CONSUMER CREDIT LAW REVIEW

PART 5: REDRESS AND ENFORCEMENT

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EXECUTIVE SUMMARY

This is the fifth public consultation document to be released by the Ministry of Consumer Affairs as part of the Consumer Credit Law Review. The previous four documents have discussed ways in which consumer credit law can be improved and simplified.

The focus of this discussion paper is on the redress and enforcement provisions of the Credit Contracts Act 1981. It examines whether the Act provides strong enough incentives for borrowers and lenders to comply with the law. Without effective redress and enforcement, the Act cannot provide adequate protection to those taking part in credit deals. As well, inadequate compliance will mean that much of the benefit from the reforms proposed in the previous discussion papers in this Review will be lost.

The Credit Contracts Act

The Credit Contracts Act places two main responsibilities on lenders. First, lenders must disclose certain information about a credit contract – most importantly, the total cost of credit and the annual finance rate – to borrowers. Secondly, lenders must not take advantage of the imbalance in bargaining power that characterises most consumer-credit relationships by acting in an oppressive manner towards borrowers.

This discussion paper concentrates exclusively on the first responsibility – the duty of lenders to disclose specified information about the loan to the borrowers. Oppressive conduct by lenders and unfair contracts is not being dealt with as part of the Consumer Credit Law Review (and no changes are proposed to the current provisions in this area).

The Credit Contracts Act is self-enforcing. That is, borrowers must take action themselves if lenders breach its provisions. This threat of individual action is intended to create incentives for lenders to comply with the Act.

Borrowers can take action in a number of ways.

When a lender has breached the disclosure provisions of the Act, a borrower can act to reduce their debt under the contract by a specified amount (the civil penalties regime). These civil penalties are automatic, and can be negotiated directly with the lender. The borrower does not need to apply to the Disputes Tribunals or the Court to enforce their rights, unless the lender objects to the remedy.

If a lender's behaviour is particularly "problematic" – such as repeatedly breaching the Act's disclosure requirements, or being convicted of a crime involving dishonesty – a borrower or any other interested party can apply to the Court to have that person banned temporarily or permanently from providing credit. This is known as "negative licensing".

When a lender has acted oppressively, a borrower can apply to the Court to have the credit contract re-opened and for the Court to make orders (such as setting aside the contract and the payment of damages to the borrower).

A lender can also be liable for criminal fines for breaching the credit advertising provisions of the Credit Contracts Act.

Criticisms of the Credit Contracts Act

This paper concludes that the Credit Contracts Act currently does *not* create strong enough incentives for some lenders to comply with its provisions. The main area of concern is with "marginal" lenders outside the mainstream – marginal lenders are characterised by limited competition, low incentives to invest in reputation, and operations that are relatively small scale.

The following features of the Act's redress and enforcement provisions support the Ministry's conclusion that reform is needed.

First, it is not straightforward for borrowers to enforce their rights at the Disputes Tribunal or Court. The Court process is inaccessible to many borrowers because of the cost and time involved in bringing an action. The Court can also be an intimidating environment, particularly if the other party to the dispute is a large company. The Disputes Tribunal provides borrowers with greater access to justice, but problems remain. Referees are not required to have legal training, nor are they bound to follow the Credit Contracts Act, which can lead to inconsistent and inaccurate decision-making. This not only adversely affects borrowers, but also can weaken the incentives for lenders to comply with the Act.

Secondly, the Act's provisions for redress and enforcement do not fit well with self-enforcement. There are two key problems here:

- the penalty regime is complex and places a heavy burden on borrowers to enforce their rights
- borrowers do not have the information or incentive to bring actions against lenders under the Act's negative licensing provisions.

Thirdly, the usual imbalance of knowledge and power between consumer and trader is heightened in consumer-credit law. Research suggests that consumers often do not know their rights, and that 45 percent of New Zealand adults are "functionally illiterate". These difficulties are compounded – because of the inherent complexity of the Credit Contracts Act and most credit contracts – when consumers are involved in credit deals.

The upshot is that very few borrowers use the Act to bring actions to the Disputes Tribunal or the Court. The infrequency of applications does not mean that serious breaches of the Act do not occur. Anecdotal evidence and regular complaints gathered by the Ministry and consumer organisations indicate that the Act is regularly breached and that there is a high level of consumer dissatisfaction with this area of law.

From the analysis it has done, the Ministry considers that reform of the Act's redress and enforcement provisions is needed. This is to ensure that borrowers receive adequate redress for breaches of the Act and that *all* lenders face sufficient incentives to comply with it.

The Ministry has identified a number of alternatives for reform. Although redress and enforcement are closely intertwined, the options are discussed separately for each area. This has been done to make the analysis and shape of any proposals clearer.

Improvements in redress

The Ministry has looked at areas that could be reformed in order to improve borrowers' access to redress, and consequently increase the incentives on lenders to comply with the Act.

Improvements to the Disputes Tribunal decision-making procedure – some options for improving the operation of the Tribunals include:

- improvements to the training of Tribunal referees on the requirements of the Credit Contracts Act
- the establishment of a specialist credit tribunal
- an increase in the Tribunal's monetary jurisdiction.

Changes to the penalty regime for breaches of disclosure – two options are put forward to assist borrowers in taking action when the Act is breached:

- simplifying the calculation of any penalty, so that it is either twice the total cost of credit or a proportion of the outstanding balance of the loan
- setting a minimum penalty for each breach of the Act by a lender.

If other reforms to the Act are made – particularly by strengthening enforcement – it may be appropriate for lenders to minimise or, in some circumstances, avoid their liability altogether. A number of options are considered here:

- setting maximum penalties
- incorporating into the Act a requirement for lenders to have compliance programmes – either by adopting a defence used in Canadian consumer credit law legislation, or by drawing on the "reasonable mistake" defence from New Zealand's Fair Trading Act
- allowing lenders to use "model form" contracts as a means of minimising their liability – this alternative is based on United States' consumer credit law

- adopting a new approach to the entire civil penalties regime, based on the Australian Consumer Credit Code, which abolishes the concept of automatic penalties.

Other options for improving redress – three other possible reforms are discussed:

- moving the disclosure requirements of the Credit Contracts Act into a Consumer Information Standard made under the Fair Trading Act
- specifically allowing class actions to be taken under the Credit Contracts Act
- allowing the Disputes Tribunals and Courts to award compensatory and/or exemplary damages under the Credit Contracts Act.

Improvements to enforcement

Even if borrower's rights to redress are improved in various ways, the Act's current self-enforcing approach is unlikely to provide powerful enough incentives for lenders to comply with the Act. The Ministry puts forward three main options to improve enforcement:

An enforcement agency – the various powers and functions of an agency are discussed; the role of the Commerce Commission under the Fair Trading Act is a useful model for how a credit enforcement agency could operate.

Occupational regulation – two alternatives for licensing or registering lenders are also considered.

A dedicated fund for private and voluntary sector enforcement – such a fund could be accessed by community agencies, which could take action against lenders who consistently breach the law.

Ministry's preferred options

The Ministry believes that the reform with the greatest overall benefit to borrowers and lenders is to **establish an enforcement agency**. This specialist agency will provide borrowers with advice as well as responding to complaints. It will also be able to monitor the entire industry, greatly increasing lenders' incentives to comply with the Credit Contracts Act.

The Ministry considers that there are two realistic alternative agencies that could fulfil this role: the Ministry of Consumer Affairs and the Commerce Commission.

Other reforms the Ministry considers appropriate are:

- **appointing** and training specialist credit referees to deal with credit disputes at the Disputes Tribunal
- **simplifying** the calculation of the penalty regime by setting penalties as a specified proportion of the outstanding balance of the loan
- **providing** for a maximum penalty of $3,000 for breaches of the Act by lenders, should an enforcement agency be appointed

- **incorporating** the idea of "reasonable mistake" into the current "inadvertent disclosure" defence of section 31, to provide lenders with incentives to establish credit-compliance programmes
- **providing** that a Court must take account of whether a lender has an effective compliance programme when considering whether to reduce or waive a penalty under section 32 of the Credit Contracts Act.

CALL FOR SUBMISSIONS

The Ministry encourages written submissions from interested parties on the content of this document. The purpose of the submissions will be to inform the Ministry as it proceeds with the Review of consumer credit law. Ultimately, the submissions will inform the government on any decisions it chooses to take with respect to the reform of consumer credit law.

Questions for submitters

The Ministry of Consumer Affairs would like to receive comment on all aspects of this document. Specific questions are also asked in Chapters 3,4 and 5

Final date for submissions and contact details

Final date for receipt of submissions is 1 February 2001.
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OFFICIAL INFORMATION ACT 1982

In providing your submission, please advise us if you have any objections to the release of your submission. If this is the case, please advise us of the parts of your submission that you would wish withheld, and the grounds for withholding. In preparing and releasing any summary, and in considering any formal Official Information Act requests that might be received, the Ministry will carefully review any representations that you make in this regard.

PRIVACY ACT 1993

Any personal information that you supply to the Ministry in the course of making a submission will be used by the Ministry in conjunction with consideration of matters covered by this discussion paper only.

When preparing any summary of submissions for public circulation, it is the Ministry's normal practice to set out the names of parties making submissions. Your name will be included in any summary unless you inform the Ministry that you do not wish your name to be included. In order to indicate your wishes, or to view personal information held about you in respect of the matters covered by this discussion paper, or to request correction of that information, please contact the Ministry of Consumer Affairs, ph (04) 474 2750.

INTRODUCTION

A key goal of the Consumer Credit Law Review is to promote compliance with the law by lenders and borrowers when they take part in a credit deal. One of the ways of doing this is through an adequate system of redress and enforcement.

This discussion paper focuses on the system of redress and enforcement contained in the Credit Contracts Act 1981 – and on how this system may be improved to benefit both borrowers and lenders. Two main areas will be looked at: the redress and enforcement provisions for disclosing information about the loan by the lender (Part II of the Act); and the banning of "problematic" lenders through "negative licensing" (Part IV of the Act).

The re-opening provisions of the Act (Part I) are not discussed in this paper. The Ministry of Consumer Affairs has decided to defer further work on investigating the remedies for oppressive conduct by lenders – possibly within a wider context of consumer protection law enforcement – rather than cover them within the present Consumer Credit Law Review.

There are several reasons for this decision. The Review's consultation and analysis so far has highlighted application, disclosure, and redress and enforcement as areas where more serious problems have been identified than with oppressive conduct by lenders. The Ministry is also aware of the difficulties that policymakers and law-reform agencies have had in developing legislation to deal with "unfair contracts".[1] This suggests that more in-depth analysis is required than is possible in the timeframe of the present Review.

Structure of the discussion paper

This discussion paper consists of five chapters. Chapter 1 describes the Credit Contracts Act's current redress and enforcement regime. Chapter 2 critically analyses this regime and identifies a number of shortcomings.

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[1] The New Zealand Law Commission decided not to proceed with its work on *"Unfair" Contracts* (NZLC PP11, 1990); for examples of academic criticism of various unfair contracts legislation and proposals see D McLauchlan, (1991). "Unfair Contracts: The New Zealand Law Commission's Draft Scheme". *New Zealand Recent Law Review*, 311; A Duggan (1991). "Some Reflections on Consumer Protection and the Law Reform Process", *Monash Law Review 17*(2), 252; and D Vaver, (1988). "Unconscionability: Panacea Analgesic or Loose Can(n)on". *Canadian Business Law Journal 14*, 40.

Chapters 3 and 4 look at options for reform and the approaches taken in other countries with similar systems of consumer credit law. In Chapter 5, the Ministry puts forward its preferred options for reform.

1. A SUMMARY OF THE STATUS QUO

The Credit Contracts Act recognises that the relationship between borrower and lender is often unequal. Lenders have greater knowledge and experience in credit contracts and frequently much more economic power or "deeper pockets" than their clients. This imbalance of knowledge and power often skews the credit market in favour of lenders. Borrowers, for instance, may not always receive (or understand) the information they need to make an informed choice about a credit deal. Thus, they may be subject to exploitation.

The Act attempts to redress this power imbalance by placing various obligations on lenders. Borrowers[2] are entitled to redress when a lender breaks these obligations:

- the lender has not correctly disclosed the information necessary for the borrower to make an informed decision about a credit contract covered by the Act
- the lender is advertising its products in a way that is misleading
- the lender has acted in such a way that they should not be allowed to continue operating as a lender
- the borrower has been subject to oppression by a lender in relation to a credit contract.

The redress available to a borrower as a result of these breaches can take various forms. The borrower's debt may be reduced as the penalty for non-disclosure by the lender. Or the entire credit contract may be set aside, if the contract was entered into as a result of oppression on the lender's part.

The Act is self-enforcing, so borrowers must take action themselves to enforce their rights. They can either negotiate directly with the lender or take an action to the Disputes Tribunal or Court. This policy of self-enforcement reflects the underlying assumption of much of New Zealand's consumer legislation: that consumers are usually in the best position to decide whether their rights have been infringed and the costs and benefits of seeking redress for that infringement. Therefore, no government department or agency enforces the Credit Contracts Act. The Act relies upon the threat of individual action by borrowers to provide the incentives for compliance by lenders.

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[2] Guarantors of controlled credit contracts also have rights of redress in relation to the disclosure requirements of the Act. Sections 16A, 24A and 25A respectively: require that disclosure be made to guarantors; provide that such disclosure is a prerequisite to any claim being made against a guarantor; and provide for penalties for failure to disclose to guarantors. Guarantors face similar issues to those arising for borrowers under the Act, particularly in relation to the disclosure provisions. However, it remains unclear whether guarantors are able to avail themselves of the oppression and re-opening provisions of the Act: *Gault on Commercial Law* Brookers: Wellington, at para CCIntro. 01.

1.1 Consequences of non-compliance with disclosure requirements

The disclosure requirements of Part II of the Act apply only to *controlled* credit contracts. These are contracts where the lender supplies finance in the course of its trade or business, or where a professional has either brought together the borrower and lender or prepared the contract, and where the amount lent will be less than $250,000. Providers of credit under controlled credit contracts must disclose certain information – most importantly, the total cost of credit and the annual finance rate[3] – to borrowers at the times specified by the Act. These times will vary depending on whether the disclosure is initial, continuing, modification, or on request.

There are two main consequences for lenders if they do not disclose this information or disclose it incorrectly:

1.1.1 Credit contracts are unenforceable until the required disclosure is made

A controlled credit contract cannot be enforced by the lender, until the lender has made the disclosure required by the Act. This applies to all types of disclosure. Similarly, until the required disclosure has been made, only the borrower can enforce any right to recover property to which the controlled contract relates, or enforce any security under the contract.

1.1.2 There are penalties for failure to make disclosure

The Act sets penalties for failure on the lender's part to disclose information as required. This means that the amount the borrower owes under a controlled credit contract is reduced by a "specified amount" for each case of non-disclosure.

Unless it is agreed otherwise, these penalties take effect at the end of the contract. The borrower continues to make repayments until they have paid back the debt left after subtracting the penalty.

These penalties are *automatic* – they apply as soon as a lender has breached the Act, and can be enforced by the borrower without having to apply to the Disputes Tribunal or Court. But under section 31 of the Act, lenders may avoid penalties for failing to disclose correctly if this failure results from inadvertence or events outside their control. This ability to avoid penalties under section 31 is referred to as the "inadvertent disclosure defence" throughout this discussion paper. While not technically a defence, the section acts like one since it enables a lender to avoid paying penalties altogether.

To use this "defence", the lender must make disclosure as soon as is reasonably practicable after discovering the failure and offer to compensate the borrower for any harm caused by the failure to disclose. If the finance

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[3] For fixed credit only.

rate has been stated as less than the correct finance rate, the lender must also reduce the finance rate to the stated rate.

The lender does not have to go to Court to use this defence – all it must do is show the borrower that it has fulfilled these requirements. But if the borrower is unsatisfied, the lender may have to apply to the Tribunal or Court to use the defence. Even if the lender has not met the requirements of section 31, it still can apply to Court for relief at the Court's discretion under section 32 of the Act.

1.2 Prohibition of financiers ("negative licensing")

The Credit Contracts Act contains no registration requirements for financiers – that is, anyone who provides credit, either as their main business or in the course of their business.[4] The Contracts and Commercial Law Reform Committee, whose proposals formed the basis of the current Credit Contracts Act, considered it too onerous on the thousands of honest lenders to require them to obtain licences.[5] Instead, the Committee recommended a system of "negative licensing" whereby dishonest or unscrupulous lenders could be banned.

Under section 39 of the Act, anyone can apply to the District Court for an order prohibiting or restricting a particular financier from entering into controlled credit contracts or from acting as a director, manager, employee or agent of a financier. Orders can be made against:

- someone convicted of an offence against the Act or of a crime involving dishonesty
- a lender who has had a credit contract re-opened under the Act
- someone who has failed more than once to comply with the Act's disclosure requirements, or its restrictions on credit advertisements.

1.3 Restrictions on advertising

Section 34 of the Act, which generally prohibited misleading credit advertisements, was repealed at 1 March 1999. Lenders who place credit advertisements that are misleading or deceptive, or likely to mislead or deceive, could still be liable under the Fair Trading Act 1986. The Ministry's view, which is supported by the submission documents received so far in this Review, is that the Fair Trading Act regulates this area effectively. There are still restrictions on advertising in the Credit Contracts Act: these relate to the information that must still be disclosed in any advertisement.

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[4] Section 2 Credit Contracts Act 1981.

[5] *Credit Contracts: Report of the Contracts and Commercial Law Reform Committee on Credit Contracts* February 1977, at pp 45-46 (para 5.10).

1.4 Enforcement of the regime

Since the Act is self-enforcing, it is up to the borrower to work out whether the lender has breached the Act, to inform the lender of the breach, and to enforce the appropriate penalty (this is discussed further in Chapter 2). If a lender disputes liability, the borrower may need to take a complaint to the Disputes Tribunal or the District Court.

1.4.1 Disputes Tribunal

Disputes Tribunals (formerly called Small Claims Tribunals) were established to increase the public's access to justice. They allow for the relatively speedy, inexpensive and informal resolution of small disputes. In most cases any resolution is final.[6]

Disputes Tribunals are attached to every District Court in New Zealand. The Disputes Tribunal process differs from that of a Court in several ways:

- The hearings are held in private, and no reasons need be given in writing for decisions (unless a party requests in writing)
- The parties are not permitted to be represented by a lawyer
- The decision-maker – the referee – is not necessarily legally trained and is not strictly bound to follow the law when resolving disputes
- The referees assist the parties to negotiate an agreed settlement, and will make a binding decision only where a negotiated settlement is not possible or appropriate
- The decisions of the Tribunal can only be appealed on the ground that the proceedings or inquiries were conducted in a manner that was unfair to either of the parties and prejudicially affected the outcome. A decision cannot be appealed if the referee makes a mistake about the law.[7]

The Disputes Tribunal used to be able to hear only claims about the re-opening of oppressive credit contracts (Part I), but in March 1999 the Tribunal's jurisdiction was extended to breaches of the Credit Contract Act's disclosure requirements (Part II).

The Tribunal can hear claims about credit for up to $7,500, or $12,000 if the parties agree.[8]

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[6] See *Brookers District Courts Procedure*, Brookers: Wellington, at para DT Intro.01.

[7] See Disputes Tribunal Act 1998. See also K Tokeley, (2000). *Consumer Law in New Zealand*. Wellington: Butterworths, at 382-387.

[8] Disputes Tribunals Act 1988, Sections 10, 13.

1.4.2 District Court

Borrowers can also bring an action to the District Court under Parts I and II of the Act, as long as the credit contract is not for more than $200,000.[9] The parties may agree to waive this limit if the contract is for more than $200,000. If they do not agree, actions must be taken to the High Court.

Borrowers and lenders can also bring actions to the District Court under the Act's remaining credit-advertising and negative-licensing provisions.

[9] The cost of credit is not included in this amount: *Gault on Commercial Law*, *supra* n2 at CC45.04.

2 CRITICISMS OF THE STATUS QUO

2.1 Scale of non-compliance with the Act

It is only rarely that borrowers take action under the redress provisions of the Credit Contracts Act. In the 10 years to May 1999, the *Briefcase* database records that there were only 140 reported Court cases on the Act; and only 56 percent – around 79 cases – were brought by consumers. Borrowers who were in default on their loans brought most of these cases. This indicates that the Act is being used not so much to protect borrowers from unscrupulous lenders, but rather as a last-ditch effort by some borrowers to avoid repaying a loan.[10]

The Disputes Tribunal does not keep formal records of the nature of the disputes it hears, but anecdotal evidence suggests that disputes relating to the Act are relatively infrequent. However, this does not mean that serious breaches of consumer credit law do not occur.[11]

Over the (nearly) twenty years that the Act has been in force, the Ministry has received hundreds of complaints about credit matters. It has also been involved in investigating and settling with several lenders who have breached the Act, some of which have been well known national businesses.[12] The Ministry is also aware that many consumer and community groups consider credit to be the most widespread and severe of all problems faced by consumers.

The Ministry's concerns about compliance with the Act by lenders are largely focused on "marginal lenders". This segment of the market was described in the initial consultation document, *Setting the Scene*. Marginal lenders can be distinguished from mainstream lenders by:

- comparatively small-scale operations
- a lack of self-regulation (or even an industry association)
- low investment in the "reputational capital" of their businesses
- a client base that has limited access to other sources of credit.

Some cash-loan companies meet these criteria, but perhaps the area with the greatest number of consumer complaints is hire purchase finance provided through motor vehicle dealers. The exact scale of these problems is

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[10] G Hannis, *The Consumers' Institute's View of Credit Law: Protecting the Rights of the Consumer*, paper to the BIIA New Zealand Credit Law Conference, 24 February 2000. *Briefcase* is a comprehensive index of case summaries in electronic format. In the past, *Briefcase* sourced from secondary publications, so only cases that were reported or noted in publications were catalogued. Cases are now summarised directly from actual judgments emanating from a wide variety of Courts, Tribunals and judicial bodies. However, *Briefcase* is not a complete record of all cases, and therefore the figures quoted in the text are a good but not final representation of the number of cases involving the Act in the ten years to May 1999.

[11] See also the comments in *Gault on Commercial Law*, *supra* n, at CCIntro.01 "It is fair to say that non-compliance with the provisions of the Act by ["fringe financiers"] is common."

[12] For details of some of these investigations, see Hannis, *supra* n10 at section 3.3

difficult to measure, but there is plenty of anecdotal evidence in the form of a regular stream of consumer complaints to indicate that a significant problem exists.

Deliberate or reckless non-compliance is not a feature of the mainstream segment of the market, so enforcement is much less of an issue. For instance, the members of the Bankers' Association have a self-regulatory code, as well as an Ombudsman who is able to monitor compliance with both the code and the law. Other mainstream lenders have an incentive to develop a good reputation and maintain high standards of commercial practice: the high volume of lending by the largest lenders makes non-compliance extremely risky. A small breach may mean compensating thousands of consumers – the cost will be significant, even if lenders consider the likelihood of consumers discovering the breach is low.

In the "marginal lender" segment of the credit market there is generally less incentive for lenders to comply with the Act. As well, individual borrowers are not generally receiving appropriate redress when the Act is breached. Therefore, the Act offers little real protection for borrowers from unscrupulous behaviour by lenders.

There appear to be three broad categories of reasons why borrowers are not enforcing their rights under the Act:

- problems with how the Court/Tribunal systems operate generally – and, more particularly, how these processes relate to the Credit Contracts Act
- problems with the redress and enforcement provisions of the Credit Contracts Act
- problems that characterise most consumer law issues, but which are particularly apparent in consumer credit law.

2.2 Problems with the Tribunal/Court system

2.2.1 Disputes Tribunal

That few consumers take consumer credit law cases to a Disputes Tribunal still appears to be the case, even though the Tribunals were allowed to hear disputes about disclosure in credit contracts and the monetary jurisdiction was increased from March 1999. The Ministry has identified the following features of the Disputes Tribunal system that make it somewhat unsatisfactory as a compliance mechanism for enforcing the Act. Some of them might also contribute to the low number of complaints heard by the Tribunals.

Monetary jurisdiction not high enough for many credit disputes

The Disputes Tribunal can hear only claims for up to $7,500 (or $12,000 with the agreement of the parties). But credit disputes involving the purchase of a house or, more likely, a car may be for much greater amounts than this. Lenders also have a vested interest in not agreeing to the higher monetary limit, so many disputes will fall outside the Disputes Tribunal's jurisdiction.

Referees lack specialist knowledge

Disputes under the Act can be complex. They may involve difficult financial calculations to establish whether the law has been breached, and further calculations to determine the appropriate remedy. Referees need in-depth knowledge of the Act's requirements, but do not receive any specialist training in them. In 1997, when it was recommended that the Disputes Tribunal's jurisdiction be extended to disputes about disclosure, referees were asked about general training requirements. Of the referees surveyed, 91 percent said that further training was needed. The Credit Contracts Act was identified as the legal area in which training was most needed. [13]

Since then a principal referee has been appointed, whose functions include giving the other referees legal advice as appropriate to improve the consistency of decision-making. However, while undoubtedly of benefit to those bringing credit claims to the Tribunal, this appointment may be insufficient to ensure informed and consistent decisions.[14]

Recurring problems and lack of precedent

Many consumer credit disputes are substantially the same. In the Disputes Tribunal system, however, there is no recognition of precedent – every case is approached afresh. Moreover, Disputes Tribunal referees are not strictly bound by the law when resolving disputes. While such an approach has many advantages, in the context of credit disputes it has several disadvantages:

- consumers have to argue their case from scratch each time, which can be difficult and time-consuming given the complexity of credit disputes

- referees do not benefit from previous decisions on the same point, which limits their ability to develop expertise about credit

- Tribunal procedures and decision-making processes across the country may become inconsistent, which can lead to further difficulties: [15]
  - consumers' ability to gain adequate redress may be compromised
  - lenders do not receive clear guidance on what is acceptable behaviour on their part

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[13] Centre for Research, Evaluation and Social Assessment ("CRESA") (August 1997). *Disputes Tribunal Research Project* at 17-19.

[14] Tokeley, *supra* n7 at 385.

[15] In 1997 almost two thirds (64%) of Tribunal referees surveyed identified the lack of consistency in procedures across the country as a weakness of the Tribunal system, and a third also identified the lack of consistency in decision making as a weakness: *Disputes Tribunal Research Project, supra* n13 at 27.

  - uneven and inconsistent application of the Act means that the incentives on lenders to comply with it will be lessened. The Disputes Tribunal's preference for mutual resolution by the parties before adjudication makes it more likely that the Act is being under- rather than over-enforced, which further weakens lenders' incentives to comply with the Act
- repeat offenders and problems with the operation of parts of the Act are less likely to be detected, and cannot be effectively dealt with.

Limited rights of appeal

The feature of the Disputes Tribunal system of perhaps most concern to legal observers is that legally untrained referees can make binding decisions that are wrong in law and cannot be appealed. Referees are required to determine disputes according to the substantial merits and justice of the case, but this does not guarantee that the law will be followed. This is more likely to be a problem if the referee is not familiar with the law relevant to the dispute or the law is difficult to understand and apply, as is the case with the Credit Contracts Act.[16]

Not only is this unfair to those parties who do not obtain their legal rights as a result of a Tribunal decision, it also contributes to inconsistency between decisions as there is no further opportunity to "get the law right".

Limited use by Maori and Pacific Island people

There is evidence that Maori and Pacific Island people are less aware of the Disputes Tribunals and more reluctant to use them than the rest of the population.[17] This is a concern because Maori and Pacific Island people are more highly represented in the lower socio-economic groups – and therefore more likely to borrow from marginal lenders. Reluctance to use the Tribunals suggests they are less likely to enforce their rights if the lender does not comply with the law.

2.2.2 District Court

The fact that court cases relating to the Credit Contracts Act are rare can be attributed to a number of factors. Going to Court is too expensive for those on low and middle incomes, particularly if the amount at stake is relatively small. Legal aid is unlikely to be granted for a case under the Act. Taking an action can also be drawn out and time-consuming. As well, the complexity of the Act and the likelihood that the defendant is a large institution may make the Court process too daunting for most borrowers.[18]

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[16] Tokeley, *supra* n7 at 385-6.

[17] Ministry of Consumer Affairs (July 1994). *Review of the Operation of Disputes Tribunals from a Consumer Perspective*.

[18] Actions under other consumer legislation are similarly infrequent for the reasons described above: *CCH New Zealand Business Law Guide*. Commerce Clearing House, Auckland at 51, 301.

2.3 Problems with the Act's system of redress and enforcement

2.3.1 Self-enforcement of penalties

The automatic penalties available to consumers for lack of disclosure allow them to reduce their debt by the appropriate "specified amount." In theory, the lender cannot enforce the contract until the required disclosure is made. But to enforce these rights, the borrower must:

- determine whether disclosure has been made in accordance with the Act. For example, this might involve checking the finance rate calculation against the formula found in the "complicated" First Schedule of the Act.[19] According to the CCH *Business Law Guide,* the definitions of the terms "credit", "total cost of credit" and "finance rate" have "caused considerable difficulties to the legal profession."[20]

- inform the lender that it has not complied with the Act

- work out the total amount of credit (the "specified amount") that the lender forfeits as a result of non-disclosure, and how this reduces the total amount of money owed under the contract.[21]

- adjust the remaining sum to be paid to the lender to take account of the reduced credit costs.

This is a long list that can involve difficult financial calculations and legal interpretation – let alone the transaction costs for the borrower in terms of time and effort. Few consumers could undertake this without legal advice and, as noted, even lawyers have had difficulties with these provisions.

The Ministry does not believe that there is sufficient expertise within community advice agencies to help consumers. While lenders should assist borrowers in this exercise, there is little incentive under the Act for them to do so.

2.3.2 Negative licensing

Banning lenders from providing credit is also part of the self-enforcing regime. Borrowers can do this by bringing an action to the District Court under section 39 of the Act. To be successful, the borrower must satisfy the Court on two distinct points. First, that one of the events described in section 39(1)(a)(i) to (iv) occurred – for example, that the lender has been convicted of a crime involving dishonesty, or has failed to comply with the disclosure provisions more than once. Secondly, the borrower must convince

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[19] *Butterworths Laws of New Zealand*, "Consumer Credit and Hire Purchase", para 15.

[20] At para 60-150.

[21] This is made more complex, because the legislation does not state whether "total cost of credit that relates to the period from the day the contract is made" (section 25(2)(a)) refers to a calculation based on the fraction of the time period, or an actuarial calculation based on the relationship between the total cost of credit and the outstanding balance for that period.

the Court that the lender is not a fit and proper person to offer controlled credit contracts.

Borrowers are not usually in a position to know if a lender is breaking the law, or what can be done about it. There are also the substantial barriers to taking an action to the District Court set out above in section 2.2.2. The borrower makes no financial gain by taking an action under this section – the only incentive for them to do so is to protect other potential clients of the lender (or perhaps retribution against the lender). Therefore, it is not surprising that nobody has ever taken action against a lender under section 39.

The fact that rival lenders have not taken an action under this section – as they and anybody else are entitled to do – can probably be explained by the size and diversity of the credit market. Lenders are not likely to be sufficiently familiar with the activities of every other lender – and a large credit institution may not be concerned by the activities of a cash loan company, because they operate in different sectors of the market. Traders' ability to use the Fair Trading Act for complaints about competitors' advertising and sales practices may also contribute to the non-enforcement of section 39.

It appears that the "self-enforcing" objective of the Act is fundamentally unrealistic. This does not mean, however, that the principle of self-enforcement is unrealistic – the Ministry considers that it works well with the Consumer Guarantees Act 1993.

2.4 General issues

In many respects the specific problems discussed so far are examples of more general issues that characterise most consumer law disputes. These issues are now looked at in the context of the Credit Contracts Act's provisions for redress and enforcement.

2.4.1 Unequal position of borrower versus lender

The lender will usually know more than the borrower about the contract, the Credit Contracts Act, and the legal system generally. Lenders are often large institutions, with far greater resources and "clout" than an individual borrower. Consumer credit policy has traditionally recognised that there is a major imbalance of knowledge and power between lender and borrower. Some of the criticisms in this chapter suggest that the redress and enforcement provisions of the Credit Contracts Act do not always rectify this imbalance between borrower and lender.

2.4.2 Consumers' ignorance of their rights

The Ministry and other consumer organisations such as the Community Law Centres, the Consumers' Institute and the Citizen's Advice Bureaux aim to raise awareness of the Act through pamphlets, free advice, school programmes, radio sessions, videos and other educational tools. Television programmes such as *Fair Go* and *Target* also help to inform consumers of their rights.

Despite these efforts, most consumers are unable to name the main Acts that protect them, much less describe their rights under the main provisions of these Acts.[22] Some consumers have difficulty reading, or cannot read English, and so are unable to make use of the information contained in legislation or pamphlets.[23] As observed in previous discussion papers in this Review, about 45 percent of New Zealand adults are "functionally illiterate" and will not fully understand what they are signing.[24] This lack of knowledge by consumers makes it unlikely that a borrower will seek redress when they think that something is amiss, or that they will realise something is amiss in the first place.

2.4.3 The disincentive of high transaction costs

Transaction costs refer to the costs involved in completing a transaction, including time and effort. Pre-transaction costs are a type of transaction cost and costs include searching out information about a product or service, and the cost of negotiating. Transaction costs can also occur after a transaction has taken place, such as the time and effort it takes to pursue a complaint and obtain redress. In many cases, the transaction costs outweigh the value of the complaint. This may often be the case for the Credit Contracts Act, where redress is far from straightforward – and costly.

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[22] Tokeley, *supra* n7 at 379.

[23] *Ibid.*

[24] The Consumers' Institute reports that in a 1997 survey some budget advisers claimed that the vast majority of their clients did not understand the nature of their contracts: Consumers Institute, (August, 1998). *The Reform of Consumer Credit Law in New Zealand*, at section 3.4.

3. IMPROVEMENTS IN REDRESS

Since the Credit Contracts Act is self-enforcing, redress and enforcement are inter-related. Improved avenues for redress are likely to increase overall enforcement of the Act, while improved enforcement reduces the need for redress by consumers generally. But to make the shape of the Ministry's proposals clearer, these two aspects of the overall regime have been dealt with in separate chapters. The intertwined nature of redress and enforcement, however, means that from time to time both concepts are discussed together within their separate chapters.

This chapter puts forward a range of options for reforming the Credit Contracts Act's provisions for *redress*. Briefly, these are:

- improvements to the Disputes Tribunal decision-making procedures
- changes to the penalty regime
- incorporating disclosure requirements as a Consumer Information Standard
- providing for the possibility of class actions under the Act
- providing for the availability of damages under the Act.

3.1 Improvements to Disputes Tribunal decision-making procedures

The Ministry believes that there are some aspects of the Disputes Tribunals process that could be improved for the benefit of both borrowers and lenders.
Four options for reform are discussed below:

- improvements to the training of referees
- the establishment of a specialist credit tribunal
- increasing the monetary jurisdiction for credit disputes
- a special right of appeal from decisions concerning credit disputes.

3.1.1 Improvements to training

As discussed in Chapter 2, referees themselves desire more specialised training in the consumer credit area. This training would particularly focus on the technical requirements of the disclosure provisions, as well as on the more general principles of the Credit Contracts Act. Both borrowers and creditors should benefit from more informed decisions from referees as a result of this training. The decisions are also more likely to be consistent with the Credit Contracts Act and therefore provide stronger incentives for lenders to comply with it.

But given the relative rarity of consumer credit claims, referees are unlikely to develop real expertise in this area. General training for all referees may not improve the status quo in any substantial way.

An alternative is to appoint specialist credit referees. These referees would come from the general "pool" of referees, but would receive specialist training in credit disputes. All claims involving consumer credit would be heard by these referees.

The advantage of this alternative is that these referees will be able to develop specialist knowledge and experience in the consumer credit area. Borrowers in turn should benefit from improved decisions about credit disputes, but still retain the advantages of the Disputes Tribunal process. Only minor legislative amendment would be needed to create these specialist credit referees.

This option does have some disadvantages. Specialist referees may not be available in all Tribunals, and would therefore have to travel between Tribunals to hear credit disputes or conduct hearings by tele- or video-conference. This may result in lengthier periods between complaint and resolution and some administrative cost. However, the Ministry considers these to be relatively minor disadvantages.

3.1.2 Establish a specialist credit tribunal

A second option is to establish a specialist credit tribunal. This tribunal could either be a separate tribunal (like the Motor Vehicle Disputes Tribunal that hears claims under the Motor Vehicle Dealers Act), or run in tandem with the Disputes Tribunal. These specialist tribunals could be based with each Disputes Tribunal, or "roam" the country.

The creation of a specialist tribunal would have these advantages:

- it should provide borrowers with all the benefits of the Disputes Tribunal – informality, accessibility, speed, low cost and fairness
- its sole focus on credit disputes would help ensure that disputes are settled fairly and consistently by referees who are specially trained and experienced in credit law
- it could have a higher monetary jurisdiction, say up to $30,000.

Several of the Australian States have some form of specialist tribunal that deal specifically with consumer credit disputes, although their operations are rather different from our Disputes Tribunals.[25]

A specialist tribunal would increase access to justice for consumers involved in credit disputes and overcome many disadvantages of the current system. However, setting up specialist tribunals would require quite substantial amendment to the Disputes Tribunal Act, or new specific legislation, as well as amendment to the Credit Contracts Act. The implementation and

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[25] Some examples are the Fair Trading Tribunal of New South Wales, the Commercial Tribunal of Western Australia and the Australian Capital Territory Credit Tribunal. These tribunals, as do the general tribunals which perform equivalent functions to the Disputes Tribunal here, differ from the Disputes Tribunal in that disputes are heard by more than one referee (in Victoria one referee has to be a lawyer), and decisions can be appealed on points of law. Several of the tribunals also allow legal representation in some circumstances, and in most states the hearings are usually open to the public. For further detail see A Duggan and E Lanyon, (1999). *Consumer Credit Law* Butterworths: Sydney, at 487-493.

maintenance of specialist tribunals would also require significant government funding. It may be hard to prioritise funding a credit tribunal above other parts of the existing courts system.

3.1.3 Other options

Two other options are briefly mentioned here. One is that parties to credit disputes could be given a special right of appeal against the decision of a Disputes Tribunal if the amount in dispute exceeded a particular level, say $3000. The Ministry considers that the disadvantages of this proposal outweigh the advantages, as the appeal process would be far more accessible to lenders. The prospect of appeal to the District Court, and the associated cost, would deter many consumers from taking a dispute in the first place.

Another option is to increase the jurisdiction of the Disputes Tribunal for credit disputes only. There is, however, no reason why such a measure should be limited to credit and it would raise issues of inconsistency with other types of dispute. It would have the clear advantage of improving accessibility to the Courts system.

Which of the following options do you support? Why?
- Training of specialised Disputes Tribunal referees?
- The establishment of a specialist Credit Tribunal?
- A special right of appeal from the Tribunal for credit disputes?
- Increasing the monetary jurisdiction of the Tribunal for credit disputes?

Which of these options do you not support? Why?

3.2 Changes to penalty regime for breaches of disclosure

It was suggested in section 2.3.1 that one reason why borrowers do not enforce their rights under the disclosure provisions is because the provisions are too difficult for most consumers to understand and apply. Part 3 of this Review*, Transparency in Consumer Credit: Interest, Fees and Disclosure*, put forward some options for simplifying the disclosure requirements of the Act. Simplifying the disclosure requirements will make it easier for borrowers and their advisers to work out whether the lender has breached them, making it more likely that the borrower will lodge a complaint about the breach. But the borrower still has to work out how much the penalty should be, which is a fairly complex calculation.

Two options for simplifying the penalty provisions and strengthening them in favour of borrowers are discussed:
- a change to the calculation of penalties, so that all penalties are simply a function of either the total cost of credit or the outstanding balance of the loan
- setting a minimum penalty, to increase borrowers' incentives to take action for redress.

The interests of consumers in having accurate and timely information about credit contracts must be balanced against the cost to lenders of complying with the disclosure requirements. Lenders also find the Act difficult to

understand, and therefore difficult to comply with. It seems unjust not to recognise the efforts of lenders who genuinely attempt to comply with the Act compared with those who blatantly disregard it.

If the penalties are effectively increased for non-compliance, or the disclosure provisions are strengthened in favour of borrowers in some other way, then it may be appropriate to improve lenders' ability to minimise or avoid liability if a mistake has been made. One option here is the introduction of a maximum penalty.

Several changes to lenders' defences to liability for penalties under the Act are also discussed:
- the adoption of the "excusable error" defence from Canadian legislation
- the adoption of the "reasonable mistake" defence from New Zealand's Fair Trading Act
- the use of "model form" contracts from United States legislation.

The final option is a new approach to the penalty regime, which has been adopted in Australia. It differs significantly from the New Zealand regime in its abolition of automatic penalties.

3.2.1 Simplifying the calculation of penalties

When a lender breaches a disclosure provision in the Act, the borrower's debt is reduced by a "specified amount". In the case of a breach of the *initial* disclosure requirement, for example, the "specified amount" is the *smaller* of:
- three times the part of the total cost of credit that relates to the period from the day the contract is made until the earlier of the following days:
  - the day on which initial disclosure is made;
  - the day that is 8 months after the day the contract is made;

  or
- the total cost of credit payable under the contract.

This provision is much more complicated[26] than the Canadian equivalent, where the borrower is entitled to the lesser of $500 or 5 percent of the outstanding balance.[27] The United States' Truth In Lending Act also provides a fairly simple penalty: twice the amount of any "finance charge" (a figure roughly equivalent to the total cost of credit), provided that this amount is more than $100 and less than $1000.[28]

One way of making the disclosure provisions more "user-friendly" would be to choose a figure or a simple function of that figure as a penalty. One choice is the total cost of credit – it would have been disclosed to the borrower if the contract is for fixed credit and can be found in the disclosure documents

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[26] Particularly for revolving credit, when the consumer will have to calculate the total cost of credit him or herself as it would not have been disclosed by the lender.

[27] See section 98, Fair Trading Act 1999 Alberta, Canada. "Outstanding balance" refers to the maximum amount of a fixed credit contract and the credit limit for revolving credit.

[28] Truth in Lending Act (15 USCS § 1640). In Canada and the United States the borrower must bring an action against the lender to recover this amount.

rather than having to be calculated. But if it has not been disclosed correctly (or not disclosed at all), then the consumer will have to calculate the correct figure.

For revolving credit, calculating the total cost of credit is even more complex. It is calculated on the basis of the credit limit (if there is no limit the lender must estimate the amount that is likely to be drawn down) for the minimum period the credit is provided for, or (where there is no minimum) for 12 months.

The Ministry has also raised in its *Transparency* document the option of no longer requiring lenders to calculate the total cost of credit.

For these reasons, the Ministry prefers a similar provision to that in Canada, where the automatic penalty is a specified proportion of the outstanding balance of the loan, with "outstanding balance" referring to the maximum outstanding balance under a fixed credit contract and the credit limit under a revolving credit contract.

A simplified penalty scheme means that lenders will have a clearer indication of their potential liability, and it will be easier for borrowers (and Tribunal referees when there are disputes) to determine the correct penalty in each case. This will increase the incentives for lenders to comply with the disclosure provisions of the Act, while encouraging borrowers to bring a complaint to the Disputes Tribunal or Court.

Which method of calculating automatic penalties do you think is best:

- The status quo?
- A penalty based on a specified proportion of the outstanding balance? Why?
- What disadvantages can you identify with these methods?

3.2.2 Minimum penalties

Under the Truth in Lending Act in the United States, lenders' liability for breaching the disclosure requirements is a minimum of $100. This minimum penalty acts as an incentive for the borrower to bring an action. It could be adopted here to encourage complaints to the Disputes Tribunal, provided that the minimum amount is an appropriate margin above the cost of bringing a complaint (including the filing charge).

The idea of a minimum penalty was originally introduced in the United States as a low-cost method of ensuring overall compliance because it would encourage class actions.[29] This provision, however, was perceived as exceedingly harsh on lenders, "raising the spectre of enormous damage suits for minor violations of the statute",[30] and has now been amended so that

[29] See W Whitford, (1973). "The Functions of Disclosure Regulation in Consumer Transactions". *Wisconsin Law Review, 2,* at 443.

[30] E Rubin, (1991). "Legislative Methodology: Some Lessons from the Truth-in-Lending Act". *The Georgetown Law Journal, 80,* 233 at 237.

minimum recovery does not apply to class actions. But in New Zealand class actions are still developing and contingency-fee arrangements are rare. So minimum penalties pose far less of a threat to lenders in New Zealand than they do to their counterparts in the United States. This will be the case for the foreseeable future, even if class actions were expressly allowed under the Credit Contracts Act. (The pros and cons of doing this are discussed in section 3.4.) The threat of class action will operate as an effective incentive for lenders to avoid breaching the Act.

A minimum penalty is probably required to ensure compliance by lenders of small loans. For example, 5 percent of the outstanding balance on a $500 loan only comes to $25. This may not be enough to deter some lenders from breaching the law, and hardly makes it worthwhile for the borrower to seek redress. Therefore, a minimum penalty of a relatively modest amount (say $100) is appropriate; it can be modified, if necessary, to take account of class-action recoveries.

Do you agree that there should be a minimum penalty? Why?If so, at what level should it be set? Why?

3.2.3 Maximum penalties

As mentioned above, Canada has fixed a maximum penalty of $500 for breaching its disclosure requirements, and the United States has both a minimum and a maximum penalty of $100 and $1,000 respectively. In both these jurisdictions, however, the lender may also be liable to the borrower for damages, and may face relatively large criminal penalties and even imprisonment. The penalties for incorrect disclosure are just one of a number of different measures designed to compensate the borrower and ensure compliance with the law by lenders.

In New Zealand, the current penalty provisions in the Credit Contracts Act are rarely enforced; to further limit their deterrent effect, by capping the amount for which a lender can be liable, could undermine the Act even further. The Ministry believes, however, that a maximum penalty may be appropriate in certain circumstances. In Chapter 4 of this discussion paper the Ministry proposes the establishment of an enforcement agency. If an agency is set up, lenders will face an increased exposure to liability under the Act. On these grounds, the Ministry considers it appropriate that there be a maximum penalty of $3000 for a breach of the disclosure provisions.

Do you agree that there should be a maximum penalty?
If so, at what level should it be set? Why?

3.2.4 Changes to lenders' defences against penalties

Three main options are considered here. The first is the adoption of the Canadian “excusable error” defence. The second is the adoption of the “reasonable mistake” provision of the New Zealand Fair Trading Act. Lastly, the use of “model form” contracts in the United States is discussed. Each of these options has several variations.

(a) "Excusable error" and the role of compliance programmes

The Fair Trading Act[31] of Alberta, Canada, provides that a breach of the Act by a lender is an "excusable error" if:

- the lender had a compliance procedure when the contravention occurred
- the contravention was accidental or the result of an employee's or agent's failure to follow the compliance procedure, and
- the lender, on discovering the contravention, promptly took steps to minimise its effect on any affected borrower.[32]

If the lender can show that the breach is an "excusable error", the lender does not have to pay the penalty.

The Ministry particularly wants to encourage lenders to establish credit-compliance programmes. These programmes have two advantages: lenders have incentives to minimise the risk of breaches (a benefit to borrowers); and lenders' potential liability would correspondingly be reduced (a benefit to lenders). One way to encourage these programmes is to introduce the defence of "excusable error" into the Credit Contracts Act. The defence would have to be adapted in several ways to take account of New Zealand's different legal and institutional framework. There are three ways the Canadian defence of "excusable error" could be incorporated into the Act.

(i) Replacement of the inadvertent non-disclosure defence with that of "excusable error"

The excusable error defence could replace section 31 of the Act. But there are aspects of the current "inadvertent non-disclosure" defence that the Ministry believes should be retained, particularly the requirements that correct disclosure is made as soon as is reasonably practicable and that the lender offers to compensate the borrower for any harm suffered as a result of the error. Lenders in New Zealand are also familiar with the requirements of the "inadvertent non-disclosure" defence. In the interests of certainty, it would be better to build on the existing defence if possible.

(ii) Amalgamation of the inadvertent non-disclosure and the excusable error provisions

This approach would combine the new concept of the compliance procedure with all the elements of section 31 as it currently stands, thus retaining lenders' familiarity with these elements. Making a compliance programme a mandatory part of the defence may be too onerous on lenders. A more flexible approach, based on the concept of "reasonable mistake" in the Fair Trading Act, is discussed after the next paragraph.

(iii) Replacement of "compensation" with "minimising effect"

Another possible amendment to section 31 would be to replace the lender's obligation to compensate the borrower with the lesser Canadian requirement that the lender promptly takes steps to minimise its effect on any affected

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[31] The consumer credit provisions in this Act are based on the Cost of Credit Disclosure Act, drafted and recommended for adoption by the Uniform Law Conference in October 1998 (www.law.ualberta.ca/alri/ulc/acts).

[32] Section 98(1) Fair Trading Act 1999, Alberta, Canada.

borrower. If the Credit Contracts Act is reformed in other ways that favour the borrower, this lesser requirement may be appropriate. Currently, however, the penalty provisions of the Act are the only means by which borrowers can receive compensation for any loss suffered from incorrect disclosure. Until the law changes, the Ministry considers that it is more desirable to retain the requirement of compensation.

(b) "Reasonable mistake" under the Fair Trading Act

Compliance programmes are not specifically mentioned in the Fair Trading Act, but the Courts and the Commerce Commission have placed considerable importance on the existence of effective programmes designed to prevent or minimise breaches of the Fair Trading Act. As well as playing a preventive role, evidence that "reasonable precautions" have been taken (by implementing a compliance programme) is considered favourably by the Commission in its decisions to take action under the Fair Trading Act. The Court will take a similar view in deciding verdict or sentence.[33]

It makes sense to deal with compliance programmes for the Credit Contracts Act in a similar way to the Fair Trading Act. There are three main reasons for this:

- From a *policy perspective,* the considerations for non-disclosure are similar to those for misleading conduct and false representation. Both represent a breach of law because the supplier has not given the consumer the type or quality of information that the law requires.

- From a *lender's perspective,* it would be better if compliance programmes were similar for both the Fair Trading Act and the Credit Contracts Act. This would make it easier for lenders to develop such programmes, as they may already have a Fair Trading Act compliance programme. If not, there is guidance from the Commerce Commission and case law about what is required.

- From an *enforcement perspective,* it would be easier to investigate and rule on compliance under the Credit Contracts Act if its compliance programmes had a similar role and legal weight to those under the Fair Trading Act. The latter Act has established clear principles that the Court follows and examples of successful and unsuccessful compliance programmes.

There are two ways that the Credit Contracts Act could be changed to give compliance programmes the same importance as they have under the Fair Trading Act:
- incorporating the defence of reasonable mistake into the "inadvertent non-disclosure" defence of section 31
- giving the Courts discretion under section 32 to reduce a penalty if a lender has a compliance programme.

[33] Gault on Commercial Law, *supra* n2 at para FT 40.11.

(i) Incorporation of defence of reasonable mistake into section 31
Under the Fair Trading Act, it is a defence against prosecution if the defendant proves that the breach was because of a reasonable mistake. The Courts have held that to prove a "reasonable mistake" a trader must show that there was an intention to act correctly; and that this means there should have been some system of checking, such as an compliance programme, to detect errors.[34] The compliance programme must be effective, not just nominally in place.[35]

To incorporate a similar approach into the disclosure provisions of the Credit Contracts Act, section 31(a) could read "the failure was owing to a *reasonable mistake* or to events outside the control of the lender". Such a change in wording, coupled with an appropriate introduction in Parliament, would indicate to lenders, borrowers, any enforcement agency, and the Courts that the amended section 31 should be approached in the same way as the equivalent provision in the Fair Trading Act.

Under this change, the lack of a compliance programme would not be fatal to a lender's defence under section 31 if the events were outside their control. When events *are* within the lender's control, it is appropriate that the Court or the enforcement agency consider whether the lender had an effective compliance programme. Thus, the defence of "reasonable mistake" provides a flexible and relatively familiar way of introducing compliance programmes into the Credit Contracts Act.

(ii) Reduction of penalty if lender has a compliance programme
Under the Fair Trading Act "reasonable mistake" is only a defence to criminal prosecution, although the Court will take account of any compliance programme when considering the appropriate level of civil liability.

The Courts could take a similar approach to a breach of the Credit Contracts Act's disclosure provisions – even though the Act's penalties for not disclosing would be civil not criminal. Under section 32, a Court may reduce or waive the penalty on the application of a lender. The Court can consider any matter it thinks fit when deciding whether to reduce the penalty, and so technically may already be able to take account of compliance programmes. But direct reference in the Act to a compliance programme, as part of the relevant criteria the Court must take into account, would clearly signal its importance.

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[34] See for example *Commerce Commission v Telecom Corp of NZ Ltd* (1990) 4 TCLR 1; *Commerce Commission v Warkworth Supermarket Ltd* 21/11/91, Judge Buckton, DC North Shore CRN1084003797.

[35] *Foodtown Supermarkets v Commerce Commission* [1991] 1 NZLR 466.

(c) Model-forms

The United States' Truth in Lending Act requires the Federal Reserve Board to promulgate model-forms of contract. Lenders' proper use of these forms is regarded as compliance with the disclosure provisions of the Act, except if mistakes are made in the specific numerical disclosures (such as the interest rate).[36]

Model-forms could be developed to provide guidance about the information that needs to be disclosed. The model-forms could be included in a schedule to the Act, or could be promulgated by the Ministry of Consumer Affairs or an enforcement agency. As with the "excusable error" defence, if lenders adopt these model forms and follow them they are not liable for any penalties under the Act.

Model-form contracts pose a number of problems in practice. They would require constant monitoring and alteration to be kept up to date, and they may be difficult to apply to the numerous forms of credit available and the current trend for "tailor-made financing". Even if there were model-form "clauses" that could be included in a lender's own contract, such clauses simply might not fit all contracts because of the nature of the credit product to which they relate. Moreover, the appropriateness of a particular clause may well depend on the context in which it is used.

Another alternative is not to make the use of model-forms a defence, but rather a factor that an enforcement agency or a Court can take into account. But, because of the difficulties highlighted above, this is unlikely to create a strong enough incentive for lenders to use them.

For these reasons, the Ministry considers that model-forms are an option only for regulating *presentational* standards as discussed in Part 3 of this Review, *Transparency in Consumer Credit: Interest, Fees and Disclosure.*

Which option to you think is the most appropriate on which to base a defence for lenders?

- Replacement of the inadvertent disclosure defence with that of "excusable error".
- Replacement of requirement of "compensation" with "minimising the effect" of any breach.
- Introducing a defence of "reasonable mistake" based on that in the Fair Trading Act? How might this work?
- A defence based around model-forms.

What advantages and disadvantages do you see with these options?

[36] 15 USCS s105(b).

3.2.5 The Australian approach to penalties

The civil penalties regime under Australia's various repealed Credit Acts was similar to New Zealand's current regime. The credit charges under the credit contract were automatically irrecoverable if the lender failed to comply with the disclosure obligations. Also, like the Credit Contracts Act, lenders could apply to the courts for a reduction or a waiver of the penalty.

In 1996 the Credit Acts were replaced with the Consumer Credit Code. The Code does not retain the concept of automatic penalties, and instead requires borrowers to apply to the Court for relief.

Briefly, the main features of the civil penalties regime under the Code are as follows:

- The civil penalty does not apply to every case of non-compliance with the disclosure requirements, but is limited to contravention of a "key requirement" (such as incorrect disclosure of the annual percentage rate).
- The penalties are designed to create a "race" to the court between borrowers and lenders, so that breaches are revealed and dealt with as quickly as possible.[37] If a lender or a government consumer agency applies for an order first, all applications by borrowers (and guarantors) are blocked and the maximum penalty the lender has to pay is $500,000. If the borrower applies first, there is no cap on the lender's liability. A lender will be especially keen to "confess" where the breach has been repeated across a large number of documents and the total civil liability is potentially enormous.
- If a borrower or a guarantor makes the application, the maximum civil penalty the Tribunal may impose is an amount equivalent to the greater of the interest charges payable under the contract from the date the contract was made, or the borrower's loss resulting from the breach. In these cases the penalty is payable to the borrower or the guarantor.

This approach appears to have definite advantages when viewed in light of the problems New Zealand is currently experiencing. It would also increase the harmonisation of New Zealand and Australian law, which is an objective of the New Zealand and Australian governments. The regime also encourages lenders to "confess" to a breach of the disclosure requirements, whereas in New Zealand there is little incentive for lenders to do so. The penalty awarded also takes into account the seriousness of the breach, whereas in New Zealand the same penalty applies whether the breaches are substantial or trivial, deliberate or otherwise. And to obtain any relief from the automatic penalty, a lender must meet the requirements of section 31 or 32 of the Credit Contracts Act.

[37] See Duggan and Lanyon, *supra* n25 at 434.

The pivotal aspect of the Australian regime is the existence of an enforcement agency with the ability to take action to a Tribunal or Court. Such an agency facilitates the “race” to the Tribunal or Court. In New Zealand borrowers consistently under-enforce breaches of the Credit Contracts Act, despite the current *automatic* penalty provisions. This suggests that forcing the borrower to make a complaint to a Tribunal or take an action to Court, without also appointing an enforcement agency, will worsen the current under-enforcement of the Act. In turn, the current level of under-enforcement means that a lender can safely assume there is little risk of a borrower making a complaint, and so undermines the “race” by not making an application itself.

Therefore, adopting the Australian civil penalty regime would require the establishment of an enforcement agency with similar powers to those in Australia. (Establishing an enforcement agency is further discussed in the next chapter.)

Any penalties ordered against lenders on the application of the consumer agency or lender are to be paid into a “consumer credit fund”; if a borrower wants compensation for the breach they must make an independent application to the Tribunal or Court. Therefore New Zealand, if it wanted to provide individuals with redress, would also have to adopt a similar system of separate application for compensation.

Automatic penalties were abandoned in Australia because they were seen as giving borrowers the upper hand in the credit deal. The Consumer Credit Code was an attempt to redress the balance in favour of lenders. This clearly differs from the New Zealand experience.

Although the Australian regime has merit, adopting it is not the Ministry’s preferred option. This is because of the differing New Zealand experience with the civil penalties provisions, and the different institutional arrangements for enforcement.

3.3 Disclosure requirements as a Consumer Information Standard

This option was initially raised in Part 3 of the Review, *Transparency in Consumer Credit: Interest, Fees and Disclosure,* for the formatting and presentation of disclosure.[38]

It would be possible to “transplant” the Credit Contracts Act’s disclosure provisions into a Consumer Information Standard under the Fair Trading Act. The Standard would require the disclosure of certain cost-of-credit information to consumers, and would be enforced by the Commerce Commission like the other Consumer Information Standards.

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[38] The option was raised in the Ministry’s 1988 paper and has been recommended to the Ministry from time to time since then.

The mechanism for creating standards under the Fair Trading Act is wide enough to cover all the disclosure requirements in the Credit Contracts Act. This would be by far the biggest and most complicated Standard so far, and the first to deal with services rather than goods.

Advantages of a Credit Consumer Information Standard

The main advantage of moving the Credit Contracts Act's disclosure provisions to a Standard would be that the Commerce Commission would enforce it. As a piece of subordinate legislation under the Fair Trading Act, it would be easier and quicker to amend, making it potentially more responsive to developments within the credit market. The transfer from the Credit Contracts Act to a Standard could also address other issues with the current disclosure provisions, such as complexity and timing, that were identified in *Transparency in Consumer Credit: Interest, Fees and Disclosure.*

Disadvantages of a Credit Consumer Information Standard

There are, however, significant disadvantages in adopting a Consumer Information Standard to regulate disclosure. It would be a further fragmentation of consumer credit law, which is undesirable as that law is already dispersed over several statutes. The adoption of a Standard would mean that a consumer seeking redress for *both* failure to disclose and relief from an oppressive contract would have to take action under separate pieces of legislation.

Adopting a Standard would also cause inconsistency in enforcement. The Commerce Commission could take action for breaches of disclosure, but provisions that would seem more appropriate for an enforcement agency, such as the negative licensing provision, would remain enforceable only by individuals.

Enforcement is clearly an issue in all aspects of the Credit Contracts Act, not just the disclosure provisions. If an agency – such as the Commerce Commission – were appointed to enforce the entire Act, the principal benefit of using a Standard would be achieved without its drawbacks. It could simply be written into legislation that the agency undertake this overall enforcement role and it would not specifically require a Standard. For this reason, the Ministry considers the argument in favour of a Standard to be misconceived.

Do you think that cost-of-credit disclosure information should remain a part of consumer credit legislation or be transferred to the Fair Trading Act as a Consumer Information Standard?

3.4 Class actions

A class action allows a single plaintiff to bring an action on behalf of all persons with a common interest in a piece of litigation. Class actions are particularly well suited to consumer law disputes, because they enable people to "pool" the costs and time associated with legal action. An American

judge of a senior United States Court, Chief Justice Bird, aptly described the benefits of class actions in *State v Levi Strauss & Co* when he observed that:

> without such actions defendants may be permitted to retain ill-gotten gains simply by their conduct harming large numbers of people in small amounts instead of small numbers of people in large amounts.[39]

New Zealand lenders make wide use of standard-form credit contracts, and so class actions would be a particularly useful form of redress for breaches of the disclosure provisions. This is because a breach of the disclosure provisions in a standard-form contract will be of exactly the same nature across all of these contracts. It will affect many people, who then have a common interest in seeking redress. Setting a minimum penalty for breach of the disclosure requirements, as discussed above in section 3.2.2, could also facilitate class actions.

Class actions, however, are of not much practical benefit to consumers where the breach of the disclosure requirements arises from an isolated instance of inadequate disclosure in an otherwise complying standard-form. In this case, the failure to disclose will not affect a large number of contracts and borrowers.

Class actions are common in the United States, and to a lesser degree in Canada and Australia. Class actions in New Zealand are permitted by Rule 78 of the High Court Rules, making them technically available under the Credit Contracts Act. To encourage borrowers to bring class actions, the Act could be amended to specifically provide for this type of redress.

Class actions, however, have been little-used in New Zealand, for a number of reasons. Firstly, our courts historically have interpreted Rule 78 very narrowly, making it difficult for individuals to meet the criteria for bringing a class action. A second reason is that contingency fees[40] are rarely used in this country because of concerns that they are technically illegal. Contingency fees encourage class actions, because they avoid the need for the individuals taking the action to organise financing between them. They also remain controversial. Many critics fear that they will encourage lawyers to act unethically in their zeal to win the case and their fee, and will lead to a much more litigious society.[41]

Despite these concerns, it seems likely that doubts about the status of contingency fees will be resolved eventually and class actions will become more common in New Zealand. At present, however, class actions in New Zealand are still very much in their infancy, and so cannot be relied upon to ensure effective redress and compliance with the Credit Contracts Act.

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[39] 224 Cal Rpt 605 at 612 (1986); quoted in Tokeley, *supra* n7 at 391.

[40] A contingency fee system operates whereby a lawyer does not charge for their services, but takes a percentage of the Court award if the case is successful.

[41] Tokeley, *supra* n7 at 389.

What case, if any, is there for class actions under credit legislation?

3.5 Damages

3.5.1 Compensatory damages

The Credit Contracts Act's civil penalty regime is designed primarily to promote compliance, rather than compensate the borrower for any losses as a result of a breach. This is also the case with consumer credit law in Australia, Canada and the United States, although these jurisdictions also give the Court the power to award damages to the borrower for their loss.

In New Zealand, apart from seeking damages for oppressive contracts under Part II of the Act, a borrower has no means under the Credit Contracts Act of recovering their losses when the penalty is not adequate compensation. A borrower's only option is to try to bring a claim for damages under another statute or by using the common law. This will probably involve taking legal advice and bringing an action to the District Court.[42]

The Credit Contracts Act's present focus is on overall compliance through self-enforcement, and so the Act must provide sufficient incentive for borrowers to enforce their rights. One way of doing this would be to allow borrowers to seek damages from the Tribunal or Court when they feel they have suffered loss over and above the amount of the penalty awarded. The Tribunal or Court would have the discretion to award damages as it saw fit.

The advantage of this proposal is that it may make bringing a claim to the Tribunal or Court more worthwhile for the borrower. As a consequence, the prospect of more proactive borrowers and higher costs may deter lenders from breaching the Act's provisions.

In most cases, however, the penalty already available under the Act is enough to compensate borrowers for any loss they may have suffered. It may be that damages are most appropriate when the disclosure breach amounts to oppression, which means the borrower can apply for compensation under Part II of the Act. As was noted in the Introduction, the Ministry has no immediate plans to change the Act's current requirements relating to oppression.

On balance, the Ministry considers that there will be no significant benefits from instituting damages awards for disclosure breaches, and so it does not recommend this course of action.

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[42] The Tribunal's jurisdiction in tort extends only to loss to property, and in *DGSW v Disputes Tribunal* (1999) 12 PRNZ 642; 9 TCLR 106, the High Court in an obiter dictum interpreted this as meaning that a claim for pure economic loss cannot be brought in the Tribunal. But if, for example, a borrower brought a claim under the Contractual Mistakes Act 1977 or the Contractual Remedies Act 1979 that they had entered into a credit contract as a result of a mistake or misrepresentation, the Tribunal would have jurisdiction up to $12,000.

3.5.2 Exemplary damages

Exemplary damages are damages designed to punish the defendant, rather than compensate the claimant. Their purpose is also to deter others from behaving in a similar way.[43] New Zealand courts can award exemplary damages in certain common law and statutory circumstances.[44] The Tenancy Tribunal also has the power to award exemplary damages under the Residential Tenancies Act 1986.[45] And the Fair Trading Act of Alberta gives its Courts similar powers to award exemplary damages against contravening lenders.[46]

The Credit Contracts Act could be amended to grant similar powers to our Courts where lenders' behaviour is particularly outrageous. This might not be necessary, however, as "problematic" lenders can already be removed from the market permanently though the Act's "negative licensing" provisions – and if an enforcement agency was appointed this provision could act as an effective "punitive" measure.

An enforcement agency could also be granted the right to apply for pecuniary penalties for breaches of the Act, something that the Commerce Commission can do under the Commerce Act. These penalties can perform the function of exemplary damages. (Providing an enforcement agency with these powers is discussed more fully in the next chapter.)

Should consumer credit legislation allow for a borrower to claim compensatory damages? Exemplary damages?

3.6 Other redress options

This section briefly overviews other redress options. Whether and how these options proceed depends on the content of any amendments to credit legislation resulting from this Review. Therefore, they are only raised in passing here.

3.6.1 Charges improperly imposed by lenders

If a lender imposes a charge on a borrower that is either restricted by legislation or not authorised by the contract, the borrower should be able to recover that charge. This type of redress would cover, for instance, fees charged by lenders that are not authorised by the credit contract, or fees for services that are not actually provided as part of the contract.

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[43] S Todd, (1988). "Exemplary Damages" *Victoria University of Wellington Law Review, 18,* 145 at 146.

[44] Accident Insurance Act 1998, section 396; Crown Pastoral Land Act 1998, section 19.

[45] Residential Tenancies Act 1986, section 77.

[46] Section 99 Fair Trading Act 1999, Alberta, Canada.

3.6.2 Criminal penalties

Criminal penalties could be provided for breaches of the Act, as is the case in Canada and the United States. This type of penalty would reinforce the existing civil penalties for redress.

Under the Credit Contracts Act, the remaining credit advertising restrictions still attract criminal fines and this approach could be extended to areas such as the disclosure requirements, breaching a negative licensing order, and insurance charges.

When criminal fines are enforced, they can act as a significant incentive for lenders to comply with the Act. It is the Ministry's experience that, except for the Fair Trading Act where the Commerce Commission is funded to bring criminal prosecutions, criminal fines under consumer legislation are rarely enforced. However, fines should still be considered for those breaches of the Credit Contracts Act where some sanction should apply and the automatic penalties are inappropriate or insufficient.

4. IMPROVEMENTS IN ENFORCEMENT

A number of proposals for simplifying and improving the Credit Contracts Act have been suggested in this discussion paper and in other parts of the Review, but it remains unlikely that the level of action taken directly by borrowers under the Act will be enough to ensure compliance by all lenders. This is because the usual imbalance of knowledge and power between trader and consumer is heightened in the credit area because of its inherent complexity.

Equally, borrowers may realise that their rights have been infringed. But the amount at stake will frequently be too small to warrant making a complaint even to the Disputes Tribunal (particularly given recent increases in filing fees). This problem is widespread in consumer law, and is well illustrated by the criticism the Ministry made of a major retailer in 1994. The retailer had incorrectly calculated penalty interest on more than 42,000 hire purchase contracts, and had overcharged borrowers a total of $750,000. While this is a substantial total amount, it amounts to only $17.85 per borrower – an amount too small for some people to even consider making a complaint to the retailer itself.

This chapter, therefore, looks at the possibilities for improving enforcement of the Credit Contracts Act. The central focus is on the option of creating an agency to enforce the entire Act, and the various powers and responsibilities such an agency could possess. An agency's ability to enforce the "negative licensing" provision of the Act is specifically discussed. The corresponding extension to the Court's powers under the Credit Contracts Act is also examined. Occupational regulation and registration of lenders are the two other enforcement options covered in this chapter.

Many of these options are interdependent – for example, the changes to the enforcement of negative licensing depend on the establishment of an enforcement agency. And if some reforms are adopted, others will not be necessary or appropriate. A wide range of options has been proposed to gauge industry and consumer reaction.

4.1 Establishment of an enforcement agency

4.1.1 Call for an agency

The suggestion that an enforcement agency should oversee and enforce compliance with the Credit Contracts Act is far from new.

In 1977 the Contracts and Commercial Law Review Committee recommended that the government department administering the Act should also enforce it.[47] Although this recommendation was not adopted, the call for

[47] Report of the Contracts and Commercial Law Committee, *supra* n5 at 188-190.

an enforcement agency has been made repeatedly over the 20 years that the Act has been in force, most recently by the Consumers' Institute in its 1998 Report.[48]

Credit contract legislation is enforced by specialist agencies in other jurisdictions, including the United States, Australia, Canada and the United Kingdom. The Commerce Commission is already responsible in this country for enforcing the Fair Trading Act, although that Act also provides for self-enforcement.

4.1.2 Effectiveness of an agency

An agency might be more effective in enforcing and obtaining redress in situations where aggrieved consumers might not be successful or choose not to act at all. This is because:

- an agency will have the power and resources to investigate the activities of lenders, putting it in a better position to discover a breach or assess the merits of an action
- an agency will have specialist expertise in the complexities of credit law, unlike the vast majority of borrowers
- there will be no power imbalance between an agency and a lender
- an agency can act on behalf of a number of consumers who have each suffered a small loss, when those consumers individually are unlikely to take any redress or enforcement action.

An enforcement agency would also be vigilant about lenders whose behaviour is of particular concern. This is a much easier and more flexible option than attempting to change the law to target these lenders.

Major breaches of credit law have often emerged only when an agency becomes involved.[49] The Ministry was involved in the retailer case referred to above, and has investigated and reached agreements with other offending lenders. The Commerce Commission has also taken action under the Fair Trading Act in areas that overlap with credit law.[50] To maximise the benefits of "third party" involvement in consumer credit disputes, the Ministry's view is that one body must be responsible for enforcing the Credit Contracts Act.

4.1.3 Functions of an agency

The functions of the Commerce Commission under the Fair Trading Act are a useful guide to the possible functions of a credit law enforcement agency. These functions can be broken down into three broad categories.

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[48] *Supra* n24.

[49] Ibid.

[50] See Chapter 5, n55 for further detail.

Educate and raise awareness

An agency could educate consumers and lenders of their rights and obligations under the Act, which should decrease the likelihood of a breach and increase the likelihood that borrowers will act when there is a breach. The agency's activities could include publishing information pamphlets and compliance guides, giving industry seminars, and releasing regular publications and media statements.

Section 2.4.2 of this paper noted the difficulties in informing consumers about their rights and legal protections. These problems are compounded in the area of consumer credit, because most borrowers have little incentive to gain this information until they think something has gone wrong. As well, knowing their rights does not necessarily help borrowers work out whether those rights have been infringed in a particular situation. For example, knowing that a lender has to disclose "the total cost of credit" does not help a borrower work out what that figure is for a particular contract.[51] So while it is important to disseminate information about the Act's requirements generally, it is perhaps more useful to improve borrowers' ability to access this information when they need it. This will involve support for community agencies that provide advice to consumers caught up in disputes with lenders.

Undertake investigations

An agency could receive and investigate complaints from consumers about breaches or potential breaches of the Act by lenders. Under the Fair Trading Act, for example, the Commerce Commission has the power to obtain information from a lender or enter its premises if there are grounds to suspect a breach of the Fair Trading Act. This allows an enforcement agency to detect and deal with repeat offenders, in a way that the current individual self-enforcement regime cannot. By receiving borrower complaints, the agency will also be in a better position to identify deep-seated problems with the Act and recommend legislative change if necessary.

Take enforcement action

An agency could act in a number of ways to ensure the Act is enforced. It could:

- give formal warnings to offending lenders that their behaviour breaches the Act
- negotiate settlements with offenders whereby the offender undertakes not to breach the Act again and to compensate affected consumers
- take further disciplinary actions against the lender if it fails to comply with its undertakings; or take disciplinary action anyway if a lender's undertakings would not have been sufficient redress to borrowers in the circumstances.

[51] As discussed in *Transparency*, knowing what a finance rate is does not inform a consumer how to interpret and use the rate.

4.1.4 Agency enforcement

The Ministry considers that an enforcement agency should enforce the Act *proactively* as well as reactively. The agency should not be limited to acting on consumer complaints as they come up, but instead should be able to actively monitor industry actions and developments, and to act on its own initiative.

As this agency would be actively searching out and investigating potential breaches of the Credit Contracts Act, it would need to be given similar investigative powers to those of the Commerce Commission under the Fair Trading Act. To link this proactive ability to the losses that may be suffered by borrowers, there would need to be a provision in the Credit Contracts Act similar to section 43 of the Fair Trading Act. Section 43 allows any person to apply to the Court to make orders for the benefit of any other person that has suffered or may suffer from the actions of a defendant.

This type of provision would help the enforcement agency act on behalf of a "class" of borrowers (who are affected by a standard-form contract that breaches the Act), which would provide much of the benefit to borrowers that class actions offer. The agency could also respond to a type of contract or practice that may be a one-off or much more limited breach. The agency would be able to recover civil penalties, damages, and any other redress available to individual borrowers, as well as apply to the Court for the remedies discussed below in section 4.1.5. These measures should provide the incentives for compliance that the current self-enforcement regime lacks.

4.1.5 Expansion of Court orders if an agency is set up

The types of Court orders that are suitable following successful proactive action by an enforcement agency are different from what is suitable after a successful reactive action. Proactive action is focused on stopping a certain behaviour before it causes more harm, while reactive action provides redress for the harm and punishes whoever caused the harm. Ideally, the best protection for borrowers is stopping the activity as soon as it is discovered, rather than waiting for it to cause harm before acting.

With the exception of section 39, which acts as the ultimate preventive order by removing the lender from the market, there is no power under the Credit Contracts Act to stop a lender acting in a certain way. Even where the Court finds that a contract is oppressive and sets aside or alters that contract, this does not affect other borrowers who may be suffering under another contract with the same lender on the same terms.

For an enforcement agency to play a proactive role under the Act, the Courts need to be given the power to make a broader range of orders. Again, the Fair Trading Act is a useful guide. The power of the Court to make orders for the benefit of people not party to the proceeding – as is the case with the Fair Trading Act – has already been discussed in section 4.1.4 above.

Another useful power – derived from the Fair Trading Act – is the power to order injunctions to restrain behaviour that breaches or is likely to breach the Credit Contracts Act. This would allow an agency to act pre-emptively

and stop a certain type of conduct before too much harm is caused. For example, an injunction would force a lender to stop using a credit contract that is misleading or fails to properly disclose various costs. In many cases, a credible threat by the agency that it will seek such a remedy will be enough to persuade the lender to alter its conduct.

4.1.6 Section 39 - negative licensing

An aspect of the Credit Contracts Act that would particularly benefit from the establishment of an enforcement agency is section 39. This is the negative licensing provision that allows the Court to make an order preventing certain people from acting as lenders.

Section 39 is theoretically a useful power. It allows the general free-market operation of the credit industry, while reserving the right to "prune off" inappropriate lenders. This right has never been used – in the 19 years the Act has been in force, there has *never* been any action taken under section 39. This is not surprising. Most borrowers would not know this provision existed, would not personally benefit from bringing an action, are unlikely to know which lenders are operating outside the law, and would find it extremely difficult to gather the evidence needed to show that the lender is not a fit person to provide credit.

The same constraints do not apply to an enforcement agency. With its specialist knowledge, greater resources and knowledge of the overall industry, an agency is far better equipped to detect and take action against problematic lenders. Australia has long had agencies that enforce negative licensing systems: the Northern Territory, New South Wales, Queensland, and South Australia all use a negative licensing scheme enforced through an agency. The threat of an agency enforcing the negative licensing scheme would provide strong incentives for lenders to comply with the Credit Contracts Act, particularly those with bad track records.

It is envisaged that the enforcement agency would apply to the Court for disciplinary action to be taken against a lender. An alternative option would be for the agency itself to have the power to make orders under section 39. This is the case in several states in Australia. The Ministry believes that this would create a confusing overlap of roles for the agency, and consequently does not recommend it. Given the gravity of removing someone from a particular trade, it is appropriate that only a Court makes such an order.

If an enforcement agency is not set up, then the negative licensing provision of section 39 could still be included under a broader injunctive power – such as those discussed in section 4.1.5 above. This negative-licensing injunctive power by the Court could operate in the absence of an enforcement agency.[52]

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[52] E.g. section 80 Trade Practices Act 1974 (Commonwealth, Australia).

4.1.7 The cost of establishing an enforcement agency

The main drawback to establishing an enforcement agency is the cost of establishing and operating it. It might be possible to set up the enforcement agency on a full or partial self-funding basis. One option for a “user-pays” scheme is to give the agency the power to recover at least some of its costs by charging lenders for the reasonable costs of any investigation the agency undertakes into them. This is the position under the Fair Trading Act in Alberta.

Costs could also be spread across the industry by requiring registration of all lenders and then charging registration and periodic renewal fees. Registration is discussed in more detail below in section 4.2.1.

Ultimately, it is difficult to justify funding the enforcement agency for consumer credit protection in any different way than consumer protection generally under the Fair Trading Act – which is entirely taxpayer-funded.

Establishment costs could be minimised by using an existing agency, such as the Commerce Commission or the Ministry of Consumer Affairs. The Commission has had a number of new functions imposed on it recently and its workload may increase in the near future with the proposed amendments to the Commerce Act and possible regulatory rules for electricity and telecommunications (as well as various proposals for new Consumer Information Standards). The Commission, therefore, would probably need to be given extra resources to carry out an enforcement role under the Credit Contracts Act, or would have to reduce the resource that is dedicated to existing functions.

Is self-enforcement an adequate means of promoting compliance with consumer credit legislation?

Do you agree with the proposal for an enforcement agency? If so:

- What should be its role?
- How should it be established and funded?

What range of orders should be available to the Court in credit disputes?

4.2 Increased occupational regulation of the credit market

Section 39 of the Credit Contracts Act currently provides for the negative licensing of lenders. The Contracts and Commercial Law Reform Committee’s underlying rationale for recommending a negative licensing regime for the Act was that a positive scheme would be too onerous on the vast majority of honest lenders.

New Zealand effectively has *no* licensing scheme as long as section 39 remains unenforced. As has been discussed above in section 4.1.6, establishing an enforcement agency is a credible and effective way of enforcing section 39. But if this agency is not implemented, then increased occupational regulation of lenders may be required to better monitor the industry and increase compliance with the Credit Contracts Act. Two options for occupational regulation are set out below.

4.2.1 Positive licensing and registration

Positive licensing allows only those lenders who have obtained a licence after meeting certain prescribed standards to operate in the credit market. It aims to prevent abuses by adopting entry criteria relating to the lender's honesty, solvency and skill.[53]

A lower level of occupational regulation than positive licensing is registration of all lenders. Registration is used throughout Australia. There are no restrictions on who may be registered – and registration generally places no constraints on the way the market may operate. The agency in charge of the register need only carry out administrative functions.

Either option is possible, but neither seems justified given the cost of establishing, maintaining and enforcing such a system. Commercial law reform in recent years has emphasised that a strong justification is needed before imposing licensing or registration on an industry.[54] While this case might be made for marginal lenders, it is much less plausible for the remainder of the credit market.

4.3 Facilitate private and voluntary sector enforcement

A suggestion that has been made to the Ministry in the past is that rather than set up a new agency, or extend the functions of an existing agency, there should be a dedicated fund for private sector actions against lenders who have breached the law. This is similar in concept to "legal aid" but the purpose is but to enforce the law in the public interest, rather than aid private litigants.

Agencies such as community law centres could apply to the fund directly or could arrange for a lawyer to make the application. The lawyer could then take the action on behalf of the agency. This proposal is untested but may be an effective way of increasing applications under the negative licensing provisions or against lenders whose regular breaches of the law affect a large number of consumers. Solicitors and community groups are often aware of the practices of local lenders; a fund could enable them to take action.

A major advantage of this proposal is that it may be less costly than funding an agency. This is because the required expenses associated with establishing an office, such as recruiting staff and marketing, would be reduced. It would also utilise existing local knowledge.

The disadvantage of this proposal is that it would require systems for receiving applications, monitoring, quality control and disbursement of funds. The funding department would need to set up criteria for accessing the fund, have systems in place for paying out of the fund and ensuring that

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[53] See Duggan and Lanyon, *supra* n25 at 451.

[54] In 1999, the Ministry of Commerce released the *Policy Framework for Occupational Regulation: A guide for government agencies involved in regulating occupations*, which discusses when licensing and regulation are appropriate for an industry.

it is used appropriately. The "arms-length" nature of the scheme may be problematic in that it would not provide for close control by the funding department that is ultimately accountable for the expenditure.

A further disadvantage is that the fund would be limited to court action. It could not be used for investigations and gathering evidence, legal advice, and case assessment – all of which may be prerequisites to successful court action.

Do you have a view on the other options discussed for improving enforcement?

- Occupational regulation?
- An enforcement fund?

5. THE MINISTRY'S PREFERRED OPTIONS

The previous chapters of this discussion paper have identified serious limitations in New Zealand's current consumer credit redress and enforcement regime. Reforms are necessary to ensure that individuals are able to obtain effective redress for breaches of the Credit Contracts Act, and to ensure that lenders comply with it.

When suggesting reforms, it must be remembered that the Act regulates a large and diverse market of lenders. Many of these lenders comply with the Credit Contracts Act as it currently stands. Reform measures designed to improve compliance must not be too onerous on these lenders; yet still provide enough incentive for compliance by those lenders who currently breach the Act.

The Ministry believes that its proposals for reform to the redress and enforcement regime of the Act, and to the Disputes Tribunal's procedures for credit disputes, will meet this goal.

5.1 Appoint an enforcement agency

The Ministry proposes that the most important and beneficial reform that can be made to the Credit Contracts Act is the establishment of an enforcement agency. An agency will not only improve borrowers' opportunities for redress, but its proactive enforcement powers will also create greater incentives for compliance by lenders.

A choice would have to be made whether to establish a new agency with specific functions and powers to enforce credit law, or whether to create new functions and powers for an existing agency.

The advantage in establishing a new agency is that it could be dedicated to consumer credit issues. However, the obvious disadvantage is that establishment would incur significant costs.

If it is considered appropriate to utilise an existing agency, the Ministry considers that there are two options:

5.1.1 The Commerce Commission

The Commission has 14 years of experience in consumer law investigation and enforcement. Over that time it has demonstrated its effectiveness in enforcing the Fair Trading Act in cases involving consumer credit (and one occasion prosecuted a trader under Part III of the Credit Contracts Act).[55]

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[55] For example, in 1996 the Commission prosecuted a major bank for running misleading credit advertisements. The bank was fined $16,000. The Commission has also successfully prosecuted several organisations under the Fair Trading Act in relation to the advertising of supposedly interest-free credit deals when the cash price of the items is less than the interest-free price.

There are also strong synergies between the Credit Contracts Act and the Fair Trading Act – both Acts are consumer oriented and address the quality of information given consumers. The emphasis on compliance programmes recommended in this document is also relevant. Further, the functions and powers given to a new agency would likely be similar to those currently given to the Commission under the Fair Trading Act.

In the United Kingdom, the Office of Fair Trading – which is similar to the Commerce Commission in that it enforces competition and fair trading laws, enforces the Consumer Credit Act 1974. In the United States, however, the Federal Trade Commission is not responsible for consumer credit law – that is the responsibility of the Federal Reserve Board.[56]

As noted above, a number of new functions have been proposed for the Commission, most notably concerning the electricity market. Therefore, a disadvantage with the appointment of the Commerce Commission is that a further extension of its functions and powers would add to resource pressures.

5.1.2 The Ministry of Consumer Affairs

Since its inception, the Ministry of Consumer Affairs has developed considerable experience in dealing with credit disputes – as noted above this has included major investigations into breaches of the Credit Contracts Act and the negotiation of settlements with consumers.

It currently has an enforcement role under the Weights and Measures Act 1987, it is not lacking in enforcement experience. In 1999, the Ministry's enforcement functions were increased when it was aligned with the Energy Safety Service. The Service enforces the safety provisions of the Electricity Act 1992 and the Gas Act 1992.

The enforcement of credit law in Australian and Canadian states is undertaken by the fair trading departments, which are counterparts to the Ministry of Consumer Affairs.

There would be two distinct disadvantages in appointing the Ministry of Consumer Affairs. One is that it lacks the specific enforcement experience that is likely to be required to enforce credit laws. For instance, its experience in taking traders to Court is limited to occasional prosecutions under the Weights and Measures, Gas, and Electricity Acts (where the subject matter is quite different).

The other disadvantage is that the Ministry has a role in recommending policy for consumer credit law (it administers the Hire Purchase and Credit (Repossession) Acts). Public policy in New Zealand in recent years has

[56] The Federal Trade Commission is similar in function to the Commerce Commission, while the Federal Reserve Board is more akin to the Reserve Bank of New Zealand.

recommended the separation of policy and operational/enforcement functions,[57] so it would be unconventional to merge the two in the consumer credit context.

5.1.3 Other considerations

Whichever agency is appointed, the Ministry believes that this agency should have similar powers and functions as those of the Commerce Commission under the Fair Trading Act. The Ministry also notes that, should the enforcement role be undertaken by an existing agency, increased funding would be necessary to enable the agency to undertake the additional role, without restricting its performance of existing functions.

5.2 Changes to Disputes Tribunal process

5.2.1 Appointment of specialist credit referees on Disputes Tribunal.

If an enforcement agency for the Credit Contracts Act is established, borrowers will have increased assurance that lenders are complying with the Act. This, coupled with the relatively infrequency of consumer credit disputes that are heard by the Disputes Tribunal, suggests that the establishment of a specialist credit tribunal is unwarranted. However, the training of specialist credit referees would go some way to ensuring that any credit disputes heard by the Tribunal would be decided with greater accuracy and consistency.

5.3 Changes to penalty regime for breaches of disclosure provisions

5.3.1 Simplified penalty for breach

The Ministry proposes that the calculation of the automatic penalties for breaches of the Act's disclosure provisions should be simplified. The penalty payable in cases of breaches of these provisions should be calculated as a proportion of the outstanding balance – possibly 5 percent, with a minimum penalty set at $100. This simplification should make it easier for borrowers and Tribunal referees to calculate and enforce penalties, and easier for lenders to recognise their potential liability for breaches of these provisions. The result should be improved compliance by lenders.
Since lenders would be facing much higher potential liability if an enforcement agency was implemented, the Ministry considers that the compliance burden on lenders for disclosure should be eased in two ways:

Maximum penalty of $3,000

The Ministry recommends that the maximum penalty for a breach of the disclosure provisions is $3,000. This reform is unlikely to be of significant

[57] This document is not the place to discuss the advantages and disadvantages in separating operational from policy functions. On advantage is that it improves the flow of information used in policy development, whereas a disadvantage may be less objectivity.

detriment to borrowers, as most of the penalties would fall below this amount. It should provide some relief to lenders, since these penalties would more likely be enforced if an enforcement agency is established.

Introduction of "reasonable mistake" defence and compliance programmes into sections 31 and 32

The Ministry recommends the adoption of the "reasonable mistake" defence from the Fair Trading Act into section 31 of the Act, so that lenders may minimise or avoid liability for penalties by implementing effective compliance programmes. These programmes would be of use to the enforcement agency when it is considering bringing an action against a lender, as well as to the Court when it is determining liability under section 31.

The Ministry considers that section 32 should be amended, so that the Court must take into account the existence and effectiveness of a lender's compliance programme when deciding whether to reduce or waive a penalty.

What is your view of the Ministry's preferred options?
Do you have any suggestions as to which agency could fulfil an enforcement function in credit law?
What are your reasons?