EDR Review Secretariat

Financial System and Services Division

Markets Group

The Treasury

Email: EDRreview@treasury.gov.au

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Submission by Min-it Software & Financiers Association of Australia

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Foreword

This submission is made on behalf of the Financiers Association of Australia (“FAA”) and Min-it Software (“Min-it”) clients.

The FAA and Min-it welcomes the opportunity to make this submission on the review of the External Dispute Resolution framework.

As the EDR Review Secretariat has advised it cannot consider any extension of time for submissions, as the author is currently on leave, has limited internet access and no access to files or clients, this submission is being made in the only available medium. Consequently, it contains no formatting or file notes as would normally be the case and we trust the Secretariat and Panel will accept this, given the circumstances.

It is a pity the extension could not have been granted as we, our clients and the FAA's members are all small businesses whose primary focus is to run those businesses. Given one of the Government's stated intentions is to assist small businesses, it is to be hoped Government Departments will, in future, allow sufficient time to accommodate those that wish to make submissions. In this regard, despite the fact that ASIC has a database of all Australian Credit Licencees ("ACL holders"), it would appear this consultation has not been widely circulated as we know of no individual ACL holder that has been advised of it. In view of the ramifications of this review, we consider this to be a serious oversight.

Rather than respond to the specific questions raised, we will respond in numerical point format.

1. Whilst the idealogy behind External Dispute Resolution ("EDR") is admirable, in practice, our clients and members have found the practices of both EDR providers to leave a lot to be desired, aided in part by ASIC in approving or faily to oversee unfair new policies and rule changes.

2. Both the Credit Industry Ombudsman Ltd's ("CIOL") and the Financial Ombudsman Service Ltd ("FOSL") are private, not-for-profit companies but neither entity gives its 'members' any detailed financial accounts annually as required by any true association. If the ACL holders are trully 'members' of each entity, then they would be entitled to a full set of financial accounts and have other rights, including nominating board members.

3.'Members' have never been advised of what has become of the undistributed profit. Not-for-profit entities can legally make profit but any profit made must be applied for the organisation's purpose(s). 'Members' are not being advised of how this is being achieved. Whilst it could be argued that for privacy reasons, salaries of some individuals should not be disclosed, this same reasoning affects every public company and there is now demand for transparency by shareholders and other stakeholders alike. For that reason, this requirement should be applied to both EDR providers.

4. The author is unaware of how FOSL nominates its board members but inasfar as CIOL is concerned, the current industry ('member') directors, and , are not representative of the vast majority of small businesses that make up its membership. CIOL's 'membership' base is, at point 36 of the consultation paper, made up of sole traders and small businesses that is said to be around 97% of its total 'membership'. Instead, these directors are ASX-listed CEO's. Under its constitution, each member director is appointed by the other board members that must have “experience in and knowledge of one or more sectors of the Financial Services Industry”, but only after consultation and having regard to parties the board considers appropriate. It raises the questions of consulting with whom and why should the other board members consider them appropriate? This smacks of cronyism and encourages "group thinking". Essentially, the board becomes a group of "yes" men and women and there is no one to challenge ideas and processes. By surrounding itself with like-minded individuals, there can be no diversity of thought by the board.

5. One of CIOL's past board Directors, when it was called the Credit Ombudsman Service Ltd ("COSL"), representing consumers from 2003 to 2011, with the (now called the) has used her inside knowledge to promote actions that incur pecuniary penalties to ACL holders. Based on what the current CIOL chair, , said when she was replaced by (her manager, also from), no doubt has shaped some of CIOL's policy statements and rule changes over the years that were designed to adversely impact on ACL holders.

6. An example of what can only be described as her sheer under-handedness was seen in a video recording of a training session in 2012 I made and which I circulated throughout the industry. was one of two presenters, the other being from , to a group of NSW Financial Counsellors and they admit to being on a mission to crush payday lending. They recommended that all complaints no matter what the circumstance be sent to EDR rather than IDR because the EDR providers charge them a fee and that hit the lender in the pocket and it was "war". The two

presenters said the aim was to get the whole loan written off. A copy of this recording to verify these claims can be provided to the Panel should they wish to view it.

7. These statements show that from a consumer advocacy perspective, the desired result was to have all advocates and financial counsellors seek to have the entire loan written off rather than just the fees and any charges that may have been incurred. We believe that amounts to an unjust enrichment which is plainly unfair to the ACL holder and beyond mere restitution. The current Assistant Treasurer, the Hon Kelly O'Dwyer, MP said earlier this year that Government believed in accountability and in people taking responsibility for their actions. If people are responsible for their own decisions, then assuming there was no coercison or other improper action, should a payment or payments not be made on time and fees and charges are debited to the borrower's account through lack of payment, then the lender is entitled to get his or her lent funds back at the very least.

8. This opening gambit of no debt owing whatsoever and immediate referral to EDR (and in some instances, directly to ASIC as well, so they have two bites at the cherry) has been at the heart of every claim we have ever been advised about by our clients and members yet this plainly goes against the requirement in ASIC Regulatory Guide RG165 that IDR is generally the first required step. Note, we acknowledge there may be instances when referral to an EDR provider is required to stop enforcement action, for example, but this is an exception to the general principle. In part, this is designed to penalise the ACL holder because both EDR providers charge their members a fee for rewgistration. The fee increases depending on the amount of work (and in some cases, we will add the word "allegedly") done.

9. Neither CIOL nor FOSL disclose on their website the range of fees their members are charged and as few of our clients currently use FOSL, not having the information to hand, I will concentrate on demonstrating how CIOL uses its rules to charge members a fee in what can only be described as a clear conflict of interest.

10. Despite the RG165 requirement of the complainant having undertaken IDR first, if a complaint is sent initially to CIOL, it will record and register the complaint and, if the complaint has not been through the ACL holders' IDR process, refer it back to the ACL holder for this to occur. In doing so, it charges the ACL holder a fee of what is currently $210.00 (inc GST). How this fee is derived is anyone's guess and one of our clients queried this many years ago when it was $165.00 (inc GST). No amount of probing provided any elucidation and one can only guess it was a figure plucked from thin air which has increased with time.

11. CIOL currently states it has 5 levels of charges, these being for Enquiries, Validation, Initial Review, Investigation and Determination. The charge for the "Enquiry" stage has always been $0.00 but there is no mention of it either on its website or in its Complaint Handling Process sheet. We have no idea what might constitute this level but as CIOL doesn't report any figures for complaints at this level, we must presume it doesn't really exist.

12. CIOL a number of years ago issued a Position Statement, Position Statement 6, which stated that they would take the stance that any complaint referred to it had already been through IDR. In doing so, they could then advance the complaint to the next stage and charge the relevant Initial Review fee, currently $775.00 (inc GST) instead of the $210.00 Validation fee. As we had evidence to show this was untrue, on behalf of the industry, I wrote to ASIC and asked that they instruct CIOL to

withdraw it. They refused, on the basis that they did not interfere with the EDR processes. I appealed against their refusal but was still refused. We had a client that was willing to use this refusal to go to the Administrative Appeals Tribunal but Position Statement 6 has since been quietly withdrawn, but exactly when this occurred, I do not know. However, CIOL's rules allow it to record a complaint as being received, even before any checking to see if IDR has occurred and to see if it falls within its jurisdiction. If it does, these rules enable it to charge the ACL holder a fee, being the Validation fee. We are of the opinion that as most of these complaints are settled by IDR, CIOL has worded these rules purely to be able to charge what is now a $210 fee. We consider this unfair as instead of enquiring to see if IDR has occurred with the ACL holder without charge, it merely accepts the complaint without any enquiry. It doesn't even assess whether the complaint is vexacious.

13. CIOL recently changed its rules (yet again, to the 10th edition) and Sections 41.4, 41.5 and 41.7 on page 36 quietly added new sections on systemic issue investigations, all of which we believe are particularly draconian. For example, section 41.4 states:

In conducting a system issues investigation, the scheme will observe procedural fairness and have regard to:

a. relevant laws,

b. applicable codes of practice,

c. good practice in the financial services industry, and

d. fairness in all the circumstances.

Whilst this might sound quite reasonable, what exactly does that catch-all "fairness in the all the circumstances" actually mean? Fairness to whom - the ACL holder or the consumer? Even though the ACL holder might have obeyed all laws and exhibited good practice, the law might not actually be favourable to the consumer and so which of these requirements overrides all others? Relevant laws or the need to dole out some form of social justice?

Section 41.5 is particularly draconian in that it states:

Conducting a system issues investigation includes, but is not limited to:

a. identifying system issues,

b. requiring the financial services provider to provide to, or procure for, the scheme any information or documents that the scheme considers necessary,

c. making any recommendations the scheme considers necessary for the resolution of a systemic issue, and

d. making any order under Rule 41.7.

Under 41.7 it states:

The Ombudsman can make an order requiring the financial services provider to do or refrain from doing some act or in relation to a systemic issue identified by the scheme, and which the scheme considers necessary to achieve any one or more of the following objectives:

a. facilitating the scheme's investigation of the systemic issue,

b. improving industry practice and communication,

c. remedying loss or disadvantage suffered by consumers (not all of whom may have complained about the systemic issue),

d. preventing foreseeable loss or disadvantage to consumers,

e. minimising the risk of the systemic issue recurring, or

f. efficiently dealing with multiple complaints or disputes related to the systemic issue.

Under these two sections, CIOL has given itself the same powers as ASIC has been given by Parliament by virtue of the requirement for compulsory 'membership' of an EDR scheme before issue of its ACL and it can now require the ACL holder to produce any document or do anything it considers necessary without a s.253 Notice under the NCCP Act. In addition, in the case of a Class Action, I would argue it now has the ability to force the financial service provider to compensate every consumer that has been affected and not just those that joined the Class Action. ASIC has seemingly allowed and approved these new rules and having spoken with 2 lawyers, it is our belief they are unconstitutional. It is likely we shall be making a complaint to ASIC about these new rules, particularly as a 'systemic issue' has not been defined. In contrast, we note FOSL does have a definition for a systemic issue.

14.Under RG139, ASIC requires EDR providers to be:

(a) accessible;

(b) independent;

(c) fair;

(d) accountable;

(e) efficient; and

(f) effective.

In our opinion, in approving these allegely "minor" rule changes, it shows how far out of touch ASIC is with ensuring fairness by the two EDR providers. It is using them to enforce what amounts to defacto legislation that only a Government regulator has been delegated with.

15. Since the introduction of the NCCP Act, it has been apparent that ACL holders have to not only comply with the actual legislation passed by Parliament and the Regulatory Guides which ASIC would

like to have interpreted as law but also the sometimes overriding requirements of the two EDR providers. This is not a satisfactory state of affairs.

16. The Panel have asked whether the criteria it's using is correct. Whilst the chosen parameters are important, the overriding ones that ASIC requires the EDR providers to consider when arriving at their decisions has been omitted. This is totally unsatisfactory. Our clients and members are firmly of the belief the system is seriously flawed because they lack what the industry considers to be the most important attribute of all those listed, fairness. To avoid being deficient, we argue the Panel must consider them and look at what is actually going on as well.

17. For example, we have been made aware that, and this applies to CIOL in particular, uses the current edition of its Rules to determine outcomes. As we have pointed out, CIOL has amended its Rules a number of times since the inception of the NCCP Act and if a contract was written a couple of years ago, then any adjudicator should use the relevant rules, legislation and Regulatory Guides in force at the time the contract was created to assess a case. To do otherwise is like applying retrospective legislation yet when this is pointed out, the amount of correspondence that the ACL holder has to then engage in becomes almost insurmountable.

18. There is certainly a culture that pervades the EDR providers, even if there is no written policy, that appears to be designed to overwhelm the ACL holders and it is a constant fight to have points of law considered rather then any other matter they might consider also applies. This catch-all opens up the entire EDR process to applying social justice in the event the ACL holder is legally correct but the adjudicator is sympathetic to the case and so decides to make the ACL holder pay anyway. We've been advised of numerous instances of this occurring and there seems to be an attitude that ACL holders are all big profitable entities and they can afford it. In fact, this is far from the truth. The general industry stance is that as EDR costs so much, capitulation is better than fighting a matter yet this unfortunately leads to adverse and unintended consequences for the lenders subsequently.

19. One client some years ago was the recipient of at least 5 complaints from on behalf of one consumer arising from the same event when CIOL was COSL. When each complaint looked like it might fail, another was lodged with COSL. At each complaint instigation, the lender copped another fee. Each subsequent one was clearly vexacious but the EDR provider refused to accept it stating there may have been an underlying complaint issue on each. Well, they had plenty of opportunity of bringing them to the fore the first time around. Even when our client brought to COSL's attention that each of these 5 complaints was being dealt with by different staffmembers, they refused to have the matters dealt with by one. I cannot provide the exact figure this cost the lender but it was thousands. In our opinion, this was orchestrated by against the lender aided by inside-knowledge from those on its Board. Fair? No way, yet any EDR system must be fair to all parties rather than favouring just the consumer.

20. The industry can't even trust the EDR auditors either. Some years ago, we wrote to COSL's auditor over concerns we had with its then Rules, pointed out inconsistencies and challenged what was occurring on behalf of our clients and members. He brought this to the attention of COSL's board and instead of doing anything about it, the auditor suggested to the COSL board they could simply amend the Rules retrospectively to ensure its revenue stream remained intact. These documents can be supplied on request.

21. In a submission to ASIC in 2009 on 'Dispute Resolution requirements for consumer credit and margin lending', we stated "although the Courts are separate from Parliament, given the way in which ASIC can regulate the EDR scheme providers, there is the real ability to direct them to dispense forms of social justice". As we advised in another submission to Treasury in 2014, this is exactly what industry perceives to be the case and given one of comments that she was working with ASIC, we question ASIC's transparency in approving these kind of changes.

22. In that 2014 submission, which was on 'Extending Unfair Contract Term Protections to Small Businesses', we stated that should the unfair contract terms be applied to small businesses, we saw "the EDR providers' oversight becoming larger when the finance industry wants their abilities curtailed." Our lawyer, Dr Francina Cantatore, Associate Professor, Law Faculty, Bond University and Special Counsel at Cronin Litigation wrote a paper she co-authored with Brenda Marshall (see attachment) entitled "A step too far in consumer credit protection: Are external dispute resolution schemes wielding the sword of Damocles?" In this article, written before the passing on the Unfair Contract Terms legislation, Cantatore and Marshall explore the scope of what is now CIOL's powers, finding them to be excessively wide, and inherently unfair towards credit providers. The principal contention of the article is that, instead of providing a dispute resolution service, CIOL imposes a "tyranny" on credit providers obliged to comply with the scheme's onerous and oppressive Rules. We encourage the Panel to read it in its entirety as we foresee further instances of interference and claims of irresponsible lending under the new legislation.

Reference:Franci Cantatore and Brenda Marshall. Australian Business Law Review Vol. 40 Iss. 5 (2012) p. 322 - 335 ISSN: 0310-1053

23. One recent example of this can be shown by a client that is preparing to have a complaint heard by CIOL. The $18,000 loan was for business purposes and the borrower's original intention was to have the loan paid back in full within 6 months. The client offered her home as security. The borrower had issues getting the business going and repaid just over $3,500 in 12 months. She will have to sell her home to repay the debt but hasn't even put the property on the market. She doesn't want to pay all the accumulated interest either and has offered the balance of principal owing plus a rate of interest no one in their right mind would offer to a new start up. Through her lawyer, she is now claiming that the loan shouldn't have been granted and the lending was irresponsible. CIOL has said it will accept the complaint. Anyone going into business accepts a degree of risk and if that means losing their property and they can't or won't accept that outcome, then they should remain an employee; it shouldn't require an EDR decision to decide that. Based on past experience, it's probable CIOL will find against the lender in its bid to pacify the borrower without considering the effect of what hardship this may impose as it's member is a small business. In this regard, we must mention the undue delay FOSL has previously taken to arrive at a decision and for some of our clients and members, this has created serious financial consequences. In at least one case, it completely denied the lender the ability to take enforcement action.

24. This kind of decision is likely to adversely affect what many smaller or non-ADI financiers will do to assist small businesses seeking finance. It is likely to stifle some investment and if the bigger financiers won't help, then there may be unforeseen consequences. It is too early to tell exactly how this will pan out if the current EDR schemes remain.

25. We must question the way the consultation paper has provided significant details for FOSL (see points 33 and 34 on page 9) yet has not provided either the same or similar information for CIOL identically. For example, at point 39, it states that "CIO closed 23 per cent of claims within 30 days, 46 perent within 60 days and 64 per cent within 90 days" yet makes no mention of the remaining 36 per cent. Has the Panel or Secretariat enquired about this? If not, why not as the information provided for CIOL is haphazard.

26. Many of our clients and members would have changed EDR providers but ASIC has refused to consider any more EDR scheme providers and it's a Hobson's Choice. Most joined COSL simply because at the time of the NCCP Act's inception, FOSL announced it didn't want to take on the smaller, and particularly the payday, lenders as members.

27. EDR providers appear to regard the consumer as the sole user of their EDR schemes, given the ACL holder is unable to bring the consumer to task under them. They appear to hold the general view their members are merely there to pay for their processes. Consequently, whilst the Panel may take the view both consumers and the ACL holders are the users, this is not demonstrated in application. It it were, for example, CIOL should have circulated its new Rules to all members yet a number of our clients haven't even been made aware they've been changed.

28. We note the consultation paper on page 17 states CIOL can change its rules after public consultation yet we know of not one client or member that has ever been consulted. As a consequence, we believe this to be fictional. Also, ASIC must approve non-minor or non-technical nature rule changes yet there is no definition of what constitutes these so when does ASIC actually have to be involved?

29. The funding arrangements used by CIOL in particular are a cause for concern as there is no one representing small businesses on its board. Small businesses are more likely to be affected by complaint charges than the ADI's and even two adverse decisions for say a small car financier can be the catalyst to exit the industry, no matter how great the benefit being provided to other consumers.

30. As we have stated, we do not regard the EDR processes as being fair and with the real inability to appeal to a higher authority in the event of dissent of a decision, we consider a Tribunal to be a far more appropriate body to consider complaints. The Tribunal should be able to hear not only complaints by the consumer but also complaints brought by the ACL holder against the consumer in such cases where enforcement action has already been commenced in a Court. Currently, an EDR scheme provider can order a member to cease all legal action including where the matter has been brought before a Court so that a complaint can be heard. Failure to do so can lead to the EDR provider referring the matter to ASIC with a view to having the ACL holder's ACL suspended or rescinded. One member was threatened with this an hour before a matter was due to go before a Court. He was forced to withdraw and the consumer subsequently sold the secured property and left the country, leaving him with a loss measured in hundreds of thousands of dollars. In our opinion, if a matter has already been scheduled to go before a Court, it should remain there and any complaint be heard by the Court and not the EDR provider.

31. A Tribunal would also remove the need for any ASIC oversight of an EDR scheme.

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A step too far in consumer credit protection: Are external dispute resolution schemes wielding the Sword of Damocles?

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A STEP TOO FAR IN CONSUMER CREDIT PROTECTION: ARE EXTERNAL DISPUTE RESOLUTION SCHEMES WIELDING THE SWORD OF DAMOCLES?[1]

Franci Cantatore* and Brenda Marshall**

Under existing consumer credit legislation, all credit providers are required to be licensed with the Australian Securities and Investments Commission. Membership of an external dispute resolution scheme – either the Credit Ombudsman Service Limited (COSL) or the Financial Ombudsman Service (FOS) – is compulsory for license holders. As members, credit providers are subject to the Rules and Constitutions of the respective schemes, a requirement which has far-reaching effects on commercial dealings. This article explores the scope of COSL's powers, finding these to be excessively wide, and inherently unfair towards credit providers. The principal contention of the article is that, instead of providing a dispute resolution service, COSL imposes a "tyranny" on credit providers obliged to comply with the scheme's onerous and oppressive Rules.

INTRODUCTION

In an ongoing bid to protect consumers from what might best be described as their own lack of judgment, the Australian Government has in recent years implemented National Credit legislation to regulate credit providers, consisting of the *National Consumer Credit Protection Act 2009* (Cth) ("the NCCPA") which incorporates the *National Credit Code* ("the Code"). This legislation replaced State-based consumer credit legislation, charging the Australian Securities and Investments Commission ("ASIC") with the role of industry watchdog for consumer credit in place of the various State Offices of Fair Trading. In this regard, ASIC's powers as financial regulator are derived from the *Australian Securities and Investments Commission Act 2001* ("the ASIC Act")[2] and the provisions of the NCCPA.[3]

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1 In Cicero's anecdote, the tyrant Dionysius placed Damocles on a golden couch with a beautifully embroidered woven rug, surrounded by good food and servants. However, he ordered that a shining sword be fastened above the young man's head with a horse hair, pointing directly down at his neck. This resulted in Damocles being unable to appreciate the benefits bestowed upon him and begging the tyrant that he may depart. From Cicero's *Tusculan Disputations*, translated by CD Yonge, 1877. Available at http://www.livius.org/sh-si/sicily/sicily_t11.html, viewed on 15 March 2012.

2 *Australian Securities and Investments Commission Act 2001* (Cth), s 12A(1). Mirroring the more general provisions of the *Australian Consumer Law* ("the ACL"), the ASIC Act also contains a range of consumer protection provisions relating specifically to financial products and services, which are administered by

In accordance with the NCCPA,[4] since 1 July 2010, all consumer credit providers ("lenders") have been required to hold an Australian Credit Licence ("ACL") and scrutiny has been exerted upon their responsible lending practices and internal dispute resolution ("IDR") procedures, statutory expectations of lenders under the Code. Furthermore, in order to obtain the requisite ACL, lenders have to be members of an external dispute resolution ("EDR") scheme – in the realms of the credit industry, either the Credit Ombudsman Service Limited ("COSL") or Financial Ombudsman Service ("FOS").[5]

As between these two EDR schemes, this article has chosen to focus on COSL, although it is noted that FOS operates under an almost identical structure and is subject to the same ASIC requirements. COSL's membership – comprising credit providers, credit assistance providers and credit representatives – stood at 15,565 members as at 18 October 2011.[6]

Consumers are able to lodge complaints with COSL, at no cost to themselves, on a range of issues, including complaints about members acting "unfairly" towards consumers and financial hardship complaints (ie, an inability to meet their debt repayments or obligations under their credit contracts). In the past two years, complaint levels have escalated significantly, especially in relation to financial hardship complaints, no doubt reflecting prevailing economic conditions. In its 2010 Annual Report, COSL noted that the number of complaints received during July-October 2010 had increased by 90% compared to the same period in 2009.[7] COSL's 2011 Annual Report confirmed a continuation of this trend, revealing that during the 2011 financial year complaints increased by 72% compared to the previous year. Approximately 34% of these complaints related to financial hardship.[8]

ASIC. Financial products and services are expressly excluded from the application of the ACL, precluding oversight by the ACCC: *Competition and Consumer Act 2010* (Cth), s 131A(1).

3 *National Consumer Credit Protection Act 2009* (Cth), s 239.

4 *National Consumer Credit Protection Act 2009* (Cth), Chapter 2.

5 *National Consumer Credit Protection Act 2009* (Cth), s 47(1)(i).

6 Credit Ombudsman Service Limited, Annual Report 2011, p 13. Available at http://www.cosl.com.au/Resources/COSL/Files/COSL-Annual-Report-2011.pdf, viewed on 15 March 2012.

7 Credit Ombudsman Service Limited, Annual Report 2010, p 6. Available at http://www.cosl.com.au/Resources/COSL/Files/COSL%20Annual%20Report%202010%20-%20Web.pdf, viewed on 15 March 2012.

8 COSL Annual Report 2011, p 4.

Although COSL claims to have "achieved a satisfactory outcome in 46% of the financial hardship cases [it] closed",[9] arguably this assessment is one-sided. The authors' view is that the COSL Rules, as currently drafted, impede the ability of credit providers to collect outstanding debts and/or realise their security interests, adversely affecting their cash-flow and business operations. In many instances, this results in members succumbing to unreasonable demands by consumers in an attempt to circumvent the delays experienced once a consumer complaint is made to COSL.[10]

This article deals with the impact of EDR obligations imposed on credit providers under the National Credit legislation, providing a "high level" overview of a range of significant issues that arise in this context. Specifically it explores the COSL Rules in respect of limitations placed on members, including COSL's extensive powers to make final and binding decisions. The far-reaching ramifications of its decision making powers in relation to members beg the question: Do the COSL Rules represent a fair and balanced contract between EDR scheme and member, creating an equitable environment for dispute resolution; or is the relationship characterised by a fundamental imbalance, resulting in undue pressure on members and unprecedented interference with their legal remedies? This article argues that the latter view accurately reflects some crucial weaknesses in the structure of the EDR scheme, and proffers suggestions to address these inadequacies.

In particular, specific issues that bear scrutiny are the following:

- the wide nature of COSL's discretionary powers;
- COSL's ability to amend its Rules with little or no consultation with members;
- the COSL/member relationship and the limitation of members' legal rights under the rules;
- COSL's ability to make decisions which are final and binding on its members with limited possibilities for appeal or review;
- the limitation of members' access to legal remedies in the event of debtor defaults, as soon as a complaint is lodged with COSL;
- the application of the COSL Rules for the benefit not only of consumers who are natural persons, but also for business entities with up to 19 employees, leading to interference with business dealings and patently unintended effects; and
- the consequential impact on provisions of existing legislation such as the *Bankruptcy Act 1996* (Cth) and the *Corporations Act 2001* (Cth), resulting in the erosion of insolvency law principles.

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9 COSL Annual Report 2011, p 8.

10 Bransgrove M, "Why the External Dispute Resolution regime is hurting capital availability in Australia", *Submission to the Parliamentary Joint Committee on Corporations and Financial Services and the Senate Economics Legislation Committee*, December 2011, p 9.

A discussion of these matters now follows.

COSL POWERS AND ACCOUNTABILITY

As the status of Ombudsman has been conferred upon COSL, its structural features require some examination here. Unlike the Commonwealth Ombudsman (or State Ombudsmen), the Credit Ombudsmen (COSL and FOS) are corporations – companies limited by guarantee as defined in the *Corporations Act 2001* (Cth)[11] – and not government bodies. As such, they are private bodies to which the functions of external dispute resolution have been outsourced by ASIC. As one of the two ASIC-appointed EDR schemes (pursuant to s 11(1)(a) of the NCCPA and the *National Credit Regulations*[12]), COSL is obliged to comply with the Guidelines provided by ASIC from time to time in *Regulatory Guide 139: Approval and oversight of external dispute resolution schemes*,[13] which sets out the ambit of ASIC's regulatory function in relation to the schemes.

ASIC describes EDR schemes as playing "an important role in the financial services and credit regulatory systems", providing "a forum for consumers and investors to resolve complaints or disputes that is quicker and cheaper than the formal legal system" and presenting "an opportunity to improve industry standards of conduct and … relations between industry participants and consumers".[14] While these objectives are unquestionably meritorious and it is acknowledged that EDR schemes play an important role in pre-emptive dispute resolution, it is imperative that the scope of their powers is properly regulated, and does not infringe upon the inherent jurisdiction of the Courts or conflict with existing legislation. Furthermore, there should be an adherence to the principles of procedural fairness and natural justice. In appointing a scheme, ASIC is obliged to consider the scheme's "accessibility, independence, fairness, accountability, efficiency and effectiveness".[15] EDR schemes are also required to maintain these attributes on an ongoing basis.[16]

COSL duly undertakes in its Constitution "to provide timely, efficient and effective resolution of complaints against Members having regard to the criteria of relevant legal requirements (including

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11 *Corporations Act 2001* (Cth), s 9.

12 *National Consumer Credit Protection Regulations 2010* (Cth), reg 10(4)(b); ASIC Class Order [CO 10/249], para 4.

13 Australian Securities and Investments Commission, *Regulatory Guide 139*, April 2011. Available at http://www.asic.gov.au/asic/asic.nsf, viewed on 15 March 2012.

14 ASIC, *Regulatory Guide 139*, RG139.35.

15 ASIC, *Regulatory Guide 139*, RG139.26 – based on the principles in *Benchmarks for Industry-Based Customer Dispute Resolution Schemes* ("DIST Benchmarks"), published by the then Commonwealth Department of Industry, Science and Tourism in 1997.

16 ASIC, *Regulatory Guide 139*, RG139.43.

rights provided by law to consumers), applicable codes of practice, good practice in the Financial Services Industry, and fairness in all the circumstances."[17] Notably absent here is a reference to "rights provided by law to members". However, the requirement of fairness would suggest that a perceived lack of fairness in making a decision on the part of COSL may provide grounds for review.

In the case of *Masu Financial Services Pty Ltd v FICS and Julie Wong (No 2)* [2004] NSWSC 829, a matter involving the Financial Industry Complaints Service ("FICS") – now amalgamated with FOS – Shaw J held that:

> Although FICS is a private body, it is empowered to make decisions of a public character. It follows that such decisions are susceptible to judicial review.[18]

His Honour further stated that the contractual arrangement (between Masu and FICS) involved at least the obligation to grant procedural fairness, and accepted that the contractual effect arose from the FICS Rules.[19]

Shaw J relied on the English case of *R v Panel on Take-overs and Mergers: Ex parte Datafin Plc* [1987] QB 815 in support of the view that companies administering external complaints schemes concerning participants in the finance industry are judicially reviewable.[20] In *Datafin*, Lloyd LJ had stated:

> I do not agree that the source of the power is the sole test whether a body is subject to judicial review … Of course the source of the power will often, perhaps usually, be decisive. If the source of power is a statute, or subordinate legislation under a statute, then clearly the body in question will be subject to judicial review. If, at the other end of the scale, the source of power is contractual, as in the case of private arbitration, then clearly the arbitrator is not subject to judicial review …
>
> But in between these extremes there is an area in which it is helpful to look not just at the source of the power but at the nature of the power. If the body in question is exercising public law functions, or if the exercise of its functions have public law consequences, then that may … be sufficient to bring the body within the reach of judicial review.[21]

More recently, in the Victorian case of *CECA Institute Pty Ltd v Australian Council for Private Education and Training* [2010] VSC 552, Kyrou J noted that the *Datafin* decision had been cited with

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17 Credit Ombudsman Service Limited, Constitution, para 3.1(d). Available at http://www.cosl.com.au/Resources/COSL/Sites/COSL/PDF/About/COSL-Constitution.pdf, viewed on 15 March 2012.

18 *Masu Financial Services Pty Ltd v FICS and Julie Wong (No 2)* [2004] NSWSC 829 at 830.

19 *Masu Financial Services Pty Ltd v FICS and Julie Wong (No 2)* [2004] NSWSC 829 at 831.

20 *Masu Financial Services Pty Ltd v FICS and Julie Wong (No 2)* [2004] NSWSC 829 at 830.

21 *R v Panel on Take-overs and Mergers: Ex parte Datafin Plc* [1987] QB 815 at 847.

"apparent approval" in at least eleven Australian cases.[22] His Honour summed up the approach as follows:

> The *Datafin* principle is that a decision of a private body which was not made in the exercise of a statutory power may be amenable to judicial review if the decision is, in a practical sense, made in the performance of a 'public duty' or in the exercise of a power which has a 'public element'.[23]

In line with the judicial reasoning above, particularly in *Masu (No 2)*, it would seem that all binding decisions by industry EDR schemes in Australia are potentially open to full judicial review.[24] Additionally, the wording of ASIC's *Regulatory Guide 139* implies that judicial review of decisions by the Credit Ombudsmen would be possible. It states, for example, that an EDR scheme's "complaints/disputes handling and other procedures must accord with the principles of natural justice",[25] implying that judicial review will be an option if such principles are breached.

However, the possibility of judicial review may not sufficiently address perceived problems within the EDR schemes. Notably the cases deal with "a decision of a private body".[26] This suggests that the *Datafin* principle will be relevant only in instances of procedural unfairness in the application of the COSL Rules, but that judicial review will be precluded where fundamental inequities exist within the EDR Rules or where COSL effects unilateral changes to the contractual arrangement between the parties.

Thus, more pressing than the ability of members to address matters of procedural unfairness is the substantive content of the COSL Rules and Constitution and the impact of these provisions on members. It must be borne in mind that members are already subject to strenuous responsible lending obligations under the NCCPA and the Code.[27] Indeed, it has been noted that consumer credit obligations under the Code are "materially broader in scope and rights of action" than the consumer guarantees under the *Australian Consumer Law*.[28]

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22 *CECA Institute Pty Ltd v Australian Council for Private Education and Training* [2010] VSC 552.

23 *CECA Institute Pty Ltd v Australian Council for Private Education and Training* [2010] VSC 552 at [77].

24 Sams D, "Judicial review of decisions made by industry ombudsman schemes" (2007) 18 ADRJ 222 at 225.

25 ASIC, *Regulatory Guide 139*, RG139.112.

26 *CECA Institute Pty Ltd v Australian Council for Private Education and Training* [2010] VSC 552 at [77].

27 *National Consumer Credit Protection Act 2009* (Cth), Chapter 3.

28 Taylor B, "New national responsible lending obligations – Pt 2" (2012) 40 ABLR 43 at 45.

COSL's discretionary powers are wide and even extend to dealing with a complaint where it is alleged that the member "acted unfairly towards the complainant".[29] COSL is entirely responsible for handling and determining all complaints against its members, accountable only to the COSL Board.[30] Rulings may be made in respect of any relevant complaint by a consumer, where "complaint" is defined by the COSL Rules as follows:

> [F]or the purpose of EDR, an expression of dissatisfaction made to COSL, related to a Member's conduct, products or services, whether or not the Complainant has first tried to resolve the Complaint with the Member using the Member's IDR process.[31]

Such complaints also include "financial hardship complaints",[32] which are by nature not actual complaints against members but rather indulgences sought by consumers in respect of debt repayments. For COSL's purposes, however, these instances are also treated as complaints for which members may be charged "complaint fees". Additionally, although members are required to comply with prescribed IDR procedures pursuant to credit legislation,[33] COSL does not expect this of consumers, but accepts complaints from consumers who bypass members' IDR processes.

Presumably in an effort to limit its jurisdiction in this regard, COSL Rule 10.1(d) states that COSL will not deal with any complaint relating to a fee, charge, commission or interest rate unless:

(i) the Complaint concerns the non-disclosure, misrepresentation, miscalculation or incorrect application of the fee, charge, commission or interest rate;
(ii) the fee, charge or commission is unconscionable or otherwise in breach of the law;
(iii) the change in the interest rate is unconscionable or the interest rate is in breach of the law.

Practically, the exceptions stated here include the most commonly raised complaints by borrowers (in addition to financial hardship complaints), rendering these limitations artificial and ineffectual.

It is of further concern that in making its determinations, COSL is not bound by any legal rule of evidence and "may inform itself about the complaint and all matters relating to it in whatever manner and by whatever means" in its discretion it deems appropriate.[34] Considering the binding

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29 Credit Ombudsman Service Limited, Rule 7.1. Available at http://www.cosl.com.au/Resources/COSL/Sites/COSL/PDF/About/COSL-Rules-Edition-8.pdf, viewed on 15 March 2012.
30 COSL Rule 2.3.
31 COSL Rule 45.1.
32 COSL Rule 9.6.
33 *National Credit Code*, s 47(h).
34 COSL Rule 3.3.

nature of COSL decisions,[35] it is evident that COSL staff members are endowed with wide discretionary powers, potentially making it difficult for members to prepare to meet a complaint made against them.

Although ASIC provides that an EDR scheme should be subject to an independent review of its operation and procedures every 5 years,[36] there are no provisions to indicate that the scheme should implement any recommendations emanating from such a review. The scheme is only required to report to ASIC "any systemic issues and matters involving serious misconduct" by a scheme member, while also collecting and reporting information about complaints and disputes it receives to ASIC on a quarterly basis and in its annual report.[37]

With regard to consultation, provision is made that a scheme should publicly consult about proposed changes to its Terms of Reference, but ASIC recognises "that there may be some proposed changes to a scheme's rules or procedures that are 'minor' in nature", which do not require public consultation.[38] As will be discussed below, this enables COSL to amend its Rules and Constitution without reference to its members. The effect of these provisions is that members will have to resort to judicial review proceedings should they wish to challenge the exercise of COSL's decision making powers.

ABILITY OF COSL TO AMEND ITS RULES WITHOUT CONSULTATION

ASIC specifically requires that a scheme must not give its members a right of veto over changes to the Constitution or Terms of Reference.[39] However, COSL's Constitution goes further in providing that, apart from ASIC and the Mortgage and Finance Association of Australia ("MFAA"), stakeholders need not be consulted before making "minor amendments" to the Rules.[40] Minor changes are defined as any changes that:

(i) do not result from a change to any relevant regulatory guide issued by ASIC;
(ii) in the opinion of the Board, ASIC or MFAA do not alter or adversely impact upon any rights of consumers under the COSL Rules; or

35 COSL Constitution, para 7.15(b).
36 ASIC, *Regulatory Guide 139*, RG139.158(b).
37 ASIC, *Regulatory Guide 139*, RG139.118.
38 ASIC, *Regulatory Guide 139*, RG139.109-110.
39 ASIC, *Regulatory Guide 139*, RG139.104.
40 COSL Constitution, para 37.2.

(iii) in the opinion of the Board, ASIC or MFAA do not raise policy issues in the context of the Financial Services Industry which require wider consultation with interested persons.[41]

It follows then that amendments to the Rules adverse to members may be allowed as "minor amendments" at the discretion of the COSL Board. This practice has become evident in recent amendments to the Rules, such as the amplification of the definition of "complaint" to include complaints where the complainant has not tried to resolve the complaint with the member using the member's IDR process.[42]

Furthermore, if the amendments are regarded as "substantive" (ie, not "minor"), the Constitution only requires consultation with the MFAA, ASIC, and "such consumer organisations, industry organisations and relevant stakeholders as may be determined by the Board for the purpose from time to time".[43] Relevantly, no mention is made of consultation with members in respect of amendments to the Rules which are perceived to be adverse to them, resulting in changes to the Rules (and by implication, the contract between COSL and its members) which are unilateral in nature.

COSL/MEMBER RELATIONSHIP AND LIMITATION OF MEMBERS' LEGAL RIGHTS UNDER THE RULES

In order to contextualise this discussion, it is necessary to consider the contractual nature of the relationship between COSL and its members. Significantly, this relationship is regulated by the provisions of the COSL Rules and Constitution, which form the contractual arrangement between the parties.[44] The COSL Constitution[45] provides that the member is bound by both the provisions of the COSL Constitution and the COSL Rules, Guidelines, By-laws and Practice Notes.[46] Additionally, the member is bound by every Order, Award or Direction to Comply made pursuant to the COSL Rules.[47]

Should a member fail to comply with any of the above, COSL is able to expel the member and revoke its membership,[48] thereby rendering the member in breach of its ACL obligation of compulsory EDR

41 COSL Constitution, para 37.4(b).
42 COSL Rule 45.1.
43 COSL Constitution, para 37.1.
44 As held by Shaw J in *Masu Financial Management Pty Ltd v FICS (No 2)* [2004] NSWSC 829.
45 COSL Constitution, para 7.14.
46 COSL Constitution, para 7.15(a).
47 COSL Constitution, para 7.15(b).
48 COSL Constitution, paras 10.1, 38.2-3.

membership under the National Credit legislation.[49] This in turn exposes the member to disciplinary action by ASIC, which may result in the suspension or cancellation of the member's ACL[50] and civil and criminal penalties (including up to 2 years' imprisonment), should it continue operating without an ACL.[51]

Thus, a fundamental characteristic of the COSL/member relationship is the peremptory nature of the member's obligations under the agreement. In addition, members are subject to membership fees (with certain exceptions where they have fewer than 5 employees) as well as the complaint fees charged by COSL in respect of consumer complaints.

Although COSL describes itself as providing "an accessible and independent dispute resolution service as an alternative to legal proceedings for resolving complaints with a Member",[52] it appears to have taken on a regulatory function outside the scope of its service credo of dispute resolution.

Members' legal rights are curbed under the COSL Rules to a significant degree. This is manifested in the limitation of their rights against COSL as well as "consumer" debtors.

First, in relation to liability towards the member, the COSL Constitution provides that members must indemnify COSL and agree not to take action against it for anything done under the COSL Constitution or Rules.[53] Second, members are required to waive the right to take action against COSL in respect of any information it may choose to publish in relation to a member under its Rules and Constitution[54] (such as statistics on complaints). These limitations contrast sharply with COSL's wide powers under the Rules to take action and make binding decisions against members. A further example of the imbalance in this relationship is the provision in Rule 19.1(f) of the COSL Rules, which provides that where COSL receives a complaint, it may "obtain such specialist advice as COSL reasonably considers is desirable or necessary to deal with the Complaint" at the expense of the member,[55] irrespective of whether the complaint is found to be valid.

As evidenced by these disparities, the relationship between COSL and its members is characterised by a significant absence of power on the part of its members, especially given the compulsory

49 *National Consumer Credit Protection Act 2009* (Cth), s 47(1)(i).
50 *National Consumer Credit Protection Act 2009* (Cth), s 55(1)(a); ASIC, *Regulatory Guide 139*, RG139.225.
51 *National Consumer Credit Protection Act 2009* (Cth), ss 29(1)-(2).
52 COSL Rule 1.2(a).
53 COSL Constitution, para 32.1.
54 COSL Constitution, para 33.8.
55 COSL Rule 19.1(f).

requirement of EDR scheme membership[56] and the penalties attached to non-compliance on their part.

COSL DECISIONS ARE FINAL AND BINDING

It has already been noted that the member is subject to final and binding decisions by COSL under its Rules. Such a decision is only final and binding on a complainant if the complainant accepts it;[57] however, the member is bound to comply regardless. Thereafter, the COSL decision may only be reviewed or reopened in the circumstances allowed in the COSL Rules or Guidelines.[58]

There is a limited provision that a member may object to a complaint and ask that COSL suspends its dealings in respect of the complaint. However, under Rule 29 of the COSL Rules, the member will have to demonstrate to COSL's "reasonable satisfaction":

> (a) that the Complaint involves or may involve an issue which could have important consequences for the Member's business or the Financial Services Industry generally; or
> (b) that the Complaint raises an important or novel point of law.[59]

Rule 29 further sets out the procedure of giving such an Objection Notice, and provides that COSL may refuse to accept the Notice for various reasons, including if COSL "reasonably considers that the Member has no or inadequate grounds for seeking a declaration from a Court or Tribunal".[60] Furthermore, the objection procedure is made onerous on the member by providing that the member must:

> (a) commence proceedings in an Australian Court within 14 days of giving the Objection Notice to COSL; and
> (b) give an undertaking to COSL and the Complainant to:
> (i) pay the Complainant's costs and disbursements (on a solicitor and client basis) of the proceedings and any subsequent appeal that may be commenced by the Member;
> (ii) make interim payments of account of such costs if and to the extent that it appears reasonable to do so; and
> (iii) seek to prosecute the Complaint expeditiously.[61]

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56 *National Consumer Credit Protection Act 2009* (Cth), s 47(1)(i).
57 COSL Rule 39.3.
58 COSL Rule 39.2.
59 COSL Rule 29.1.
60 COSL Rule 29.3(b).
61 COSL Rule 29.4.

Thus, not only does the member have to satisfy one of the two initial grounds acceptable to COSL, but it also has to has to pay the complainant's costs on a solicitor and client (as opposed to a party and party) basis to proceed with the objection. Given COSL's discretionary powers to accept or reject an objection and the costs burden placed on the member in the (unlikely) event of the objection being accepted by COSL, it may be argued that the process allows COSL to decide on issues of law in preference to the Courts and effectively forces the member to submit to COSL's complaints process. Neither its 2010 nor its 2011 Annual Report reflects any instances of complaints suspended by COSL, which creates the impression that such suspension rarely, if ever, occurs.

The COSL complaints process is then followed through its various stages, which include obtaining information, investigating the complaint (which may include a hearing) and thereafter making a Determination[62] or Award[63] which is binding on the member.[64] How long will this process take? The "Credit Ombudsman Process" set out in Rule 19 of the COSL Rules allows for an extensive, open-ended investigation. The Rules further provide that:

> COSL will try to complete the Investigation Phase within 90 days (but it can take longer, particularly if any party is given extra time to provide the information, documents and response requested by COSL).[65]

This may realistically mean an estimated delay of 3-6 months in the recovery process for a lender once COSL is in receipt of a consumer complaint. The Rules also specify that:

> If the Complainant is able to reasonably demonstrate to COSL that a financial hardship application should have been approved by the Member at the time the Complainant made the Member aware, or at the time the Member ought to have become aware, that the Complainant was experiencing financial hardship, the Member is not entitled to recover default interest and fees and enforcement costs from that time.[66]

This seems to indicate that default interest and costs would be recoverable in other instances. However, COSL also has the power to order that a lender repay, waive or vary a fee or any other amount which is payable or has been paid to the lender or its agent, including a variation of the interest rate on a loan.[67] The delay in resolving complaints could thus conceivably affect the member's ability to recover default interest and fees.

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62 COSL Rules 19-25.
63 COSL Rule 24.3.
64 COSL Constitution, para 7.15(b).
65 COSL Rule 22.4.
66 COSL Rule 18.7.
67 COSL Rule 9.6(d).

In its 2011 Annual Report, COSL states that the median number of days it took to "close" financial hardship complaints over the 2011 financial year was 45 days.[68] This statement must, however, be viewed in the context of its assertion that a satisfactory outcome was achieved in (only) 46% of hardship cases.[69] There is also evidence to show that some cases take much longer – more than a year in some instances.[70] These delays may impact on the member's business dealings and cash-flow, due to its inability to collect debts and realise security interests, as discussed below.

Once a matter is finalised, the member faces difficulties if it wishes to challenge the COSL decision. Although the COSL Rules allow for a COSL determination to be challenged by a member by instituting legal proceedings, the member has to comply with all of the following requirements to avail itself of this opportunity:

> (a) the legal proceedings must be instituted within 28 days after the Credit Ombudsman sends the Member the Determination or Award or COSL notifies the Member about the COSL decision or the Board Direction; and
> (b) as a condition of commencing legal proceedings, the Member must pay on a solicitor and client basis the legal costs of, and disbursements incurred by, the Member, COSL and the Complainant in relation to the legal proceedings and any appeal; and
> (c) if COSL so specifies, the Member must furnish security for costs and disbursements in relation to the legal proceedings and any appeal as COSL reasonably requires.[71]

There is further provision that:

> [A] member who fails to institute legal proceedings within 28 days or otherwise fails to satisfy all the requirements of this Rule forever waives its rights to institute legal proceedings to challenge any COSL decision or a Board Direction.[72]

These provisions are onerous and inequitable from the member's perspective, especially in a case where a member is subsequently successful in the legal proceedings, but still obliged to pay the legal costs (on an indemnity scale) of COSL and the complainant. Not surprisingly, COSL reports that no proceedings were instituted against it during either the 2010 or 2011 financial years.[73]

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68 COSL Annual Report 2011, p 7.
69 COSL Annual Report 2011, p 8.
70 Bransgrove, n 10, p 9.
71 COSL Rule 39.6.
72 COSL Rule 39.7.
73 COSL Annual Report 2010, p 13; COSL Annual Report 2011, p 13.

INTERFERENCE WITH CONTRACTUAL RIGHTS AND LEGAL PROCEEDINGS AGAINST DEBTORS

It is clear that the COSL Rules severely impair lenders' ability to recover loans that are in default, should the borrower see fit to make a complaint to COSL. The acceptance of a complaint requires the cessation of all legal and recovery proceedings.[74] Specifically, Rule 17.2(a) provides that, "once COSL records a complaint and for as long as COSL deals with the complaint: (a) the member *must not initiate enforcement action against the complainant in relation to any aspect of the subject matter of the complaint*".[75] Furthermore, where the member commenced such enforcement action before the complaint was received by COSL, the member must not continue the enforcement action and, in particular, must not:

(i) seek judgment in the legal proceedings; or

(ii) where default judgment has been entered, seek to enforce the default judgment.[76]

The Rules further provide that the member must not sell or assign the debt that is the subject of the Complaint[77] or list a default on the Complainant's credit reference file.[78]

The severe limitations these provisions place on the member are somewhat modified in Rule 17.3 of the COSL Rules, which provides that COSL may, at its discretion and on such terms as it may require, permit the member to issue proceedings in order to preserve the member's legal rights where the limitation period for the proceedings is in danger of expiring, where assets may need to be preserved or where the complainant has taken steps in the legal proceedings beyond lodging a defence or a defence and counterclaim.[79] Notably, these exceptions are dependent on COSL's discretion and are scant comfort to the member, who will have to satisfy COSL that the necessary grounds for allowing such exception exist. In the absence of such permission, the member's security interests (including mortgage security on real property) is at risk of erosion by other creditors of the debtor, who are not subject to these Rules. It is difficult to conceive how a member would convince COSL that its security interests warrant a greater measure of preservation than those of other members who are in the same position.

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74 COSL Rule 17.2.

75 COSL Rule 17.2(a) (authors' emphasis).

76 COSL Rule 17.2(b).

77 COSL Rule 17.2(c).

78 COSL Rule 17.2(d).

79 COSL Rule 17.3.

Although COSL reports that a "satisfactory outcome" was reached in 46% of financial hardship cases during the 2011 financial year,[80] it is not clear at what stage of the investigation these complaints were resolved. It also raises questions about the remainder of the complaints and suggests that a large number remained unresolved. Relevantly, it is revealed that in 72% of hardship cases received by COSL during that period "the borrower had been served with a default notice or the lender had commenced legal proceedings, repossessed the security (with or without obtaining judgment) or issued a notice to vacate".[81] In these cases, all legal proceedings would have been halted pursuant to the COSL Rules. This, from the member's viewpoint, translates into the frustration of its legal rights against the debtor, in terms of the parties' loan or security agreement. Considering the ability of COSL to disregard the agreement between credit provider and borrower and prevent the member from exercising its rights under the contract, it is evident that members are effectively placed "in limbo" until they either capitulate to the borrower's demands or the matter is determined by COSL.

Of further concern are COSL's determinative powers to make binding decisions, which extend to varying the terms of credit contracts between the credit provider (member) and the borrower (complainant).[82] It may also direct the member to release the security held for the complainant's debt,[83] waive or vary fees or interest rates,[84] discontinue enforcement action against the complainant,[85] stay the execution of a default judgment,[86] or release the complainant from the credit contract.[87]

These provisions extend much further than what would be regarded as mediation or "dispute resolution" powers and can be criticised as effectively assuming the role of the Courts. In its Position Statement (Issue 3),[88] COSL explains its stance on staying the execution of default judgment orders, ostensibly acknowledging that:

> Unlike the Courts, COSL has no ability to set aside or interfere with default judgments. COSL will not act in a way which could be perceived as seeking to do so.[89]

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80 COSL Annual Report 2011, p 8.
81 COSL Annual Report 2011, p 8.
82 COSL Rule 9.6(h).
83 COSL Rule 9.6(c).
84 COSL Rule 9.6(d).
85 COSL Rule 9.6(e).
86 COSL Rule 9.6(f).
87 COSL Rule 9.6(g).
88 Credit Ombudsman Service Limited, Position Statement, Issue 3. Available at http://www.cosl.com.au/Resources/COSL/Files/PositionStatement-Issue3.pdf, viewed on 15 March 2012.
89 COSL Position Statement, Issue 3, para 2.1.

Yet in the following paragraph, it states that where COSL considers that a borrower has valid grounds for seeking a stay, it will "ask or order the lender to stay execution of the default judgment for a particular period of time".[90] This would appear to be direct interference with default judgments, rendering the judgment unenforceable and allowing undetermined extensions to judgment debtors. While it is stated by COSL that the main focus of the Position Statement is on default judgments in loans secured by residential properties, it will apply the same general principles in a request for a stay of a default judgment regardless of the type of loan involved, or the nature of any security taken for the loan.[91]

The ramifications of these actions may have extensive implications for members:

(i) they are no longer able to rely on contractual terms agreed on between the parties, these being subject to variation by COSL, to the extent of ordering the release of security and even release of the borrower from the debt;

(ii) they are prevented from enforcing their legal rights under the contract and may be ordered to discontinue enforcement action under the contract;

(iii) even after obtaining judgment against the debtor, they are prevented from execution on or otherwise enforcing the judgment; and

(iv) COSL can interfere in any type of loan and any security, including business loans and security interests.

Notably, COSL prides itself on exercising its jurisdiction in a similar manner to the Courts "with the aim of achieving the same result (or a comparable result) to that which a borrower could reasonably be certain of achieving if they applied to the Court".[92] It relies in this argument upon a number of instances in which the Courts have allowed stays of default executions, which include instances where:

(i) the borrower can show that they are suffering from personal (as distinct from financial) hardship and need a reasonable time to organise their affairs; and

(ii) the judgment was obtained in contravention of a legal requirement.

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90 COSL Position Statement, Issue 3, para 2.2.

91 COSL Position Statement, Issue 3, paras 1.4-1.5.

92 COSL Position Statement, Issue 3, para 1.11.

In the first instance, COSL notes the case of *Permanent Custodians Limited v Carolyn Joy Upston* [2007] NSWSC 223,[93] in which it was held that a credit contract cannot be varied on the grounds of financial hardship after judgment. Yet it is evident from the COSL Rules that these are exactly the cases it invites as complaints, and on which it makes determinations. It could thus be argued that COSL is in fact assuming the power to make decisions in conflict with those of existing Court precedent.

Furthermore, in the second instance, COSL states that "contravention of a legal requirement" includes "a contravention of COSL Rules (for example: contravention of COSL Rule 18 relating to financial hardship applications)".[94] This statement supports the contention above that COSL regards itself as capable of exercising not only powers of dispute resolution, but also of operating effectively as "law maker", with the contravention of its Rules being treated as grounds for frustrating judgments already obtained by its members.

These two instances illustrate not only how COSL effectively usurps the powers of the Court in dealing with default judgments, but also includes its own Rules as "legal requirements", the breach of which entitles the borrower to relief, even after judgment.

WIDENING THE AMBITS OF POWER: BUSINESSES ARE PEOPLE TOO

Perhaps the most disconcerting feature of the COSL Rules is their ability to impede commercial dealings between credit providers and business entities.

In the COSL Rules, a consumer is defined as "an individual (whether acting as a trustee or otherwise), a partnership comprising individuals or a Small Business."[95]

A small business is further defined as a business employing fewer than:

(a) 100 full-time (or equivalent) employees, if the business is or includes the manufacture of goods; or
(b) otherwise, 20 full-time (or equivalent) employees.[96]

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93 Credit Ombudsman Service Limited, Position Statement, Issue 2, para 9.1(c). Available at http://www.cosl.com.au/Resources/COSL/Files/PositionStatement-Issue2.pdf, viewed on 15 March 2012.

94 COSL Position Statement, Issue 3, para 1.9(d)(ii).

95 ASIC, *Regulatory Guide*, RG 139.112.

96 *Corporations Act 2001* (Cth), s 761G.

The definition of "consumer" therefore includes sole traders, partnerships and corporations, thus widening its ambit substantially. This definition also provides the option for small to medium sized businesses to complain to COSL as a "consumer" on a variety of issues. The NCCPA does not reflect this extended definition of "consumer", limiting its regulation instead to natural persons. The COSL definition, however, includes, for example, mid-size firms with up to 19 full-time employees trading in, say, motor vehicles or office furniture, as well as manufacturing firms with up to 99 employees. It thus enables these firms to file financial hardship complaints with COSL if they are unable to service their debts, with the consequent application of the COSL Rules in such matters. Notably, it results in the credit provider being subjected to the COSL dispute resolution process, leaving the debtor firm free to continue trading until the resolution of the matter. Commercial creditors who are not members of an EDR scheme are presumably also able to pursue their claims against the debtor free from external interference.

In view of COSL's extensive determinative powers as discussed above, the broad definition allows for unprecedented interference by COSL in the contractual relations between two commercial entities, to the extent of ordering the release of security held for the borrower firm's debt,[97] the waiving or variation of fees or interest rates,[98] the discontinuance of enforcement action against the borrower firm,[99] the stay of execution of a default judgment,[100] or the release of the borrower firm from the credit contract.[101] Although COSL states that it will not direct the member to vary the loan agreement in the case of non-regulated (by the NCCPA) borrowers,[102] it does not exclude any of the other powers in respect of borrower firms or corporations.

It may be questioned whether the impact of these outcomes on commercial and contractual dealings can be justified, especially when they affect existing areas of law, as outlined below.

IMPACT ON EXISTING LEGISLATION

The frustration of legal process as a result of the COSL Rules can have even more pervasive effects than those contemplated above. Significantly, it may impact on the following legislation in certain identified respects.

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97 COSL Rule 9.6(c).
98 COSL Rule 9.6(d).
99 COSL Rule 9.6(e).
100 COSL Rule 9.6(f).
101 COSL Rule 9.6(g).
102 COSL Position Statement, Issue 2, para 3.8.

Bankruptcy Act 1966 (Cth)

If the borrower has requested hardship provisions, then it may be argued that the borrower is technically insolvent as it implies that it is unable to meet not only its existing debt liability, but also future liabilities. The *Bankruptcy Act 1966* (Cth) provides, inter alia, that a person commits an act of bankruptcy if:

> [H]e or she gives notice to any of his or her creditors that he or she has suspended, or that he or she is about to suspend, payment of his or her debts.[103]

COSL's Rules thus penalise the member in relation to other creditors of the borrower, being unable to institute bankruptcy proceedings against an insolvent borrower. Additionally, it may be observed that the COSL Rules effectively assist the individual or sole trader borrower to continue trading while insolvent.

Moreover, where a bankruptcy notice has been issued against a borrower pursuant to s 40(1)(g) of the *Bankruptcy Act 1966* (Cth) the member is prevented from progressing such action due to COSL Rule 17.

This provision thus frustrates not only the provisions of the *Bankruptcy Act 1966* (Cth) regarding acts of insolvency, but it also affects the powers of the Courts under Part III and s 43 of the Act to make sequestration orders where appropriate. It may be suggested that COSL's frustration of these powers are in conflict with the legislation and consequently affect the powers of the Court to deal with bankruptcies, with possible adverse effects for creditors.

Corporations Act 2001 (Cth)

These disparities are also apparent in the *Corporations Act 2001* (Cth) provisions relating to insolvency. Insolvency is defined under s 95A(1) of the Act as follows: "A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable." Section 95A(2) continues: "A person who is not solvent is insolvent." Again, the COSL Rules make these provisions inoperative in practice, as no steps can be taken against the insolvent entity. Furthermore, s 459B of the Act provides that the Court may order winding up if a company is insolvent. Clearly this will not be possible once a complaint is filed with COSL. It may thus be argued

[103] *Bankruptcy Act 1966* (Cth), s 40(1)(h).

that in this regard the COSL Rules also make inroads on the powers of the Courts and undermine the rule of law.

Additionally, the COSL provisions frustrate the provisions of s 462 of the *Corporations Act 2001* (Cth), which provide that a creditor may apply for a winding up order where grounds exist under s 461 of the Act. In practice, the COSL Rules effectively prevent a lender from bringing such an application as COSL demands cessation of all legal proceedings once a complaint is raised. It is not unreasonable to predict that the impact of this may be erosion of insolvency law principles.

CONCLUSIONS – SOME DEFICIENCIES IN THE COSL STRUCTURE

This overview of the perceived deficiencies in the COSL Rules has highlighted some inequitable – even if unintended – consequences in relation to COSL members. Concerns have been identified in respect of members' contractual rights under the COSL Rules and the impact of certain COSL Rules on existing legislation. Furthermore, the wide powers of COSL to amend its Rules have been noted as a matter of some disquiet.

Some would argue that EDR scheme rules which interfere with the Courts' powers should be void and unenforceable, by virtue of their effective ousting of the Courts' jurisdiction, as being against public policy. If the reasoning in *Baker v Jones* [1954] 2 All ER 553 were to be applied, there might be cause to contend that the COSL Rules are attempting to rule on matters of law, thereby ousting the jurisdiction of the Courts. Additionally, the limitations placed on members' access to legal remedies could be regarded as interference with the power of the Courts.

Whether or not a *Baker v Jones* argument would succeed in this particular context, there are palpable problems with the COSL Rules. Notably, COSL's ability to unilaterally amend the Rules is incompatible with the principle of "fairness", as required by ASIC's *Regulatory Guide 139*, which implies consultation with members prior to changing the terms of their contractual relationship.

The relationship between COSL and its members appears to resemble an autocratic system with COSL assuming a dictatorial position towards its subordinate members. Although cloaked as 'membership' of an EDR scheme, members are effectively deprived of exercising any power in decision-making due to COSL's ability to amend its Rules as it deems fit. Viewed through the lens of "fairness", the relationship between COSL and its members is fundamentally flawed, being

characterised by a significant power imbalance between the parties which is reflected in the ability of one party to make unilateral amendments to the terms of the agreement. Moreover, membership is obligatory and the member has no say in the terms of agreement.

Consumer credit legislation by its very nature has a primary purpose of consumer protection, aligning itself with the "weaker" consumer vis-à-vis the "stronger" credit provider, the Damocles in our analogy. Yet it is difficult to deny that undue pressure is being exerted on credit providers as a consequence of the obligation to belong to an EDR scheme, resembling a "sword of Damocles" positioned precariously above their unfortunate heads.