

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body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

We also operate MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians experiencing financial difficulty.

Broad remarks

As we have argued in the past, we believe there are serious and systemic problems with the regulation of consumer lease providers. Despite the reforms relating to consumer leases in the *Consumer Credit Legislation Amendment (Enhancements) Act 2012*, the regulation of consumers leases vis-à-vis credit contracts is such that suppliers are able to structure contracts to take advantage of weaker consumer protections. We note that Treasury is already aware of these problems and indeed has explained it in detail itself in its 2010 National Credit Reform Green Paper.¹

In that paper, the following issues were identified:

1. Some providers of leases offer products where the consumer has no right or obligation to purchase the leased goods (rather than a credit contract or a lease where the consumer has this right or obligation), because of the lower regulatory burden under the Code.

This issue is illustrated by the practices of Motor Finance Wizard. When a change in regulation had an impact on the provision by Motor Finance Wizard of "interest free" loans that were not Code regulated, clients no longer presented with loans from Motor Finance Wizard, but with leases. This change of contract appeared to be made because there were less regulatory compliance associated with a consumer lease compared with a credit contract.

2. Consumers are being misled about whether or not they will own the goods, or have a right to purchase them, under the lease.

We commonly see lease contracts that, while not giving a consumer a right or obligation to purchase the product, instead provides the consumer with the right to purchase an item that is similar to the goods originally leased by the consumer, or by allowing the consumer to sell the goods as the lender's agent, and to retain all but a nominal amount as sales commission. Furthermore, these arrangements are sometimes marketed as allowing the consumer to buy the goods (i.e. Radio Rental's "Rent, Try, \$1Buy" deals, or Motor Finance Wizard's phone number being 1800 CAR LOAN). These contracts appear to be designed to ensure the arrangement is regulated as a consumer lease rather than a credit contract, and operate to mislead consumers about the nature of the bargain they have entered.

¹ The Treasury (2010) *National Credit Reform: Enhancing Confidence and Fairness in Australia's Credit Law*, pages 72-3. Accessed from

http://archive.treasury.gov.au/documents/1852/PDF/National_Credit_Reform_Green_Paper.pdf

3. The exclusion from the Code of short-term or indefinite leases results in some providers being able to avoid the Code entirely.

We raise these issues again simply to make the point that the problems with consumer leases can only be solved by acknowledging that it is the regulatory construct of consumer lease itself that facilitates avoidance of consumer protection and results in consumers being misled. While we welcome attempts to improve transparency and fairness in lease termination fees, these fees are just one symptom of the bigger problem. Our concern is that by focusing on smaller problems rather than confronting the central problem itself, we indirectly validate and legitimise business models that inappropriately use consumer leases (even if we make smaller advances that improve consumer outcomes in regards to termination fees).

There may well be a legitimate role for consumer lease providers in the economy, for example, where the arrangement is truly one of temporary hire of goods and the risk associated with ownership stays with the supplier. However, our experience is that providers of consumer leases commonly use this model to avoid the reasonable obligations which all other credit providers must follow. Regulatory reform should be focused on correcting this practice.

We accept that these comments are beyond the scope of the current discussion paper. However, we feel it is important to reiterate them to be clear that we think the options suggested in the discussion paper, our responses to those options below are at best band-aid solutions to what is a much larger problem.

Response to options in the discussion paper

Option 1: Prescribe a formula for determining consumer lease termination fees

Consumer Action could support the introduction of a formula to prescribe a maximum consumer lease termination fee, however the formula would be complex to design and would come with significant drawbacks.

Design of formula

If the Government favoured option one, the formula would need to take into account that lessors can and do, or have the opportunity to, re-hire or sell ex-rental goods. As such, the formula must not allow a termination fee to recover future returns for those goods. It follows that the formula should provide that the only liquidated damages payable should be for administrative or collection costs.

Handling complexity

Assuming a fair formula could be designed, it would need to consider a number of different factors (as the discussion paper notes) and so would be very complex. This creates drawbacks in that it would not provide consumers with any real transparency and would be difficult for regulators to monitor and enforce. For that reason it may be advantageous to regulate a relatively simple formula which is more transparent even if it is less precise.

One approach may be to develop a formula, but to also provide for a 'safe harbour' amount which might represent a fair termination fee. This kind of mechanism is used by the Victorian Essential Services Commission in its Energy Retail Code. Paragraph 31(c) of the code provides that:

Any amount of an early termination fee payable by a customer upon the customer breaching their energy contract must be determined by reference to, and must not exceed, the total of the following direct costs incurred by the retailer in relation to that particular customer which remain unamortised at the time of termination:

(i) pro-rata costs of procuring the customer to enter into the contract; and

(ii) \$20:

which comprises:

- the additional costs of giving effect to the early termination of the contract, final billing and ceasing to be responsible for the supply address; and
- the value of any imbalance in the retailer's electricity or gas hedging program to the extent that it is directly attributable to that breach of contract.²

This provides a balance between ensuring termination fees are reasonable (by determining what costs can be considered and calculating the likely value of those fees with a formula) and allowing the regulation to be enforceable (by providing for a maximum reasonable amount based on the formula). If we translate this method to consumer lease termination fees, the maximum reasonable amount could perhaps be expressed either as a dollar amount, the value of a certain period of payments (for example one month, three months), or a percentage the value of the contract.

Penalties and unfair contract terms

If the Government favoured option one, we strongly recommend that the regulation clearly state the common law doctrine of penalties and the law regarding Unfair Contract Terms in the ASIC Act still apply to consumer lease termination fees. Without such a statement, the regulation (and the section of the Code supporting it) could be interpreted as overruling penalties and the prohibition against unfair terms.

Option 2: Reasonable estimate of loss

We do not support option 2. The discussion paper notes three disadvantages with this option, (with which we agree):

- this option may not change current behaviour: we suspect that lessors would argue that their current termination fees are reasonable estimates of loss even if they are not;
- this option does not provide any extra certainty for business;
- this option will not necessarily improve transparency for consumers.

Option 3: Deem a consumer lease to be a sale by instalments in some circumstances

Option 3 would deem a consumer lease to be a sale by instalments if the termination fee either equalled the total amount due under the contract or exceeded a percentage of the amount due, specified in the regulations.

Determining the point at which the contract becomes a sale by instalments

Consumer Action could support this option, but the percentage would need be very low. While we are open to discussing what an appropriate amount should be, we are firmly of the view that it should be below 30 per cent of the amount remaining to be paid under the contract. An appropriate figure may be closer to 10 per cent.

² Victoria, Essential Services Commission (2012), *Energy Retail Code: Version 10*. Accessed from: <http://www.esc.vic.gov.au/getattachment/06661f37-494a-4f8c-8604-7fdf33a27dd2/Energy-Retail-Code-Version-10.pdf>

Based on a basic search of the Radio Rentals website, it appears that the total payments over a 36 month contract can be more than three times the retail purchase price of similar goods (according to an online comparison site). Thirty-six months is the minimum term to qualify for Radio Rentals' 'Rent, Try, \$1 Buy' offer. That being the case, a 30 per cent termination fee is likely to be more than the retail purchase price of the goods.

A termination fee this size would appear to us to be designed to ensure the consumer pay the retail cost of the goods (either by paying the termination fee or completing the lease term) rather than paying the lessor's liquidated damages for the breach. Noting that the lessee will have in most cases already made some lease payments before terminating the contract, it follows that a termination fee of 30 per cent of the amount due makes the arrangement more like a credit contract than a lease.

Penalties and unfair contract terms

As above, if this option is favoured by Government, the regulations should explicitly state that a termination fee can still be considered a penalty or an unfair contract term regardless of whether it is above or below the specified percentage.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

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