SUBMISSIONS TO THE TREASURY, AUSTRALIAN GOVERNMENT

REGARDING THE NATIONAL CONSUMER CREDIT PROTECTION AMENDMENT (CREDIT REFORM PHASE 2) BILL 2012

Provided by: Fixed Charter Lending Pty Ltd

Date: 28 February, 2013

OVERVIEW

Fixed Charter Lending is a licensed credit provider which conducts small amount lending to the consumer market. Its sole director has 20 years experience working in the credit market for a range of lenders and is a qualified Australian legal practitioner.

We thank Treasury for the opportunity to make submissions on the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012*.

Fixed Charter Lending only currently operates in relation to consumer credit lending. Due to time constraints caused by impending legislation start dates (see "Final Comments"), we are restricting our submissions to Schedule 6 of the Bill.

COMMENTS ON SCHEDULE 6 – ANTI-AVOIDANCE

6.1 **Carrying out a scheme so as to avoid the application of a provision of the Act**

6.1.1 Proposed section 323A of the Bill seeks to prohibit avoidance of the *National Consumer Credit Protection Act*'s provisions (including those of the *National Credit Code*) by making it a contravention to have anything to do with a scheme which is determined to have the purpose of avoiding the application of the *Act*.

6.1.2 The penalty for contravention will be, according to current rates, $340,000. This figure, in itself, potentially prohibits industry innovation of credit products.

6.1.3 When the *Consumer Credit (Queensland) Bill,* the template legislation introducing the *Consumer Credit Code,* was introduced in the Queensland Legislative Assembly in 1994, the late Honourable Tom Burns delivered a second reading speech in which he stated:

> *"The Bill attempts the achieve the dual goal of ensuring that strong consumer protection remains a cornerstone of the exercise,* ***but at the same time recognises that competition and product innovation must be enhanced and encouraged by the development of non-prescriptive flexible laws****."*[1]

6.1.4 While this speech was given almost 19 years, and in respect of a different legislative instrument, the current *National Credit Code* is both the literal and spiritually descendent of the *Consumer Credit Code*. Both Codes, to date, are almost identical and retain the same core provisions.

[1] Queensland Parliament Hansard, 4 August, 1994, at pages 8828 to 8829, emphasis added.

6.1.5 It is irreconcilable that one of the dual purposes of the *Code* (regardless of how many times that particular purpose seems to be dropped off or forgotten) is so utterly destroyed by the proposed provisions. They will stifle product innovation, which will lead to a drop in competition, by placing industry at risk of being arbitrarily determined to be in breach of the *Code* at the whim of regulators. When viewed in light of the potential penalties (and the risk to their Australian Credit Licence), this will only drive industry participants to be more conservative if it doesn't just drive them out of the market altogether. While that may be an aim of provisions, it is hardly in the best interests of Australia's citizens or economy.

6.2 **Engaging in conduct with others**

6.2.1 Proposed subsection 323A(1) and 323A(1)(e) allow the connection of multiple parties to establish the existence of an avoidance scheme.

6.2.2 There does not appear to be any provision which defines or limits the scope of what could be deemed to constitute a "*connection*" or engaging "*with others*". The only applicable reference is contained in proposed subsection 323A(3)(g) which has regard to "*the nature of any connection (whether of a business, family or other nature) between the person and a connected person*" as a factor in determining the provision.

6.2.3 These provisions have the potential to cause great uncertainty to industry. The scope by which a connection could be determined is wide – indeed far wider than other Federal laws (predominantly the provisions of the *Corporations Act* as it sets out what are related entities). Potentially, any of the following situations could give rise to a "connection" between parties:

(a) Family members being employed by two unrelated entities; regardless of position held, degree of family connection or degree to which the familial connections is observed (for example, estranged relatives, second cousins and relatives by marriage);

(b) Past joint ventures between two businesses, including joint advertising or sharing of business premises;

(c) Single common directorships in situations that do not constitute the entities being related for the purposes of the *Corporations Act*; or

(d) In addition, and further to (c), instances of participation in industry representative bodies.

***For example regarding (d)**: A director of Lender A Pty Ltd and a director of Lender B Pty Ltd, two unrelated proprietary limited companies, are board members of the National Financial Services Federation Ltd ("Federation"). The Federation is a public company limited by guarantee. Because of the constitution of the board, none of the companies are related at law. However, because of the common "connection" it could be successfully argued that there is a connection between Lender A Pty Ltd and Lender B Pty Ltd for the purposes of proposed section 323A.*

The degree of uncertainty in the provision, compounded with the onus of proof and the penalty for breach, can only lead to a determination that such a potentially wide scope is unconscionable.

6.2.4 In addition, with the provisions of proposed subsection 323A(6) it would fall to an accused party to prove that no such connection existed.

6.3 **What is a scheme**

6.3.1 Proposed subsection 323A(2) sets out that a scheme may be:

(a) An express or implied:

(i) Agreement;
(ii) Arrangement;
(iii) Understanding;
(iv) Promise; or
(v) Undertaking; or

(b) A unilateral or otherwise:

(i) Scheme;
(ii) Plan;
(iii) Proposal;
(iv) Action or course of action; or
(v) Course of conduct.

6.3.2 The definition of scheme creates a far reaching net that includes all immediately apparent and usual methods of business operation.

6.3.3 While such a far reaching net may be a necessary part of being able to able to objectively determine what is covered by such a provision, there is an exception to that necessity. The proposed definition of a scheme includes a range of implied circumstances. This creates problems in terms of being certain of the existence of the conduct, and invites a subjective determination. It is entirely possible for such a "scheme" to not actually exist, but a determination may be made that it is implied and corresponding action taken against the business.

6.3.4 Given the wide range of the definition of scheme it may be almost impossible for any business which is the subject of action under proposed section 323A to argue that a scheme does not exist, placing a great burden on them in the defence against any regulatory action.

6.4 **Matters to have regard to in determination**

6.4.1 There are a wide range of actions that may be referred to in making a determination of the existence of an avoidance scheme.

6.4.2 Some of the criteria set out in subsection 323A(3) describe situations which are too remote from the operation of the Act and Code, while still being sufficiently under the auspices of

credit so that they could be deemed applicable. It must be remembered that the Code is prescriptive in the form of credit to which it applies (predominantly through section 5) and exemptions thereto (section 6). The Code application to "consumer credit", as defined, is a subset of the much larger definition of "credit" and the anti-avoidance criteria must be judged in the light that this casts. To do otherwise invites the argument that something which legitimately falls within the larger realm of credit (and is supposed to be) is actually consumer credit because of a subjective determination, and therefore falls afoul of the anti-avoidance provisions and incurs the corresponding penalties.

The criteria that could fall under this situation are all those set out in proposed subsection323A(3).

6.4.3 Some of the criteria set out in subsection 323A(3) describe situations where businesses may be found in contravention based upon evidence from parties who stand to benefit from a finding of avoidance. Setting aside any question of bias by regulators, subsections 323A(3)(e), (f), (g) and (l) and especially subsection 323A(3)(i) rely (at least in part) on the subjective representations of persons given in evidence. Where those representations pertain to the consumer, it is easy to see that a finding of avoidance ranks in their favour as such a finding could lead to a benefit for the consumer due to an order refunding an amount paid or payable under the contract. This leads to the real potential for conflict and unfair bias.

6.4.4 Some of the criteria set out in subsection 323A(3) describe situations which are largely or arguably subjective. These criteria are subsections 323A(3)(a), (f), (g), (h), (i), (l), (m) and (n).

6.4.5 Criteria of a subjective nature, in the face of potential penalties, will only encourage industry to be conservative in nature and stifle innovation and competition.

6.5 **Presumption of avoidance**

6.5.1 Subsection 323A(5) provides for circumstances where the existence of an avoidance scheme is presumed where the scheme is one that regulations or ASIC determine is an avoidance scheme. There appears to be no restriction on the ability to make such a determination or even a requirement to act reasonably.

6.5.2 The existence of this ability to make such a determination is one thing when it is in the hands of legislators, and quite another in the hands of a regulator. As noted above, the limits of the Code's application are written into the *National Credit Code*. As the *Code* is a schedule to the Act the ability to change its coverage is mired in the process of legislative reform. The process to enact regulations is a much simplified process, which is subject to less scrutiny. Stepping further again, the process for ASIC to make its determination is simpler again. While ASIC's determinations are subject to legislator scrutiny, they will already carry the weight of the regulator's decision.

6.5.3 The ability to make a determination, in either of these ways, has the ability to immediately invalidate any business model that incurs the negative attention of legislators or regulators. Any industry participant which continues to operate in the face of a determination, despite taking action to attempt to prove its innocence, would do so at its own risk in the face of the

penalties. Alternatively, the participant would need to abandon their model until a final ruling is made by a court of law - a disastrous consequence if they do not have sufficient alternate means of operation. Therefore, regardless of the avenue taken, a determination that a particular method of operation is an avoidance scheme is ruinous to business.

6.6 **Onus of proof and resulting cost**

6.6.1 Proposed subsection 323A(6) sets out that an industry participant must prove its innocence in the face of a determination by regulation or ASIC that its actions constitute an avoidance scheme.

6.6.2 Recent legislative reform has seen a raft of provisions such as this, which amount to being guilty until proven innocent and masquerading under spurious reasoning such as "business having the resources to prove their innocence" and "decreasing the difficulty of consumers to bring an action". This stance completely disregards the ability of business to sustain such action, especially in the face of prosecution by a public authority who is much better resourced than the average small to medium enterprise (which the majority of entities facing action under these provisions will no doubt be). Further, having the prima facie standpoint being one of guilt is a denial of natural justice.

6.6.3 The time and cost to business to protest its innocence is prohibitive, especially in the face of:

(a) Having to cease trading in that particular activity (as described in 6.5.3) and dealing with the resultant loss of revenue – which may make the whole process a moot point; and

(b) The legislator or regulator already having made a determination of guilt and being unlikely to keep an open mind in the judicial process. Once a decision is made to take action against business, it is likely that significant time and labour has been devoted to an investigation by the regulator. At that time, having made the decision to prosecute, their stance is all but certain and their investment in the matter means that they are unlikely to change that stance.

6.6.4 It is fundamental in nature that it is easier to prove that something exists than to prove that it does not. If something is apparent, it may be pointed to and observed. If something is not, then its lack of appearance in any particular position is not evidence that it exists nowhere else. By the same token, having to prove that an avoidance scheme does not exist could only require such voluminous submissions in a legal proceeding as to be almost insurmountable.

6.6.5 Requiring any defendant, in any setting, to prove their innocence is a fundamental breach of the rule of law. Both the Law Council of Australia[2] and the Rule of Law Institute of Australia[3] hold that the rule of law involves the application of certain principles in practice, including "*all people are entitled to the presumption of innocence"*. Proposed subsection 323A(5) is anathema to that principle.

[2] www.lawcouncil.asn.au/programs/international/rule-of-law.cfm
[3] www.ruleoflaw.org.au/principles/

6.7 **ASIC determination – in the face of previous conduct ("we want everyone under the Act")**

6.7.1 Proposed subsection 323A(7) allows ASIC to determine that a particular scheme is for the purposes of avoiding the operation of a provision of the legislation.

6.7.2 The proposed subsection creates a number of issues:

(a) There are no guidelines or rules laid down which refer to the manner in which ASIC may make such a determination;

(b) ASIC may use the powers contained in the subsection to usurp the role of the judiciary in determining the application of the act, both prospectively and retrospectively; and

(d) There is no reasonable ability to challenge such a determination or apparent capacity for a court to rule on it.

6.7.3 In respect of 6.7.2(a), the proposed Act does not contain any form of constraint on ASIC into the manner or method of making a determination of a scheme. There is not even a requirement under the section for ASIC to have regard to the criteria laid out in proposed subsection 323A(3).

On the face of the proposed legislation, ASIC could make a determination of a scheme in any and all situations where is had the slightest proclivity to do so. Given the regulator's past public comments to the effect of "we want everyone licensed, and then we'll sort them out from there" it is easily foreseeable that ASIC will make determinations in all cases possible that any particular business undertaking is a scheme and therefore subject to the *NCCP Act*.

It does not go unnoticed, either by us or ASIC (we suspect), that the only available way to overcome their determination is to undertake a costly and risky court exercise in which the defendant must prove their innocence (further commented on in 6.6). Then, in the unlikely event that the defendant prevails, that would not do anything to validate a way of operating as ASIC could continue their determination and the next defendant would be required to prove themselves innocent anew (albeit with a precedent that may or may not be of assistance).

6.7.4 In respect of 6.7.2(b) and (c), the proposed subsection will allow ASIC to institute law which will deem a particular business method is in breach of the law. The provisions of proposed subsection 323A(5) create a presumption that any method matching their determination is in breach of the law until proven otherwise by the defendant. This process takes the ability to make a determination out of the hands of the judiciary, and relegates them to making a decision not about the conduct itself but whether the conduct is not in existence based on the defendant's submissions.

This would ordinarily be concerning enough, but the potential for ASIC to overcome an adverse court ruling makes it unconscionable. In the form presented, the provisions could give rise to the following situation:

(a) Business engages in conduct which comes to the attention of ASIC;

(b) ASIC does not have a determination in place that addresses the conduct;
(c) After investigation, ASIC institutes prosecution of the business under the anti-avoidance provisions;
(d) A court of competent jurisdiction hears the case and holds that the conduct does not breach the anti-avoidance provisions;
(e) ASIC, unsatisfied with the decision, uses its powers to determine that the business conduct is a scheme;
(f) On the strength of that determination, ASIC proceeds to prosecute instances of the conduct; followed by
(g) Courts are unable to make a determination on the conduct, and must only rule on whether the defendant has proved that the conduct does not exist.

Such an eventuality is not only possible, but likely, and creates a situation where ASIC will have the ability to shut down any particular business model which it does not like.

FINAL COMMENTS

While we thank Treasury for the opportunity to provide submissions regarding the proposed legislation, we have serious concerns about the timing and consideration of the ability to do so.

Submissions regarding the Bill are due by 1 March, 2013. It is no secret that the provisions of the Bill, particularly with regards to anti-avoidance, are aimed squarely at the participants in the small amount lending industry. On 1 March, Schedules 1, 3 and 5 of the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* take effect. Schedule 3 of that Act contains fundamental changes to the operation of small amount lending in Australia.

We note that both the Bill and Act are legislature arising out of Treasury, and that it is reasonably arguable that they are so closely related as to possibly have been created by the same authors.

We find it hard to fathom then that there is any simple coincidence in the two due dates being the same. Surely it is disrespectful (in the least) to require business to:

- prepare for such an important date with respect to new laws taking effect that will fundamentally change their business operations and invoke severe penalties for non-compliance; and
- find time to prepare submissions on a Bill that has the prospect of introducing a draconian anti-avoidance scheme which has the capacity to invalidate legitimate business practices due to regulator opinion without the ability to have the matter decided fairly in a court of law,

and have them both due on the same day. We further note that both of these come only a week after the due date for submissions on ASIC's *Consultation Paper 198 – Review of the effectiveness of an online database for small amount lenders* – which paper was concerning an anticipated review in 2015 provided for in the Act taking effect on 1 March.

Evidence would appear to show that there is no regard for the welfare or confidence of business, especially for those making every attempt to do the right thing and to take part in the development of law by partaking in stakeholder consultation.