



29 August 2008

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

Unfair Contract Terms Taskforce
Consumer Affairs Victoria
GPO Box 123
MELBOURNE VIC 3001

Dear Sir/Madam

The application of unfair contract terms legislation to consumer credit contracts - credit cards

Consumer Action Law Centre (**Consumer Action**) is pleased to make a submission to Consumer Affairs Victoria's (**CAV**) consultation paper on the application of unfair contract terms legislation to credit card contracts (the **Consultation Paper**).

Introduction

Consumer Action has consistently argued that laws prohibiting unfair terms in consumer contracts are necessary given realities of modern commercial life, including the emergence of standard form contracts. Unfair contract terms undermine consumer welfare by allowing traders to misuse their superior bargaining power to the detriment of consumers. Victoria's unfair consumer contract terms legislation has been a major step forward in redressing many negative outcomes that the imbalance of power between traders and consumers has caused.

Credit is a key consumer product, and there is no legitimate reason to exclude consumer credit from the unfair contract terms prohibition.¹ CAV research has also highlighted the prevalence of unfair contract terms in the banking-finance-credit sector.²

Credit cards, in particular, exemplify the importance of ensuring unfair consumer contract terms legislation covers credit. Credit cards are one of the most widely used financial

¹ See our previous submission to CAV: Consumer Action, *Response to the Consultation Paper "Application of unfair contract terms legislation to consumer credit contracts"*, July 2007.

² Consumer Affairs Victoria, *Unfair contract terms in Victoria: Research into their extent, nature, cost and implications*, Research Paper No. 12, October 2007, page 9.

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products in Australia, with more than 14 million currently used in Australia³ and the majority of Australian adults holding one or more credit cards.⁴

However, credit card transactions are of small value individually⁵ and it will therefore not usually be worthwhile for consumers to take legal action where they are treated unfairly. In addition, credit card transactions can become more profitable for the issuer when the consumer's debt level increases, in other words, when the consumer fails to repay all charges within the interest free period.⁶

Credit cards are also a type of product for which it is difficult to remedy consumer harm through disclosure alone. The complexity of credit card contracts means that it is not rational for consumers to consider all pertinent terms, even terms that are, in practice, very important. Thus disclosure is not sufficient to respond to unfairness in credit card contracts.⁷

Given the extent of credit card use in Australia, and the significance of credit cards as a payment and lending facility, it is entirely appropriate for unfair contract terms protection to be extended to credit card contracts, as part of the broader inclusion of consumer credit contracts within the coverage of unfair consumer contract terms legislation.

Why should unfair contract terms legislation be extended to cover credit card contracts?

For a number of reasons, it is appropriate to extend the prohibition on unfair contract terms to credit card contracts.

Credit card contracts are no exception to the general trend for suppliers in the modern marketplace to present consumers with standard form, "take it or leave it" contracts, over which consumers have no ability to negotiate. While the *process* of using standard form contracts may be efficient and fair, this does not necessarily mean that the *content* of such contracts is either efficient or fair. Examples of actual credit card contract terms highlighted in the Consultation Paper demonstrate this fact cogently.

Credit card contracts are now one of the major forms of consumer contract entered into by ordinary Australians, as demonstrated by the figures set out above and in the Consultation Paper. Further, as at May 2008, Australian credit card users owed more than \$44 billion in credit card debt, of which nearly \$32 billion was accruing interest.⁸ Credit cards, together with debit cards and EFTPOS, now constitute the principal mechanism for non-cash payment in Australia. The ownership and use of credit cards in Australia is now so widespread that, if credit card contracts were excluded from the unfair terms prohibition, there would be a noticeable and unjustifiably large gap in consumer protection coverage.

An additional concern related to credit card contracts in particular is the financial risk to some consumers arising from the product design and marketing strategies. While the majority of borrowers repay their balance in full each month, a significant minority retain ongoing, interest-bearing balances – which in some cases gradually increase over time. We understand that it is these customers who are generally the most profitable for lenders. For

³ Reserve Bank of Australia, *Bulletin statistical table C01 – Credit and Charge Card Statistics*, version current at May 2008, http://www.rba.gov.au/PaymentsSystem/PaymentsStatistics/payments_data.html.

⁴ Reserve Bank of Australia, *Reform of Australia's Payment System: Issues for the 2007/2008 Review*, May 2007, page 17.

⁵ Professor Ronald J Mann, "Contracting" for Credit', *104 Michigan Law Review* (2006), page 900.

⁶ As above, page 925.

⁷ As above, pages 911, 922.

⁸ Reserve Bank of Australia, above n3.

a minority of consumers, the debt gradually increases to a level that they cannot afford to pay – or that leaves them extremely vulnerable to even minor life changes.

Marketing strategies – often designed to attract interest-paying customers and to encourage an increase in credit spending – can result in unfair terms, and the unfair application of those terms.

Unfair contract terms relating to fees and charges (particularly where there is a default) can contribute to increasing indebtedness for consumers who are not fully in control of their debt levels. These fees and charges can be levied for the slightest default, can accrue several times in a single billing cycle, and the amount of the fees can be excessively high. This will negatively impact on consumers who have problems controlling debt most. Ultimately, the poor often pay more for default fees and charges⁹ and therefore it is entirely appropriate that such charges only be levied if they arise from fair (as opposed to unfair) contract terms.

Finally, it is advantageous to give the government regulator the power to proactively take steps to increase the fairness of contracts in certain industries (as CAV has done – for instance – in relation to mobile telephone contracts). The detriment a consumer will suffer from an unfair term, for example a penalty fee or a small amount of extra interest, is typically small. Thus, it will not generally be worthwhile or rational for the consumer to pursue a remedy. However, collectively, the consumer detriment can be great – and one of the obvious benefits in these circumstances is that the regulator has the power to proactively take action to stamp-out problematic unfair terms on behalf of consumers generally.

Common unfair terms in consumer credit contracts

CAV has identified several examples of credit card contract terms which it considers unfair, and we agree that these terms are unfair. From our experience with credit card contracts, we can identify several common categories of unfair terms, which are described below.

Unilateral right to vary the contract

Terms that give traders the right unilaterally to vary the contract in any way, at any time, for any reason, are archetypical of unfair terms.

Credit card contracts typically contain a universal unilateral variation term in favour of the lender. For example the Commonwealth Bank's terms state that it can "vary any of these Conditions of Use, at any time."¹⁰ Both Westpac,¹¹ and ANZ¹² have similar variation terms. Terms that give one party the unilateral right to vary the contract in such a universal way cause a significant imbalance in the rights and obligations of the parties to the detriment of consumers and are unfair terms.

Credit providers can take advantage of these terms to make generous marketing offers to consumers, confident that they can change the fee structure if the marketing strategy does not go to plan – for example where too many consumers take advantage of the offer without using (or maintaining) the high debt levels envisaged by the designers of the campaign.

This appeared to be the case in relation to the Citibank ReadyCredit card, where consumers

⁹ Nicole Rich, *Unfair fees: A report into penalty fees charged by Australian banks*, Consumer Law Centre Victoria, December 2004.

¹⁰ Commonwealth Bank, *Important information about Credit Cards: Credit Cards Conditions of Use*, undated, clause 32.

¹¹ Westpac, *Consumer Credit Cards: Conditions of Use*, Effective 17 December 2007, clause 13.3.

¹² ANZ, *Credit Cards Conditions of Use*, February 2008, clause 33.

were attracted to the offer to pay no interest on transferred balances. When too many consumers took advantage of the offer, and too few spent too little interest-bearing debt, Citibank applied a \$160 fee to those customers who failed to spend a specified amount on their credit cards.

An increasing number of lenders are using lures of no, or low, interest for short periods of time or on transferred balances. There is a risk that lenders can simply vary the terms (even if not as blatantly as Citibank) to recoup “losses” arising from a marketing campaign.

Unilateral interpretation/unilateral right to produce evidence

A number of terms in credit card contracts purport to give the lender the right unilaterally to interpret an event.

For example, Westpac requires that its consumer credit cards be used predominantly for personal, domestic or household expenditure, and reserves “the right to determine, in any instance, whether use or proposed use of your Card has been or will be in accordance with this requirement.”¹³ The Commonwealth Bank retains the right to interpret when payments are made, and does so in a way that will benefit it to the consumer’s detriment: “We regard your payments as being made only when we credit them to your card account.”¹⁴ Westpac claims the right to determine whether a transaction is a purchase or a cash advance without any right for the consumer to challenge the information on which Westpac makes its determination:

Westpac, as the issuer of your Card, is only able to determine whether to treat a transaction you make with a Merchant on your Card Account as a purchase or a Cash Advance, based on information (including the type of business conducted by the Merchant) provided by that financial institution in the course of processing the transaction.¹⁵

Accordingly, Credit Card transactions made with certain Merchants may be treated as Cash Advances, even though such transactions do not fall within any of the above transaction categories.¹⁶

Other terms give the lender the sole right unilaterally to determine the evidence that can be admitted to prove a fact. For example, in relation to ATM deposits, Westpac’s term states that: “Our count of the funds deposited is regarded as conclusive evidence of the amount deposited.”¹⁷

Terms that give the lender and not the consumer the unilateral right to interpret an event or submit evidence to prove a fact cause a significant imbalance in the rights and obligations of the lender and consumer to the detriment of the consumer and are unfair terms.

Cancellations and stops of cards

Many credit card contracts give lenders the right to cancel cards instantly and without notice, while at the same time typically limiting the rights of consumers to stop or cancel their cards.

¹³ Westpac, *Consumer Credit Cards: Conditions of Use*, Effective 17 December 2007, clause 4.4.

¹⁴ Commonwealth Bank, *Important information about Credit Cards: Credit Cards Conditions of Use*, undated, clause 21.

¹⁵ Westpac, *Consumer Credit Cards: Conditions of Use*, Effective 17 December 2007, clause 2.0.

¹⁶ As above, clause 2.0.

¹⁷ As above, clause 9.3.

For example, the Commonwealth Bank's terms state: "We may cancel your card at any time without prior notice."¹⁸ However, if the consumer conversely asks the Commonwealth Bank to stop their credit card, the relevant term states this:

You should be aware that a stop on your card account will not take full effect immediately. You will continue to be liable for any of the following transactions made by a card:

- transactions made before we fully process the stop request...¹⁹

Not only do lenders generally retain the right to cancel cards at any time without prior notice, Westpac's terms require consumers to immediately repay the balance of the account and hold the consumer liable for periodic debits made after cancellation:

Where the Card Account has been terminated, you must immediately pay us the full balance of the account, including (where applicable) any amount reasonably expended by us in collecting payments.²⁰

You will remain liable for transactions debited to the Card Account which were made prior to termination. You will also be liable for standing order authority transactions which have not been cancelled by you prior to termination.²¹

Pursuant to Westpac's terms, it could terminate the consumer's credit card without justification or notice to the consumer, yet still hold the consumer liable for periodic debits that the consumer entered into prior to termination. Clearly, both the right to terminate and the right to hold the consumer liable in these circumstances creates a significant imbalance in the rights and obligations and thus the above terms are unfair contract terms.

The use of unfair terms in relation to consumers' continuing liability after termination is not limited to Westpac, but is widespread. For example, ANZ limits the right of the consumer to cancel an additional card: "ANZ will only cancel the additional card when the account holder has returned it to ANZ or has taken all reasonable steps to return it to ANZ."²²

Terms that give the lender the right to cancel the credit card, but place restrictions on the consumer's right to do the same, patently cause a significant imbalance in the parties' relative rights, to the detriment of consumers, and are unfair. Likewise, terms that make the consumer liable for transactions that take place after the credit card has been terminated, cancelled or stopped cause an imbalance and are unfair.

Unauthorised access to other accounts

Credit card contracts with banks typically contain a term giving the bank the right to make good a shortfall on the credit card by accessing, without authority, any other accounts the consumer has with the bank.

For example, the Commonwealth Bank's term notes, "we may exercise our banker's right to combine your card account with other accounts held in your name with us at our discretion."²³ Westpac's contract contains a similar term:

¹⁸ Commonwealth Bank, *Important information about Credit Cards: Credit Cards Conditions of Use*, undated, clause 34.

¹⁹ As above, clause 4.

²⁰ Westpac, *Consumer Credit Cards: Conditions of Use*, Effective 17 December 2007, clause 13.1(b).

²¹ As above, clause 13.1(c).

²² ANZ, *Credit Cards Conditions of Use*, February 2008, clause 4.

²³ Commonwealth Bank, *Important information about Credit Cards: Credit Cards Conditions of Use*, undated, clause 38.

If you (being the Primary Cardholder) have money in any account with us (other than the Card Account) we can, but need not, use it to pay amounts owing under the Credit Card Contract. If the Card Account has a positive (credit) balance, we may also use all or part of that balance to clear debts which you owe us in other loan or deposit accounts.²⁴

These terms allow the bank to raid a consumer's other accounts if a credit card is over its limit or a minimum repayment has not been made. The bank may simply withdraw money from these accounts without the explicit permission of the consumer, even where the other accounts are unrelated to the credit card. Consumers these days also typically have periodic payments and direct debits established in relation to other accounts, which could be negatively affected by a bank's withdrawal of funds from consumers' accounts.

Worse, under such terms a bank could pay itself using a consumer's credit card, incurring credit card debt on the consumer's behalf without the consumer's permission or even knowledge. Giving the banks rights to raid unrelated accounts of consumers causes a significant imbalance in the parties' rights, and the above terms are unfair.

We note that these terms reflect long-standing banking practice, however, this does not mean that such practice was or is fair. Indeed, the fact that such practice is manifestly unfair to consumers yet has become established as common across an entire industry demonstrates the lack of bargaining power that individuals have to affect standard form contracts presented by large institutions. Further, there have been changes to modern consumer banking, such as the practice of direct debits noted above, that render such terms even more unfair than they may have been in an era of paper-based banking.

Conclusion

Credit card contracts frequently contain a number of unfair contract terms. In addition to a number of common unfair terms identified by CAV in the Consultation Paper, we have identified above several categories of unfair contract terms in credit card contracts with which we have experience.

There is good reason for credit card contracts to be given high priority in terms of combating unfair terms. Credit cards are probably the most commonly-used and widespread consumer credit product, and because of this any unfair terms will have an impact on many consumers.

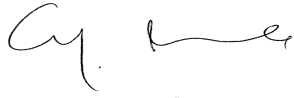
The Victorian Government can take an important step to protect ordinary Victorians by extending protection against unfair terms to consumer credit contracts as quickly as possible.

If you have any questions or wish to discuss this submission, please contact Neil Ashton on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE

²⁴ Westpac, *Consumer Credit Cards: Conditions of Use*, Effective 17 December 2007, clause 14.5.



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