THE CONSUMER CREDIT CODE - THE EFFECT OF NON-COMPLIANCE

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INTRODUCTION

In this paper, I propose:

1. to consider the role of civil penalties in achieving the policy objectives of the Consumer Credit Code;[1]

2. to examine some of the differences between the civil penalties regime under the Credit Acts[2] and the civil penalties regime under the Code.

3. to consider the circumstances in which, under the Code, a credit provider might make a civil penalty application;

4. to look at some of the practicalities involved in making such an application; and

5. to examine the interaction between compliance programmes and civil penalty applications under the Code.

THE RELATIONSHIP BETWEEN TRUTH IN LENDING AND CIVIL PENALTIES

The fundamental policy objective of the Code is to achieve "truth in lending". This in turn may be broken down into the following elements:

- disclosure of information in relation to credit;

- which is adequate to enable an intending debtor properly to assess the credit; and

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1 I shall refer to the Consumer Credit Codes of the various States and Territories simply as "the Code".

2 New South Wales: Credit Act 1984 (NSW); Victoria: Credit Act 1984 (Vic); Western Australia: Credit Act 1984 (WA); Australian Capital Territory: Credit Act (formerly Ordinance) 1985 (ACT); Queensland: Credit Act 1987 (Qld). I shall refer to these comprehensively as "the Credit Act" and to the most common numbering of the relevant sections.

- which enables an intending debtor to compare that credit with other forms of credit which are available in the market place.

At the same time, the Code seeks:

- to enhance competition, so as to assist (it is hoped) in the development of a fair and efficient market for financial services;
- to ensure a more uniform regulation of credit (both by the Australia-wide cooperative scheme of regulation and by the extent of regulation - or the extent of exemption from regulation - under each Code);
- to promote diversity in the range of financial products available;
- to the extent that it is consistent with the underlying "truth in lending" rationale, to permit flexibility in the relationships between credit providers and debtors;
- to do away with the artificiality which attended the operation of the Act (eg, the housing loan credit orders and the term loan credit orders); and
- most importantly, to preserve the protections (as to enforcement and other matters) available under the Act, and to extend them to the significantly larger number of debtors (and contracts) which will be regulated.

The Code seeks to achieve its "truth in lending" objectives by a number of prescriptive provisions: most notably, by the disclosure requirements of section 14 (pre-contractual disclosure), section 15 (contractual disclosure), section 31 (obligation to furnish statements of account) and section 32 (disclosure in statements of account). The criminal penalties are undiscriminating in their application, in the sense that breaches of the Code are almost always attended by potential criminal liability (although of course the monetary amounts of that liability may vary). By contrast, the specific civil penalty provisions focus squarely on contractual and related disclosure obligations: see section 100 (key requirements). Having said that, section 114 (which contextually at least forms part of the Code's civil penalty regime) provides a civil consequence for contraventions other than those for which a civil effect is specifically provided. Presumably, section 114 was intended to act both as a stimulus to compliance generally, additional to that provided by the criminal penalties regime, and as a compensation mechanism.

Accordingly, the civil penalty provisions of the Code can be seen as buttressing the Code's truth in lending objectives. That function, of course, was also ascribed to the civil penalty provisions of the Credit Act. Under the Credit Act, a secondary function of the civil penalty regime was to compensate debtors for loss arising by reason of a contravention which triggered the civil penalty. Although in theory that remains a function of the civil penalty regime under the Code, in practice that purpose will only be served where the application is brought by a debtor or guarantor (because it is only in such cases that the civil penalty may be paid to the applicant (section 104(1), section 106).

Further, it may be thought that the changes to the civil penalty regime mean that it will be a less effective enforcement mechanism. This may be true (and it may very well reflect the view that credit providers have learned their lesson). However, should the civil penalty regime prove to be ineffective in enforcing compliance, we may confidently expect use to be made of the criminal penalty provisions of the Code.

CIVIL PENALTIES: THE CREDIT ACT VERSUS THE CODE

The most striking difference between the civil penalties regime under the Credit Act and the civil penalties regime under the Code is that, in the former, the civil penalties regime is automatic, in that (subject to section 85) it operates automatically and *ab initio*: see section 42. Thus, the civil penalties regime directly affects the contractual relationship between the credit provider and the debtor in that (subject to section 85) it disentitles the credit provider to receive, and disobliges the debtor to pay, any credit charge. By contrast, the civil penalty regime under the Code must be invoked by application (section 101). A contravention of a key requirement does not of itself have any operation upon the contractual relationship between the credit provider and the debtor. Such an effect could only arise consequentially (for example, by an order for set-off under section 104) or if the court, on application by the debtor or a guarantor, relied upon the breach of the relevant key disclosure requirement to adjudge the contract as unjust and thereby to reopen and vary the contract (sections 70, 71). In such cases, the impact on the contract of the civil penalty or the antecedent breach of a key disclosure requirement is not automatic, but the consequence of an application by a debtor or guarantor.

IN WHAT CIRCUMSTANCES SHOULD A CREDIT PROVIDER MAKE APPLICATION FOR A CIVIL PENALTY?

A credit provider who had incurred a civil penalty under the Credit Act, and who had not made an application under section 85 thereof, was not entitled to recover anything above the amount financed. In those circumstances, it is easy to see why there should be taken into account, in assessing the extent to which, under section 85, a credit provider should be relieved from the civil penalty, the promptness with which an application was brought.[3] Section 85(2) of the Credit Act directs attention to "the relevant circumstances, including the conduct of the credit provider and the debtor and loss or damage (if any) suffered by the debtor". Clearly, a credit provider's action, in receiving money to which it was not entitled when it knew or ought to have known that it was not entitled, could be regarded as relevant to the exercise of the section 85 discretion.

Such considerations dictated a view that a credit provider who became aware of non-compliance attracting the operation of section 42 of the Credit Act was in effect put to an election: either to make application under section 85, or to acknowledge the statutory forfeiture: ie, to accept an obey the operation of section 42.

By contrast, as I have already noted, the civil penalty provisions of the Code do not have automatic operation and do not directly diminish the credit provider's entitlements under the contract. Accordingly, it seems to me, there should be no imperative, moral or otherwise, which would direct the credit provider, upon becoming aware of a contravention of a key requirement, to make an application under section 101 of the Code. In my view, where a credit provider had reason to believe that the relevant contravention was random or "one off", it should be justified in not making an application. Unfortunately, this view seems to be at odds with section 102(4)(h) of the Code, which requires, when consideration is given to the imposition of a civil penalty, that regard must be had to "the time taken to make the application ...".

In any event, where the credit provider knew or had reason to believe that the contravention might be systemic or widespread, in my view a number of considerations would dictate that the credit provider should bring an application. This is so because:

- section 102(4)(h) so suggests;
- upon the making of such an application, applications by debtors or guarantors in respect of the same contravention are ousted (section 101(2));
- the finding of the court or tribunal, as to whether there has been a contravention, will bind all debtors whose contracts are affected by the contravention (section 102(1));
- the civil penalty Australia-wide would be capped at $500,000 (section 105(1)); and

3 See for example *Westpac Banking Corporation v Various Respondents (No 4)* ASC para 56-187 at 57,893: the list of relevant circumstances there set out has been adopted in other cases too numerous to justify citation.

- the outcome will govern all contracts Australia wide which are affected by the same contravention (section 105(2), (3), section 108).

At the same time, the right of debtors and guarantors to receive compensation for loss arising from the contravention is preserved (section 107(1); cf section 101(3)).

INTERVENTION BY DEBTORS AND GUARANTORS

Under the Credit Act, there was no doubt as to the entitlement of debtors to be involved in applications brought by credit providers for reinstatement of forfeited credit charges. The forfeiture operated directly on each contract made between a debtor and a credit provider, reducing the amount of the debtor's liability. Elementary considerations of procedural fairness dictated that debtors had an interest in the question of whether or not their liability should be increased, and a corresponding right to intervene in applications where that relief was sought.

Under the Code, as noted above, an order under the civil penalty provisions (regardless of whether the application brought by a credit provider or the Government Consumer Agency or a debtor or guarantor) does not directly affect the contractual relationship between the credit provider and a debtor, although the debtor's right to seek compensation is preserved (section 107). Further, in contrast to the case where the debtor is the applicant for a civil penalty, the debtor has no interest in the amount which may be ordered to be paid (section 106) and nothing more than a general interest in the outcome of the proceedings.

On balance, it is my view that debtors have no right of intervention in applications by a credit provider or the Government Consumer Agency.[4] If this be correct then it may hold out some hope that the duration and scope of such applications will be confined.

The recasting of the civil penalties regime, into one which, if it results in the imposition of a penalty, will (except in the case of applications made by debtors or guarantors) result in the payment of a civil penalty into a fund, serves only to blur the distinction between civil and criminal penalties.

There is a curious problem with section 102(4)(c) of the Code. That section directs the court, in mandatory terms, to have regard to "the loss or other detriment (if any) suffered by the debtor as a result of the contravention" in considering the imposition of a civil penalty. Nonetheless, as already noted a debtor's or guarantor's entitlement to an order for compensation for loss (section 107) is not ousted upon an application being made by a credit provider under section 101 (section 101(3)). If the civil penalty is to reflect inter alia loss or damage sustained by debtors (note: not guarantors) but at the same time debtors (and guarantors) have rights to recover loss or damage, then arguably the credit provider is exposed to the risk of a double penalty. This seems to be acknowledged, although in a rather back to front way, this seems to be confirmed, although in a rather back-to-front way, by section 107(4) which provides that an amount payable by way of compensation to debtors or guarantors does not affect the penalty which may be imposed under section 105: that is to say, it does not count towards the total of $500,000 which may be imposed for the same contravention, or group of contraventions, Australia-wide.

[4] Except, of course, to intervene and seek compensation for loss pursuant to section 107.

THE RELATIONSHIP BETWEEN COMPLIANCE SYSTEMS AND CIVIL PENALTIES

That such a relationship exists is clear. Section 102(4) of the Code dictates matters to which regard is to be had in considering the imposition of civil penalty. Those matters include:

> "(e) any systems or procedures of the credit provider to prevent or identify contraventions;
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> (f) whether the contravention could have been prevented by the credit provider;
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> (g) any action taken by the credit provider to remedy the contravention or compensate the debtor or to prevent further contraventions;".

It has been held, in relation to the civil penalty provided by the Credit Act, that the circumstances to be considered are those ordinarily to be taken into account in fixing a penalty for contravention of a statute.[5] Whatever doubt may have been felt in respect of the Credit Act[6] it is, I think, quite clear that this is the position in relation to the Code.

It follows, from the paragraphs of section 102(4) to which I have referred, that compliance systems (both as put in place at the inception of the Code and as modified from time to time in the light of operational experience) are relevant on the question of civil penalty. A credit provider which has taken "reasonable" steps to ensure, at the commencement of the Code (or at the commencement of undertaking lending activities which are regulated by the Code) that its compliance systems are adequate, and which monitors its compliance systems to ensure that they remain adequate, has a strong argument that the use of the civil penalty, as a stimulus to compliance,[7] is unnecessary.

So far, I have used quite deliberately the somewhat vague word "reasonable" as the measure of the credit provider's compliance obligations. I think it is fair to say that, whilst compliance with the requirements of the Code is an objective standard (in the sense that what is done can be seen, objectively, either to comply or not to comply), what is reasonable in an effort to achieve compliance may involve subjective considerations. Those considerations might have regard, for example, to the scope and nature of the credit provider's lending business; to the credit provider's size and the availability of resources; and indeed to the nature of the particular contravention under consideration.[8] The drafters of the Code have made laudable attempts to limit, in comparison with the Credit Act, the number of civil penalty triggers, and to restrict what has sometimes been perceived as the draconian operation of the Credit Act's civil penalties regime.[9] Nonetheless, it is at least possible that a credit provider, notwithstanding that it has used reasonable endeavours to introduce an effective compliance system, might find itself afflicted by contraventions of the Code which, in its view, would necessitate the bringing of a civil penalty application. Self-evidently, those circumstances would indicate that the credit provider's

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5 *Custom Credit Corporation Limited v Gray* (1992) 1 VR 540, 563; *Avco Financial Services Limited v Abschinski* (1994) 2 VR 659, 684 (Southwell J).

6 See Ormiston J in *Abschinski* at 713-714.

7 Cf *Canham v Australian Guarantee Corporation Limited* (1993) 31 NSWLR 246, 266 (Kirby P).

8 By this, I mean that it could be seen as "reasonable" for a credit provider to be more concerned with avoiding contraventions which, should they occur, might mislead or cause loss to debtors.

9 See the Second Reading Speech of the New South Wales Minister for Business and Consumer Affairs on the introduction of the Credit (Amendment) Bill 1990: NSW Parliamentary Debates (Legislative Assembly) 20 November 1990. See also the Second Reading Speech by the Queensland Minister for Consumer Affairs (and other portfolios) on the introduction of the Consumer Credit (Queensland) Bill 1994: Queensland Parliamentary Debates (Legislative Assembly) 4 August 1994.

compliance system was inadequate. Does that necessarily mean that the credit provider did not do what was reasonable to set up an effective compliance system. In my view, this question must be answered "no". In each case of contravention, it will in my view be appropriate to examine, as a matter of fact, the adequacy of the steps taken by the credit provider to ensure compliance.

One of the lessons which can be learned from civil penalty applications under the Credit Act is that credit providers should document, carefully and in a permanent fashion, all steps taken by them to set up an effective compliance system. All too often, credit providers who were forced to make applications under section 85 of the Credit Act found that, with the passage of time and change of personnel, it was at least difficult, and in some cases impossible, to give direct evidence of the steps taken, at the commencement of the Credit Act's operation, to ensure compliance. In my view, an effective compliance system is one which, although primarily it may be directed at ensuring compliance, is secondarily directed at facilitating applications necessitated by non-compliance: ie, one which, whilst it seeks to ensure compliance, recognises that its objective may not always be achieved. At the very least, it seems to me that such a system should include a permanent business record, of its own force admissible in evidence,[10] which proves, without the need for independent verification, the steps taken to ensure compliance.

Equally, as compliance systems are changed, effective and self-explanatory records of the changes should be maintained. I should say that compliance involves more than setting up compliance systems at the commencement of the Code's operation. It involves an ongoing review, or monitoring, of lending governed by the Code, and a willingness to amend the compliance programme in response to events which indicate that it may have been inadequate. If it is correct to say - as I have suggested - that a reasonable compliance programme should recognise at least the prospect that it will not always lead to compliance, it must follow that it should also recognise the need for monitoring and change. In my view, no compliance programme can be said to be either reasonable or effective if it is "set in stone".

If it is accepted - as I think should be the case - that an effective or "reasonable" compliance system may not necessarily produce 100% compliance then one needs to consider what steps a credit provider should take when an instance of non-compliance is detected. Obviously, the first step is to identify the extent of the non-compliance: ie, to identify the contracts which are likely to be affected. The second step (and I am not suggesting that these steps should be taken consecutively; clearly enough, it should be possible to work on them concurrently) is to halt the occurrence of the contravention. The third step is to institute amended compliance procedures which ensure that the contravention does not recur. The fourth step is to assess the impact of the contravention on debtors and guarantors. The fifth step - if, in all the circumstances, it is adjudged to be appropriate - is to bring an application. As I have already indicated, whilst it may be debateable whether an application should or should not be brought in the case of random or one off contraventions, I cannot readily conceive of circumstances in which it would not be appropriate for a credit provider, upon discovering a systemic or widespread contravention, to bring an application. Even if it be thought that section 102(4)(h) has little relevance in the case of one off contraventions, it cannot be regarded as immaterial in the case of a systemic or widespread contravention.

SECTION 114 OF THE CODE

Section 114 deals with the "civil effect of other contraventions". Section 114(1) applies where a credit provider has contravened a requirement of or made under the Code, other than one for which a civil effect is specifically provided. Where that happens, the court, on the application of anyone referred to in section 114(2) (the Government Consumer Agency or by any person affected by a contravention of the relevant kind) "may order the credit provider to make restitution or pay compensation to any person affected by the contravention ...".

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10 See section 69 of the Evidence Act 1995 (Cth) which has its counterpart in New South Wales and which, one hopes, will in due course have its counterparts in all other States and Territories.

One of the difficulties with section 114 (which it shares with the other provisions dealing with compensation) is in determining the nexus between the contravention and the entitlement to restitution or compensation. In turn, this means that there may be a problem in ascertaining the amount or measure of restitution or compensation.

Another problem lies in the expression "any person affected by the contravention". This marks a shift away from the language of section 103 and section 107, which relate only to applications by debtors or guarantors. Do the words nonetheless require some injury or grievance, over and above that which any member of the community (or of that class within the community which enters into consumer credit transactions) might justifiably feel if a credit provider does not comply with the law? Is a person "affected" by a contravention if, for example, he or she is forced to move home because the credit provider wrongfully exercises remedies under a mortgage taken from a debtor with whom the person resides? Is a person "affected" by a contravention because a debtor with whom that person resides suffers depressive illness as a result of a credit provider's alleged contraventions of the Code? Is a shareholder in a credit provider, whose shares drop in value because of adverse publicity as to the credit provider's contraventions of the Code, "affected" by those contraventions?

If section 114 is intended to give rise to claims of such width, then what is the nature of the nexus which is denoted by the words "affected by the contravention"? As already noted, it is not immediately obvious, at least if one applies the common law concept of causation, that a credit provider's contraventions of the Code are likely, of themselves, to cause loss or damage which could be the subject of an order for restitution or compensation.

It is quite clear that, where an application under section 114 is made by the Government Consumer Agency, the court may order restitution or the payment of compensation to all persons affected by the contravention. There is no distinction, in the drafting of the section, between an application made by the Government Consumer Agency and an application made by a person affected by the contravention. It would follow, in the case of an application made by a person affected by the contravention, that the court may order the credit provider to make restitution or to pay compensation not only to that person but also to all others affected by the contravention.

It is also worth noting that the right to bring an action, and to receive restitution or compensation, is not limited to debtors: the legislature has quite deliberately given both rights to any person affected by the contravention.[11] Arguably, this goes so far as to entitle (for example) a debtor who is affected by a contravention to obtain an order for restitution or compensation not only in favour of all other debtors affected by the contravention but also in favour of any other persons (such as guarantors) who are affected by the contravention. One, at least theoretical, consequence of this view of section 114 is that the "civil effect" (or "other civil penalty") for which it provides, unlike the civil penalty for which section 102 provides, is not limited either to a sum of $500,000[12] or, arguably, by the considerations as to prudential standing and other matters referred to in section 102(3) and 102(4).[13]

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11 Contrast section 103(2) which, as noted above, seems to assume that a guarantor will not suffer loss by reason of a contravention of a key requirement.

12 I refer to the section 102 penalty as having a limit of $500,000 on the assumption that there is only one contravention (or group of contraventions) and that it is unlikely, to the point where it really need not be considered, that a penalty payable to a debtor or guarantor under section 103 is likely to approach, let alone exceed, that figure.

13 Section 102 is in terms concerned with the imposition of a "civil penalty". Section 114, in terms, provides for "restitution or ... compensation". The heading to section 114 is "civil effect of other contraventions". Section 114 appears in Part 6 Division 2 which is headed "other civil penalties". It seems to be clear that the legislature, whilst recognising that section 114 provided for a form of civil penalty, desired to avoid giving, to the order for restitution or compensation for which it provided, the title of "civil penalty". Accordingly, even if it were arguable that section 102(3) and section 102(4) applied not just to the civil penalty referred to in section 102(2), but to civil penalties generally, it

CONCLUSIONS

I can summarise my views as follows:

Firstly, the civil penalty regime under the Code is, as was the civil penalty regime under the Credit Act, an essential element in that it is, in my view, the primary way chosen by the legislature to buttress enforcement. Whether it will prove to be sufficient is something which only time will tell.

Secondly, it might be thought that the change in the civil penalty regime gives a credit provider some discretion as to whether or not to bring an application; unfortunately, what would otherwise seem to me to be a clear result of the underlying policy shift is confused by the language of the Code.

Thirdly, whatever may be the position in relation to one-off applications, there is no real "discretion" involved where contraventions are systemic or widespread: in such circumstances, it is incumbent upon a credit provider, upon becoming aware of the contravention, to take a number of steps one of which is to bring an application as promptly as circumstances allow.

Fourthly, the changes in the civil penalties regime, and in the manner of application of a civil penalty, suggest that debtors have no right of appearance in an application brought by a credit provider or the Government Consumer Agency.

Fifthly, although clearly enough a credit provider should take reasonable steps to ensure that its compliance regime is effective, it does not follow necessarily, from the fact that a contravention occurs, that the steps taken **can** be said to have been less than reasonable. In other words, even a reasonable credit provider taking appropriate care should recognise the possibility that its compliance mechanism may prove to be in some respects inadequate.

Sixthly, what is "reasonable" in this context is a matter of assessment in any given case, and not something which can be dictated on an *a priori* basis.

Seventhly, and obviously, an effective compliance regime does not mean a once-off effort. It must involve continual monitoring of compliance, and a willingness to make changes as circumstances dictate.

Eighthly, it is essential that an effective compliance mechanism should involve the creation and maintenance of a permanent and complete documentary record of all steps taken to achieve compliance.

Ninthly, credit providers should bear in mind the provisions of section 114 of the Code: in some ways, it seems that the potential of section 114 may have been underestimated by the drafter, and its reach may be wider than was thought or intended.

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would be difficult to suggest that they applied to section 114 or, for that matter, to section 21(2) which is another section providing for the "civil effect" of a contravention of the Code.