



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 of 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 for 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 'Nicole Rich', written in a cursive style.

Nicole Rich
Director – Policy & Campaigns

Attach.