



18 September 2009

By email: CCAAC@treasury.gov.au

CCAAC Review of Conditions and Warranties
Competition and Consumer Policy Division
Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

**Submission to CCAAC Consumer rights: Statutory implied conditions and warranties
Issues paper**

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to respond to the Commonwealth Consumer Affairs Advisory Council's (**CCAAC**) Issues Paper, *Consumer rights: statutory implied conditions and warranties* (the **Paper**).

We recognise the delay in our provision of a submission and apologise for this delay. We hope that CCAAC will find our comments useful.

In summary, Consumer Action supports national harmonisation and clarification of Australia's laws on statutory conditions and warranties, so long as harmonisation does not weaken protections for consumers.

However, we consider that the root of the problem in this area is twofold. We agree that the laws lack clarity and this could be improved. The second and more important issue, though, is that there has been a failure by regulators to take enforcement action to tackle what is, in fact, a systemic, market-wide problem. We recommend that regulators adopt a more active and strategic approach to enforcing statutory condition and warranty laws, with the help of legislative reforms to incorporate direct enforcement mechanisms into the laws.

We also recommend legislative reform to tackle the extensive problems with the selling of extended warranties to consumers, including capping commissions and introducing measures that separate the decision to purchase the extended warranty from the purchase of the underlying item. We do not support the introduction cooling-off rights in this area, because they can encourage consumers to make hasty decisions thinking they can always cancel later, which does not tend to occur.

Our comments are detailed more fully below. This submission has also been endorsed by the Australian Financial Counselling and Credit Reform Association (AFCCRA), the peak body for financial counsellors in Australia.

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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 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.

Impact and nature of the problem

The Paper explains that consumer problems with the current approach to statutory conditions and warranties are significant and they are likely to cost consumers billions of dollars each year (pp6-7). The Consumer Affairs Victoria (**CAV**) report on warranties and refunds in the electronic goods, white goods and mobile telephone industries supports this contention, finding that consumer detriment resulting from problems relating to warranties and refunds is very large, with an estimate that they are costing Victorian consumers in the billions each year.¹

It is important to recognise that the problems with statutory implied terms are not merely large, they are also systemic, that is, embedded in the marketplace. The CAV report makes this clear, concluding:

The problems are systemic, reflecting common culture and practice across each sector and not just the approach of a few problematic traders.²

This is the case despite the fact that terms implying basic consumer rights into sale contracts have been provided for in legislation for over a century (Paper p3), not even taking into account earlier case law implying terms into contracts.³

The CAV report correctly points out that limited awareness of statutory warranty rights and obligations has been noted in several reviews over many years,⁴ including by the Australian Law Reform Commission in 1994⁵ and the Productivity Commission in 2008.⁶ Limited awareness and understanding of statutory implied terms remains an issue, but traders and consumers have had over one hundred years to become familiar with consumer rights in relation to purchases and these awareness concerns has now been considered and tackled several times. Further, the CAV report found that:

While it is well recognised that consumers and traders are not fully aware of their rights under statutory warranties, it is not clear that lack of knowledge is driving traders' current approach to warranty and refund claims...even where awareness levels were good, retailers and manufacturers

¹ CAV, *Warranties and Refunds in the electronic goods, white goods and mobile telephone industries*, Research Paper No. 17, May 2009, pp11-14.

² As above, p65.

³ The English *Sale of Goods Act 1893* implied terms of quality and fitness into contracts of sale, codifying and expanding on the existing common law.

⁴ CAV, above n1, p2.

⁵ Australian Law Reform Commission, *Compliance with the Trade Practices Act 1974*, Report No. 68, 1994.

⁶ Productivity Commission, *Review of Australia's Consumer Policy Framework*, Inquiry Report, No. 45, 30 April 2008.

were critical of the ambiguous nature of the law. In the absence of clear, objective rules, and strong enforcement of those rules, traders equate statutory warranties with their own policies and voluntary warranties.⁷

In our view, it is time to consider policy responses other than merely increasing information and education to consumers and traders, given the significant and systemic nature of the problem.

National harmonisation and clarification

Consumer Action agrees that the current legal scheme for implied terms can be confusing for traders, consumers and governments alike, due both to the differences in rights and obligations across the different Federal and State/Territory laws and to the unclear or technical nature of some parts of the laws.

In terms of the jurisdictional differences, chapter 2 in the Paper summarises a range of variations between the different jurisdictions. It would be very difficult for a layperson to understand the difference between, for instance, the treatment of services in Victoria versus New South Wales (**NSW**). In Victoria there is an implied *condition* that services will be rendered with due care and skill (s.32J of the *Fair Trading Act 1999* whereas in NSW there is an implied *warranty* that the services will be rendered with due care and skill (s.40S of the *Fair Trading Act 1987*). It would also be difficult to understand that, for instance, in Queensland a trader can exclude implied conditions under the *Queensland Sale of Goods Act 1896* but the Federal implied conditions under the *Trade Practices Act 1974* would still apply.

With regard to clarity, the nature of implied terms law is that not all the concepts are conclusively defined. Judgments must be made about questions such as whether something was 'reasonable' in the individual circumstances of a case or how long a product must work before an operational fault does or does not render a product of less than 'merchantable' quality. There are many cases in which the answers to these questions will be clear but also many cases in which it is difficult to make conclusive decisions.

Even the Paper itself struggles to clarify the legal position on certain questions. For example, it makes the point that statutory rights have no set time limit and consumers may be entitled to a remedy after any manufacturer's or extended warranty has expired depending on the price and quality of goods, subject to legal limitation periods (p5). Not long afterwards, the Paper states that if a good does not meet a statutory implied term after a consumer has owned it for some time or used it a lot, it is still a breach of contract but the consumer may not be entitled to claim a refund, only another form of remedy for the breach of contract such as replacement or repair (p6). However, with no set time limit, once a breach of an implied condition is established the time that has elapsed should not be relevant to which remedy is legally available.

Further, as the Paper points out, not all related questions are covered by the laws, such as who pays for collecting or returning goods or for a trader's costs in examining goods if they turn out not to have been inherently faulty (p18).

⁷ CAV, above n1, p65.

For these reasons, Consumer Action supports national harmonisation and clarification of Australia's laws regarding statutory conditions and warranties. The New Zealand *Consumer Guarantees Act 1993* provides an example of how this could be done by removing difficult concepts such as the difference between conditions and warranties and simply providing for more clearly stated remedies that flow from failures to comply with any guarantees. However, we do not support uniform national laws unless they reflect best practice statutory rights. For example, the Productivity Commission recommended that the ability to exclude statutory conditions should be repealed in those jurisdictions that currently provide such scope.⁸ We would expect that any one national Australian law would reflect best practice in this regard by not allowing exclusions, rather than adopting worst practice by allowing for such exclusions.

We also suggest that regulator-developed guidelines could provide more detailed guidance about how statutory implied conditions and warranties should operate in practice in different contexts, without requiring the drafting of overly detailed and prescriptive general laws about implied terms.

Enforcement

While a lack of clarity in the law has contributed to problems experienced by consumers, we believe that regulatory failure has been the key cause of detriment. We do not believe that lack of clarity is the reason that retailers refer customers to the manufacturer or deny any liability, even when goods are returned within a few days. This type of conduct, which is too common, appears to be a result of some comfort on the part of traders, that failing to honour their obligations - even misleading consumers - will lead to cost savings without any risk of regulatory action.

We understand that there have been a few cases taken under section 52 and/or section 53(g) of the *Trade Practices Act* and its State equivalents, however these generally involve "no refunds" signs and other written statements. It is our view that regulators have had significant opportunity to pursue traders that are known to repeatedly mislead consumers in this area, even if those misleading representations are made verbally.

Regardless of how clear and consistent any laws regarding statutory conditions and warranties are made, they will not function to protect consumers unless there is a real threat of consequences for non-compliance.

While we believe that the current laws may be adequate for many situations, we encourage CCAAC to consider how the law might be amended to enable enforcement action for conduct that fails to meet statutory obligations, but that is not clearly misleading and deceptive.

At present, the laws do not incorporate any direct enforcement mechanisms, only the enforcement mechanisms discussed above to deal with related but separate conduct such as misleading and deceptive conduct and making false or misleading representations.

Individual redress mechanisms are available, but these are different in nature to enforcement mechanisms. A regulator-led representative action on behalf of consumers is possible in some

⁸ As above, volume 2, p174.

circumstances, but these types of actions are also not enforcement actions, rather they are group redress actions. Further, as a matter of practice, representative actions by regulators are exceedingly rare.

The lack of direct enforcement mechanisms, combined with the Australian experience of a lack of regulator will to use available enforcement mechanisms to tackle repeated misconduct by traders, means that the laws largely rely on individual consumers being persistent enough to pursue a claim in the face of a resistant retailer. The costs of taking legal action, even in a low-cost tribunal, often outweigh the cost of the dispute. Further, the problems with implied terms are systemic, market-wide problems, thus even if an individual consumer successfully enforces their contractual rights, this does not benefit other affected consumers or provide any incentive to traders to change their overall practices. Statutory condition and warranty disputes are perhaps the archetypal example demonstrating the well-known flaws in relying solely on individual redress mechanisms to secure compliance with legal obligations.

The CAV warranties and refunds report explains this situation well:

In addition, it needs to be clear to retailers and manufacturers that there are consequences from not complying with statutory warranty obligations. More effective enforcement is, therefore, necessary so that breaches of the law are addressed at a more systemic level. Currently, redress is often limited to individuals who are willing to escalate their complaint sufficiently to force the trader to take action, but this has not changed the approach traders take to consumers more generally. Without pressure for systemic change there are incentives for traders to frustrate the process of dispute resolution and only address individual claims when necessary.⁹

Any national harmonisation of statutory condition and warranty laws should therefore not only provide for statutory rights (whether as implied terms into contracts or as guarantees pursuant to the New Zealand model). They should also provide that these consumer rights are conduct obligations, similar to other conduct obligations in the *Trade Practices Act* and State/Territory Fair Trading Acts such as those prohibiting misleading and deceptive conduct and unconscionable conduct. For example, the laws might provide that a trader must not fail to remedy a failure to comply with a guarantee as to merchantable quality.

These conduct obligations could then be enforced in the same way that other existing consumer protection conduct obligations in the *Trade Practices Act* are enforceable. Part VII of the *Trade Practices Act* provides for a range of enforcement tools, for example the regulator (or other parties) can seek an injunction against a contravention (s.80) or seek other orders addressing the conduct (s.87), and the regulator can accept court enforceable undertakings from a trader (s.87B).

Other enforcement remedies such as criminal penalties (including fines) or civil monetary penalties are also possibilities, although they would need to be considered further. Most existing consumer protection obligations in the *Trade Practices Act* are also criminal offences under Part VC, including the prohibition on making false or misleading representations about conditions or warranties, but the prohibitions on misleading and deceptive conduct and unconscionable conduct are not criminal offences. The current Trade Practices Amendment (Australian Consumer Law) Bill 2009 in the Federal Parliament provides for a new civil penalty regime for

⁹ CAV, above n1, p65.

the consumer protection obligations including unconscionable conduct, but not misleading and deceptive conduct.

Clearly, the resources and priorities of the regulator would act as an effective restraint on taking enforcement action over every breach of such conduct obligations. However, providing for enforcement mechanisms would finally allow for a strategic enforcement approach to be taken to the systemic non-compliance problem as regards implied terms. In particular, it would allow for regulator action where there were concerns about a trader's systemic practices in dealing with consumer complaints about faulty or unsuitable products or services.

We note that this is also a recognised flaw of the current New Zealand model, despite the New Zealand *Consumer Guarantees Act* providing greater clarity around consumer rights. For example, the New Zealand Government reviewed the enforcement and redress provisions of its consumer protection laws in 2006.¹⁰ In relation to the *Consumer Guarantees Act* specifically, it described the current situation:

If Direct Remedies Don't Work

The legislation does not allow for enforcement under the CGA to be carried out by the Commerce Commission or any other government or third party agency. The consumer may initiate civil legal action if the remedies are not followed through...There is one exception to the consumer-driven redress rule: if a trader attempts to contract out of the obligations imposed by the Act, they may be committing an offence under s 13(i) of the Fair Trading Act (for example, a sign in a shop that states that refunds are not available). The offending trader can then be prosecuted by the Commerce Commission.

...

New Zealand consumer protection legislation relies to a large extent on consumers taking action for themselves. No enforcement agency is responsible for enforcing the CGA and while the Commerce Commission has enforcement responsibilities with respect to the FTA, it is only able to investigate a small percentage of the complaints it receives.

...

This means that when a consumer does not get what they expect from a transaction or when a transaction goes wrong, they are largely responsible for pursuing their own remedy. Consumers may decide that it is not worth their while trying to put a transaction right...Where consumers decide to take action, they are required in the first instance to try and get redress from the trader concerned.

If consumers cannot resolve the matter with the trader there are a number of options that a consumer can pursue. The consumer may at this stage decide not to take any further action or may try and resolve the matter by, for example, contacting the head office, a trade association to which the trader belongs, a specific complaints body if there is one...or take the matter to the Disputes Tribunal. Consumers can take matters to the District Court but because of the costs involved it is unusual for consumers to do this. Court cases involving consumer protection legislation are usually instigated by businesses or the Commerce Commission.¹¹

¹⁰ Ministry of Consumer Affairs (NZ), *Review of the Redress and Enforcement Provisions of Consumer Protection Law: International Comparison Discussion Paper*, May 2006.

¹¹ As above, pp11-12.

Consumer redress

In terms of consumer redress, the problems discussed above will continue to apply, limiting the ability of individual consumers to pursue redress successfully if they have been sold a faulty or unsuitable product or service.

The Trade Practices Amendment (Australian Consumer Law) Bill 2009 recognises this problem in the context of other consumer protection provisions. It provides for a new mechanism that will enable the consumer regulators (the Australian Competition and Consumer Commission (**ACCC**) and the Australian Securities and Investments Commission) to seek orders for redress for consumers who are not parties to the regulator's legal action against a trader's contravention of a consumer protection provision of the *Trade Practices Act*, but who have suffered loss or damage as a result of the trader's contravention.

This mechanism would be well-suited to the statutory conditions and warranties context, where it may be clear that a class of consumers has been affected by a trader's conduct but it would be prohibitive for the regulator to name each individual consumer as a party to the proceedings.

Extended warranties

Rather than disadvantage retailers, problems with the enforcement and clarity of statutory condition and warranty laws have created a "marketing opportunity" for retailers.

While some consumers may appreciate the protection provided by extended warranty cover, the difficulties in enforcing statutory rights is likely to significantly increase the number of consumers who purchase extended warranties.

We believe that many consumers are paying a high price for extended warranties without the opportunity to consider the product's costs and benefits.

It appears that there is little competition in the extended warranties market. Only one provider's product is offered to consumers at the point of sale, and we believe that commissions paid to retailers to sell the product can be considerable. We suspect that higher cost warranties could actually be more attractive to retailers because the commissions are likely to be higher, leading to reverse price competition.

Our experience is that extended warranties are offered at the last minute, just as the consumer is about to pay for goods. The warranty or cost of the warranty is rarely mentioned during the sale process. Very little, or inaccurate, information is provided by sales staff. Consumers are focussed on purchasing the item and pay little attention to the cost of the extended warranty, which the salesperson is often very eager to sell.

While providers and retailers may argue that extended warranties provide value to consumers, the aggressive selling suggests that they have a significant impact on profits. For example, on its website the insurer *AIG Australia*, which offers an extended warranty, says:

For electrical retailers, manufacturers and distributors, new ways to increase profits are not easy to come by. An AIG Australia Warranty programme offers companies an opportunity to increase their profits, while improving customer satisfaction, loyalty and brand recognition.¹²

Extended warranties appear to have some similar features to consumer credit insurance, in that they are sold at point of sale (often just after a purchase has been made), there is usually only one product on offer, and sales appear to be commission driven.

Some of the findings made by the ACCC in its report on consumer credit insurance¹³ are likely to apply to extended warranties. In relation to consumer credit insurance, the ACCC found that problems arose due to the structure of the industry. These included that 'reverse competition' increased commissions (and therefore cost to the consumer) as providers 'bid against each other for access to agents',¹⁴ problems with training and supervision of agents and explanation of policy documentation, and limited choice for consumers arising partly from 'shortcomings in the timeliness, amount and quality of information made available to consumers'.¹⁵

Since 1995, the sales commission on consumer credit insurance has been capped at 20% in Australia,¹⁶ where previously some commissions were 50% or more.

In 2007, the UK Office of Fair Trading made a reference to the Competition Commission for an investigation into the sale of payment protection insurance (**PPI**) (as consumer credit insurance is known in the UK) to consumers, on the basis that it had reasonable grounds to suspect that features of the market restrict or distort competition.

The UK Competition Commission's report found that 'there were serious deficiencies in the competitive process for selling PPI policies'.¹⁷ The Competition Commission identified typical commission rates ranging from 40 to 80 percent¹⁸ and that the profit margins that distributors earned on the sale of this insurance were higher than those earned by sale of the underlying credit product.¹⁹

The Commission did not propose a cap on commissions (as is the case in Australia) but made a number of proposals to remove the decision to purchase PPI from the decision to purchase the underlying credit and goods or services. These included a prohibition on the sale of PPI within 7 days of a credit sale unless the customer proactively returned to the seller.²⁰ The Competition Commission is currently in the process of implementing a binding legal Order that will implement its recommendations.²¹

¹² <http://www.aiggeneral.com.au/Content/Individuals/ExtendedWarranty.aspx>.

¹³ ACCC, *Consumer Credit Insurance Review*, Final Report, July 1998.

¹⁴ As above, p5.

¹⁵ As above.

¹⁶ Consumer Credit Code, s.135(2).

¹⁷ Competition Commission (UK), *Market Investigation into Payment Protection Insurance*, January 2009, p1.

¹⁸ As above, p2.

¹⁹ As above, p4.

²⁰ As above, p1.

²¹ See Competition Commission (UK), *Market Investigation into Payment Protection Insurance: Notice of intention to make an Order under section 165 of and Schedule 10 to the Enterprise Act 2002 and public consultation on the proposed Order*, 8 July 2009.

We acknowledge that the purchase of credit and related insurance is usually more complex than the purchase of extended warranties, although we note that in many cases consumers are, at the same time, using credit to purchase the goods or applying for credit to purchase the goods. We do not recommend a prohibition of the sale of extended warranties at the point of sale. However, we do recommend:

- disclosure of commissions paid to retailers; and
- a maximum cap placed on those commissions,

as well as provisions to remove the decision to purchase the extended warranty from the purchase of the underlying product or service by:

- requiring retailers to give consumers a quote for an extended warranty valid for up to 30 days after the purchase of the original item; and
- requiring retailers to improve consumer awareness of the interaction of statutory warranties with extended warranties by providing written information to consumers at the point of sale.

We do not support the introduction of cooling off rights in relation to extended warranty purchases, as these do the opposite of divorcing the decision to purchase an extended warranty from the purchase of the original item. Instead, they may actually encourage the purchase of extended warranties without informed consideration by consumers, because consumers think they can always cancel later. Indeed retailers may use this as another selling tool to promote extended warranties. In practice, once consumers make a purchase they are less likely to cancel using cooling off rights, as opposed to if they had to make a positive election to buy the product at a later time.²² For example, the UK Competition Commission found that a cooling-off period would not be an effective response to the problems with PPI because consumers are 'less inclined to change policies once they have purchased them, even when they consider that they could get a better value-for-money product elsewhere.'²³

Lemon laws

Consumer Action provided a detailed submission on lemon laws to the Victorian Government during its consultations on proposed lemon laws in November 2007. A copy of this submission is attached. It is unclear whether the issue of lemon vehicles is a broad problem affecting lots of consumers, but certainly Consumer Action has advised several consumers who have bought lemon cars and, more importantly, where it is an issue it can have a very large and detrimental impact on the consumer.

²² See also, for example, Colin Camerer, Samuel Issacharoff, George Loewenstein, Ted O'Donoghue, and Matthew Rabin, 'Regulation for conservatives: Behavioral economics and the case for "asymmetric paternalism"', (2003) 151 *University of Pennsylvania Law Review* 1211: 'The status quo effect discussed above might limit the benefits of cooling-off periods. To the degree that people exhibit a bias in favor of the status quo, they will refrain from reversing a harmful decision on some occasions even though the cooling of their ardor would otherwise have led them to do so.', p1239.

²³ Competition Commission (UK), above n17, p199.

Please contact Nicole Rich on 03 9670 5088 or at nicole@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE

A handwritten signature in black ink, appearing to read 'N. Rich', written in a cursive style.

Nicole Rich
Director – Policy & Campaigns

Attach.



22 November 2007

By email: lemonlaws@justice.vic.gov.au

Janice Munt MP
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Dear Ms Munt

Victorian motor vehicle lemon laws

Consumer Action Law Centre (**Consumer Action**) is pleased to have the opportunity to submit its views regarding the proposed introduction of motor vehicle lemon laws in Victoria. We would also like to take this opportunity to thank you for meeting with us on 9 November 2007 to discuss the lemon laws proposal.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. It was formed by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service in 2006, and builds on the significant strengths of these two centres.

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 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.

Executive summary

Consumer Action strongly supports the introduction of lemon laws in Victoria. We outline below a summary of our submission.

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(i) Extent of the problem

Consumer Action has provided advice to a significant number of clients who have bought lemon vehicles. This includes clients who bought new and used motor cars, motorbikes, and motor homes. In many circumstances, the absence of lemon laws meant that the consumer had no satisfactory remedy.

Consumer Action is unable to quantify the extent of the problem with lemon vehicles, but our casework database suggests that the sale of lemon vehicles is a significant problem.

(ii) Types of vehicles that should be given lemon law protection

Lemon laws should cover all new road vehicles that are ordinarily acquired for personal, domestic or household use. Under this definition, Victorian lemon laws should cover new cars, motorcycles/mopeds, motor homes, and passenger minivans. Consideration should be given to whether lemon laws cover motorised wheelchairs. We also believe that Victorian lemon laws should cover used cars, and cars that are leased on long-term leases.

(iii) Defining a lemon

Consumer Action agrees that the easiest way to implement lemon laws is through amending part 2A of the *Fair Trading Act 1999* (Vic) (**FTA**).

This is complicated by the fact that, in order for a lemon law system to work, there must be restrictions on the re-sale of lemon vehicles that have been bought-back. The need to impose restrictions on the re-sale of bought-back lemons means that at least one new section would have to be inserted into the FTA.

The definition of a lemon should include presumptions that a vehicle is a lemon in certain circumstances. A new vehicle should be presumed to be a lemon if the vehicle has been repaired at least 3 times by the manufacturer or importer and the vehicle still has a defect or if the vehicle is out of service for 20 or more days in total due to a defect.¹ A new vehicle should also be presumed to be a lemon if it is repaired once for a defect that is a danger to the personal safety of the driver of the vehicle or other road users.

A used car should be presumed to be a lemon in the same circumstances in which a new car is presumed to be a lemon so long as the used car is subject to mandatory warranty protection under section 54 the *Motor Car Traders Act 1985* (Vic) (**MCTA**).

(iv) Alternative dispute resolution requirements

Consumer Action believes that imposing a requirement that consumers participate in alternative dispute resolution (**ADR**) as a mandatory condition precedent before filing an application in the Victorian Civil and Administrative Tribunal (**VCAT**) to exercise rights under lemon laws would be inefficient and contrary to the interests of consumers. Mandatory ADR would increase the difficulty and delay consumers face in bringing an action. This delay and

¹ New Jersey's lemon law uses a 3-repair-attempts/20-days-out-of-service criteria. New Jersey Motor Vehicle Warranty Act, *The Lemon Law 2006 Annual Report*, page 2.

difficulty would likely cause attrition of claims, leading to many valid consumer claims not being satisfactorily resolved. Rather than place obstacles in front of consumers making complaints about lemon vehicles, the law should ensure there is a seamless dispute resolution process.

(v) Charge to consumers for use of lemon vehicle

As consumers are greatly inconvenienced when their vehicle breaks-down and needs repairs, it is not reasonable to require consumers to pay for the use of the defective vehicle prior to it breaking-down. However, if there is to be a charge to consumers for use of a lemon vehicle, the amount charged for use should be calculated according to an objective mathematical definition that is not ambiguous, and therefore not an encouragement to disagreement and litigation.

(vi) Re-sale of lemon buy-backs

Manufacturers or importers that buy-back vehicles that are lemons should be required to notify all potential purchasers that the vehicle is a lemon if they re-sell it. This notice is best achieved by requiring lemon vehicles that are being re-sold to have a lemon notice physically attached to the driver's side door.² Manufacturers or importers and dealers should be required to correct any defect prior to re-sale, should be required to register any buy-back vehicles on a register held by Consumer Affairs Victoria (**CAV**), and should be required to give a mandatory minimum warranty.³

(i) Extent of the problem

Consumer Action does not have data that shows the percentages of new or used vehicles sold that are lemons.

Our legal advice service has, however, dealt with a number of consumers who have purchased new and used lemon vehicles. A search of our database showed more than 50 consumers have contacted us from 2004 to 2007 complaining that they had purchased a lemon vehicle. In many cases, the fact that they had bought a lemon was the consumer's major complaint, in other cases this was one of several complaints.

The following case-studies from our legal advice service indicate the range of lemon vehicles that consumers purchase.

Case study 1

The consumer purchased a new car in 2004. Immediately upon driving the car out of the dealership, the consumer noticed that the headlights and indicators on the car did not work. The consumer immediately took the vehicle back to the dealer to be repaired. After this, the

² This is similar to the law in California. National Association of Consumer Advocates, Before the Federal Trade Commission, In Re: Vehicle Buybacks – Comment, [FTC File No. P96-4402](http://www.ftc.gov/bcp/lemon/naca.htm) (<http://www.ftc.gov/bcp/lemon/naca.htm>)

³ In most US states, new lemon cars that are resold have a statutory mandatory warranty. Ohio's law is typical, giving a 12 month 12,000 mile warranty. Mark Dann, Attorney General, State of Ohio, *Ohio's Lemon Law*. (http://ag.state.oh.us/citizen/pubs/lemon_law_broch.pdf)

vehicle exhibited a series of defects including the fuel pump needing to be replaced, the ABS system needing to be replaced, and the ABS pump needing to be replaced notwithstanding that the entire ABS system had been recently replaced. The consumer wrote to the importer and asked for the car to be replaced, but the importer refused to do this. The consumer was very concerned about the safety of her vehicle.

Case study 2

The consumer bought a new motor home for \$380,000. From the day of possession, the motor home had major problems, including water leaking from the radiator, the batteries failing, and major electrical faults. Despite multiple repairs of the vehicle, problems persisted. The consumer was unable to obtain a refund.

Case study 3

The consumer purchased a new motorcycle. Within a year of the purchase, the motorcycle was returned 7 times for repairs for defects that included a fuel leak, oil leak and electrical failure. Finally, the motorcycle's clutch cable snapped on the Western Ring Road. A mechanic who inspected the motorcycle indicated that the vehicle was generally defective. However, although the motorcycle was still under warranty the dealer claimed the warranty was void because the motorcycle had been serviced by a mechanic other than an accredited mechanic.

Case study 4

The consumer purchased a new company car and noticed within the first week that there was something wrong with the clutch. It took 3 months before the dealer accepted there was a defect with the car. The dealer told the consumer that the car would be serviced and that this would take 5 days. In fact, the car was kept in shop for more than three weeks while the clutch problem and a number of other defects were repaired. The consumer was only offered a courtesy car after the client threatened to go to CAV. The consumer wanted a replacement car but this was refused.

Case study 5

The consumer purchased a used car manufactured in 1998. Thus the vehicle was covered under the mandatory warranty in section 54 of the MCTA. Shortly after driving the vehicle out of the dealership, the consumer filled the vehicle up with petrol. After being filled, the vehicle would not start. The consumer noticed the vehicle was leaking oil, and took it to an independent mechanic. The mechanic noted 17 defects in the vehicle, including a persistent oil leak and a sagging engine mount that had caused the sump to crack. The dealer refused to repair any of the defects, and while the client had a right of action under the mandatory warranty, this did not allow her to get a refund and be rid of the lemon vehicle.

The above case studies demonstrate that the purchase of lemon vehicles is a problem that affects both new and used cars, and other vehicles such as motor homes and motorcycles.

(ii) Types of vehicles that should be given lemon law protection

An important issue regarding the proposed lemon laws will be to determine which kinds of vehicles the laws cover. Consumer Action believes that if the laws are going to have the most effect for consumers, then they should extend beyond new cars alone.

To get an idea of the range of vehicles that lemon laws have been used to protect, it is useful to look at the different protection offered by different states in the United States. In Texas, lemon laws apply to new purchases and leases of cars, trucks, vans, motorcycles, all terrain vehicles and towable recreational vehicles (the laws exclude boats, farm equipment and non-travel trailers).⁴ In New York, lemon law protection extends to purchases and leases of used cars and motorcycles.⁵ A number of US states extend lemon law protection to motorised wheelchairs.⁶

The most practicable way of protecting Victorian consumers through lemon laws is to ensure that lemon laws cover all new road vehicles of a kind ordinarily acquired for personal, domestic or household use.⁷ Any application of the preceding criteria would obviously cover new cars, motorcycles/mopeds and passenger vehicles (eg. passenger minivans) and motor homes. Although not a road vehicle, we believe that purchasers of new motorised wheelchairs should benefit from lemon law protection. To restrict lemon laws solely to new cars would be arbitrary, and would fail to provide uniform consumer protection. Users of passenger minivans are consumers, as are users of motorcycles/mopeds and motorised wheelchairs. In the case of motorcycle/moped purchasers and motorised wheelchair purchasers, these consumers may be especially vulnerable because they may be low-income consumers (in the case of motorcycle/moped purchasers) and elderly or disabled consumers (in the case of motorised wheelchair purchasers).

We also believe that used cars that are sold by dealers and that fall within the ambit of section 54 of the MCTA should be subject to the proposed Victorian lemon law. We note that the Government's election commitment to introduce lemon laws covered 'motor vehicles and other major product purchases', and this was not limited to new cars.⁸ Further, sales of used cars amount to approximately 35% of dealer car sales.⁹

It is Consumer Action's experience that some used cars are sold in a poor state of repair, and often in circumstances where the consumer lacked knowledge about the quality of the car. For example, Consumer Action has received numerous complaints about Motor Finance Wizard during the last 12 months. Motor Finance Wizard sell used cars on instalment contracts to credit-impaired (usually low-income) consumers. The poor quality of

⁴ Texas Department of Transportation, Motor Vehicle Division, *Texas Lemon Law and General Warranty Complaints*, revised January 2004, page 6.

⁵ State of New York, Office of the Attorney General, *New York's Used Car Lemon Law: A Guide for Consumers*, April 2006, page 1.

⁶ Attorney General of New York State, Andrew M Cuomo, *New York's Motorized Wheelchair Lemon Law*, FAQ, http://www.oag.state.ny.us/health/wheelchair_law.html, extracted 19 October 2007.

⁷ This is similar to the definition of 'consumer contract' in section 3 of the *Fair Trading Act (Vic) 1999*.

⁸ Australian Labor Party, *Addressing disadvantage – investing in a fairer Victoria*, Policy for the 2006 Victorian Election, p 18.

⁹ Price Waterhouse Coopers, *Department of Equity & Fair Trading NCP Review of the Auctioneers and Agents Act*, May 2000, page 95.

cars has meant that many consumers have returned cars prior to the completion of the contract (leaving them with an outstanding debt). Often, the car is superficially repaired and re-sold. We are also increasingly seeing problems with roadworthy certificates being issued in relation to used cars, despite the cars not being in a roadworthy state. We are concerned that in many cases repairers that are linked with traders are providing these certificates, and are not undertaking the appropriate safety checks.¹⁰ Consumer Action does not believe purchasers of used cars should be in any worse position as to their legal rights in comparison with purchasers of new cars.

Considering this, for there to be consistent consumer protection it is necessary for lemon laws to cover the sale of used vehicles by dealers. We agree that there should be limits on the applicability of lemon laws to used cars. It would be simplest and easiest to use section 54 of the MCTA to provide the necessary limits. Section 54 does not apply to cars that are more than 10 years old or that have been driven for more than 160,000km. Section 54 could be used as a limiting device, whereby only those cars subject to section 54 are subject to lemon laws.

It is not clear whether it is practicable to extend lemon protection to used vehicles that are not motor cars. Consumer Action takes that view that it would be helpful to consumers to extend lemon law protection to the sale of used motorcycles (as has been done in New York).¹¹

(iii) Defining a lemon

New vehicles

Consumer Action supports the proposal to introduce lemon laws by way of amending the FTA to incorporate a deemed breach of the merchantability implied term. We note that in other jurisdictions, vehicles are deemed to be not of merchantable quality if there have been three repair attempts or the vehicle has been out of service for a cumulative period of 20 or more days within one year from the date of purchase. We would support similar presumptions operating in Victoria.

The laws should ensure, however, that there is no extra requirement is no extra requirement on a consumer to prove that the vehicle has a defect that 'substantially impairs its use, value or safety'. The intent of the presumptions should be to provide a clear statement of circumstances in which consumers will have a remedy, and requiring consumers to prove substantial impairment, or something similar, would create uncertainty in the law that some traders would exploit to the detriment of consumers.

We believe that lemon laws should provide protection to vehicles during the first two years after their sale. This should mean that if a vehicle gets re-sold within that period (perhaps because a consumer is sick of it breaking down), the law still protects a subsequent owner up to two years after the original purchase of the vehicle.

¹⁰ We acknowledge that a roadworthy certificate relates to the safety of a car, not its mechanical soundness. Many consumers, however, are not aware of this fact.

¹¹ State of New York, Office of the Attorney General, *New York's Used Car Lemon Law: A Guide for Consumers*, April 2006, page 1.

If the vehicle is a lemon and consumers have a remedy, the remedy should give them a choice of a refund or a replacement vehicle.

Used vehicles

One way of defining a lemon in relation to used vehicles is to use exactly the same formulation as used for new vehicles, but to apply it only where the vehicle is subject to section 54 of the MCTA.

The advantage of this definition is that it is clear and requires minimal legislative change. The disadvantage is that this definition would apply only to used cars, and would exclude other used road vehicles such as motorcycles. We believe that similar protection should apply to used vehicles other than cars.

(iv) Alternative dispute resolution (ADR)

Consumer Action does not support a mandatory requirement that consumers attend ADR before filing an application in VCAT. Requiring consumers to attend ADR before initiating VCAT action will cause delay in consumer claims being finalised, and attrition of claims. In Consumer Action's experience, consumers who have complaints about goods or services are often 'shunted' between a trader, advice service (such as CAV) and VCAT. This commonly results them giving up, with the consumer bearing the costs of defect goods or poor service. The goal for any dispute resolution process should be ensure that it is as seamless as possible from a consumer's perspective.

Requiring pre-filing mediation simply imposes another hurdle in the path of consumers who wish to have a lemon vehicle replaced or the purchase price refunded. Making an application in VCAT is difficult enough, and will cause attrition of consumers who do not have the skills to make an application or who are overwhelmed by the process. Requiring mandatory pre-filing ADR will cause further attrition of consumers who are overwhelmed by the greater time and complexity this will inevitably introduce. Additionally, in Consumer Action's experience, a motor car trader that refuses to make a refund or replace a vehicle is unlikely to seriously negotiate until VCAT action has been initiated. We believe that introducing a requirement that consumers attend ADR as a condition precedent to filing a VCAT application will lead to valid cases not being pursued.

In practice, VCAT requires parties in the civil list to attend a pre-trial mediation conference.¹² This provides an opportunity for mediation that is less likely to lead to attrition of valid complaints because it happens after filing which is a 'threshold step' for many consumers.

It is our view that the law should empower consumers and make it as easy as possible for them to enforce their rights. Unfamiliarity with the legal processes and lack of information are two significant causes of consumers 'giving up' and dropping their claims. Consumer Action suggests that one way to resolve this is to change the law to require traders to inform consumers of their rights and the legal avenues open to them. In the case of lemon

¹² *Victorian Civil and Administrative Tribunal Act (Vic) 1998*, section 83.

vehicles, traders should be compelled to give consumers information about their lemon law rights whenever a consumer returns a defective vehicle for servicing.

Consumer Action does believe more could be done to improve dispute resolution in the motor car industry. In particular, we believe the introduction of a compulsory industry-based external dispute resolution (**EDR**) scheme would be an excellent way of improving the resolution of consumer disputes in relation to motor cars. Industry-based EDR schemes exist in many other industries, including energy, water, telecommunications and financial services. Generally, such schemes are supported by consumers and industry alike, as they provide cheap, fair and accessible dispute resolution. We note that Mr Noel Pullen MP recommended consideration of the establishment of an industry-based EDR scheme for the motor vehicle industry in his independent review of the MCTA.¹³ The Victorian Government supported this recommendation.¹⁴

The Victorian Government could introduce an industry-based EDR in the motor vehicle industry by making membership of such a scheme a condition of holding a licence to trade in motor vehicles. If such a scheme were introduced, consumers would have access to a cost free dispute resolution service (all costs being paid by industry), that is independent, and that can make decisions binding on the industry member. We strongly welcome further consideration of such a scheme as part of the current consultations.

(v) Charge to consumers for use of lemon vehicle

Consumer Action does not support the imposition of an obligation on consumers to pay for 'reasonable amount' for use of a lemon vehicle for those periods when the consumer has been able to use the vehicle. However, if consumers are to be required to pay for use of a lemon vehicle they should, at the very least, only be required to pay for the period between purchase and the first occurrence of the vehicle being off-road due to defect and service. Consumer Action believes that if a 'reasonable amount' charge is implemented, as for instance is the case in many US states,¹⁵ the amount the consumer is obligated to pay should be an amount that is capable of objective calculation and not an ill-defined, or defined in a manner not capable of objective mathematical estimation.

There are issues about how to calculate a charge for use of a vehicle. Consumer Action believes that the amount should be based on a mathematical formula (eg. based on the purchase price of the vehicle and the amount of time it has been used by the consumer). Our concern is that if the amount is ill-defined, then traders will use the requirement to pay a 'reasonable amount' as a bargaining tool to put pressure on consumers not to pursue claims.

If manufacturers or dealers are to be allowed to charge consumers a fee for use, the right should be limited to the period from the time when the purchaser or lessee first bought the vehicle until the time that the purchaser or lessee first notifies the manufacturer, importer or

¹³ Noel Pullen MP, *A report on the Motor Car Traders Act consultations*, December 2004, 74.

¹⁴ Consumer Affairs Victoria, *The Victorian Government's response to Mr Noel Pullen MP's Report on the Motor Car Traders Act Consultations*, May 2006, page 31.

¹⁵ For example, in the state of Maine manufacturers or importers can deduct 'a reasonable allowance for use'. Maine Attorney General, *Maine Consumer Law Guide: The Maine Lemon Law and State Arbitration*, revised 3 March 2004, 7 – 3.

dealer of a defect. Consumers should not have to pay for sporadic use of a vehicle between repair efforts.

(vi) Re-sale of lemon buy-backs

A consequence of having lemon laws is that there will be an economic incentive for manufacturers or importers to re-sell lemon vehicles. The re-sale of lemon vehicles creates the risk that the vehicles problems continue affecting the new purchaser. Therefore, any system that introduces lemon laws will need to introduce laws that regulate the re-sale of lemon vehicles that have been bought-back from consumers.

In the United States, the problem is solved by forcing re-sellers of lemons to disclose that the vehicle has been returned to the manufacturer or importer as a lemon, and requiring re-sold lemons to include mandatory warranties.¹⁶

In a Victorian context, the disclosure laws in the United States should be replicated. All re-sellers of lemon vehicles should be required to disclose that the vehicle is a lemon buy-back. This notice should feature conspicuously (eg. in bold font) in the contract of sale, and a notice should be physically attached to the vehicle in a prominent place (eg. as a sticker attached to the driver's side door).

Any reseller of lemon vehicles in Victoria should be required to provide a mandatory minimum warranty. In the case of used vehicles, the mandatory warranty in section 54 of the MCTA is a suitable warranty. In relation to the resale of new car lemon buy-backs, it may be that a more extensive mandatory warranty could be introduced, or that the section 54 warranty would apply.

Consumer Action sees the resale of lemon buy-backs as a significant risk in the introduction of the proposed Victorian lemon law scheme. Resale laws are often skirted, such as when there was systemic selling of lemons with out notice in California in 1997¹⁷ and 2002.¹⁸ It has also been noted in the United States that manufacturers and importers can sidestep the lemon laws by reselling lemon vehicles in states with laxer laws.¹⁹

The regulator, Consumer Affairs Victoria, will have to be sufficiently resourced to ensure that lemons are not being re-sold in breach of the proposed laws. Victorian consumers will view the laws to have failed if there comes to be systemic selling of lemons without notice. We note that if restrictions on resales of lemon vehicles are implemented in Victoria (as is suggested) then there is an incentive for importers and manufacturers to ship the vehicles to other states. All States and Territories have mandatory minimum warranties for used cars

¹⁶ In North Dakota, the mandatory warranty is the lesser of 1 year or 12000 miles. Office of the Attorney General of North Dakota, Consumer Protection Division, *North Dakota's "Lemon" Law*, page 2.

¹⁷ Siskos, Catherine, *Recycling troubled cars*, Kiplinger's Personal Finance Magazine, Volume 54, Issue 2, February 1997, page 124.

¹⁸ Holt, Janet, *Sellers of 'laundered lemons' forced to come clean (Johnston v Ford Motor Co.)*, Trial, April 2002, page 78.

¹⁹ Ibid.

sold by dealers.²⁰ These mandatory warranties would provide some protection to purchasers outside Victoria who purchase a car that has been previously bought-back as a lemon.

Unfortunately, Victoria would not be able to enforce disclosure requirements in relation to lemon vehicles bought-back in Victoria, but transported and sold interstate.

This would not affect Victorian consumers. However, until all States and Territories introduce lemon laws, consumers of second-hand cars in these States and Territories may unwittingly purchase vehicles that have underlying defects and that were bought-back in Victoria. For this reason, the issue should be brought to the attention of the Ministerial Council on Consumer Affairs.

Conclusion

Consumer Action is pleased that the Victorian Government has taken the initiative to present proposals for lemon laws to protect Victorian consumers. Consumer Action considers lemon laws a valuable tool for consumer protection.

Should you have any questions about this submission, please contact Neil Ashton on 03 9670 5088.



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²⁰ The cars to which mandatory warranty protection extends differs state-to-state, but many states and territories impose a mandatory warranty on cars not more than 10 years old that have traveled less than 160,000 kilometres (ie. they use the same wording as section 54 of the *Motor Car Dealers Act (Vic) 1986*).