UNFAIR BUT NOT ILLEGAL

Are Australia's consumer protection laws allowing predatory businesses to flourish?

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Predatory businesses that systematically take advantage of vulnerable consumers are far too common. While most commerce in Australia is conducted fairly and in a way that benefits consumers, there are still many businesses that take advantage of the poorest and most vulnerable in our community.

There are a range of possible legislative responses to predatory business behaviour. Governments can introduce 'bright line' rules that regulate specific business practices, such as payday loans or door-to-door sales. However, general protections that are 'standards-based' are important as well — the most relevant being the prohibitions against misleading and deceptive, and unconscionable conduct, in various consumer laws.[1] Standards-based rules help to fill the gaps left by bright line rules, which often struggle to keep pace with emerging predatory business models.[2]

These core consumer protections have enabled effective enforcement action against some very sharp business practices. However, some unfair business models continue to flourish. This article examines some of the common unfair business models in today's marketplace and the role of our existing consumer laws. In particular, the article considers the core prohibition designed to protect vulnerable consumers — the prohibition against unconscionable conduct. The article argues that this prohibition, based on equitable principles around conscience and morality, is outdated in today's modern services-driven economy. A new prohibition on unfair trading, drawing on similar laws in the European Union ('EU') and the United States ('US'), may be more effective at tackling these business models.

Predatory business models

In each of the models discussed below, the businesses use unfair tactics to target consumers with unsuitable products or confusing contracts. Generally consumers end up with a product that is unsuitable for their needs or which they can't afford.

Credit repair

Credit repair companies ('CRCs') charge very high up-front fees, sometimes thousands of dollars, to 'repair' customers' credit histories. People who contact CRCs may not understand Australia's credit reporting system and are often experiencing acute financial stress. This means that they are vulnerable to high-pressure sales techniques and unrealistic promises.

The promise at the centre of this business model is that CRCs will remove barriers to accessing credit, which many consumers hope will relieve financial pressure. Many Australians believe, wrongly, that CRCs can remove legitimate listings from their credit files. Capitalising on this lack of understanding, often CRCs fail to tell their clients that, in some cases, they can amend incorrect listings on their own credit reports simply by contacting their creditors directly. Instead, CRCs charge high fees for services provided free of charge by industry ombudsmen, financial counselling services and community legal centres. CRCs are also reluctant to publicise their fees and often impose large additional charges for late payment, cancellation or other 'administrative' services.[3]

For-profit debt negotiation

For-profit debt negotiators or debt settlement companies promise to settle a consumer's debt for a fraction of what they owe. The idea is simple: debt settlement companies offer to negotiate down the outstanding debt (usually from credit cards or personal loans) owed to a more manageable amount so that the consumer can become debt free. Unfortunately debt settlement carries significant risks that may result in consumers becoming even worse off.

Debt settlement is an inherently risky venture: often the advice is for consumers to default on their debt which can result in fees, increased interest rates, and sometimes even legal action by creditors. Even after assuming all of this risk, consumers are offered no guarantees. In fact, some creditors refuse to negotiate with these businesses at all. Even if a settlement is reached, a consumer unable to keep up with the new settlement arrangement risks falling back into default.

These businesses regularly target their marketing efforts at those who are heavily in debt and thus vulnerable to accepting their promises. For example, these businesses purchase lists of judgment debtors or trawl court lists with details of bankruptcy and home repossession. Consumers on these lists can find themselves inundated with marketing paraphernalia and promises to 'solve' their debt stress.

Car napping

Many Australians have little understanding about their rights and obligations when involved in collisions, and they can be vulnerable to traps orchestrated by towers, repairers and debt collection lawyers.[4] At accident scenes, drivers who are not-at-fault may be approached and offered a towing service by tow-truck drivers. They

REFERENCES

1. *Competition & Consumer Act 2010* (Cth), Schedule 2 - The Australian Consumer Law, s 18, s 21; *Australian Securities and Investments Act 2001* (Cth), s 12CA, s 12CB

2. See Jeannie Paterson and Gerard Brody, 'Safety Net Consumer Protections' (2015) *Journal of Consumer Policy* 38(3), 331–55.

3. Paul Ali, Lucinda O'Brien and Ian Ramsay, 'A Quick fix? Credit Repair in Australia' (2015) 43(3) *Australian Business Law Review*, 179–205.

4. Josie Taylor, 'Suncorp reports spike in smash repairers car-napping vehicles and holding owners to ransom', *ABC News (*online), 6 November 2015 <http://www.abc.net.au/news/2015-11-05/suncorp-sees-rise-in-car-napping-vehicles-held-for-ransom/6914588>.

may be asked to sign paperwork to facilitate this, often at the roadside. Unbeknown to them, this paperwork may be providing the repairer with authority to store and repair a vehicle, and also an authority to a lawyer to seek recovery of costs from the 'at fault' driver. The driver is sometimes told that the repairer is quick or cheap, or that it has a free hire car. In some cases, drivers may be told that this is a better option than involving insurance companies, because claiming may impact their no-claim bonus.

This practice is known as 'car-napping', as the driver may later be asked to pay significant amounts for repair and storage to recover their vehicle if these amounts cannot be recovered from the other driver (or their insurer). The practice can impact the 'at fault' driver as well, when they or their insurance company are targeted with inflated claims for the cost of repairs. In some instances, this results in court action initiated by the lawyer acting on behalf of the 'not at fault' driver, commonly without the full knowledge of that driver.

The limitations of unconscionable conduct provisions

What are the prohibitions against unconscionable conduct?

The primary standards-based rules to protect vulnerable consumers are the prohibitions against unconscionable conduct. The law of unconscionable conduct has its roots in the doctrines of the courts of equity, developed over the course of several centuries, to do what justice required in cases where the strict application of the law would be unduly harsh.[5] In Australia, the two key cases of *Blomley v Ryan*[6] in 1956 and *Commercial Bank of Australia Ltd v Amadio*[7] in 1983 set the tone of the judge-made law on unconscionable conduct, which may be characterised as addressing a situation where one party to a transaction is at a special disadvantage in dealing with the other, and the other party then 'unconscientiously takes advantage of the opportunity thus placed in his hands'.[8]

Prohibitions against unconscionable conduct became part of the statutory consumer protection regime in 1986, and were later introduced into a range of other legislation including the *Australian Securities & Investments Commission Act 2001* (Cth) ('ASIC Act'). The relevant provisions were initially introduced into the *Trade Practices Act 1974* (repealed), but are now part of the Australian Consumer Law ('ACL').[9]

The ACL has two substantive provisions relating to unconscionable conduct.[10] The first prohibits unconscionable conduct 'within the meaning of the unwritten law from time to time'. The courts have not settled on what constitutes such conduct, but it is generally understood to refer to the situations described in *Blomley* and *Amadio*.

The second prohibition, often referred to as 'statutory unconscionable conduct', is a broader concept.[11] For example, the prohibition now states:

- it is not limited by the unwritten law relating to unconscionable conduct; and
- it is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour; and
- it is not limited to conduct relating to the formation of a contract, and consideration may be given to the terms of the contract and the manner in which and the extent to which the contract is carried out.

The ACL also sets out a list of factors to which the court may have regard when considering whether there has been statutory unconscionable conduct, including the relative bargaining positions of the parties, and whether the consumer was under influence or pressure.[12] This is not an exhaustive list. This provision, however, does not have a settled legal meaning.

Unconscionable conduct involves a high threshold of misconduct

The prohibition imposes a high threshold before conduct will be considered 'unconscionable'. Conduct that is simply unfair will not be sufficient.

This high threshold makes it difficult for regulators to take action against traders that test the boundaries. In a submission to a 2013 Senate Inquiry, the Australian Securities and Investments Commission ('ASIC') stated:

> The courts have set a high bar for establishing unconscionability, particularly for commercial transactions. Whether a specific transaction is unconscionable depends on the individual facts and circumstances of the case. A general power imbalance between parties or a contract that favours one party more than the other is not sufficient to support a claim of unconscionable conduct.[13]

Further, the unconscionable conduct provisions do not actually prohibit unfair trading. The Federal Court recently stated that 'conduct which is unfair or unreasonable is not for those reasons alone unconscionable'.[14] The prohibition imposes a

5. Many of the early cases concerning what could be described as unconscionable conduct focused on 'catching bargains', or deals struck between moneylenders and expectant heirs at usurious rates of interest. For an account of the development of the law of unconscionable conduct generally see JW Carter, Elisabeth Peden and GJ Tolhurst, *Contract Law in Australia* (LexisNexis, 5th ed, 2007) 517–9.

6. *Blomley v Ryan* (1956) 99 CLR 362.

7. *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.

8. *Blomley v Ryan* (1956) 99 CLR 362 at 415, per Kitto J.

9. *Competition & Consumer Act 2010* (Cth), Schedule 2 - The Australian Consumer Law.

10. These provisions are replicated in the ASIC Act in relation to financial services.

11. *Competition & Consumer Act 2010* (Cth), Schedule 2 - The Australian Consumer Law, s 21.

12. *Competition & Consumer Act 2010* (Cth), Schedule 2 - The Australian Consumer Law, s 22.

13. Australian Securities and Investments Commission, 'Senate Inquiry into the performance of the Australian Securities and Investments Commission - Submission by ASIC on reforms to the credit industry and 'low doc' loans', (October 2013) 6.

14. *Australian Competition and Consumer Commission v ACN 117 372 915 Pty Ltd (in Liq) (formerly Advanced Medical Institute Pty Ltd)* [2015] FCA 368 at [39].

The term 'unfair' [rather than 'unconscionability' and 'moral obloquy'] makes much more sense to consumers and traders, and would allow them to make at least a general assessment of the likely lawfulness of conduct themselves.

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Uncertainty of meaning

Various federal and state judiciaries have wrestled with the statutory concept of 'unconscionable conduct' and have arrived at different interpretations.[15] The High Court is yet to consider the statutory prohibition in any depth, meaning confusion is likely to persist in the lower courts for some time yet.

In *Attorney General (NSW) v World Best Holdings Ltd,*[16] Chief Justice Spigelman found that 'moral obloquy' needed to be found in order for conduct to be 'unconscionable'.[17] 'Moral obloquy' might be defined as disgraceful immoral conduct, such that deserves public condemnation.

In *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd,*[18] the Full Federal Court diminished the importance of the concept of moral obloquy. While noting that moral obloquy or moral tainting might be relevant, the Court ruled that the court should be concerned with 'conduct against conscience by reference to the norms of society that is in question.' This approach has been followed in other Federal Court decisions, such as *Australian Competition and Consumer Commission v Coles Supermarkets Australia Pty Ltd19* and *Paciocco v Australian and New Zealand Banking Group Ltd.20*

However, the Victorian Supreme Court of Appeal decision of *Director of Consumer Affairs (Vic) v Scully (No 3)* ('the Scully decision')[21] reverted to the narrower and restrictive interpretation by requiring moral obloquy once again. This approach has been followed by subsequent Victorian Supreme Court cases, including *DPN Solutions Pty Ltd v Tridant Pty Ltd*[22] and *Sgargetta v National Australia Bank Ltd.*[23]

It seems that two differing lines of authority are developing around the meaning of unconscionable conduct in the Federal Court and Victorian Supreme Court, again demonstrating the difficulty of applying this imprecise concept. In fact, the Full Federal Court has acknowledged that it is futile to attempt to define the concept of unconscionable conduct, saying:

> any agonised search for definition, for distilled epitomes or for short hands of broad social norms and general principles will lead to disappointment, to a sense of futility, and to the likelihood of error. The evaluation is not a process of deductive reasoning predicated upon the presence or absence of fixed elements or fixed rules.[24]

Some judges appear to believe that the statutory prohibition 'could result in the transformation of commercial relationships in a manner which … was not the intention of the legislation.'[25] This concern appears to have unnecessarily limited the application of the prohibition against unconscionable conduct in some courts to those cases that involve 'moral obloquy'. This sentiment appears to be shared by the High Court, with the Court in *Kakavas v Crown Melbourne Limited* toying with the idea that moral obloquy was relevant in evaluating unconscionability, although not deciding the matter.[26]

Difficulties in enforcement

If a regulator chooses to proceed with an unconscionable conduct case, it will face evidentiary challenges. Victims are often vulnerable and disadvantaged consumers, and raise particular issues for enforcement activity. They are often less willing to complain, more easily intimidated, less likely to have retained documentary records and less likely to perform well as witnesses in court proceedings where among other things they can be readily confused under skilled cross examination.[27] As such, regulators may face barriers when taking on cases affecting vulnerable and disadvantaged consumers that significantly rely on individual consumer testimony. In the regulators' defence, courts and the rules of evidence are not generally open to approaches that may ameliorate the impact on vulnerable consumers.

Community understanding

Perhaps most importantly, however, is the complexity of the phrase 'unconscionable conduct' itself. Ask an average business owner or consumer what the phrase 'unconscionable conduct' means and you are likely to get a blank stare in response. Business people deciding whether to pursue a particular marketing strategy should not have to delve into case law to discover whether that strategy will operate within the limits of the law. Nor should a consumer have to consider the interplay between equity and statute law when determining whether they have a remedy against a dodgy trader. 'Unconscionable' is not commonly understood, and makes it difficult for businesses and consumers alike to recognise when conduct may be 'unconscionable'.

Developments abroad

For many years, there has been discussion in Australia of the possibility of extending the prohibition on

15. Stephen Corones et al, *Comparative Analysis of Overseas Consumer Policy Frameworks* (QUT, April 2016) <http://consumerlaw.gov.au/files/2016/05/ACL_Comparative-analysis-overseas-consumer-policy-frameworks-1.pdf> Part 3.2.4, 22.

16. *Attorney General (NSW) v World Best Holdings Ltd* [2005] 63 NSWLR 557.

17. Bob Baxt, 'A clear definition', *Company Director* (May 2015) 58.

18. *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd* [2013] FCAFC 90.

19. *Australian Competition and Consumer Commission v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405.

20. *Paciocco v Australian and New Zealand Banking Group Ltd* [2015] FCAFC 50.

21. *Director of Consumer Affairs (Vic) v Scully (No. 3) [*2013] VSCA 292.

22. *DPN Solutions Pty Ltd v Tridant Pty Ltd* [2014] VSC 511.

23. *Sgargetta v National Australia Bank Ltd* [2014] VSCA 159.

24. *Paciocco v Australian and New Zealand Banking Group Ltd* [2015] FCAFC 50 at [304].

25. *Attorney General (NSW) v World Best Holdings Ltd* [2005] 63 NSWLR 557 at [121].

26. *Kakavas v Crown Melbourne Limited* (2013) 250 CLR 392. See also *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28.

27. See Australian Law Reform Commission, *Uniform Evidence Law: Examination and cross-Examination of Witnesses* (ALRC Report 102, 8 February 2006) ch 5 <http://www.alrc.gov.au/publications/5.%20Examination%20and%20Cross-Examination%20of%20Witnesses%20/examination-witnesses>.

unconscionable conduct to a prohibition on unfair trading.[28] Both the US and the EU have prohibitions outlawing unfair trade practices.

United States

Section 5 of the *Federal Trade Commission Act* prohibits unfair or deceptive acts or practices in or affecting commerce. Under this provision, an act or practice is unfair if it is likely to cause substantial consumer injury, the injury is not reasonably avoidable by consumers, and the injury is not outweighed by benefits to consumers or competition.[29]

This provision has been interpreted in an economic way, considering whether the costs to consumers of particular acts or practices are outweighed by countervailing benefits to consumers or competition. Unlike the Australian prohibition on unconscionable conduct which is based on moral standards of conscience, this prohibition might be viewed as a type of cost-benefit analysis. Indeed, the Federal Trade Commission ('FTC') has stated that it will not consider non-economic factors, such as whether the practice violates public morals, in deciding whether to prosecute conduct as an unfair method of competition.[30]

This provision has been used by the FTC in relation to practices that are arguably not unconscionable. For example, a company that markets home security video cameras settled an unfair practices claim initiated by the FTC, after it was found that the cameras had faulty software that left them open to online viewing such that they were not 'secure'.[31] Such a provision might also be used in relation to debt negotiation or car-napping, described above. For example, these practices might not only harm individual consumers, but may cause harm to other industry participants, such as banks or insurers. They are unlikely to deliver countervailing benefits to consumers or competition.

Europe

One feature of the comprehensive scheme on consumer protection in the European Union is the Unfair Commercial Practices Directive ('the EU Directive').[32] The EU Directive takes a three-tiered approach which consists of a general prohibition of unfair commercial practices, prohibitions against practices that are misleading (whether by act or omission) or aggressive, and 31 specific practices that are prohibited in all circumstances.[33]

A business will contravene the first tier, the general prohibition of unfair commercial practices, if it is contrary to the requirements of professional diligence, and it materially distorts (or is likely to materially distort) the economic behaviour of the average customer to whom it is addressed.[34] Economic behaviour will be 'materially distorted' if, for example, the average consumer would buy a product they would not otherwise have bought.

The second tier prohibition against misleading acts/omissions[35] and aggressive practices[36] focusses on whether the business' conduct has caused the average consumer to make decisions they wouldn't otherwise have made. In relation to aggressive practices, there is also consideration of the impact the business' conduct has on the average consumer's 'freedom of choice' concerning the product.

An unfair trading provision for Australia

Drawing on the international approaches, there are three ways in which Australia's existing prohibition could be enhanced. First, being more specific about aggressive market practices; secondly, extending to misleading omissions; and thirdly, becoming prospective.

The first enhancement might involve defining aggressive market practices — not as in specific conduct or practices, but in terms of the effect of such practices on consumer decision-making. This picks up on the EU Directive's focus on conduct that 'materially distorts' the economic behaviour of the 'average consumer' or 'significantly impairs the average consumer's freedom of choice or conduct'. Rather than focusing on whether the conduct offends conscience, such analysis can bring in consideration of consumers' behavioural biases that might be exploited by traders. For example, tactics used by some in-home salespeople that make it more likely that a consumer will sign up may be caught. Framed in this way, the prohibition is more likely to be pro-competitive, as it promotes consumer choice.

The second enhancement relates to misleading omissions. Australia's existing prohibition on misleading or deceptive conduct (or conduct that is likely to mislead or deceive) does extend to misleading omissions. However, cases such as *Australian Competition and Consumer Commission v AGL South Australia Pty Ltd* show that misleading omissions will not be caught unless there is a 'reasonable expectation for disclosure'.*37* The EU Directive is broader, covering conduct by a trader that 'hides or provides [material information] in an unclear, unintelligible, ambiguous or untimely manner'.[38] This approach would require traders to bring much more clarity to their marketing and business practices than the current Australian provisions.

The third enhancement would be to make the prohibition prospective. Currently, the prohibition on unconscionable conduct applies to past conduct. This contrasts with the EU Directive where the prohibition includes conduct that 'is likely to' significantly impair the average consumer's freedom of choice or conduct concerning the product or 'is likely to' result in the average consumer making a different transaction decision. This approach aligns with the prohibition on conduct that 'is likely to' mislead or deceive. Such an approach may mean that a regulator does not need to prove that the conduct occurred and harm resulted. It may also mean that the regulator does not need to rely on vulnerable witnesses. Instead, a broader range of evidence could be considered, including survey evidence or evidence from experts about consumer decision-making.

28. Productivity Commission, 'Review of Australia's Consumer Policy Framework: Productivity Commission Inquiry Report', (30 April 2008), vol 2, 141.

29. 15 USC § 45(n) (2012). See also FTC Policy Statement on Unfairness (appended to Int'l Harvester Co, 104 E.T.C. 949, 1070 (1984)).

30. Commissioner Joshua D Wright, 'Proposed policy statement regarding unfair methods of competition under section 5 of the Federal Trade Commission Act' (19 June 2013) <https://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf>

31. Federal Trade Commission, 'Marketer of Internet-Connected Home Security Video Cameras Settles FTC Charges it failed to protect consumers' privacy' (Media Release, 4 September 2013) <https://www.ftc.gov/news-events/press-releases/2013/09/marketer-internet-connected-home-security-video-cameras-settles>.

32. European Commission, *Directive 2005/29/EC on Unfair Commercial Practices*, [2005] OJ L 149/22 <http://ec.europa.eu/consumers/consumer_rights/unfair-trade/unfair-practices/index_en.htm>. Implemented in the UK through the *Consumer Protection from Unfair Trading Regulations 2008*.

33. See Paterson and Brody, above n 2, 331.

34. *Directive 2005/29/EC on Unfair Commercial Practices*, [2005] OJ L 149/22 Article 5.

35. *Directive 2005/29/EC on Unfair Commercial Practices*, [2005] OJ L 149/22 Articles 5 and 7.

36. *Directive 2005/29/EC on Unfair Commercial Practices*, [2005] OJ L 149/22 Article 8.

37. *Australian Competition and Consumer Commission v AGL South Australia Pty Ltd* [2014] FCA 1369.

38. *Directive 2005/29/EC on Unfair Commercial Practices*, [2005] OJ L 149/22 Art 7.

An unfair trading prohibition also provides a lifeline to regulators. … Regulators may be more proactive, with powers to intervene before significant harm has occurred, rather than engage in late-stage intervention strategies.

The benefits of an unfair trading prohibition

The benefits of introducing a general unfair practices provision extend beyond simply providing better protections to consumers. There are also economic and social benefits for the broader community.

The Productivity Commission has suggested that allowing market misconduct to occur without redress can be anti-competitive in that it gives legally non-compliant traders an advantage over those that do comply.[39] Allowing consumers and 'fair' businesses to absorb the cost of the practices of unfair traders is inefficient and does not promote productivity. In addition, unfair practices have a detrimental impact on consumer confidence, which affects the business community more broadly. An unfair trading prohibition would arguably increase competition and consumer confidence, to the benefit of all 'fair' traders.

An unfair trading prohibition also provides a lifeline to regulators. Such a provision would enable regulators to prosecute traders based on their business models, rather than focus on individual incidents of past misconduct. Regulators may be more proactive, with powers to intervene before significant harm has occurred, rather than engage in late-stage intervention strategies.

Any standard for unfair trading should be linked to the distortion of economic behaviour, which is more certain than the morally-rooted concepts of 'unconscionability' and 'moral obloquy'. The term 'unfair' makes much more sense to consumers and traders, and would allow them to make at least a general assessment of the likely lawfulness of conduct themselves. This could have clear compliance benefits.

Conclusion

Unfair business models will continue to thrive until we seal the gaps in our consumer protection laws. While existing prohibitions against unconscionable and misleading conduct have served the community well, further reform is needed to stamp out unfair practices. The government will be reviewing the Australian Consumer Law in 2016, and must consider whether it is time for a new standard that demands businesses treat consumers fairly. But a general prohibition against unfair practices is not just important for consumers. Robust protections for consumers would level the playing field between those who seek to do the right thing by consumers and those who don't. The introduction of an unfair trading prohibition would be a win for consumers, 'fair' businesses, and the economy.

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39. Productivity Commission, above n 28, 193.